

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)	\$ 45,363	\$ 50,555	\$ 47,959
Marketable Securities(2)	0	0	0
Accounts Receivable.....(3)	1,758	1,816	1,787
Fertilizer and Supplies.....(4)	21,367	25,406	23,387
Investment in Growing Crops.....(5)	0	0	0
Crops Held for Sale and Feed(6)	133,049	158,710	145,880
Market Livestock(7)	83,469	81,001	82,235
TOTAL CURRENT ASSETS(8)	\$ 285,006	\$ 317,488	\$ 301,247
(Add Lines 1 through 7)			
Breeding Livestock.....(9)	\$ 53,813	\$ 55,117	\$ 54,465
Machinery and Equipment(10)	220,734	241,546	231,140
Buildings(11)	32,913	35,480	34,197
Investments in Cooperatives(12)	20,298	22,208	21,253
Land(13)	529,026	544,592	536,809
TOTAL NONCURRENT ASSETS(14)	\$ 856,784	\$ 898,943	\$ 877,864
(Add Lines 9 through 13)			
TOTAL ASSETS.....(15)	\$1,141,790	\$1,216,431	\$1,179,111
(Add Lines 8 and 14)			
LIABILITIES AND OWNER EQUITY:			
Accounts Payable.....(16)	\$ 0	\$ 0	\$ 0
Taxes Payable.....(17)	0	0	0
Accrued Expenses.....(18)	3,871	4,207	4,039
Current Portion: Deferred Taxes(19)	51,351	59,993	55,672
Notes Due Within One Year.....(20)	119,716	122,345	121,031
Current Portion of Term Debt(21)	14,545	15,203	14,874
Accrued Interest(22)	2,000	2,00	2,000
TOTAL CURRENT LIABILITIES.....(23)	\$ 191,483	\$ 203,748	\$ 197,616
(Add Lines 16 through 22)			
Noncurrent Portion: Deferred Taxes(24)	\$ 51,266	\$ 53,936	\$ 52,601
Noncurrent Portion: Notes Payable(25)	60,888	63,641	62,265
Noncurrent Portion: Real Estate Debt(26)	127,527	133,291	130,409
TOTAL NONCURRENT LIABILITIES(27)	\$ 239,681	\$ 250,868	\$ 245,275
(Add Lines 24 through 26)			
TOTAL LIABILITIES(28)	\$ 431,164	\$ 454,616	\$ 442,890
(Add Lines 23 and 27)			
OWNER EQUITY.....(29)	\$ 710,626	\$ 761,815	\$ 736,221
(Subtract Line 28 from Line 15)			
TOTAL LIABILITIES AND OWNER EQUITY (30)	\$1,141,790	\$1,216,431	\$1,179,111
(Add Lines 28 and 29)			

Table 2. Current Portion of Deferred Taxes

January 1

	Market Value	Tax Basis	Difference
Accounts Receivable	\$ 1,758	\$ 0	\$ 1,758
Fertilizer and Supplies	21,367	0	21,367
Crops Held for Sale and Feed	133,049	0	133,049
Market Livestock	83,469	62,602	20,867
EXCESS OF CARRYING VALUE OVER TAX BASIS OF CURRENT ASSETS			\$ 177,041
Deferred Income Liability on Crop Insurance, Disaster Payments, and Contracts			\$ 0
TOTAL DEFERRED INCOME			\$ 177,041
Accounts Payable			0
Income Taxes Payable (State and Local Only)			0
Accrued Expenses			3,871
Accrued Interest			2,000
TOTAL DEFERRED EXPENSES			\$ 5,871
NET DEFERRED INCOME SUBJECT TO INCOME TAX			\$ 171,170
ESTIMATED DEFERRED TAX LIABILITY RELATED TO CURRENT ASSETS AND CURRENT LIABILITIES			\$ 51,351

December 31

	Market Value	Tax Basis	Difference
Accounts Receivable	\$ 1,816	\$ 0	\$ 1,816
Fertilizer and Supplies	25,406	0	25,406
Crops Held for Sale and Feed	158,710	0	158,710
Market Livestock	81,001	60,751	20,250
EXCESS OF CARRYING VALUE OVER TAX BASIS OF CURRENT ASSETS			\$ 206,182
Deferred Income Liability on Crop Insurance, Disaster Payments, and Contracts			\$ 0
TOTAL DEFERRED INCOME			\$ 206,182
Accounts Payable			\$ 0
Income Taxes Payable (State and Local Only)			0
Accrued Expenses			4,207
Accrued Interest			2,000
TOTAL DEFERRED EXPENSES			\$ 6,207
NET DEFERRED INCOME SUBJECT TO INCOME TAX			\$ 199,975
ESTIMATED DEFERRED TAX LIABILITY RELATED TO CURRENT ASSETS AND CURRENT LIABILITIES			\$ 59,993

Table 3. *Noncurrent Portion of Deferred Taxes*

January 1

	Market Value	Tax Basis	Difference
Raised Breeding Livestock	\$ 26,905	\$ 0	\$ 26,905
Purchased Breeding Livestock	26,908	13,450	13,458
Machinery and Equipment	220,734	110,365	110,369
Buildings	32,913	16,455	16,458
Investments in Cooperatives	20,298	20,298	0
Land	529,026	354,445	174,581

DEFERRED TAXABLE INCOME RELATED
TO EXCESS OF MARKET VALUE OVER BASE VALUE \$ 341,771

ESTIMATED DEFERRED TAX LIABILITY RELATED TO VALUATION EQUITY \$ 51,266

December 31

	Value	Market Basis	Tax Difference
Raised Breeding Livestock	\$ 27,555	\$ 0	\$ 27,555
Purchased Breeding Livestock	27,562	13,780	13,782
Machinery and Equipment	241,546	120,770	120,776
Buildings	35,480	17,740	17,740
Investments in Cooperatives	22,208	22,208	0
Land	544,592	364,875	179,717

DEFERRED TAXABLE INCOME RELATED
TO EXCESS OF MARKET VALUE OVER BASE VALUE \$ 359,570

ESTIMATED DEFERRED TAX LIABILITY
RELATED TO VALUATION EQUITY \$ 53,936

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