**ROOSTERFISH CORPORATION**

Roosterfish had a tax liability for 20X7 of $20,000 based on a tax rate of 40%. The accounting staff of Roosterfish is having trouble putting together the 20X7 financials. They need your help in determining the tax expense and deferred tax amounts for 20X7. The enacted tax rates for the future periods follow:

35% for: 20X8, 20X9, 20Y0, 20Y1, 20Y2

30% for: 20Y3, 20Y4, 20Y5, 20Y6

Roosterfish does not believe that temporary differences can be reasonably projected beyond those periods. The taxable income for 20X8 was $100,000.

Roosterfish also owned a 30% interest in Cubera, Inc. Cubera reported income of $50,000 and $60,000 in 20X7 and 20X8 respectively. Roosterfish received dividends from Cubera in the amounts of $5,000 and $8,000 for 20X7 and 20X8 respectively. Roosterfish expects this pattern of earnings and dividends to continue over the next ten years.

Estimated warranty expense recognized by Roosterfish was $7,500 in 20X7 and $10,000 in 20X8. Actual warranty cost for the two years was $6,000 and $12,000 respectively. The bad debts expense recognized on the income statement was $15,000 in 20X7 and $20,000 in 20X8. Actual bad debt write-offs per the tax return were $10,000 in 20X7 and $15,000 in 20X8.

On January 1, 20X8 Roosterfish also received $30,000 of rent in advance covering a two year rental agreement, and $5,000 for interest income on municipal bonds (classified as held-to-maturity securities). The bonds mature in 20Y0.

Other data with respect to Roosterfish include:

|  |  |  |
| --- | --- | --- |
| Year | Cost Recovery | Depreciation |
| 20X7 | $24,000\* | $10,000 |
| 20X8 | 24,000 | 10,000 |
| 20X9 | 17,000 | 10,000 |
| 20Y0 | 12,000 | 10,000 |
| 20Y1 | 9,000 | 10,000 |
| 20Y2 | 9,000 | 10,000 |
| 20Y3 | 8,500 | 10,000 |
| 20Y4 | 4,500 | 10,000 |
| 20Y5 | --0-- | 10,000 |
| 20Y6 | --0-- | 10,000 |
| TOTALS | $108,000 | $100,000 |

\*Includes some immediate expensing per Section 179.

**Required:**

a. Determine the tax expense amounts for 20X7 and 20X8.

b. Determine the tax liability amount for 20X8.

c. Determine the deferred tax amounts for 20X7 and 20X8.

d. Prepare the journal entries for two year period.

e. Prepare a partial income statement presentation for the income before tax, provision for income tax, and net income for 20X7. (The best example for this is page four of a corporate income tax return—schedule M-1.)

**Key Terminology**

Taxable Income:

Income (per IRC) less deductions (per IRC) per tax return

Tax Liability:

Taxes owed to government per income tax return (based on Taxable Income)

Net Income:

Revenue minus expenses per GAAP

Provision for Income Taxes or Income Tax Expense:

An income statement amount determined based upon the taxable/deductible components GAAP. Includes the amount currently payable per tax return (tax liability) plus/minus any deferred amounts computed per schedules.

Deferred Income Taxes:

A theoretical/conceptual liability that will be paid, only if the entity continues to generate a profit into the future continues as a going concern. Deferred taxes are not a legal obligation.