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Introduction

Whitley corporation plans to strategize its expansion initiatives. The year 2010 has witnessed a decrease in sales due to recession. Hence, in order to cope with the present situation, its management is considering purchase of equipment. This would affect the earnings of the company if the purchase is to take place in the last quarter of the year. Therefore, an analysis has been conducted to determine the timing of the purchase.

Answer Part A)

Calculation of income tax expense if the equipment is purchased next year

$$50000 * 0.40 = \$20,000$$

Answer Part B)

Income tax expense = Taxes payable - Deferred Tax Asset + Deferred Tax Liability

Income tax expense = Pre Taxation income * rate of tax

$$\text{Income tax expense} = 200,000 * 0.40$$

$$\text{Income tax expense} = \$80,000$$

Hence,

Tax payable = 80,000 - Deferred Tax Liabilities + Deferred Tax Assets

$$\text{Tax payable} = 80,000 - 70,000 + 15,000$$

$$\text{Tax payable} = \$25,000$$

Answer Part C)

Whitley should wait until the start of next year, when it would be feasible to purchase the equipment. The reason is that Whitley already has deferred tax liabilities, which are likely to increase if the equipment is purchased now. If that is the case, it is likely to reduce the net earnings and also the earning per share. However, if the equipment is purchased next year, it would not affect the earning per share of current year.

Answer Part D)

The ethical considerations in this case are that, the dividends that is to be received by shareholders for the current year should not be affected. If the equipment is purchased as on October 2010, it is likely that the earnings of the company will decrease, resulting in lower profits. The company can wait a further three months, after which it can purchase the required equipment. This would not affect the profits for this year, and the due dividends to be received by shareholders would not reduce.

References

CIMA (2012), *Financial Management*, Pp. 120-135, BPP House, London.

CIMA (2013), *Performance Strategy*, Pp. 78-90, BPP House, London.