Corporate Income Taxes

GAAP treatment

- GAAP is not IRS
    - Income tax expense on the income statement (GAAP) includes permanent and temporary differences with what is required by the IRS
        - Income tax expense is composed of:
            - Current tax expense (taxes payable to government)
            - Deferred tax expense (increase (CR) to deferred tax liability)
    - GAAP is full accrual accounting (revenues when earned and expenses when incurred)
    - IRS is a modified cash basis (income is when cash comes in, deductions are when cash goes out)
        - Congress shapes tax provisions to achieve political, social and economic objectives
            - Excluding certain revenues from taxation
            - Limiting deductibility of certain expenses
            - Permit the deduction of other expenses above costs
    - Examples of financial←→taxable differences
        - Interest on state and municipal obligations
        - Proceeds on life insurance
        - Fines and expenses from law violations
    - Permanent differences will never reconcile

Carry-backs and Carry-forwards

- When a company has a net operating loss (when tax-deductible expenses exceed taxable revenues)
    - Carry-back loss for 2 years (earlier year first)
        - File an amended return
            - Income Tax Refund Receivable (current asset)
    - Carry-forward remaining loss for 20 years
        - Future tax savings
        - Issue: should deferred tax asset have different requirements:
            - Deductible temporary differences
            - Operating loss carry-forwards
        - "Benefit due" is a contra-income tax expense
        - A valuation allowance is used if it is likely that the loss will not be realized (thereby not resulting in tax savings)

Toward Business Literacy: Accounting Outlines

Deferred taxes

- Taxes that will be paid in future periods
- A **liability** means that taxes will be higher in the future→depends on past transactions, present obligation and future sacrifice
- An **asset** means taxes will be lower in the future
    - Arise from deductible temporary difference
    - Tax asset must be reduced by a valuation allowance if it is more likely than not that some portion will not be realized
        - Evaluated at the end of the accounting period
    - Deferred tax consequences are attributable to taxable temporary differences
        - Temporary differences arise under the following conditions
            - When assets are recovered in future years (taxable)
        - When liabilities are settled in future years (deductible)
        - Examples of revenues and gains
            - Sales (accrual vs. installment cash)
            - Contracts (% completion vs. portion of gross profit deferred)
            - Investments (equity (financial) vs. cost (tax)
            - Gain on involuntary conversion of asset
        - Examples of expenses and losses
            - Product warranty liability
            - Estimated liability→discontinued operations
            - Litigation accruals
            - Bad debt expense (allowance for financials)

Balance Sheet Presentation

- Recognize a current or non-current asset or liability based on expected reversal date of temporary differences

From Intermediate Accounting by Keiso
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