Depreciation and Deferred Taxes

15.511 Corporate Accounting

Summer 2004

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July 7, 2004

Tax and Timing Effects

- Tax Depreciation
  - Accelerated depreciation
  - No judgment in determining depreciation expense
- Tax Reporting $\neq$ Financial Reporting ==> timing differences in measurement of income
  - Why would a firm prefer accelerated depreciation for tax purposes?
  - Why does government allow this?
  - Why not use the tax method for financial reporting?
- Different depreciation for tax and financial reporting gives rise to *Deferred Taxes*

Deferred Tax Expense

- Is deferred tax expense a line item expense on the income statement?
  - No
- If not where is it?
  - It is a component of reported income tax expense
- What is the journal entry?
- (Recall: Income tax expense = taxes payable + deferred tax expense)

Dr Income tax expense	15,000	
Cr Tax payable		7,800
Cr Deferred tax liability		7,200

Deferred Taxes over Time

Deferred taxes caused by timing differences are temporary; they reverse over time.

Year	Financial reporting depreciation	Tax reporting depreciation	Depreciation difference	Deferred Tax Expense	Acc. Depr Difference, (EB)	Def Tax Liability (EB)
2000	30,000	54,000	24,000	7,200	24,000	7,200
2001	30,000	36,000	6,000	1,800	30,000	9,000
2002	30,000	-	(30,000)	(9,000)	0	0

- Timing differences that create / increase deferred taxes are called ***originating differences***
- Timing differences that remove / decrease deferred taxes are called ***reversing differences***