

LM09 · FINANCIAL STATEMENT ANALYSIS · CFA LEVEL I

Analysis of Income Taxes

Why accounting profit $\neq$ taxable income, and how the gap creates DTA, DTL, and tax expense

Why Income-Tax Accounting Is Tricky

A company must show the same basic facts to its **tax authorities** that it shows its **owners and lenders**: revenue, expenses, and a positive difference on which it pays tax. But *tax laws are not the same as financial-reporting standards*, so financial reporting needs a special set of rules to account for the differences — primarily **deferred tax liabilities (DTLs)** and **deferred tax assets (DTAs)**.

Learning Outcome Statements

- LOS a** Calculate the tax base of a company's assets and liabilities
- LOS b** Calculate income tax expense, income taxes payable, deferred tax assets, and deferred tax liabilities, and calculate and interpret the adjustment to the financial statements related to a change in the income tax rate
- LOS c** Evaluate the effect of tax rate changes on a company's financial statements and ratios
- LOS d** Identify and contrast temporary versus permanent differences in pre-tax accounting income and taxable income
- LOS e** Explain recognition and measurement of current and deferred tax items
- LOS f** Describe the valuation allowance for deferred tax assets — when it is required and what effect it has on financial statements

Exam Tip: The single most tested LM09 formula is **Income Tax Expense = Taxes Payable + Δ DTL – Δ DTA**. Memorize it, know every sign, and recognize how each driver flows through the financial statements.

KEY TERMINOLOGY · ACCOUNTING PROFIT VS. TAXABLE INCOME

Two Different "Profit" Numbers

ACCOUNTING PROFIT

The **pretax income** from the income statement. Based on **accounting standards** (IFRS or US GAAP). Prepared on an **accrual basis**.

Also called: pretax income, income before tax, financial-reporting income.

TAXABLE INCOME

Income **subject to tax**. Based on the **tax return**. Follows the **tax code**, which often uses modified-cash or accelerated methods.

Also called: tax-return income, income per the tax code.

Why They Differ — Two Classic Examples

- 1. Depreciation:** Accounting profit is usually calculated using **straight-line** depreciation, while taxable income is usually calculated using **accelerated** depreciation.
- 2. Accrual vs. cash:** Accounting profit is usually based on the **accrual basis**; taxable income is usually based on **cash-basis** (or modified-cash) accounting.

The Three Tax Rates an Analyst Uses

RATE	DEFINITION
Statutory tax rate	The tax rate established by law .
Effective tax rate	Income tax expense ÷ pretax income — the tax amount reported on the income statement divided by the pre-tax income.
Cash tax rate	Cash taxes actually paid ÷ pretax income.

Differences between cash taxes and reported taxes occur due to timing differences between accounting and tax calculations. These differences are reflected as a deferred tax asset or a deferred tax liability on the balance sheet.

Exam Tip: Analysts compare all three rates. A persistent gap between the *statutory* and *effective* rates flags permanent differences or tax credits; a persistent gap between the *effective* and *cash* rate flags temporary (timing) differences that are building DTLs or DTAs.

LOS A · TAX BASE OF ASSETS AND LIABILITIES

Tax Base vs. Carrying Amount

Tax base = the amount attributed to the asset or liability for *tax purposes* (i.e., the balance sheet as it would appear for tax purposes).

Carrying amount = the value of the asset or liability shown on the financial-reporting balance sheet.

Tax Base of an Asset

The amount that will be **deductible for tax purposes in future periods**.

For a depreciable fixed asset: **Tax base = Cost – any depreciation previously taken for tax purposes**.

If the asset is sold, the taxable gain or loss on the sale = **sale price – asset's tax base**.

Tax Base of a Liability

The **carrying amount of the liability less any amounts that will be deductible for tax purposes** (i.e., amounts that will *not* be taxed in the future).

Example — unearned revenue: cash was received and taxed already; the remaining carrying amount is a liability for financial reporting but its tax base is zero, because none of it will be deductible in future.

DTA VS DTL — SIGNS FROM CARRYING AMOUNT AND TAX BASE

Sign map for temporary differences

TAXABLE TEMPORARY DIFFERENCE → DTL

Asset: Carrying > Tax base

Liability: Carrying < Tax base

Future taxable income > future accounting income

DEDUCTIBLE TEMPORARY DIFFERENCE → DTA

Asset: Carrying < Tax base

Liability: Carrying > Tax base

Future taxable income < future accounting income

Measurement formula

$$DTL = (\text{Carrying amount} - \text{Tax base}) \times \text{Tax rate}$$

(A negative result is a DTA — or re-state as $(\text{Tax base} - \text{Carrying}) \times t = \text{DTA}$)

Summary Table

ITEM	RELATIONSHIP	RESULT	EXAMPLE
------	--------------	--------	---------

Asset	Carrying amount > Tax base	DTL	Straight-line depreciation for accounting; accelerated depreciation for tax
Asset	Carrying amount < Tax base	DTA	Research cost expensed for accounting; amortized for tax
Liability	Carrying amount > Tax base	DTA	Cash from customers before revenue recognition (cash is taxed now)
Liability	Carrying amount < Tax base	DTL	— (rarer; e.g., certain accrual mismatches)

LOS B · HOW DTL AND DTA ARISE

Deferred Tax Liabilities and Assets — Mechanics

DTL ARISES WHEN

Income tax expense > **Taxes payable** (TP < ITE)

Drivers on the tax return: **higher tax expenses** / **lower tax revenue** = **lower taxable income**.

Pay less tax now but more on reversal.

Classic trigger: Accelerated depreciation for tax (faster than straight-line for GAAP) → early tax deduction → DTL.

DTA ARISES WHEN

Taxes payable > **Income tax expense** (TP > ITE)

Drivers on the tax return: **lower tax expense** / **higher tax revenue** = **higher taxable income**.

Pay more tax now but less on reversal.

Classic triggers: warranty accruals (GAAP expense now, tax deduction when paid); deferred / unearned revenue (taxed on receipt, GAAP recognized later); NOL carryforward.

How a Change in DTL or DTA Flows Through the Statements

Since $ITE = TP + \Delta DTL$:

- ↑ **Increase in DTL** → Total Liabilities ↑ · NI ↓ · Retained Earnings ↓ · Equity ↓
- ↓ **Decrease in DTL** → Total Liabilities ↓ · NI ↑ · Retained Earnings ↑ · Equity ↑

And since $ITE = TP - \Delta DTA$:

- ↑ **Increase in DTA** → Total Assets ↑ · NI ↑ · Retained Earnings ↑ · Equity ↑
- ↓ **Decrease in DTA** → Total Assets ↓ · NI ↓ · Retained Earnings ↓ · Equity ↓

The Master Equation

$$\text{IncomeTaxExpense} = \text{TaxesPayable} + \Delta DTL - \Delta DTA$$

Taxes payable is the current-period liability computed from *taxable income*. The deferred-tax adjustments reconcile the cash tax to the accounting tax.

Exam Tip: Sign rules to memorize: ↑DTL raises ITE; ↓DTL lowers ITE; ↑DTA lowers ITE; ↓DTA raises ITE.

LOS B, D · COMMON EXAMPLES THAT CREATE DTL / DTA

Which Events Create a DTL? A DTA?

DTL triggers

- **Accelerated depreciation** for tax (faster than GAAP straight-line) → early tax deduction
- Revenues recognized on IS before being included on the tax return (e.g., **credit sales** under accrual accounting, when the tax code taxes on cash)
- Expenses tax-deductible before being recognized on IS
- Asset revaluations above cost (IFRS)

DTA triggers

- **Warranty accruals** recognized for GAAP but deductible only when paid
- **Deferred / unearned revenue** — cash from customers taxed now; GAAP revenue recognized later
- **NOL carryforward** — a current or past tax loss that can reduce taxable income in the future
- Expenses recognized on IS before they are tax-deductible (e.g., research cost expensed for accounting, amortized for tax)

Common Sources of Temporary (Timing) Differences

- | | |
|----------------------------------|--|
| • Depreciation methods | • Pension expense |
| • Asset revaluations (IFRS only) | • Unrealized gains/losses on investments |
| • Warranty provisions | • Earnings from group companies (unless parent controls timing of reversal or it is unlikely to reverse) |
| • Impairments | • Fair-value adjustments in a business combination (but <i>not</i> goodwill or goodwill impairments) |
| • Restructuring provisions | |
| • Revenues received in advance | |

Exam Tip: Inventory accounting differences do *not* create DTA/DTL under either IFRS or US GAAP, because the standards require consistent inventory treatment between reporting and tax (with limited exceptions).

WORKED EXAMPLE • ACCELERATED DEPRECIATION BUILDS A DTL

DTL Example: Straight-Line (book) vs. Accelerated (tax) Depreciation

IFT 2024 HYN • VERBATIM

Financial reporting vs. tax reporting, 2010 & 2011

□ GIVEN

Financial Reporting

	2010	2011
Sales	100	100
Cash expenses	40	40
Depreciation (SL)	20	20
PBT	40	40
Tax expense (@40%)	16	16
PAT	24	24

Tax Reporting

	2010	2011
Sales	100	100
Cash expenses	40	40
Depreciation (Acc Dep)	40	10
Taxable Income	20	50
Tax payable (@40%)	8	20
PAT	12	30

SOLUTION

□ WALK-THROUGH

1

2010 — DTL is created.

At the end of 2010, tax payable is 8 which is less than the tax expense of 16, so the difference of 8 which is not paid is recorded as a **DTL**.

$$\text{ITE } 16 = \text{TP } 8 + \Delta \text{DTL } 8 \rightarrow \text{DTL ending balance} = 8$$

2

2011 — DTL reverses.

At the end of 2011, the tax payable is 20 which is more than the tax expense of 16, so the DTL reduces by 4 to account for the difference between tax payable and the tax expense. The DTL at the end of 2011 is **4**.

$$\text{ITE } 16 = \text{TP } 20 + \Delta\text{DTL } (-4) \rightarrow \text{DTL } 8 \rightarrow 4$$

□ TAKEAWAY

When a company takes an **early tax deduction** (accelerated depreciation), current taxes payable are *below* the GAAP tax expense. The shortfall is a liability today (DTL) because more tax will be owed on reversal. If capital spending keeps growing, new DTLs can outpace reversals and the DTL balance persistently grows — a key analytical signal.

QUIZ 1 · CHECKPOINT

Test Your Understanding: Tax Base, DTL/DTA Mechanics

Q1. Accounting profit and taxable income differ primarily because:

Q2. For a depreciable asset, Carrying amount > Tax base. This creates a:

Q3. A company receives cash from customers in advance of delivering the goods. The cash is taxable on receipt but GAAP revenue will be recognized later. The deferred-revenue liability has Carrying amount > Tax base. This creates a:

Q4. In 2010, pretax income is 40, taxes payable are 8, and income tax expense is 16. What is ΔDTL for the period?

Q5. Which of the following is *least likely* to create a deferred tax asset?

LOS D • TEMPORARY VS. PERMANENT DIFFERENCES

Temporary vs. Permanent Differences

TEMPORARY DIFFERENCE

A difference between the **tax base and carrying amount** of an asset or liability that is **expected to reverse** in future. DTA and DTL are created *only* because of temporary differences.

Example: accelerated tax depreciation vs. SL book depreciation.

PERMANENT DIFFERENCE

A difference between **taxable income** and **pre-tax income** that **will not reverse** in the future. Because it never reverses, a permanent difference does **not** create a DTA or DTL — instead it changes the **effective tax rate**.

Examples: non-taxable revenue, non-deductible expenses, tax credits.

Permanent-Difference Examples

Non-taxable revenue Government grants, municipal-bond interest (tax-exempt)

Non-deductible expenses Fines, penalties, and some meals/entertainment

Tax credits Credits for specific activities (R&D, green energy, etc.) that directly reduce tax owed

*Permanent differences result in differences between the **effective** and **statutory** tax rates.*

Summary of Resulting Accounting Treatment

TYPE	REVERSES?	CREATES DTL/DTA?	EFFECT ON EFFECTIVE TAX RATE?
Temporary	Yes	Yes — DTA or DTL	No (eventually matches statutory)
Permanent	No	No	Yes — drives wedge between effective and statutory

Temporary difference at initial recognition — special case

If Carrying $\neq$ Tax base *at initial recognition* of an asset or liability, a company **cannot recognize a DTA/DTL** unless initial recognition was a **business combination**.

e.g., government grant for purchase of energy-efficient equipment: grant = 8,000; equipment = 50,000.

Carrying = 42,000 but tax base = 50,000. The difference is still temporary — both will depreciate the asset to \$0 — but no DTA is recognized at initial recognition.

Unused Tax Losses / Credits — IFRS vs. US GAAP

IFRS

May only be recognized to the extent of **probable future taxable income**.

US GAAP

Recognized **in full** and reduced through a **valuation allowance** if unlikely to be realized.

LOS D, E • EFFECTIVE-TAX-RATE RECONCILIATION

Effective Tax Rate & Its Drivers

Effective Tax Rate (ETR)

$$\text{EffectiveTaxRate} = \text{IncomeTaxExpense} \div \text{PretaxIncome}$$

Tax expense $\neq$ Pretax income $\times$ statutory rate — because of permanent differences and tax credits. That's why companies must disclose a **reconciliation between the statutory rate and the effective rate** in the footnotes.

Why the Statutory Rate and Effective Rate Diverge

DRIVER	DIRECTION VS. STATUTORY RATE	TYPICAL CAUSE
Tax-exempt income	Lowers ETR	Municipal-bond interest; certain grants
Non-deductible expenses	Raises ETR	Fines, penalties, some meals & entertainment
Tax credits	Lowers ETR	R&D, foreign tax, green-energy credits
Foreign-income rate differentials	Either direction	Income earned in jurisdictions with different statutory rates
Changes in the valuation allowance	Either direction	Increase raises ETR; decrease lowers ETR
Tax-rate changes on DTL/DTA	Either direction	Re-measurement runs through ITE in the period of the change

Required Footnote Disclosures (LM09)

- **DTL, DTA, valuation allowance, and change in valuation allowance**
- Undistributed earnings in subsidiaries, associates, and joint ventures
- Current-year effect of each source of temporary difference
- Components of income tax expense
- Tax-loss carryforwards
- **Reconciliation between statutory and effective tax rates**

Exam Tip: An ETR far below the statutory rate often indicates heavy reliance on tax credits, tax-exempt income, or valuation-allowance reversals — drivers that may not repeat. Analysts scrutinize the reconciliation footnote to separate sustainable from one-time items.

LOS B, C • TAX RATE CHANGES

Changes in Tax Rates — Re-measurement

Rule: If tax rates **increase**, DTA & DTL both **increase**. If tax rates **decrease**, DTA & DTL both **decrease**.

Adjustments run through income tax expense **in the period the rate changes** (no restatement of prior periods).

- Lower DTL reduces future tax payments
- Lower DTA reduces future tax benefits

WORKED EXAMPLE

Verbatim Mark Meldrum example — rate drops from 30% to 25% in YR 3

	YR 3	YR 2	YR 1
C (carrying)	14,000	16,000	18,000
TB (tax base)	11,429	14,286	17,143
C > TB	2,571	1,714	857
∴ DTL (at 30%)	771	514	257

When the rate is assumed to change to 25% in YR 3: $\text{DTL} = 2,571 \times 0.25 = 643$ (129 lower than at 30%).

SOLUTION

The YR 3 DTL falls from 771 to 643, a reduction of 128–129. That reduction in DTL lowers tax expense and boosts net income in YR 3 under the new rate.

Net Deferred Position × Rate Change Direction

POSITION	RATE MOVE	EFFECT
Net DTL	Tax rates ↓	L ↓, ITE ↓, Equity ↑
Net DTA	Tax rates ↓	A ↓, ITE ↑, Equity ↓
Net DTL	Tax rates ↑	L ↑, ITE ↑, Equity ↓

Net DTA	Tax rates ↑	A ↑, ITE ↓, Equity ↑
---------	-------------	----------------------

A quick balance-sheet vs. income-statement view

BS benefits: $DTA > DTL$ (net tax assets) → BS benefits when taxes ↑; $DTA < DTL$ (net tax liability) → BS benefits when taxes ↓.

IS benefits when tax rates go **down** (lower future tax expense flowing through NI).

Exam Tip: Re-measurement is a one-period "catch-up." It is recorded through income tax expense, so it moves ETR in the year of the rate change but not in subsequent periods (assuming no further rate changes).

LOS F · VALUATION ALLOWANCE

Valuation Allowance for DTAs

DTA/DTL are not discounted to present value to ascertain book value, even though they relate to temporary differences expected to be recovered (DTA) or settled (DTL) at some future date.

All DTA/DTL balances must be evaluated at each balance sheet date to ensure that they will be recovered.

$\therefore$ **Carrying value = expected recoverable amount.**

US GAAP Mechanics

Under US GAAP, DTAs are reduced through a **contra-asset account** called the "**Valuation Allowance**".

A valuation allowance is required if it is "**more likely than not**" that some or all of the DTA will not be realized (i.e., there is insufficient future taxable income to absorb it).

Effect of an *Increase* in the Valuation Allowance

- ↓ **Reduces** the net DTA on the balance sheet
- ↑ **Increases** income tax expense (ITE)
- ↓ **Lowers** NI, Retained Earnings, Shareholders' Equity

If conditions change, previous reductions can be reversed.

Effect of a *Decrease* in the Valuation Allowance

- ↑ **Increases** net DTA on the balance sheet
- ↓ **Decreases** ITE
- ↑ **Raises** NI for the period

Analyst warning

The valuation allowance can be **understated** to show higher asset values, and it can be **adjusted over time to smooth earnings**. Track year-over-year changes in the valuation allowance as an indicator of financial-reporting quality.

IFRS contrast

Under IFRS, no explicit valuation allowance is reported; instead, **deferred tax assets (and liabilities) are adjusted directly to the expected recoverable amount.** The economic effect is similar but the presentation differs.

QUIZ 2 · CHECKPOINT**Test Your Understanding: Temp/Perm, ETR, Rate Changes, Valuation Allowance**

Q6. Which of the following is *most likely* a *permanent* difference?

Q7. A firm has a net DTL. If the statutory tax rate decreases, the *most likely* effect is:

Q8. In the MarkMeldrum example with C – TB of 2,571 in YR 3, if the tax rate falls from 30% to 25%, the YR 3 DTL becomes:

Q9. An *increase* in the valuation allowance is *most likely* to:

Q10. A persistent wedge between a firm's statutory and effective tax rates is *most likely* driven by:

LOS E · RECOGNITION & MEASUREMENT

Recognition & Measurement of Current and Deferred Tax

Governing principle: recognition of DTL and current income tax should be treated **similarly to the asset or liability that gave rise to them**.

Worked Example — Property Revaluation (IFRS)

WORKED EXAMPLE

Fact pattern: A company revalues property *above* cost under IFRS. The revaluation is recorded in **OCI** via a "*Revaluation Surplus*" account (not through the income statement).

SOLUTION

Any resulting DTL (or income tax) from the revaluation is recognized in **OCI (equity)** — **the same place as the gain**. Conversely, a DTL arising from *depreciation* is recognized through the **income statement**, because depreciation runs through the IS.

Measurement Rules

- 1 **Amount:** DTL or DTA = temporary difference × **statutory tax rate** expected to apply in the period of reversal.
- 2 **No discounting:** DTA/DTL are not discounted to present value even though they relate to future tax flows.
- 3 **Re-evaluate every BS date:** balances must be evaluated at each balance sheet date to ensure they will be recovered.
- 4 **Same-statement-as-underlying rule:** DTA/DTL on items recognized in OCI (IFRS revaluations) flow through OCI; DTA/DTL on items recognized in the IS flow through income tax expense.

Initial Recognition Exception

A company **cannot recognize a DTA/DTL at initial recognition** of an asset or liability when Carrying ≠ Tax base, **unless initial recognition was a business combination**.

Example: government grant of 8,000 for energy-efficient equipment costing 50,000: Carrying = 42,000, Tax base = 50,000. The difference is temporary (both depreciate to zero) but **no DTA is booked at initial**

recognition.

LOS E • IFRS VS. US GAAP DIFFERENCES

IFRS vs. US GAAP — Income Tax Differences

TOPIC	IFRS	US GAAP
Unused tax losses / credits	Recognize DTA only to the extent of probable future taxable income	Recognize DTA in full , then reduce via a valuation allowance if unlikely to be realized
Valuation allowance	Not reported. DTA/DTL are adjusted directly to the expected recoverable amount	Explicit contra-asset account; required when "more likely than not" the DTA will not be realized
Asset revaluation above cost (PP&E, intangibles)	Permitted; the gain goes to OCI (Revaluation Surplus) , and any resulting DTL also goes to OCI / equity	Revaluation above cost is generally not permitted — so no such DTL arises
Uncertain tax positions	Different recognition thresholds (typically based on probability of being accepted)	Different recognition thresholds (a two-step "more-likely-than-not" approach)
Discounting of DTA/DTL	Not discounted	Not discounted

Revaluation — why the OCI routing matters

Under IFRS, when a company revalues PP&E above cost, the gain bypasses the income statement and lands in OCI. The associated deferred tax liability must follow the same path, so it lands in **equity (OCI)**, not in tax expense. This is a key item analysts re-classify when comparing IFRS and GAAP firms.

Exam Tip: The exam loves to test the "**same statement as underlying**" principle. If a gain bypasses the income statement (OCI), so does its DTL; if a gain runs through NI, so does its DTL.

ANALYST ADJUSTMENTS TO DEFERRED TAX ITEMS

Analyst Treatment of DTL — Liability, Equity, or Ignore?

DTLs are *expected* to reverse — but not always. How an analyst treats an existing DTL depends on the **probability and timing of reversal**.

The Three-Way Decision Rule

EXPECTED OUTCOME	ANALYST CLASSIFICATION	RATIONALE
Reversal expected in foreseeable future	Treat as a liability	Genuine future tax outflow
No reversal expected (e.g., permanently growing capex book)	Reclassify as equity	Never-paid tax effectively belongs to shareholders
Reversal uncertain	Ignore for analytical purposes	Neither clearly a liability nor clearly equity

WORKED EXAMPLE

When does DTL get re-classed as equity?

The primary example of temporary differences that create DTLs is using **accelerated depreciation for tax reporting** and straight-line for financial reporting. If a company is **increasing its investments in physical capital over time**, it can have more new depreciable assets coming onto its balance sheet than old ones reaching the end of their useful lives. In this case, its **DTL will keep increasing and will not reverse** until its capital spending stops growing.

SOLUTION

An analyst who does not expect a company's DTL to reverse in the foreseeable future may treat it as equity **for analytical purposes only**, by decreasing the DTL and increasing shareholders' equity by the same amount. This lowers debt-to-equity and leverage ratios.

Classification on the Balance Sheet (Reporting View)

If deferred tax liabilities are expected to reverse in the future, they are classified as **liabilities**. If they are **not expected to reverse** in the future, they may be classified as **equity**.

DTA Analytical Issues

- DTA will only benefit the firm on reversal if there are **sufficient future taxable earnings**
- Loss carryforwards can only be utilized if there are **future profits**
- If the asset cannot be utilized in full, it is reduced via the **valuation allowance** (US GAAP) or adjusted directly (IFRS)
- A valuation-allowance buildup reduces assets *and* reduces net income simultaneously

QUIZ 3 · CHECKPOINT

Test Your Understanding: Recognition, IFRS/GAAP, Analyst Adjustments

Q11. Under IFRS, a property revaluation gain is recorded in OCI. The DTL that arises from that revaluation is *most likely* recorded in:

Q12. A firm's DTL relates to accelerated tax depreciation, and the firm's capex has been growing for years with no slowdown in sight. An analyst who believes the DTL will *not* reverse should:

Q13. Which statement about the valuation allowance is *most accurate*?

Q14. Which difference between IFRS and US GAAP is *most likely* correct?

MODULE COMPLETE

Your Scorecard

0 / 14

LM09 Key Takeaways — Exam-Ready Cheat Sheet

Definitions

- 1 **Accounting profit** = pretax income (GAAP/IFRS); **taxable income** = tax-return income (tax code). They differ because of rulebook choice — SL vs. accelerated depreciation, accrual vs. cash basis, etc.
- 2 **Tax base** = balance-sheet amount for tax purposes. Asset tax base = future tax deductions. Liability tax base = carrying amount less future deductions.
- 3 **Temporary difference** reverses → creates DTA/DTL. **Permanent difference** never reverses → moves effective tax rate only.

Signs & Formulas

- 4 **Master equation:** $\text{Income Tax Expense} = \text{Taxes Payable} + \Delta\text{DTL} - \Delta\text{DTA}$.
- 5 **DTL** ← Asset C > TB or Liability C < TB; **DTA** ← Asset C < TB or Liability C > TB. **DTL** = $(C - TB) \times t$.
- 6 **Effective Tax Rate** = $\text{ITE} / \text{Pretax income}$. Footnote reconciles statutory to effective.

Common Triggers

- 7 **DTL:** accelerated tax depreciation; IFRS asset revaluation above cost (DTL in OCI).
- 8 **DTA:** warranty accruals, deferred revenue taxed on receipt, NOL carryforward.

- 9 Permanent differences:** municipal-bond interest (tax-exempt), fines/penalties (non-deductible), tax credits.

Rate Changes & Valuation Allowance

- 10 Rate** $\uparrow \rightarrow$ DTA $\uparrow$ & DTL $\uparrow$; **Rate** $\downarrow \rightarrow$ DTA $\downarrow$ & DTL $\downarrow$. Adjustment runs through ITE in the period of the change.
- 11 Net DTL + rate** $\downarrow \rightarrow$ L $\downarrow$, ITE $\downarrow$, Equity $\uparrow$. **Net DTA + rate** $\downarrow \rightarrow$ A $\downarrow$, ITE $\uparrow$, Equity $\downarrow$.
- 12 Valuation allowance** (US GAAP): contra-asset reducing DTA; required when "more likely than not" unrealizable. Increase $\rightarrow$ net DTA $\downarrow$, ITE $\uparrow$, NI $\downarrow$. IFRS adjusts DTA directly.

Analyst Adjustments & IFRS vs GAAP

- 13 DTL treatment:** reversal expected $\rightarrow$ liability; no reversal (permanently growing capex) $\rightarrow$ equity; uncertain $\rightarrow$ ignore.
- 14 IFRS vs GAAP:** IFRS revalues PP&E above cost (DTL through OCI); GAAP generally does not. IFRS: no explicit valuation allowance. Uncertain tax positions use different recognition thresholds. Neither discounts DTA/DTL.

Last-Minute Exam Checklist

Master equation: $ITE = TP + \Delta DTL - \Delta DTA$

DTL on BS: $DTL = (\text{Carrying} - \text{Tax base}) \times t$ (for asset); DTA for opposite sign

Rate changes: DTA & DTL both move *with* the rate; adjustment through ITE in year of change

Permanent differences: never create DTA/DTL — they only move ETR

Valuation allowance (US GAAP): reduces DTA when unrealizable; IFRS adjusts DTA directly

OCI items: their deferred tax follows into OCI (IFRS revaluations)

Analyst DTL: liability (reversal) vs. equity (permanent growth) vs. ignore (uncertain)