What Are Deferred Tax Assets and Liabilities?

Worksheet

A deferred tax liability arises when taxable income will be higher than accounting income in the future (tax paid later); a deferred tax asset arises when taxable income will be lower than accounting income in the future (tax saved later). Both equal the temporary difference multiplied by the applicable tax rate.

@text{TaxDeferred} = @Delta @ times r

Questions

1. A $400,000 taxable temporary difference exists with a 20% tax rate. What is the deferred tax liability?
A) $400,000
B) $80,000
C) $20,000
D) $320,000

2. A deferred tax asset arises when:
A) Book income exceeds taxable income permanently
B) Taxable income will exceed book income in the future
C) Taxable income exceeds book income now, reversing later
D) There is no temporary difference

3. A valuation allowance is used to:
A) Increase a deferred tax liability
B) Reduce a deferred tax asset that may not be realized
C) Eliminate all deferred taxes
D) Increase current tax expense only

4. Accelerated tax depreciation compared to straight-line book depreciation typically creates a:
A) Deferred tax asset
B) Permanent difference
C) Deferred tax liability
D) No difference

5. A company reports $500,000 of accelerated tax depreciation versus book depreciation, creating a $500,000 taxable temporary difference. The tax rate is 25%. Find the deferred tax liability.

6. A company accrues a $200,000 warranty expense for book purposes that isn't tax-deductible until warranty claims are actually paid, creating a $200,000 deductible temporary difference. Tax rate is 30%. Find the deferred tax asset.

7. A company has $50,000 of tax-loss carryforwards it expects to fully use against future taxable income. The enacted future tax rate is 21%. Find the deferred tax asset.

8. Define: What creates a deferred tax liability?

9. Define: What creates a deferred tax asset?

10. Define: What is the deferred tax formula?

Answer Key

1. B) $80,000 - $400,000 20% = $80,000.

2. C) Taxable income exceeds book income now, reversing later - A deductible temporary difference (taxable income now higher, book income later higher) creates a deferred tax asset.

3. B) Reduce a deferred tax asset that may not be realized - A valuation allowance reduces a deferred tax asset when realization isn't probable.

4. C) Deferred tax liability - Higher tax depreciation now means lower taxable income now and higher taxable income later - a taxable temporary difference, i.e., a deferred tax liability.

5. Deferred tax liability = $500,000 25% = $125,000

6. Deferred tax asset = $200,000 30% = $60,000

7. Deferred tax asset = $50,000 21% = $10,500

8. A taxable temporary difference - book income exceeds taxable income now, reversing later (e.g., accelerated tax depreciation).

9. A deductible temporary difference - taxable income exceeds book income now, reversing later (e.g., warranty accruals, tax-loss carryforwards).

10. Deferred Tax = Temporary Difference Tax Rate.