Farm Management Guide MF-2358

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.

[1] *The 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)	$ 33,588	$ 37,605	$ 35,597
Marketable Securities	(2)	0	0	0
Accounts Receivable	(3)	1,823	1,653	1,738
Fertilizer and Supplies	(4)	13,177	16,198	14,688
Investment in Growing Crops	(5)	0	0	0
Crops Held for Sale and Feed	(6)	93,556	109,861	101,709
Market Livestock	(7)	$ 82,220	$ 85,672	$ 83,946
TOTAL CURRENT ASSETS (Add Lines 1 through 7)	(8)	$ 224,364	$ 250,989	$ 237,677
Breeding Livestock	(9)	47,343	49,260	48,302
Machinery and Equipment	(10)	185,283	197,847	191,565
Buildings	(11)	27,051	28,421	27,736
Investments in Cooperatives	(12)	18,094	18,223	18,159
Land	(13)	438,208	450,516	444,362
TOTAL NONCURRENT ASSETS (Add Lines 9 through 13)	(14)	$ 715,979	$ 744,267	$ 730,123
TOTAL ASSETS (Add Lines 8 and 14)	(15)	$ 940,343	$ 995,256	$ 967,800
LIABILITIES AND OWNER EQUITY:				
Accounts Payable	(16)	0	0	0
Taxes Payable	(17)	0	0	0
Accrued Expenses	(18)	2,778	2,763	2,771
Current Portion: Deferred Taxes	(19)	37,300	43,310	40,305
Notes Due Within One Year	(20)	108,847	112,549	110,698
Current Portion of Term Debt	(21)	12,299	12,782	12,541
Accrued Interest	(22)	2,000	2,000	2,000
TOTAL CURRENT LIABILITIES (Add Lines 16 through 22)	(23)	$ 163,224	$ 173,404	$ 168,314
Noncurrent Portion: Deferred Taxes	(24)	43,136	45,013	44,075
Noncurrent Portion: Notes Payable	(25)	51,483	53,508	52,496
Noncurrent Portion: Real Estate Debt	(26)	107,828	112,069	109,949
TOTAL NONCURRENT LIABILITIES (Add Lines 24 through 26)	(27)	$ 202,447	$ 210,590	$ 206,519
TOTAL LIABILITIES (Add Lines 23 and 27)	(28)	$ 365,671	$ 383,994	$ 374,833
OWNER EQUITY (Subtract Line 28 from Line 15)	(29)	$ 574,672	$ 611,262	$ 592,967
TOTAL LIABILITIES AND OWNER EQUITY (Add Lines 28 and 29)	(30)	$ 940,343	$ 995,256	$ 967,800

Table 2. *Current Portion of Deferred Taxes*

January 1

	Market Value	Tax Basis	Difference
Accounts Receivable	$ 1,823	$ 0	$ 1,823
Fertilizer and Supplies	13,177	0	13,177
Crops Held for Sale and Feed	93,556	0	93,556
Market Livestock	82,220	61,665	20,555
EXCESS OF CARRYING VALUE OVER TAX BASIS OF CURRENT ASSETS			$ 129,111
Deferred Income Liability on Crop Insurance, Disaster Payments, and Contracts			0
TOTAL DEFERRED INCOME			$ 129,111
Accounts Payable			0
Income Taxes Payable (State and Local Only)			0
Accrued Expenses			2,778
Accrued Interest			2,000
TOTAL DEFERRED EXPENSES			$ 4,778
NET DEFERRED INCOME SUBJECT TO INCOME TAX			$124,333
ESTIMATED DEFERRED TAX LIABILITY RELATED TO CURRENT ASSETS AND CURRENT LIABILITIES			$ 37,300

December 31

	Market Value	Tax Basis	Difference
Accounts Receivable	$ 1,653	$ 0	$ 1,653
Fertilizer and Supplies	16,198	0	16,198
Crops Held for Sale and Feed	109,861	0	109,861
Market Livestock	85,672	64,254	21,418
EXCESS OF CARRYING VALUE OVER TAX BASIS OF CURRENT ASSETS			$149,130
Deferred Income Liability on Crop Insurance, Disaster Payments, and Contracts			0
TOTAL DEFERRED INCOME			$149,130
Accounts Payable			0
Income Taxes Payable (State and Local Only)			0
Accrued Expenses			2,763
Accrued Interest			2,000
TOTAL DEFERRED EXPENSES			$ 4,763
NET DEFERRED INCOME SUBJECT TO INCOME TAX			$144,367
ESTIMATED DEFERRED TAX LIABILITY RELATED TO CURRENT ASSETS AND CURRENT LIABILITIES			$ 43,310

Table 3. *Noncurrent Portion of Deferred Taxes*

January 1

	Market Value	Tax Basis	Difference
Raised Breeding Livestock	$ 23,650	$ 0	$ 23,650
Purchased Breeding Livestock	23,693	11,850	11,843
Machinery and Equipment	185,283	92,650	92,633
Buildings	27,051	13,525	13,526
Investments in Cooperatives	18,094	18,094	0
Land	438,208	292,285	145,923
DEFERRED TAXABLE INCOME RELATED TO EXCESS OF MARKET VALUE OVER BASE VALUE			$ 287,575
ESTIMATED DEFERRED TAX LIABILITY RELATED TO VALUATION EQUITY			$ 43,136

December 31

	Market Value	Tax Basis	Difference
Raised Breeding Livestock	$ 24,625	$ 0	$ 24,625
Purchased Breeding Livestock	24,635	12,325	12,310
Machinery and Equipment	197,847	98,925	98,922
Buildings	28,421	14,210	14,211
Investments in Cooperatives	18,223	18,223	0
Land	450,516	300,495	150,021
DEFERRED TAXABLE INCOME RELATED TO EXCESS OF MARKET VALUE OVER BASE VALUE			$ 300,089
ESTIMATED DEFERRED TAX LIABILITY RELATED TO VALUATION EQUITY			$ 45,013

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