ASC 740 FUNDAMENTALS SERIES

A Step-by-Step Guide to Complying with Accounting for Income Tax Standards

Allen Gregory, CPA

As the tax environment grows more complex, so too does accounting for income taxes.

Material weaknesses related to ASC 740 are a leading cause of financial restatements and management disclosures. Mistakes in this area can be costly and include:

- loss of investor confidence;
- drop in shareholder value;
- significant expense related to financial restatements; and
- a distraction for the company.

Income tax restatements are the second leading cause of financial restatements.

Tax-related material weaknesses are primarily due to lack of tax accounting expertise and inadequate review procedures.

Having the in-depth knowledge, tax technical understanding and experience to manage estimates and assumptions related to tax provisions is critical to getting ASC 740 calculations and disclosures right.

Read on for a step-by-step practical guide to complying with accounting for income tax standards.

TaxOps
Tax Intelligence

TABLE OF CONTENTS

Introduction …………………………………………………………4

Terms and Definitions ……………………………………………5-7

Frequently Asked Questions …………………………………8-12

Identifying Permanent and Temporary
Differences …………………………………………………….13-14

Computing Current Income Tax Payables and
Receivables ……………………………………………………15-16

Analyzing the Return to Provision ……………………………17

Calculating Deferred Income Tax Expense
or Benefit ……………………………………………………18-19

Determining Uncertain Tax Positions ………………….20-21

Determining Valuation Allowance ……………………..22-23

Computing Total Income Tax Expense
or Benefit …………………………………………………….24-27

Contact Us ……………………………………………………...28

TaxOps
Tax Intelligence

INTRODUCTION

ASC 740, the financial accounting standard for computing and reporting income tax provisions, demands painstaking attention to detail. The guidance addresses financial accounting and reporting for the effects of income taxes that result from business activities in the current and preceding years. As a result of these efforts, companies recognize current year taxes due or refundable and manage expected future tax consequences of deferred assets and liabilities.

In this Fundamentals Series, we break ASC 740 down to highlight a practical approach to compliance and answer many questions you may have about what the standard is, who it applies to and how to prepare the provision analysis.

TaxOps
Tax Intelligence

TERMS AND DEFINITIONS

Before we launch into calculating the ASC 740 provision, we must first understand the key terms and definitions found in the guidance. You can refer to this guide in calculating the provision.

ASC 740 liability. Organizations are required to establish a tax reserve for potential liabilities that could result from uncertain tax positions. The term ASC 740 stands for the Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic (ASC) 740, Income Taxes. ASC 740 includes FASB Interpretation No. 48 (FIN 48) Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement (FAS) No. 109.

Current tax provision. A current expense or benefit tax provision is a tax liability or refund that can be expected on the current year's tax return. It can also include a prior year's return-to-accrual adjustment or any changes in provision liability for open tax years.

Deferred tax asset. A Deferred Tax Asset (DTA) is a future benefit the company can reasonably expect. The tax effect of future deductible amounts impacts loss carryovers and credit carryovers. In calculating a DTA, companies should consider the need for a valuation allowance .

Deferred tax liability. A Deferred Tax Liability (DTL) is a future liability that affects future taxable income amounts. The actual liability may be affected by tax laws and rate changes in the period the DTL is expected to be settled or realized. The DTL is calculated separately for each tax-paying component in each jurisdiction, and for each individual entity or group of entities consolidated for tax purposes. A DTL is either classified as current or non-current based on the underlying asset or liability.

TaxOps
Tax Intelligence

TERMS AND DEFINITIONS

Deferred tax provision. A deferred expense or benefit is a tax liability or refund that will eventually be paid or received. The deferred expense can be adjusted by any changes in net deferred tax assets or liabilities relating to the balance at the beginning of the year versus the balance at the end of the year. Changes in the valuation allowance may also adjust the deferred tax position.

Effective tax rate. An effective tax rate (ETR) is the total tax expense divided by book income. Calculating the ETR requires rate reconciliation, and reconciliation between the tax expense or benefit computed by applying the statutory federal rate to book income and the actual expense recorded as income tax expense or benefit.

Permanent difference. Differences that arise from statutory provisions under which specified revenues are exempt from taxation and certain expenses are not allowed as deductions in determining taxable income. Among the expense disallowed under permanent difference is non-taxable income (tax-exempt interest); non-deductible expenses (fines and penalties); limited expenses (meals and entertainment); and tax credits. Permanent differences are considered when measuring taxes payable or refundable (current tax expense). These differences are generally found on the income statement, and impact total tax expense and the effective tax rate.

Return-to-Accrual adjustment. Also known as the "Return-to-Provision" adjustment or "Prior Year True-up," a Return-to-Accrual (RTA) adjustment results from the comparison of individual items included in the prior year provision to the final income tax returns. These adjustments can relate to permanent items that generally affect the income statement or temporary items, such as a reclassification between balance sheet accounts.

TaxOps
Tax Intelligence

TERMS AND DEFINITIONS

Temporary difference. Temporary differences occur because the book and tax treatment of certain transactions are different. It is a difference between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. Temporary differences show up on the balance sheet, and can include carryovers, such as net operating losses and credits. It is expected that temporary differences will be recovered and settled at their financial statement amounts.

Uncertain tax position. ASC 740-10 (formerly FIN 48) addresses and establishes uniform accounting for “uncertain tax positions”. Although there may be substantial authority to take a position on a return for a particular income or expense item, the possibility of success may ultimately not be “more likely than not.” In these situations, the benefit of the position cannot be taken for financial reporting purposes until the tax year is closed or the taxpayer ultimately prevails on the issue with the IRS or other reporting entity.

Total tax provision. A total tax provision is a book basis expense resulting from current expenses (benefit) plus deferred expenses (benefit). It may also include increases or decreases to uncertain tax positions. A total tax provision equals the amount of total tax that will be paid or refunded in connection with income, expenses, and events that are captured in this period’s financial statements. The total tax provision can increase due to adjustments in the uncertain tax position relating to new or existing items. Similarly, the provision can be decreased when uncertain tax positions are not settled with cash or other tax attributes.

TaxOps
Tax Intelligence

FREQUENTLY ASKED QUESTIONS

What is ASC 740?

ASC 740 attempts to shed light on how companies should account for and report the effects of taxes based on income on their financial statements. The requirements of ASC 740 can significantly impact how a company reports its current and future income tax expense or benefit on the income statement, as well as how deferred tax assets or liabilities are reported on the balance sheet.

Additionally, ASC 740 addresses how a company reports uncertain tax positions on its financial statements under a "more-likely-than-not" recognition threshold (formerly known as FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes or FIN 48). This standard requires specific uncertain tax position disclosures in the annual financial statements, including a reconciliation of total unrecognized tax benefits, classification of income tax-related interest and penalties, identification of years that remain open to examination, and unrecognized tax benefits expected to significantly change within 12 months of the reporting period.

Why should companies be concerned with ASC 740?

The uncertain tax position guidance contained in the ASC 740 standard has the effect of requiring organizations to track uncertain tax positions for both tax compliance and financial reporting. For many companies, implementing a plan and associated processes and procedures to ensure that evaluation and tracking occurs can be overwhelming, particularly for organizations subject to multiple tax jurisdictions.

Where companies get into trouble with the standard varies. Companies that take aggressive taxable income positions that exceed a threshold set by ASC 740 must disclose the uncertain position in the footnotes to the financial statements. Any footnote that indicates an uncertain position raises the risk that an IRS, state, or foreign tax authority could challenge the validity of the tax position taken on the company's previously filed income tax returns.

TaxOps
Tax Intelligence

Companies with a large number of uncertain tax positions may trigger an audit that could potentially increase tax revenues for the taxing jurisdiction. When it comes to a challenge by a tax authority, companies that lose could be forced to eliminate deductions or include additional items of income that could ultimately result in an upward adjustment to previously reported taxable income and in turn decrease net income reported on the financial statements.

What is the scope of ASC 740?

ASC 740 establishes standards of financial accounting and reporting for currently payable income taxes as well as deferred income taxes payable at some point in the future. The provision takes into consideration the following.

- Revenues, expenses, gains, and losses that are recognized as taxable income in the prior year or a later year.

- Other events that create differences between the tax bases of assets and liabilities and their carrying amounts for financial reporting.

Operating loss or tax credit carrybacks for refunds of taxes paid in prior years and carryforwards to reduce taxes payable in future years.

What income taxes are covered by ASC 740?

ASC 740 covers federal, foreign, state and local (including franchise) taxes based on income. Also covered are an enterprise's domestic and foreign operations that are consolidated, combined, or accounted for by the equity method, and foreign enterprises that prepare financial statements in accordance with U.S. GAAP.

Among the taxes not covered are the following: Sales and use taxes; property taxes; payroll taxes; excise taxes; VAT taxes; and capital (equity) based franchise taxes.

TaxOps
Tax Intelligence

Although not directly addressed by ASC 740, there are several taxes worth considering under these requirements, including the following.

- Withholding taxes

- Tax systems that heavily modify their tax base

Any system that produces a liability even when the company is producing losses (AMT)

What is a tax position?

ASC 740-10-20 defines a tax position as a position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities for interim and annual periods. A tax position can result in a permanent deduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in expected deferred tax assets. The term tax position also encompasses but is not limited to the following.

- A decision not to file a tax return

- An allocation or a shift of income between jurisdictions

- The characterization of income or a decision to exclude reporting taxable income in a tax return

- A decision to classify a transaction, entity, or other position in a tax return as tax exempt

- An entity's status, including its status as a pass-through entity or a tax-exempt not-for-profit entity (FASB ASU 2009-06 modifies the definition of a tax position to include additional language to address tax positions related to pass-through and tax exempt not-for-profit entities.)

FREQUENTLY ASKED QUESTIONS

What is an "uncertain tax position?"

ASC 740 defines an uncertain tax position as the "recognition of tax balances on financial statements that are not recorded on corporate tax returns, if those returns include uncertain tax positions." Some examples of "tax positions" include determining whether a meal expense is 50 percent or 100 percent deductible or determining whether or not a tax return should be filed in another state.

How does an organization determine an "uncertain" tax position?

Under ASC 740, organizations must develop a cumulative tax risk portfolio limited to income taxes that is contemporaneously monitored and maintained. Material tax positions must be evaluated in all jurisdictions for open years in order to evaluate whether tax positions subject to exam are uncertain.

What characteristics of private companies make complying with ASC 740 more difficult than their public company counterparts?

While all entities are subject to ASC 740, private enterprises often possess characteristics that will present additional challenges under the standard that are less common issues for public enterprises, and include the following.

- Specific issues related to income attribution for flow-through entities
- Time consuming identification process, especially for enterprises with consolidations, acquisitions, and significant state or international operations
- Lack of sufficient internal tax or U.S. GAAP expertise
- Nonexistent or minimal internal controls for tax processes
- Poor documentation of tax positions taken by the organization
- Limited tax authority history on which to base conclusions
- More aggressive tax positions taken historically

TaxOps
Tax Intelligence

FREQUENTLY ASKED QUESTIONS

What is the difference between ASC 740 and ASC 740-10?

ASC 740 applies to all public and private institutions. ASC 740-10 clarifies requirements of pass-through entities and tax-exempt not-for-profit organizations. Notably, ASC 740 is required only under United States Generally Accepted Accounting Principles (US-GAAP) and is not present in international accounting standards.

TaxOps
Tax Intelligence

IDENTIFYING PERMANENT AND TEMPORARY DIFFERENCES

One of the first steps in calculating the income tax provision is to review financial and other company information to identify permanent and temporary differences between book income and taxable income. Permanent differences arise from statutory provisions of the tax law that specify that certain revenues are exempt from taxation and certain expenses are not allowed as deductions in determining taxable income. Municipal bond interest income is an example of revenue that is exempt from federal taxation.

Examples of deductions that are not allowed in determining taxable income are fines, penalties and meals and entertainment expenses. Also, tax credits are an example of tax benefit items that reduce income tax payable but are not an item shown on the financial statements. As a result, tax credits could be considered a permanent difference. Because permanent differences do not reverse in the future, the identified items will have a direct impact on total income tax expense.

Temporary differences are differences between the tax basis of an asset or liability and its reported amount in the financial statements. Temporary differences occur because the book and tax treatment of certain transactions are different - specifically the timing of their recognition. For example, the amount of depreciation expense from the purchase of a fixed asset will be the same over a period of time for both book and tax purposes. The amount of depreciation in any one year will be different depending upon the calculation method used and the life over which the asset is depreciated.

Temporary differences may also include attribute carryovers such as net operating loss carryover and tax credit carryover. These differences will result in deductible or taxable amounts in future years when the reported amount on the financial statement is recovered and settled. Temporary differences will reverse in the future and there will be no impact to total income tax expense for any change in a temporary difference.

TaxOps
Tax Intelligence

IDENTIFYING PERMANENT AND TEMPORARY DIFFERENCES

Both permanent and temporary differences are identified by performing a detailed review of the trial balance or general ledger of the company. A review of the company's significant accounting policies should also be performed.

The identification of new balance sheet and income statement accounts and the determination of the tax method of accounting for these items and corresponding difference from book treatment are particularly important. Additional steps for identifying differences are to review discrete transactions such as acquisitions or divestures that occurred during the year and to review prior year tax returns and income tax provisions for completeness and consistency of continuing differences.

TaxOps
Tax Intelligence

COMPUTING CURRENT INCOME TAX PAYABLES AND RECEIVABLES

Once the permanent and temporary differences have been identified, current income taxes payable or receivable will need to be computed for the particular tax year. The computation usually includes the tax consequences of most events that have been recognized in the financial statements for that year and should be computed on a tax jurisdiction by tax jurisdiction basis. The computation is equivalent to preparing the current year tax return for each jurisdiction where the company files an income tax return. There is no real guidance provided by ASC 740 for this computation. Basically, it is just applying local tax law to the current year results.

To determine the amount of income taxes payable or receivable for a particular year in each jurisdiction, generally use the following basic formula.

Book income before tax

+/- Identified permanent differences

+/- Identified temporary differences

= Taxable income

X Enacted current tax rate

= Current income tax before credits

- Credits

= Current income tax expense

- Prepayments

= Current income tax payable or receivable

TaxOps
Tax Intelligence

COMPUTING CURRENT INCOME TAX PAYABLES AND RECEIVABLES

The available loss carryovers would be included in identified temporary differences.

After current income taxes payable or receivable is determined, the calculated amount should be compared to the balance in the income tax payable or receivable for that particular tax year. The total payable or receivable balance could contain several tax years. If any difference exists, adjusting entries should be made to reflect the proper payable/receivable on the balance sheet, with the offset recorded to the appropriate income tax expense account.

TaxOps
Tax Intelligence

ANALYZING RETURN TO PROVISION

After calculating the current income tax expense based on an analysis of current income taxes payable or receivable, the next step is to calculate the return to provision adjustment. Begin by comparing each individual item on the prior year's current income tax provision with the actual final income tax returns subsequently filed.

Differences between the income before tax and permanent differences generally affect the income statement through adjustments to current income tax expense. Differences between temporary items generally result in a balance sheet reclassification between current income tax payable/receivable and deferred income tax asset/liability. The amount of the adjustment is calculated by multiplying the identified difference with the enacted tax rate for the applicable tax jurisdiction.

During this process, it must also be determined whether any of the differences identified would be considered an error or a change in estimate. The difference is considered an error if incorrect information is used at the time the income tax provision is calculated or incorrect computations are included in the calculation. An error, if material, can result in a restatement of the financial statements. An error could also result in a significant deficiency or material weakness in internal controls related to financial statement reporting of income tax.

A change of estimate results when better information becomes available subsequent to the provision being prepared. This generally means new information that could not have been quantified at the time of the provision calculation. If the information was available but the requisite work was not done to determine the correct permanent or temporary difference, this would likely be considered an error rather than a change of estimate. A change of estimate will not result in a restatement of the financial statements.

TaxOps
Tax Intelligence

CALCULATING DEFERRED INCOME TAX EXPENSE OR BENEFIT

The income tax expense or benefit includes not only current income taxes, but also a deferred income tax component. This deferred portion is calculated by analyzing the change in the company's total net deferred income tax asset or liability from the beginning to the end of the reporting period. Similar to the calculation of current income tax, the calculation of deferred taxes should be done on a tax jurisdiction-by-tax jurisdiction basis. A deferred tax asset is determined by identifying the cumulative deductible temporary differences at the end of the reporting period. These cumulative differences should represent either:

- Future tax deductible items that have not been recognized such as an allowance for bad debts expensed on the books currently but not deductible for tax purposes until actually written off; or

Future book income items that will not be recognized for tax purposes such as that portion of deferred revenue that represents future book income that has already been recognized for tax purposes when cash was received.

Also included in cumulative deductible temporary differences are any loss carryforward amounts. Once the cumulative deductible temporary differences are quantified, each is then multiplied by the enacted tax rate expected to apply when the temporary difference reverses. Tax credit carryforwards are then added to the deferred tax asset amount at tax-affected rates. The same process is used to determine a deferred tax liability, with the exception that the cumulative taxable temporary differences are identified at the end of the reporting period. A taxable temporary difference can be either:

- Future book expenses that will not be recognized for tax purposes such as a future book depreciation expense that will not be recognized for tax purposes where tax depreciation has already been deducted under an accelerated method; or

- Current book income items that will be recognized in a future period for tax purposes such as book income from an installment sale that can be deferred to a future period for tax purposes.

TaxOps
Tax Intelligence

CALCULATING DEFERRED INCOME TAX EXPENSE OR BENEFIT

The quantified cumulative taxable temporary differences are then multiplied by the enacted tax rate expected to apply when the temporary difference reverses to determine the amount of the deferred tax liability. Once the net deferred tax asset or liability is determined in each tax jurisdiction, the change from the beginning balance must be reviewed to calculate the amount of deferred income tax expense or benefit. This change will primarily be caused by current year book-tax temporary differences that have been identified earlier in the current income tax calculation.

Other possible factors that can affect the balance are return to provision adjustments affecting temporary items; purchase accounting adjustments; a change in tax rates used in the analysis; and foreign currency translation adjustments. Not all changes to deferred income tax assets or liabilities result in deferred income tax expenses or benefits. Some changes may, for example, affect goodwill, equity, or other comprehensive income. To avoid errors in calculating the ending cumulative differences, it is advisable to perform a book versus tax basis comparison of each of the items.

To ensure completeness, it is recommended that a full tax basis balance sheet be prepared and compared to the existing book basis balance sheet to identify all cumulative temporary differences. This comparison will verify the amount of ending cumulative temporary difference calculated. Just rolling forward the existing beginning balances using current year differences without performing the book versus tax basis comparison can produce unexpected errors. These errors might not be identified for several years and could potentially result in a restatement of the financial statements once discovered.

TaxOps
Tax Intelligence

DETERMINING UNCERTAIN TAX POSITIONS

An uncertain tax position is a tax position taken on a previously filed income tax return or included in the current year tax provision that has a less than a 50% chance of being sustained upon examination by the taxing authorities. The uncertain tax position occurs due to the considerable uncertainty surrounding the interpretation and application of various tax laws. Tax positions can include, but are not limited to:

- Deductions;
- Excluded income;
- Character of income such as capital gain versus ordinary income;
- Choice to not file an income tax return in a certain tax jurisdiction;
- Tax treatment of entity such as a partnership or an S Corporation; and
- Method for calculating state apportionment.

When determining the amount of uncertain tax position, it is important to recognize that under ASC 740, the identification applies only to uncertain income tax positions. Non-income "above-the-line" taxes are separately evaluated under different criteria.

There is a two-step process to determining an uncertain tax position. First, a recognition criterion is applied. For any portion of a tax position to be recognized, the position must be considered more-likely-than-not, or greater than 50%, to be sustained upon examination by a taxing authority. Detection risk cannot be considered in this equation. All positions must be assumed to be known by a taxing authority.

Second, if the tax position meets the recognition criteria, the amount realized from the tax position must be measured. Many tax positions are "binary," meaning they are either fully sustained at the 100% level or not sustained at all. In other words, when assessed by a tax authority, a binary tax position will either result in acceptance of a tax filing position in full or its rejection.

TaxOps
Tax Intelligence

DETERMINING UNCERTAIN TAX POSITIONS

Other tax positions, such as a research and development credit, can be sustained somewhere between 50% and 100%. In this case, the amount realized is the largest amount that has a greater than 50% chance of being realized upon settlement. Interest and penalty should also be calculated, including interest related to improper timing on temporary items, on any uncertain tax positions identified.

If an uncertain tax position is determined, the effect can be to record a current or noncurrent payable for the amount of cash that would be due upon adjustment by a taxing authority. If no cash would be due upon adjustment by a taxing authority, the deferred tax balance sheet account would be adjusted instead. For example, when a company is in a net operating loss position, the applicable deferred tax asset would be reduced instead of recording a liability.

Uncertain tax positions can apply to temporary as well as permanent items. It is also necessary to reevaluate existing previously identified uncertain positions to determine if a change in facts and circumstances has occurred that would make it necessary to adjust. Positions that have been settled upon examination, for example, or positions that will remain unadjusted due to the statute of limitations expiring should be reduced to zero with corresponding income statement or balance sheet effects.

TaxOps
Tax Intelligence

DETERMINING VALUATION ALLOWANCE

The company must determine the realizability of the deferred tax asset calculated in order to determine the amount of valuation allowance that a company should record. A valuation allowance reduces the deferred tax asset to an amount that is "more likely than not" to be realized. This can have a direct effect on the income statement through the amount of deferred tax expense or benefit recorded. The effect of any recording or releasing a valuation allowance occurs discretely in the period that the determination is made.

All deferred tax assets should be evaluated to determine the need for a valuation allowance based on specific facts and circumstances. The types of deferred tax assets that should be evaluated include not only tax attributes with finite carryforward periods such as net operating loss or tax credit carryforwards, but also other deferred tax assets that result from cumulative book and tax temporary differences. These types of deferred tax assets may ultimately reverse and increase the amount of net operating loss carryforward in a future period.

When evaluating the need for a valuation allowance, all pertinent evidence should be considered, both positive and negative. Generally evidence is based on the ability to objectively verify through current transactions, such as the ability for a company to carryback net operating loss to a period with taxable income. The existence of future taxable temporary differences will reverse in the net operating loss carryforward period. Evidence that cannot be objectively verified based on future events are subjective in nature and therefore not weighed as heavily. Examples of this type of evidence include future taxable income based on projections and tax planning strategies that a company could initiate to avoid the expiration of a tax attribute, such as a net operating loss carryforward.

TaxOps
Tax Intelligence

DETERMINING VALUATION ALLOWANCE

A history of cumulative losses (generally defined as book loss plus permanent differences for the current and two prior tax periods) is a particularly negative item of objective evidence. A company may be unable to justify not recording a valuation allowance that reduces or eliminates a deferred tax asset.

Nevertheless, a cumulative loss history is not a bright line test; all evidence must be considered. For example, if the company can demonstrate that it has taxable income in a prior period that can absorb net operating loss when carried back, a history of cumulative losses would not cause the company to record a valuation allowance. Similarly if the company can make a compelling argument that it could employ a tax planning strategy that would be both prudent and feasible and would effectively create future income that would absorb a net operating loss carryforward, this also could outweigh the negative evidence of a cumulative loss history.

TaxOps
Tax Intelligence

COMPUTING TAX EXPENSE OR BENEFIT

The amount of total income tax expense or benefit shown on the income statement is computed by combining both the current tax expense or benefit and deferred tax expense or benefit. The current portion is the amount of tax liability that the company expects to owe in each of its jurisdictions where it files a tax return plus such items as return to provision adjustments on permanent items and changes to the tax liability related to uncertain tax positions. The deferred portion is calculated by analyzing changes to the deferred tax asset or liability and quantifying those changes that affect the income statement.

In a basic example, assume the company has pretax book income in the current period of $200,000, non-deductible meals and entertainment expense totaling $10,000, tax depreciation greater that book depreciation of $50,000, non-deductible increase to the bad debt reserve of $20,000, and net operating loss carryforward (NOL) of $60,000. The company computes its current tax liability in the US & state jurisdictions as follows.

Pretax book income	$ 200,000	
Non-deductible meals & entertainment	10,000	–Permanent Difference
Tax over book depreciation	(50,000)	-Temporary Difference
Non-deductible bad debt expense	20,000	-Temporary Difference
Taxable income before NOL	$ 180,000	
Net operation loss carryforward	(60,000)	
Taxable income after NOL	$ 120,000	
Tax rate (Federal + State)	40%	
Tax	$ 48,000	

COMPUTING TAX EXPENSE OR BENEFIT

Also assume the non-current tax liability balance related to uncertain tax positions has increased by $20,000. Total current tax expense would be $68,000 ($48,000+$20,000).

U.S. and state deferred tax expense would be computed by analyzing the change in deferred tax asset/liability as follows.

	Beginning Cumulative Difference	Current Year Change	Ending Cumulative Difference
Bad Debt Expense	$130,000	$20,000	$150,000
Depreciation	($270,000)	($50,000)	($320,000)
Net operating loss carryforward	$60,000	($60,000)	$ -
Total	($80,000)	($90,000)	($170,000)
Tax Rate	40%	40%	40%
Net Deferred Tax Asset/(Liability)	($32,000)	($36,000)	($68,000)

TaxOps
Tax Intelligence

COMPUTING TAX EXPENSE OR BENEFIT

The current and non-current portions on the net deferred tax liability above would be summarized as follows.

Current	$190,000	($40,000)	$150,000
Tax Rate	40%	40%	40%
Non-current Deferred	$76,000	($16,000)	$60,000

Non-Current	($270,000)	($50,000)	($320,000)
Tax Rate	40%	40%	40%
Non-current Deferred Tax Liability	($108,000)	($20,000)	($128,000)
Net Deferred Tax Asset/(Liability) (Agrees with prior totals.)	($32,000)	($36,000)	($68,000)

COMPUTING TAX EXPENSE OR BENEFIT

This analysis demonstrates the net deferred tax liability has increased resulting in a deferred tax expense related to the change of $36,000.

The total tax expense for the company is $104,000 ($68,000 current income tax expense plus $36,000 deferred income tax expense).

The journal entries to record the current and deferred portions of total income tax expense in this example are as follows.

Dr.	Income Tax Expense	$68,000	
Cr.	Current Tax Liability		$48,000
Cr.	Non-Current Tax Liability		$20,000
Dr.	Income Tax Expense	$36,000	
Cr.	Current Deferred Tax Asset		$16,000
Cr.	Non-current Deferred Tax Liability		$20,000

TaxOps
Tax Intelligence

Let's Continue the Conversation

Contact Allen Gregory to share your thoughts and questions.

Allen Gregory
CPA and Partner
720.227.0060
agregory@TaxOps.com

About TaxOps

TaxOps is an award-winning business tax specialty and advisory firm. Business tax is all we do. This specialization deepens our teams' know-how in solving complex tax issues at dynamic businesses worldwide. From one-off studies to full-service tax outsourcing, we deliver small-firm attention with big-firm expertise in the areas of federal, state and local, international, tax minimization, and M&A transaction tax.

Visit TaxOps and connect with us.

Join us on LinkedIn

TaxOps
Tax Intelligence

© 2019 TaxOps LLC. The information contained in this document does not constitute tax advice. Tax rules change frequently. Please contact your tax adviser to get advice tailored to your circumstances.