Deferred Tax Liability

Companies are allowed to use one set of accounting assumptions to calculate the profit they report to the general public and another set of accounting assumptions to calculate the profit they use to determine their tax liability. What this means is that the profit they report to the public and the profit on which their taxes are based can be very different.

These assumptions usually involve the timing of costs instead outright differences; in other words, if given enough time, any difference in costs and profits between what is reported to the public and what is reported to the IRS usually reverses.

When companies show a higher profit to the public than they show to the IRS, they will also show higher taxes that need to be paid. However, these taxes will not have to be paid until the timing differences reverse. These taxes are considered deferred taxes, and accumulated deferred taxes are the **deferred tax liability**.

Like most individuals, most companies try to pay as little tax as possible, and they try to postpone paying taxes as much as possible. Consequently, the normal course of events is for companies to have deferred tax liabilities and for those liabilities to go up over time. However, this is not absolute. The deferred tax liability can vary over time.