**EXERCISE – Current and Deferred Taxes**

1. Company A’s Income Statement reports a profit before tax of € 15.000.

The depreciation expenses included in the Income Statement amounts to € 4.800 euro and relates to - plant purchased in year x-2, historical cost € 40.000, depreciation rate 12%, under tax law depreciation is permitted up to 10%. The tax rate is 20%.

**Please indicate whether this gives rise to permanent or temporary differences and to deferred tax assets or liabilities. Indicate also the sign and the amount of each permanent or temporary difference.**

**Solution**

**Temporary difference +800 Deferred tax assets 160**

Depreciation expense of plants recorded in the Income Statement for accounting purposes: 40.000\*12% = 4.800 Depreciation expense of plants deductible for tax purposes: 40.000\*10% = 4.000 Temporary difference + 800 Deferred tax asset 800\*20% = 160

2. In the Income Statement of Company A is included also a gain on sale of tangible assets for an amount of € 3.000. In the current accounting period, the company realised a gain on sale of € 3.000 from the sale of plant and equipment, purchased 5 years ago. Under tax law the taxation of gains on the sale of tangible assets is deferred over 5 years, starting from the accounting period in which the gain on sale is recorded in income statement (1/5 a year).

**Please indicate whether this item gives rise to permanent or temporary differences and to deferred tax assets or liabilities. Indicate also the sign and the amount of each permanent or temporary difference.**

**Solution**

**Temporary difference -2.400 Deferred tax liabilities 480**

Gain on sale recorded in the Income Statement for accounting purposes: 3.000 Gain on sale taxable for tax purposes: 3.000\*1/5 = 600 Temporary difference -4/5 gain on sale year x – 2.400 Deferred tax liability 2.400\*20% = 480

3. In the Income Statement of Company A are included also dividends received for an amount of € 5.000. Under tax law dividends are 95% exempt from tax.

**Please indicate whether this item gives rise to permanent or temporary differences and to deferred tax assets or liabilities. Indicate also the sign and the amount of each permanent or temporary difference.**

**Solution**

**Permanent difference -4.750 No deferred tax**

Dividends recorded in the Income Statement for accounting purposes: 5.000 Dividends taxable for tax purposes: 5.000\*5% = 250 Permanent difference (5.000\*95%) -4.750 No deferred tax

**4.** Assuming that there are no other permanent or temporary differences and that the rate of tax is 20%, **compute company A’s profit after tax for year X.**

**Solution**

**Profit before tax 15.000**

Temporary difference (depreciation) +800

Temporary difference (gain on sale -4/5) -2.400

Permanent difference (dividends -95%) -4.750

Taxable profit 8.650

**Current tax (20%) 1.730 (=8.650x20%)**

**Deferred tax assets (20%) 160 (= 800x20%)**

**Deferred tax liabilities 480 (= 2.400x20%)**

**Profit after tax 12.950 (= 15.000 – 1.730 + 160 – 480)**