

Refer to the Barnes & Noble 2002 financial statements presented on the subsequent two pages to answer these questions. All questions relate to fiscal year 2002 (year ended February 1, 2003) unless stated otherwise. On its income statement, Barnes & Noble reports income before taxes of \$199,313,000 for fiscal 2002.

Required:

1. What is the amount of income tax expense shown on Barnes & Noble's income statement for 2002?
2. Compute Barnes & Noble's effective tax rate in percentage terms for fiscal 2002.
3. Compute the effect of "state income taxes, net of federal income tax benefit" on Barnes & Noble's effective tax rate in percentage terms for fiscal 2002.
4. Explain how deferred tax assets and liabilities existing at the end of fiscal 2002 would affect Barnes & Noble's financial statements in fiscal 2003 if tax rates increased to 38%.
5. Explain the purpose of the two schedules related to deferred tax assets and liabilities on the second page of the excerpt. Both schedules show net liabilities of \$80,205. Be clear on what each schedule is communicating.
6. Refer to the top schedule related to deferred tax assets and liabilities on the second page of the excerpt. Explain what "Goodwill amortization" of (11,241) implies about the relation between past GAAP and tax amortization expense.

Excerpt from Barnes & Noble February 1, 2003 Financial Statements

10. Income Taxes

The Company files a consolidated federal return with all 80 percent or more owned subsidiaries. Federal and state income tax provisions (benefits) for fiscal 2002, 2001 and 2000 are as follows:

Fiscal Year	2002	2001	2000
Current:			
Federal	\$ 59,598	\$ 62,141	\$ 59,055
State	13,503	13,891	13,086
	73,101	76,032	72,141
Deferred:			
Federal	6,311	(25,790)	(44,390)
State	811	(4,864)	(8,782)
	7,122	(30,654)	(53,172)
Total	\$ 80,223	\$ 45,378	\$ 18,969

A reconciliation between the provision (benefit) for income taxes and the expected provision for income taxes at the federal statutory rate of 35 percent during fiscal 2002, 2001 and 2000, is as follows:

Fiscal Year	2002	2001	2000
Expected provision (benefit) for income taxes at federal statutory rate	\$ 69,760	\$ 38,271	\$ (11,549)
Amortization of non-deductible goodwill and trade names and write-down of goodwill	—	1,987	26,669
State income taxes, net of federal income tax benefit	9,304	5,868	2,798
GameStop undistributed earnings	2,332	—	—
Other, net	(1,173)	(748)	1,051
Provision for income taxes	\$ 80,223	\$ 45,378	\$ 18,969

The tax effects of temporary differences that give rise to significant components of the Company's deferred tax assets and liabilities as of February 1, 2003 and February 2, 2002 are as follows:

	February 1, 2003	February 2, 2002
Deferred tax liabilities:		
Operating expenses	\$(23,175)	\$ (19,655)
Depreciation	(31,697)	(22,278)
Gain on equity increase in GameStop	(65,306)	—
Investment in Barnes & Noble.com	(41,253)	(32,572)
Goodwill amortization	(11,241)	(6,132)
Pension	—	(5,149)
GameStop undistributed earnings	(2,332)	—
Total deferred tax liabilities	(175,004)	(85,786)
Deferred tax assets:		
Lease transactions	26,260	23,446
Investments in equity securities	15,597	9,072
Estimated accruals	11,638	5,573
Restructuring charge	12,853	13,496
Inventory	19,116	15,408

Pension	2,296	—
Insurance liability	6,824	2,312
Unrealized holding losses on available-for-sale securities	26	9,199
Unrealized holding loss on derivative instrument	2	936
Other	187	913
Total deferred tax assets	94,799	80,355
Net deferred tax liabilities	\$(80,205)	\$ (5,431)

Deferred income taxes are classified on the Company's balance sheet as follows:

	February 1, 2003	February 2, 2002
Short-term deferred tax assets (a)	\$ 39,618	\$ 30,747
Long-term deferred	(119,823)	(36,178)
	\$ (80,205)	\$ (5,431)

(a) Reflected as a component of prepaid expenses and other current assets in the accompanying balance sheet.

Solution:

- \$80,223
- Income tax expense/GAAP pretax income = $80,223/199,313 = 40.2\%$
- State effect/GAAP pretax income = $9,304/199,313 = 4.7\%$ increase
- Net deferred tax liabilities will be adjusted to the higher tax rate. Specifically, net deferred tax liabilities will increase by \$6,875 [$(80,205/.35) \times .03$]. The other side of the entry will be split between other comprehensive income and the provision for taxes. If instructors are covering the book in chapter order, students will probably not be able to identify the specific items that will decrease other comprehensive income.
- The top schedule shows the specific types of temporary differences that give rise to deferred tax assets or liabilities. The second schedule shows how the amounts appear on the balance sheet after netting current deferred tax assets with current deferred tax liabilities and noncurrent deferred tax assets with noncurrent deferred tax liabilities by jurisdiction.
- Because the amortization is creating a deferred income tax liability, goodwill amortization for tax purposes has been higher than the goodwill amortization/impairment expense for GAAP purposes.