

Second Best Corporation

Deferred Tax Example (Comprehensive)

Second Best Corporation was incorporated in 2005. Information related to its first five years of operation are shown below. Compute income tax expense and the deferred tax liability/asset for each year. Prepare journal entries. Assume that Second Best Corp. always chooses to carry back any net operating loss (if possible).

	2005	2006	2007	2008	2009	
Pre-tax accounting income	20,000	25,000	30,000	45,000	50,000	
Depreciation schedule						
Machinery with 5 year life, no salvage						
Acquired 1-1-2005 for						
30,000	2005	2006	2007	2008	2009	Total
Straight-line method (book)	6,000	6,000	6,000	6,000	6,000	30,000
MACRS method (tax)	7,500	11,400	11,100			30,000
Difference	(1,500)	(5,400)	(5,100)	6,000	6,000	0

Accounting income includes:

Interest on municipal bonds	(10,000)	(10,000)	(10,000)	(10,000)	-
Rent revenue (accrual basis)	(40,000)	(40,000)	-	-	-
Book depreciation	6,000	6,000	6,000	6,000	6,000
Warranty expense (accrual)	20,000	20,000	20,000	20,000	20,000
Contingent liability		150,000			

Taxable income includes:

Accelerated depreciation	7,500	11,400	11,100	0	0
Rent revenue (cash basis)	(80,000)				
Warranty costs paid	10,000	19,000	20,000	21,000	10,000
Actual court costs			75,000	75,000	

Income tax rates:

	2005	2006	2007	2008	2009
Enacted rate for 2005 & 2006	34%	34%			
New law enacted in 2007, effective 1/1/07			40%	40%	40%