Chapter 19

Economics, Tax

CHAPTER 19 ACCOUNTING FOR INCOME TAXES Multiple Choice 1. Major reasons for disclosure of deferred income tax information is (are) a. better assessment of quality of earnings. b. better predictions of future cash flows. c. that it may be helpful in setting government policy. d. all of these. 2. Taxable income of a corporation a. differs from accounting income due to differences in intraperiod allocation between the two methods of income determination. b. differs from accounting income due to differences in interperiod allocation and permanent differences between the two methods of income determination. c. is based on generally accepted accounting principles. d. is reported on the corporation's income statement. 3. Interperiod income tax allocation causes a. tax expense shown on the income statement to equal the amount of income taxes payable for the current year plus or minus the change in the deferred tax asset or liability balances for the year. b. tax expense shown in the income statement to bear a normal relation to the tax liability. c. tax liability shown in the balance sheet to bear a normal relation to the income before tax reported in the income statement. d. tax expense in the income statement to be presented with the specific revenues causing the tax. 4. Interperiod tax allocation results in a deferred tax liability from a. an income item partially recognized for financial purposes but fully recognized for tax purposes in any one year. b. the amount of deferred tax consequences attributed to temporary differences that result in net deductible amounts in future years. c. an income item fully recognized for tax and financial purposes in any one year. d. the amount of deferred tax consequences attributed to temporary differences that result in net taxable amounts in future years. 5. Interperiod income tax allocation procedures are appropriate when a. an extraordinary loss will cause the amount of income tax expense to be less than the tax on ordinary net income. b. an extraordinary gain will cause the amount of income tax expense to be greater than the tax on ordinary net income. c. differences between net income for tax purposes and financial reporting occur because tax laws and financial accounting principles do not concur on the items to be recognized as revenue and expense. d. differences between net income for tax purposes and financial reporting occur because, even though financial accounting principles and tax laws concur on the item to be recognized as revenues and expenses, they don't concur on the timing of the recognition. 6. Renner Corporation's taxable income differed from its accounting income computed for this past year. An item that would create a permanent difference in accounting and taxable incomes for Renner would be a. a balance in the Unearned Rent account at year end. b. using accelerated depreciation for tax purposes and straight-line depreciation for book purposes. c. a fine resulting from violations of OSHA regulations. d. making installment sales during the year. 7. Which of the following will not result in a temporary difference? a. Product warranty liabilities b. Advance rental receipts c. Installment sales d. All of these will result in a temporary difference. 8. A company uses the equity method to account for an investment. This would result in what type of difference and in what type of deferred income tax? Type of Difference Deferred Tax a. Permanent Asset b. Permanent Liability c. Temporary Asset d. Temporary Liability 9. Tax rates other than the current tax rate may be used to calculate the deferred income tax amount on the balance sheet if a. it is probable that a future tax rate change will occur. b. it appears likely that a future tax rate will be greater than the current tax rate. c. the future tax rates have been enacted into law. d. it appears likely that a future tax rate will be less than the current tax rate. 10. Accounting for income taxes can result in the reporting of deferred taxes as any of the following except a. a current or long-term asset. b. a current or long-term liability. c. a contra-asset account. d. All of these are acceptable methods of reporting deferred taxes. 11. Deferred tax amounts that are related to specific assets or liabilities should be classified as current or noncurrent based on a. their expected reversal dates. b. their debit or credit balance. c. the length of time the deferred tax amounts will generate future tax deferral benefits. d. the classification of the related asset or liability. 12. All of the following are procedures for the computation of deferred income taxes except to a. identify the types and amounts of existing temporary differences. b. measure the total deferred tax liability for taxable temporary differences. c. measure the total deferred tax asset for deductible temporary differences and operating loss carrybacks. d. All of these are procedures in computing deferred income taxes. 13. A reconciliation of Sauder Company's pretax accounting income with its taxable income for 2010, its first year of operations, is as follows: Pretax accounting income $8, 000, 000 Excess tax depreciation (240, 000) Taxable income $7, 760, 000 The excess tax depreciation will result in equal net taxable amounts in each of the next three years. Enacted tax rates are 40% in 2010, 35% in 2011 and 2012, and 30% in 2013. The total deferred tax liability to be reported on Sauder's balance sheet at December 31, 2010, is a. $96, 000. b. $80, 000. c. $84, 000. d. $72, 000. Use the following information for questions 14 and 15. Easton Co. at the end of 2010, its first year of operations, prepared a reconciliation between pretax financial income and taxable income as follows: Pretax financial income $ 400, 000 Estimated litigation expense 1, 000, 000 Installment sales (800, 000) Taxable income $ 600, 000 The estimated litigation expense of $1, 000, 000 will be deductible in 2012 when it is expected to be paid. The gross profit from the installment sales will be realized in the amount of $400, 000 in each of the next two years. The estimated liability for litigation is classified as noncurrent and the installment accounts receivable are classified as $400, 000 current and $400, 000 noncurrent. The income tax rate is 30% for all years. 14. The income tax expense is a. $120, 000. b. $180, 000. c. $200, 000. d. $400, 000. 15. The deferred tax liability–current to be recognized is a. $60, 000. b. $90, 000. c. $120, 000. d. $240, 000. Use the following information for question 16. Lansing Co. at the end of 2010, its first year of operations, prepared a reconciliation between pretax financial income and taxable income as follows: Pretax financial income $ 900, 000 Estimated litigation expense 1, 200, 000 Extra depreciation for taxes (1, 800, 000) Taxable income $ 300, 000 The estimated litigation expense of $1, 200, 000 will be deductible in 2011 when it is expected to be paid. Use of the depreciable assets will result in taxable amounts of $600, 000 in each of the next three years. The income tax rate is 30% for all years. 16. The deferred tax asset to be recognized is a. $90, 000 current. b. $180, 000 current. c. $270, 000 current. d. $360, 000 current. 17. Flynn Company reported the following results for the year ended December 31, 2010, its first year of operations: 2010 Income (per books before income taxes) $350, 000 Taxable income 560, 000 The disparity between book income and taxable income is attributable to a temporary difference which will reverse in 2011. What should Flynn record as a net deferred tax asset or liability for the year ended December 31, 2010, assuming that the enacted tax rates in effect are 40% in 2010 and 35% in 2011? a. $84, 000 deferred tax liability b. $73, 500 deferred tax asset c. $84, 000 deferred tax asset d. $73, 500 deferred tax liability 18. Seely Company sells household furniture. Customers who purchase furniture on the installment basis make payments in equal monthly installments over a two-year period, with no down payment required. Seely's gross profit on installment sales equals 40% of the selling price of the furniture. For financial accounting purposes, sales revenue is recognized at the time the sale is made. For income tax purposes, however, the installment method is used. There are no other book and income tax accounting differences, and Seely's income tax rate is 30%. If Seely's December 31, 2010, balance sheet includes a deferred tax liability of $180, 000 arising from the difference between book and tax treatment of the installment sales, it should also include installment accounts receivable of a. $1, 500, 000. b. $600, 000. c. $450, 000. d. $180, 000. Use the following information for question 19. Harter Corporation reported the following results for its first three years of operation: 2009 income (before income taxes) $ 60, 000 2010 loss (before income taxes) (540, 000) 2011 income (before income taxes) 600, 000 There were no permanent or temporary differences during these three years. Assume a corporate tax rate of 30% for 2009 and 2010, and 40% for 2011. 19. Assuming that Harter elects to use the carryback provision, what income (loss) is reported in 2010? (Assume that any deferred tax asset recognized is more likely than not to be realized.) a. $(540, 000). b. $ -0-. c. $(522, 000). d. $(330, 000). 20. Oslo Co. reports a taxable and pretax financial loss of $300, 000 for 2010. Oslo's taxable and pretax financial income and tax rates for the last two years were: 2008 $300, 000 30% 2009 300, 000 35% The amount that Oslo should report as an income tax refund receivable in 2010, assuming that it uses the carryback provisions and that the tax rate is 40% in 2010, is a. $90, 000. b. $105, 000. c. $120, 000. d. $135, 000. 21. Bass Corp.'s 2010 income statement showed pretax accounting income of $625, 000. To compute the federal income tax liability, the following 2010 data are provided: Income from exempt municipal bonds $ 25, 000 Depreciation deducted for tax purposes in excess of depreciation deducted for financial statement purposes 50, 000 Estimated federal income tax payments made 125, 000 Enacted corporate income tax rate 30% If the alternate minimum tax provisions are ignored, what amount of current federal income tax liability should be included in Bass's December 31, 2010 balance sheet? a. $40, 000. b. $55, 000. c. $62, 500. d. $165, 000. 22. Nolan Corp. prepared the following reconciliation of income per books with income per tax return for the year ended December 31, 2010: Book income before income taxes $900, 000 Add temporary difference Construction contract revenue which will reverse in 2011 120, 000 Deduct temporary difference Depreciation expense which will reverse in equal amounts in each of the next four years (480, 000) Taxable income $540, 000 Nolan's effective income tax rate is 34% for 2010. What amount should Nolan report in its 2010 income statement as the current provision for income taxes? a. $40, 800. b. $183, 600. c. $306, 000. d. $346, 800. 23. Lang, Inc. uses the accrual method of accounting for financial reporting purposes and appropriately uses the installment method of accounting for income tax purposes. Installment income of $800, 000 will be collected in the following years when the enacted tax rates are: Collection of Income Enacted Tax Rates 2010 $ 80, 000 35% 2011 160, 000 30% 2012 240, 000 30% 2013 320, 000 25% The installment income is Lang's only temporary difference. What amount should be included in the deferred income tax liability in Lang's December 31, 2010 balance sheet? a. $200, 000. b. $228, 000. c. $252, 000. d. $280, 000. 24. On January 1, 2010, Blass Corp. purchased 40% of the voting common stock of Reed, Inc. and appropriately accounts for its investment by the equity method. During 2010, Reed reported earnings of $600, 000 and paid dividends of $200, 000. Blass assumes that all of Reed's undistributed earnings will be distributed as dividends in future periods when the enacted tax rate will be 30%. Blass's current enacted income tax rate is 25%. The increase in Blass's deferred income tax liability for this temporary difference is a. $120, 000. b. $100, 000. c. $72, 000. d. $48, 000. 25. Martin Co., organized on January 2, 2010, had pretax accounting income of $550, 000 and taxable income of $1, 000, 000 for the year ended December 31, 2010. The only temporary difference is accrued product warranty costs which are expected to be paid as follows: 2011 $150, 000 2012 75, 000 2013 75, 000 2014 150, 000 The enacted income tax rates are 35% for 2010, 30% for 2011 through 2013, and 25% for 2014. If Martin expects taxable income in future years, the deferred tax asset in Martin's December 31, 2010 balance sheet should be a. $90, 000. b. $105, 000. c. $127, 500. d. $157, 500. Answer Key: | Question # | Answer | | 1 | D | | 2 | B | | 3 | A | | 4 | D | | 5 | D | |

6 | C | | 7 | D | | 8 | D | | 9 | C | | 10 | C | | 11 | D | | 12 | C | | 13 | B | | 14 | A | | 15 | C | | 16 | D | | 17 | B | | 18 | A | | 19 | D | | 20 | A | | 21 | A | | 22 | B | | 23 | A | | 24 | D | | 25 | C |