

Deferred Tax Footnotes

- **Components of Income before Tax**
 - Domestic vs. Foreign
- **Components of Income Tax Expense**
 - Currently payable vs. Deferred
- **Reconciliation from Statutory to Effective Income Tax Rates**
 - Permanent differences
- **Components of Deferred Tax Assets and Liabilities**
 - Temporary differences and Valuation Allowance
- **Differences between Footnote and Balance Sheet**
 - Deferred tax assets and liabilities may be netted by jurisdiction on the balance sheet
 - Deferred tax assets and liabilities may be split into current and noncurrent portions

Disclosure Example

- **Moth Inc. manufactures construction equipment**
- **Questions to answer from Moth's Income Tax footnote:**
 - What is the effect of Moth's non-US subsidiaries on its 2012 effective tax rate?
 - Provide a summary journal entry for 2012 Income Tax Expense
 - Provide the journal entry for the change in valuation allowance during 2011. Why did Moth make this entry? What effect does this entry have on net income?
 - Was Moth's warranty expense for tax purposes higher or lower than its warranty expense for book purposes in 2012?
 - Was Moth's depreciation expense for tax purposes higher or lower than its depreciation expense for book purposes in 2012?

Footnote 6: Income Taxes

Reconciliation of the U.S. federal statutory rate to effective rate:	Year ended Dec. 31		
	2012	2011	2010
U.S. statutory rate	35.0%	35.0%	35.0%
(Decreases) increases in taxes from:			
Net operating loss carryforwards	(0.4)	(2.1)	(1.0)
Benefit of Foreign Sales Corp.	(4.4)	(3.2)	(2.8)
Non-U.S. subsidiaries taxed at other than 35%	1.9	(0.5)	1.4
Other-net	<u>(0.1)</u>	<u>1.4</u>	<u>0.4</u>
Provision for income taxes	32.0%	30.6%	33.0%

We paid income taxes of \$306, \$714, and \$709 in 2012, 2011, and 2010, respectively.

- **Effect of non-US subsidiaries on 2012 ETR**

- Increased ETR by 1.9%
- Represents extra tax on the same pre-tax income
- Permanent difference

- **For tax calculations, we will use statutory rate: 35%**

Footnote 6: Income Taxes

(millions)	Year ended December 31		
Profit before taxes:	2012	2011	2010
U.S.	\$1,050	\$1,880	\$2,071
Non-U.S.	371	294	342
	<u>\$1,421</u>	<u>\$2,174</u>	<u>\$2,413</u>
Provision for income taxes:			
Current tax provision:			
U.S. Federal	\$179	\$471	\$571
Non-U.S.	190	102	103
State (U.S.)	21	45	54
	<u>390</u>	<u>618</u>	<u>728</u>
Deferred tax provision (credit):			
U.S. Federal	81	93	60
Non-U.S.	(25)	(55)	7
State (U.S.)	9	9	1
	<u>65</u>	<u>47</u>	<u>68</u>
Total provision	<u>\$455</u>	<u>\$665</u>	<u>\$796</u>

• Journal entry for 2012 Income Tax Expense

Dr. Income Tax Expense	455
Cr. Deferred Taxes	65
Cr. Income Tax Payable	390

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- **More detail?**

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(millions)	December 31,		
Deferred tax assets and liabilities:	2012	2011	2010
Deferred tax assets:			
Postemployment benefits	\$1,044	\$1,032	\$1,107
Warranty reserves	237	194	159
Unrealized profit	167	179	201
Net operating loss carryforwards	170	83	76
Inventory valuation method	93	78	62
Other	205	230	233
	<u>1,916</u>	<u>1,796</u>	<u>1,838</u>
Deferred tax liabilities:			
Capital assets	(383)	(263)	(177)
Pension	(138)	(83)	(99)
	<u>(521)</u>	<u>(346)</u>	<u>(276)</u>
Valuation allowance for DTAs	<u>(72)</u>	<u>(61)</u>	<u>(129)</u>
Deferred taxes — net	\$1,323	\$1,389	\$1,433

- **Deferred Tax Assets**

- **Debit of 120**

- (1916 – 1796)

- **Deferred Tax Liab.**

- **Credit of 175**

- (521 – 346)

- **Valuation Allowance**

- **Credit of 11**

- (72 – 61)

- **Cr. Def Taxes 65 =**

Dr. DTA 120

Cr. DTL 175

Cr. Val Allow 10



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• More detail?

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Dr. Deferred Tax Assets	120
Cr. Deferred Tax Liabilities	175
Cr. Valuation Allowance	10

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We paid income taxes of \$306, \$714, and \$709 in 2012, 2011, and 2010, respectively.

- **Cash paid for income taxes**

– \$306 in 2012

- **Cr. Income Tax Payable 390 =**

Cr. Cash 306

Cr. Inc Tax Pay 84

• (390 – 306)

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• More detail?

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Cr. Income Tax Payable	84
Cr. Cash	306

Footnote 6: Income Taxes

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Deferred tax assets:			
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Valuation allowance for DTAs	<u>(72)</u>	<u>(61)</u>	<u>(129)</u>
Deferred taxes — net	\$1,323	\$1,389	\$1,433

- **Journal entry for 2011 change in valuation allowance**
 - Decrease of \$68 (61 – 129)
 - Dr. Val. Allow. (-XA) 68
 - Cr. Inc. Tax Exp. (-E) 68
- **Increases Net Income by \$68**
- **Why did the Valuation Allowance decrease?**

Footnote 6: Income Taxes

As of December 31, 2012, amounts and expiration dates of net operating loss carryforwards in various non-U.S. taxing jurisdictions were:

2013	2014	2015	2016	2017	2018	2019	Beyond 2019	Total
\$1	\$4	\$8	\$18	\$15	\$45	\$45	\$482	\$618

A valuation allowance has been recorded at certain non-U.S. subsidiaries that have not yet demonstrated consistent and/or sustainable profitability to support the recognition of net deferred tax assets. Circumstances could change in the future which would allow us to reduce the remaining valuation allowance and recognize additional net deferred tax assets.

In 2011, circumstances changed at certain of our European subsidiaries which allowed us to reduce the valuation allowance and recognize additional net deferred tax assets.

Footnote 6: Income Taxes

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- **Journal entry for 2011 change in valuation allowance**
 - Decrease of \$68 (61 – 129)
 - Dr. Valuation Allow. 68
 - Cr. Income Tax Exp. 68
- **Increases Net Income by \$68**
- **Why did the Valuation Allowance decrease?**
 - “circumstances changed at certain of our European subsidiaries”



Footnote 6: Income Taxes

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- **2012 difference in Warranty Expense**
 - Warranty DTA increased by \$43 (237 – 194)
 - Dr. Income Tax Exp
 - Dr. Deferred Tax Asset 43
 - Cr. Income Tax Payable
 - Income Tax Exp < Income Tax Payable for Warranty

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	<u>1,916</u>	<u>1,796</u>	<u>1,838</u>

- **2012 difference in Warranty Expense**
 - Warranty DTA increased by \$43 (237 – 194)
 - Dr. Income Tax Exp
 - Dr. Deferred Tax Asset 43
 - Cr. Income Tax Payable
 - Income Tax Exp < Income Tax Payable for Warranty

- **Income Tax Expense < Income Tax Payable by \$43 for Warranty**
- **Pre-tax Income < Taxable Income by \$123 (43 / 0.35)**
- **Book Warranty Expense > Tax Warranty Expense by \$123**

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- **2012 difference in Depreciation Expense**

- **Capital Assets DTL increased by \$120 (383 – 263)**

Dr. Income Tax Exp

Cr. Def Tax Liab 120

Cr. Income Tax Pay

- **Income Tax Exp > Income Tax Pay for Depreciation**

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- **2012 difference in Depreciation Expense**

- **Capital Assets DTL increased by \$120 (383 – 263)**

Dr. Income Tax Exp

Cr. Def Tax Liab 120

Cr. Income Tax Pay

- **Income Tax Exp > Income Tax Pay for Depreciation**

- **Income Tax Expense > Income Tax Payable by \$120 for Depreciation**
- **Pre-tax Income > Taxable Income by \$343 (120 / 0.35)**
- **Book Depreciation Expense < Tax Depreciation Expense by \$343**