

Computation of Deferred Tax Liability — An Example



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An income tax liability arises from differences between balance sheet values of certain assets and liabilities and the tax basis of those same assets and liabilities. Farm financial statements, especially the balance sheet, should be prepared with recognition given to this income tax liability, or deferred taxes.

Deferred taxes reconcile the tax basis of a balance sheet with the basis currently being used for valuing assets and recording liabilities. That is, if all assets could be liquidated for exactly the amount shown on the balance sheet, and if all liabilities could be satisfied by payment of exactly the amount shown on the balance sheet, then what taxable income would result and what would be the tax liability?

The asset and liability values outlined in the example balance sheet (Table 1) are used to show the derivation of deferred taxes, or income tax liability, using the following two-step procedure.¹

Step 1. Computation of current portion of deferred taxes. (See Table 2 for example computations.) The total amount by which the balance sheet value of current assets exceeds their taxable basis is calculated. Deferred income, such as crop insurance proceeds — reported for financial statements, but not recorded for tax purposes and for which no asset value exists on the balance sheet — must be included. Subtract the amount of current liabilities that result in deductions for tax purposes, such as accounts

payable and accrued interest, from total deferred income calculated. The current portion of deferred taxes is then computed by multiplying an estimated total tax rate — which reflects federal, state, local, and social security taxing authorities — times the net deferred income.

Step 2. Computation of noncurrent portion of deferred taxes related to differences between market values and tax basis or base value of noncurrent assets. (See Table 3 for example computations.) Calculate the difference between the balance sheet market values of all noncurrent assets and their tax basis. Noncurrent assets include breeding livestock, machinery and equipment, real estate, and improvements. The tax basis will be zero for raised breeding livestock that have not been capitalized and depreciated for tax purposes. The noncurrent portion of deferred taxes is computed by multiplying the calculated deferred taxable income times the estimated total tax rate for capital asset sales.

The current and noncurrent portion of deferred taxes are recorded on the balance sheet as liabilities. If the total deferred income value, or taxable income, computed in steps 1 and 2 was negative, then a deferred tax refund would result, with the refund recorded as an asset on the balance sheet.

For more information on the computation of deferred taxes, see the publication *Financial Guidelines for Agricultural Producers*, revised January 2008.

¹The federal and state income tax rates outlined in the following tables were used as an example to demonstrate the methodology of computing deferred taxes. These income tax rates will vary for different farm businesses.

Table 1. Balance Sheet Statement; Example Farm

Balance Sheet (Farm Business Only)

ASSETS	Jan. 1	Dec. 31	Average
Cash(1)	\$ 48,293	\$ 54,717	\$ 51,505
Marketable Securities(2)	0	0	0
Accounts Receivable.....(3)	1,897	1,999	1,948
Fertilizer and Supplies.....(4)	26,009	32,049	29,029
Investment in Growing Crops.....(5)	0	0	0
Crops Held for Sale and Feed(6)	156,323	186,620	171,472
Market Livestock(7)	80,656	81,369	81,013
TOTAL CURRENT ASSETS.....(8) (Add Lines 1 through 7)	\$ 313,178	\$ 356,754	\$ 334,966
Breeding Livestock.....(9)	\$ 56,773	\$ 57,259	\$ 57,016
Machinery and Equipment(10)	242,339	268,556	255,448
Buildings(11)	35,431	38,855	37,143
Investments in Cooperatives(12)	22,103	24,248	23,176
Land(13)	603,135	622,980	613,058
TOTAL NONCURRENT ASSETS.....(14) (Add Lines 9 through 13)	\$ 959,781	\$1,011,898	\$ 985,840
TOTAL ASSETS.....(15) (Add Lines 8 and 14)	\$1,272,959	\$1,368,652	\$ 1,320,806
LIABILITIES AND OWNER EQUITY:			
Accounts Payable.....(16)	\$ 0	\$ 0	\$ 0
Taxes Payable.....(17)	0	0	0
Accrued Expenses.....(18)	4,217	4,300	4,259
Current Portion: Deferred Taxes(19)	59,453	70,413	64,933
Notes Due Within One Year.....(20)	122,666	128,257	125,462
Current Portion of Term Debt(21)	15,483	16,217	15,850
Accrued Interest(22)	2,000	2,000	2,000
TOTAL CURRENT LIABILITIES.....(23) (Add Lines 16 through 22)	\$ 203,819	\$ 221,187	\$ 212,503
Noncurrent Portion: Deferred Taxes(24)	\$ 57,345	\$ 60,616	\$ 58,981
Noncurrent Portion: Notes Payable.....(25)	64,811	67,885	66,348
Noncurrent Portion: Real Estate Debt.....(26)	135,742	142,182	138,962
TOTAL NONCURRENT LIABILITIES.....(27) (Add Lines 24 through 26)	\$ 257,898	\$ 270,683	\$ 264,291
TOTAL LIABILITIES.....(28) (Add Lines 23 and 27)	\$ 461,717	\$ 491,870	\$ 476,794
OWNER EQUITY.....(29) (Subtract Line 28 from Line 15)	\$ 811,242	\$ 876,782	\$ 844,012
TOTAL LIABILITIES AND OWNER EQUITY (30) (Add Lines 28 and 29)	\$1,272,959	\$1,368,652	\$ 1,320,806

Table 2. Current Portion of Deferred Taxes

January 1

	Market Value	Tax Basis	Difference
Accounts Receivable	\$ 1,897	\$ 0	\$ 1,897
Fertilizer and Supplies	26,009	0	26,009
Crops Held for Sale and Feed	156,323	0	156,323
Market Livestock	80,656	60,492	20,164
EXCESS OF CARRYING VALUE OVER TAX BASIS OF CURRENT ASSETS			\$ 204,393
Deferred Income Liability on Crop Insurance, Disaster Payments, and Contracts			\$ 0
TOTAL DEFERRED INCOME			\$ 204,393
Accounts Payable			0
Income Taxes Payable (State and Local Only)			0
Accrued Expenses			4,217
Accrued Interest			2,000
TOTAL DEFERRED EXPENSES			\$ 6,217
NET DEFERRED INCOME SUBJECT TO INCOME TAX			\$ 198,176
ESTIMATED DEFERRED TAX LIABILITY RELATED TO CURRENT ASSETS AND CURRENT LIABILITIES			\$ 59,453

December 31

	Market Value	Tax Basis	Difference
Accounts Receivable	\$ 1,999	\$ 0	\$ 1,999
Fertilizer and Supplies	32,049	0	32,049
Crops Held for Sale and Feed	186,620	0	186,620
Market Livestock	81,369	61,027	20,342
EXCESS OF CARRYING VALUE OVER TAX BASIS OF CURRENT ASSETS			\$ 241,010
Deferred Income Liability on Crop Insurance, Disaster Payments, and Contracts			\$ 0
TOTAL DEFERRED INCOME			\$ 241,010
Accounts Payable			\$ 0
Income Taxes Payable (State and Local Only)			0
Accrued Expenses			4,300
Accrued Interest			2,000
TOTAL DEFERRED EXPENSES			\$ 6,300
NET DEFERRED INCOME SUBJECT TO INCOME TAX			\$ 234,710
ESTIMATED DEFERRED TAX LIABILITY RELATED TO CURRENT ASSETS AND CURRENT LIABILITIES			\$ 70,413

Table 3. Noncurrent Portion of Deferred Taxes

January 1	Market Value	Tax Basis	Difference
Raised Breeding Livestock	\$ 28,385	\$ 0	\$ 28,385
Purchased Breeding Livestock	28,388	14,200	14,188
Machinery and Equipment	242,339	121,170	121,169
Buildings	35,431	17,715	17,716
Investments in Cooperatives	22,103	22,103	0
Land	603,135	402,290	200,845
DEFERRED TAXABLE INCOME RELATED TO EXCESS OF MARKET VALUE OVER BASE VALUE			\$ 382,303
ESTIMATED DEFERRED TAX LIABILITY RELATED TO VALUATION EQUITY			\$ 57,345
December 31			
	Market Value	Tax Basis	Tax Difference
Raised Breeding Livestock	\$ 28,630	\$ 0	\$ 28,630
Purchased Breeding Livestock	28,629	14,315	14,314
Machinery and Equipment	268,556	134,280	134,276
Buildings	38,855	19,425	19,430
Investments in Cooperatives	24,248	24,248	0
Land	622,980	415,525	207,455
DEFERRED TAXABLE INCOME RELATED TO EXCESS OF MARKET VALUE OVER BASE VALUE			\$ 404,105
ESTIMATED DEFERRED TAX LIABILITY RELATED TO VALUATION EQUITY			\$ 60,616

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