ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

May 29, 2009

740 Income Taxes
10 Overall

740-10-00 Status

General

00-1 No updates have been made to this subtopic.

740-10-05 Overview and Background

General

05-1 [The **Income Taxes** Topic addresses financial accounting and reporting for the effects of income taxes that result from an entity's activities during the current and preceding years. [FAS 109, paragraph 1, sequence 177]] [Specifically, this Topic establishes standards of financial accounting and reporting for income taxes that are currently payable and for the **tax consequences** of all of the following: [FAS 109, paragraph 3, sequence 180]]

a. [Revenues, expenses, gains, or losses that are included in **taxable income** of an earlier or later year than the year in which they are recognized in financial income [FAS 109, paragraph 3, sequence 181]]

b. [Other events that create differences between the tax bases of assets and liabilities and their amounts for financial reporting [FAS 109, paragraph 3, sequence 182]]

c. [Operating loss or tax credit **carrybacks** for refunds of taxes paid in prior years and **carryforwards** to reduce taxes payable in future years. [FAS 109, paragraph 3, sequence 183]]

05-2 This Topic includes the following Subtopics:

a. Overall

b. Intraperiod Tax Allocation

c. Other Considerations or Special Areas

d. Interim Reporting.

05-3 The Overall Subtopic provides the majority of the accounting and reporting guidance related to income taxes. The other Subtopics in this Topic provide more detailed guidance on narrower elements of accounting and reporting for income taxes.

05-4 Other Topics, including industry-specific Topics, may also have Income Taxes Subtopics that address the Topic-specific requirements for income taxes. Guidance in those Subtopics is intended to be incremental to the

ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

guidance otherwise established in the Income Taxes Topic. Topics with incremental Income Taxes Subtopics are:

a. Investments—Equity Method and Joint Ventures, Subtopic 323-740
b. Compensation—Stock Compensation, Subtopic 718-740
c. Business Combinations, Subtopic 805-740
d. Foreign Currency Matters, Subtopic 830-740
e. Reorganizations, Subtopic 852-740
f. Entertainment—Casinos, Subtopic 924-740
g. Extractive Activities—Oil and Gas, Subtopic 932-740
h. Financial Services—Depository and Lending, Subtopic 942-740
i. Financial Services—Insurance, Subtopic 944-740
j. Health Care Entities, Subtopic 954-740
k. Real Estate—Common Interest Realty Associations, Subtopic 972-740
l. Regulated Operations, Subtopic 980-740
m. U.S. Steamship Entities, Subtopic 995-740 .

05-5 [There are two basic principles related to accounting for income taxes, each of which considers uncertainty through the application of recognition and measurement criteria: [EITF 91-08, paragraph STATUS, sequence 15.1.1]]

a. [To recognize the estimated taxes payable or refundable on tax returns for the current year as a tax liability or asset [EITF 91-08, paragraph STATUS, sequence 15.1.2.1]]

b. [To recognize a **deferred tax liability** or **asset** for the estimated future tax effects attributable to **temporary differences** and carryforwards. [EITF 91-08, paragraph STATUS, sequence 15.1.2.2]]

05-6 [This Subtopic provides guidance for recognizing and measuring tax positions taken or expected to be taken in a tax return that directly or indirectly affect amounts reported in financial statements. This Subtopic also provides accounting guidance for the related income tax effects of individual tax positions that do not meet the recognition thresholds [FIN 48, paragraph B9, sequence 132]] [required in order for any part of the benefit of that **tax position** to be recognized in an entity's financial statements. [FIN 48, paragraph 2, sequence 19.1.2]] [Under this Subtopic, a tax position is first evaluated for recognition based on its technical merits. Tax positions that meet a recognition criterion are then measured to determine an amount to recognize in the financial statements. That measurement incorporates information about potential settlements with taxing authorities. [FIN 48, paragraph B27, sequence 150.2]]

05-7 A temporary difference refers to a difference between the tax basis of an asset or liability, determined based on recognition and measurement requirements for tax positions, and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. Deferred tax assets and liabilities represent the future effects on income taxes that result from temporary differences and carryforwards that exist at the end of a period. Deferred tax assets and liabilities are measured using enacted tax rates and provisions of the enacted tax law and are not discounted to reflect the time-value of money.

05-8 [As indicated in paragraph 740-10-25-23, temporary differences that will result in taxable amounts in future years when the related asset or liability is recovered or settled are often referred to as taxable temporary differences. Likewise, temporary differences that will result in deductible amounts in future years are often referred to as deductible temporary differences. Business combinations may give rise to both taxable and deductible temporary differences. [FAS 109, paragraph 13, sequence 224.2]]

05-9 [As indicated in paragraph 740-10-25-30, certain basis differences may not result in taxable or deductible amounts in future years when the related asset or liability for financial reporting is recovered or settled and, therefore, may not be temporary differences for which a deferred tax liability or asset is recognized. [FAS 109, paragraph 14, sequence 225.1]]

05-10 [As indicated in paragraph 740-10-25-24, some temporary differences are deferred taxable income or tax deductions and have balances only on the income tax balance sheet and therefore cannot be identified with a particular asset or liability for financial reporting. [FAS 109, paragraph 15, sequence 226.1.1]] [In such instances, there is no related, identifiable asset or liability for financial reporting, but there is a temporary difference that results from an **event** that has been recognized in the financial statements and, based on provisions in the tax law, the temporary difference will result in taxable or deductible amounts in future years. [FAS 109, paragraph 15, sequence 226.2]]

740-10-10 Objectives

General

10-1 There are two primary objectives related to accounting for **income taxes**:

a. [To recognize the amount of taxes payable or refundable for the current year [FAS 109, paragraph 6, sequence 194.1]]

b. [To recognize deferred tax liabilities and assets for the future **tax consequences** of events that have been recognized in an entity's financial statements or tax returns. [FAS 109, paragraph 6, sequence 194.2]]

[As it relates to the second objective, some events do not have tax consequences. Certain revenues are exempt from taxation and certain expenses are not deductible. In some tax jurisdictions, for example, interest earned on certain municipal obligations is not taxable and fines are not deductible. [FAS 109, paragraph 6, sequence 195]]

10-2 [Ideally, the second objective might be stated more specifically to recognize the expected future tax consequences of events that have been recognized in the financial statements or tax returns. However, that objective is realistically constrained because: [FAS 109, paragraph 7, sequence 196.1]]

a. [The tax payment or refund that results from a particular tax return is a joint result of all the items included in that return. [FAS 109, paragraph 7, sequence 196.2.1]]

b. [Taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years. [FAS 109, paragraph 7, sequence 196.2.2.1]]

c. [Information available about the future is limited. As a result, attribution of taxes to individual items and events is arbitrary and, except in the simplest situations, requires estimates and approximations. [FAS 109, paragraph 7, sequence 196.2.2.2]]

10-3 [Conceptually, a **deferred tax liability** or **asset** represents the increase or decrease in taxes payable or refundable in future years as a result of **temporary differences** and **carryforwards** at the end of the current year. That concept is an incremental concept. A literal application of that concept would result in measurement of the [FAS 109, paragraph 87, sequence 407]] [incremental tax effect as the difference between the following two measurements: [FAS 109, paragraph 87, sequence 410]]

a. [The amount of taxes that will be payable or refundable in future years inclusive of reversing temporary differences and carryforwards [FAS 109, paragraph 87, sequence 408]]

b. [The amount of taxes that would be payable or refundable in future years exclusive of reversing temporary differences and carryforwards. [FAS 109, paragraph 87, sequence 409]]

[However, in light of the constraints identified in the preceding paragraph, in computing the amount of deferred tax liabilities and assets, the objective is to measure a deferred tax liability or asset using the enacted tax rate(s) expected to apply to **taxable income** in the periods in which the deferred tax liability or asset is expected to be settled or realized. [FAS 109, paragraph 18, sequence 236.1]]

740-10-15 Scope and Scope Exceptions

General

> Overall Guidance

15-1 The Scope Section of the Overall Subtopic establishes the pervasive scope for all Subtopics of the **Income Taxes** Topic. Unless explicitly addressed within specific Subtopics, the following scope guidance applies to all Subtopics of the Income Taxes Topic.

> Entities

15-2 [The principles and requirements of the Income Taxes Topic are applicable to [FAS 109, paragraph 4, sequence 185]] [domestic and foreign entities, with specific exceptions noted below, in preparing financial statements in accordance with U.S. generally accepted accounting principles (GAAP), [FAS 109, paragraph 4, sequence 189]] [including not-for-profit entities (NFP) with activities that are subject to income taxes. [FAS 109, paragraph 4, sequence 188]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **740-10-65-1**

[The principles and requirements of the Income Taxes Topic are applicable to [FAS 109, paragraph 4, sequence 185]] [domestic and foreign entities in preparing financial statements in accordance with U.S. generally accepted accounting principles (GAAP), [FAS 109, paragraph 4, sequence 189]] [including not-for-profit entities (NFP) with activities that are subject to income taxes. [FAS 109, paragraph 4, sequence 188]]

15-2A The guidance in the FASB Accounting Standards Codification™ related to Income Taxes has been prepared as if FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, was fully effective for all entities. [FASB Staff Position FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, issued in December 2008, deferred the effective date of Interpretation 48 for **nonpublic entities** [FSP FIN48-3, paragraph 11, sequence 11.1]] meeting both of the following conditions:

- a. [The entity is not consolidated with a **public entity** that applies U.S. generally accepted accounting principles (GAAP). [FSP FIN48-3, paragraph 9, sequence 9.2]]
- b. [The entity has not already adopted the recognition, measurement, and disclosure provisions of that Interpretation in a full set of annual financial statements issued before December 30, 2008. [FSP FIN48-3,

paragraph 9, sequence 9.3]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **740-10-65-1**

[Not used]

15-2B An entity meeting the conditions for and electing to use the deferral should refer to authoritative literature applicable to accounting for income taxes without consideration of the effects of Interpretation 48. That literature is not presented in the FASB Accounting Standards Codification™ and includes the disclosure requirements in paragraph 10 of FASB Staff Position FIN 48-3, [which are required for all nonpublic entities that qualify for and elect to defer the application of Interpretation 48. [FSP FIN48-3, paragraph 10, sequence 10]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **740-10-65-1**

[Not used]

> Transactions

15-3 The guidance in the Income Taxes Topic applies to:

- a. [Domestic federal (national) income taxes (U.S. federal income taxes for U.S. entities) and foreign, state, and local (including franchise) taxes based on income [FAS 109, paragraph 4, sequence 186]]
- b. [An entity's domestic and foreign operations that are consolidated, combined, or accounted for by the equity method. [FAS 109, paragraph 4, sequence 187]]

15-4 The guidance in this Topic does not apply to the following transactions and activities:

- a. [A franchise tax to the extent it is based on capital and there is no additional tax based on income. If there is an additional tax based on income, that excess is considered an income tax and is subject to the guidance in this Topic. [EITF 91-08, paragraph DISCUSSION, sequence 13.2]] See Example 17 (paragraph 740-10-55-139) for an example of the determination of whether a franchise tax is an income tax.
- b. [A withholding tax for the benefit of the recipients of a dividend. A tax that is assessed on an entity based on dividends distributed is, in effect, a withholding tax for the benefit of recipients of the dividend and is not an income tax if both of the following conditions are met: [EITF 95-09, paragraph DISCUSSION, sequence 8]]
  - 1. [The tax is payable by the entity if and only if a dividend is distributed to shareholders. The tax does not reduce future income taxes the entity would otherwise pay. [EITF 95-09, paragraph DISCUSSION, sequence 9]]
  - 2. [Shareholders receiving the dividend are entitled to a tax credit at least equal to the tax paid by the entity and that credit is realizable either as a refund or as a reduction of taxes otherwise due, regardless of the tax status of the shareholders. [EITF 95-09, paragraph DISCUSSION, sequence 10]]

  See the guidance in paragraphs 740-10-55-72 through 55-74 dealing with determining whether a payment made to a taxing authority based on dividends distributed is an income tax.

740-10-20 Glossary

Alternative Minimum Tax

A tax that results from the use of an alternate determination of a corporation's federal income tax liability under provisions of the U.S. Internal Revenue Code.

Carrybacks

[Deductions or credits that cannot be utilized on the tax return during a year that may be carried back to reduce taxable income or taxes payable in a prior year. An operating loss carryback is an excess of tax deductions over gross income in a year; a tax credit carryback is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried back and the length of the carryback period. [FAS 109, paragraph 289, sequence 1042]]

Carryforwards

[Deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year; a tax credit carryforward is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried forward and the length of the carryforward period. The terms carryforward, operating loss carryforward, and tax credit carryforward refer to the amounts of those items, if any, reported in the tax return for the current year. [FAS 109, paragraph 289, sequence 1044]]

Conduit Debt Securities

[Certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing financing for a specific third party (the conduit bond obligor) that is not a part of the state or local government's financial reporting entity. [FAS 126, paragraph 3, sequence 17.2.3.1]] [Although conduit debt securities bear the name of the governmental entity that issues them, the governmental entity often has no obligation for such debt beyond the resources provided by a lease or loan agreement with the third party on whose behalf the securities are issued. [FAS 126, paragraph 3, sequence 17.2.3.2.1]] [Further, the conduit bond obligor is responsible for any future financial reporting requirements. [FAS 126, paragraph 3, sequence 17.2.3.2.2]]

Corporate Joint Venture

[A corporation owned and operated by a small group of entities (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. [APB 18, paragraph 3, sequence 44.1]] [A government may also be a member of the group. [APB 18, paragraph 3, sequence 44.2.1.1]] [The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. [APB 18, paragraph 3, sequence 44.2.1.2.1]] [A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. [APB 18, paragraph 3, sequence 44.2.1.2.2.1]] [Joint venturers thus have an interest or relationship other than as passive investors. [APB 18, paragraph 3, sequence 44.2.1.2.2.2]] [An entity that is a subsidiary of one of the joint venturers is not a corporate joint venture. [APB 18, paragraph 3, sequence 44.2.2.1.1]] [The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. [APB 18, paragraph 3, sequence 44.2.2.1.2]] [A minority public ownership, however, does not preclude a corporation from being a corporate joint venture. [APB 18, paragraph 3, sequence 44.2.2.2]]

Current Tax Expense (or Benefit)

[The amount of income taxes paid or payable (or refundable) for a year as determined by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues for that year. [FAS 109, paragraph 289, sequence 1046]]

Deductible Temporary Difference

[Temporary differences that result in deductible amounts in future years when the related asset or liability is recovered or settled, respectively. See Temporary Difference. [FAS 109, paragraph 289, sequence 1048]]

Deferred Tax Asset

[The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. [FAS 109, paragraph 289, sequence 1050]]

Deferred Tax Consequences

[The future effects on income taxes as measured by the applicable enacted tax rate and provisions of the enacted tax law resulting from temporary differences and carryforwards at the end of the current year. [FAS 109, paragraph 289, sequence 1052]]

Deferred Tax Expense (or Benefit)

[The change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets acquired in a purchase business combination during the year, it is the change since the combination date. Income tax expense (or benefit) for the year is allocated among continuing operations, discontinued operations, extraordinary items, and items charged or credited directly to shareholders' equity. [FAS 109, paragraph 289, sequence 1054]]

Deferred Tax Liability

[The deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law. [FAS 109, paragraph 289, sequence 1056]]

Event

[A happening of consequence to an entity. The term encompasses both transactions and other events affecting an entity. [FAS 109, paragraph 289, sequence 1058]]

Income Tax Expense (or Benefit)

[The sum of current tax expense (or benefit) and deferred tax expense (or benefit). [FAS 109, paragraph 289, sequence 1066]]

Income Taxes

[Domestic and foreign federal (national), state, and local (including franchise) taxes based on income. [FAS 109, paragraph 289, sequence 1062]]

Income Taxes Currently Payable (Refundable)

[See Current Tax Expense (or Benefit). [FAS 109, paragraph 289, sequence 1064]]

Nonpublic Entity

[An entity that does not meet any of the following criteria: [FAS 109, paragraph 289, sequence 1068.1]]

a. [Its debt or equity securities are traded in a public market, including those traded on a stock exchange or in the over-the-counter market (including securities quoted only locally or regionally). [FAS 109, paragraph 289, sequence 1068.2.1]]

b. [It is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets). [FAS 109, paragraph 289, sequence 1070.2.1.1]]

c. [Its financial statements are filed with a regulatory agency in preparation for the sale of any class of securities. [FAS 109, paragraph 289, sequence 1068.2.2]]

Public Entity

[An entity that meets any of the following criteria: [FAS 109, paragraph 289, sequence 1070.1]]

a. [Its debt or equity securities are traded in a public market, including those traded on a stock exchange or in the over-the-counter market (including securities quoted only locally or regionally). [FAS 109, paragraph 289, sequence 1070.2.1]]

b. [It is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets). [FAS 109, paragraph 289, sequence 1068.2.1.1]]

c. [Its financial statements are filed with a regulatory agency in preparation for the sale of any class of securities. [FAS 109, paragraph 289, sequence 1070.2.2]]

Tax Consequences

[The effects on income taxes—current or deferred—of an event. [FAS 109, paragraph 289, sequence 1076]]

Tax Position

[A position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited to: [FIN 48, paragraph 4, sequence 22]]

a. [A decision not to file a tax return [FIN 48, paragraph 4, sequence 23]]

b. [An allocation or a shift of income between jurisdictions [FIN 48, paragraph 4, sequence 24]]

c. [The characterization of income or a decision to exclude reporting taxable income in a tax return [FIN 48, paragraph 4, sequence 25]]

d. [A decision to classify a transaction, entity, or other position in a tax return as tax exempt. [FIN 48, paragraph 4, sequence 26]]

Tax-Planning Strategy

[An action (including elections for tax purposes) that meets certain criteria (see paragraph 740-10-30-19) and that would be implemented to realize a tax benefit for an operating loss or tax credit carryforward before it expires. Tax-planning strategies are considered when assessing the need for and amount of a valuation allowance for deferred tax assets. [FAS 109, paragraph 289, sequence 1078]]

Taxable Income

[The excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority. [FAS 109, paragraph 289, sequence 1072]]

Taxable Temporary Difference

[Temporary differences that result in taxable amounts in future years when the related asset is recovered or the related liability is settled. See Temporary Difference. [FAS 109, paragraph 289, sequence 1074]]

Temporary Difference

[A difference between the tax basis of an asset or liability computed pursuant to the requirements in Subtopic 740-10 for tax positions, and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. Paragraph 740-10-25-20 cites eight examples of temporary differences. Some temporary differences cannot be identified with a particular asset or liability for financial reporting (see paragraphs 740-10-05-10 and 740-10-25-24 through 25-25), but those temporary differences do meet both of the following conditions: [FAS

109, paragraph 289, sequence 1080.1]]

a. [Result from events that have been recognized in the financial statements [FAS 109, paragraph 289, sequence 1080.2.1]]

b. [Will result in taxable or deductible amounts in future years based on provisions of the tax law. [FAS 109, paragraph 289, sequence 1080.2.2.1]]

[Some events recognized in financial statements do not have tax consequences. Certain revenues are exempt from taxation and certain expenses are not deductible. Events that do not have tax consequences do not give rise to temporary differences. [FAS 109, paragraph 289, sequence 1080.2.2.2]]

Tentative Minimum Tax

An intermediate calculation used in the determination of a corporation's federal income tax liability under the alternative minimum tax system in the United States. See Alternative Minimum Tax.

Unrecognized Tax Benefit

[The difference between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to Subtopic 740-10. [FIN 48, paragraph 17, sequence 47.1.2.1]]

Valuation Allowance

[The portion of a deferred tax asset for which it is more likely than not that a tax benefit will not be realized. [FAS 109, paragraph 289, sequence 1082]]

740-10-25 Recognition

General

25-1 This Section establishes the recognition requirements necessary to implement the objectives of accounting for **income taxes** identified in Section 740-10-10 . The following paragraph sets forth the basic recognition requirements while paragraph 740-10-25-3 identifies specific, limited exceptions to the basic requirements.

25-2 [Other than the exceptions identified in the following paragraph, the following basic requirements are applied in accounting for income taxes at the date of the financial statements: [FAS 109, paragraph 8, sequence 197]]

- a. [A tax liability or asset shall be recognized based on the provisions of this Subtopic applicable to tax positions, in paragraphs 740-10-25-5 through 25-17, for the estimated taxes payable or refundable on tax returns for the current and prior years. [FAS 109, paragraph 8, sequence 198]]
- b. [A **deferred tax liability** or **asset** shall be recognized for the estimated future tax effects attributable to **temporary differences** and **carryforwards**. [FAS 109, paragraph 8, sequence 199]]

25-3 [The only exceptions in applying those basic requirements are: [FAS 109, paragraph 9, sequence 202]]

- a. [Certain exceptions to the requirements for recognition of deferred taxes [FAS 109, paragraph 9, sequence 203]] [whereby a deferred tax liability is not recognized for the following types of temporary differences unless it becomes apparent that those temporary differences will reverse in the foreseeable future: [FAS 109, paragraph 31, sequence 269]]

- 1. [An excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary or a foreign **corporate joint venture** that is essentially permanent in duration. [FAS 109, paragraph 31, sequence 270]] See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.

- 2. [Undistributed earnings of a domestic subsidiary or a domestic corporate joint venture that is essentially permanent in duration that arose in fiscal years beginning on or before December 15, 1992. [FAS 109, paragraph 31, sequence 271]] [A last-in, first-out (LIFO) pattern determines whether reversals pertain to differences that arose in fiscal years beginning on or before December 15, 1992. [FAS 109, paragraph 31, sequence 272]] See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.

- 3. [Bad debt reserves for tax purposes of U.S. savings and loan associations (and other qualified thrift lenders) that arose in tax years beginning before December 31, 1987. See paragraphs 942-740-25-1 through 25-3 for the specific requirements related to this exception. [FAS 109, paragraph 31, sequence 273]]

- 4. [Policyholders' surplus of stock life insurance entities that arose in fiscal years beginning on or before December 15, 1992. See paragraph 944-740-25-2 for the specific requirements related to this exception. [FAS 109, paragraph 31, sequence 274]]

- b. [Recognition of temporary differences related to deposits in statutory reserve funds by U.S. steamship entities (see paragraph 995-740-25-2) [FAS 109, paragraph 9, sequence 204]]

- c. [The pattern of recognition of after-tax income for leveraged leases or the allocation of the purchase price in a purchase business combination to acquired leveraged leases [FAS 109, paragraph 256, sequence 751.1]] [as required by Subtopic 840-30 [FAS 109, paragraph 9, sequence 205]]

- d. [A prohibition on recognition of a deferred tax liability or asset related to goodwill (or the portion thereof) for which amortization is not deductible for tax purposes (see paragraph 805-740-25-3) [FAS 109, paragraph 9, sequence 206]]

- e. [A prohibition on recognition of a deferred tax asset for the intra-entity difference between the tax basis of the assets in the buyer's tax jurisdiction and their cost as reported in the consolidated financial statements. Income taxes paid on intra-entity profits on assets remaining within the group are accounted for under the requirements of Subtopic 810-10. [FAS 109, paragraph 9, sequence 207]]

- f. [A prohibition on recognition of a deferred tax liability or asset for differences related to assets and liabilities that, under Subtopic 830-10, are remeasured from the local currency into the functional currency using historical exchange rates and that result from changes in exchange rates or indexing for tax purposes. [FAS 109, paragraph 9, sequence 208]] See Subtopic 830-740 for guidance on foreign currency related income taxes matters.

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

[The only exceptions in applying those basic requirements are: [FAS 109, paragraph 9, sequence 202]]

- a. [Certain exceptions to the requirements for recognition of deferred taxes [FAS 109, paragraph 9, sequence 203]] [whereby a deferred tax liability is not recognized for the following types of temporary differences unless it becomes apparent that those temporary differences will reverse in the foreseeable future: [FAS 109, paragraph 31, sequence 269]]

  - 1. [An excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary or a foreign **corporate joint venture** that is essentially permanent in duration. [FAS 109, paragraph 31, sequence 270]] See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.

- 2. [Undistributed earnings of a domestic subsidiary or a domestic corporate joint venture that is essentially permanent in duration that arose in fiscal years beginning on or before December 15, 1992. [FAS 109, paragraph 31, sequence 271]] [A last-in, first-out (LIFO) pattern determines whether reversals pertain to differences that arose in fiscal years beginning on or before December 15, 1992. [FAS 109, paragraph 31, sequence 272]] See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.
- 3. [Bad debt reserves for tax purposes of U.S. savings and loan associations (and other qualified thrift lenders) that arose in tax years beginning before December 31, 1987. See paragraphs 942-740-25-1 through 25-3 for the specific requirements related to this exception. [FAS 109, paragraph 31, sequence 273]]
- 4. [Policyholders' surplus of stock life insurance entities that arose in fiscal years beginning on or before December 15, 1992. See paragraph 944-740-25-2 for the specific requirements related to this exception. [FAS 109, paragraph 31, sequence 274]]

- b. [Recognition of temporary differences related to deposits in statutory reserve funds by U.S. steamship entities (see paragraph 995-740-25-2) [FAS 109, paragraph 9, sequence 204]]
- c. [The pattern of recognition of after-tax income for leveraged leases or the allocation of the purchase price in a purchase business combination to acquired leveraged leases [FAS 109, paragraph 256, sequence 751.1]] [as required by Subtopic 840-30 [FAS 109, paragraph 9, sequence 205]]
- d. [A prohibition on recognition of a deferred tax liability related to goodwill (or the portion thereof) for which amortization is not deductible for tax purposes (see paragraph 805-740-25-3) [FAS 109, paragraph 9, sequence 206]]
- e. [A prohibition on recognition of a deferred tax asset for the intra-entity difference between the tax basis of the assets in the buyer's tax jurisdiction and their cost as reported in the consolidated financial statements. Income taxes paid on intra-entity profits on assets remaining within the group are accounted for under the requirements of Subtopic 810-10. [FAS 109, paragraph 9, sequence 207]]
- f. [A prohibition on recognition of a deferred tax liability or asset for differences related to assets and liabilities that, under Subtopic 830-10, are remeasured from the local currency into the functional currency using historical exchange rates and that result from changes in exchange rates or indexing for tax purposes. [FAS 109, paragraph 9, sequence 208]] See Subtopic 830-740 for guidance on foreign currency related income taxes matters.

25-4 [References in this Subtopic to **income taxes currently payable** and (total) income tax expense are intended to also include income taxes currently refundable and (total) income tax benefit, respectively. [FAS 109, paragraph 10, sequence 210]]

> Basic Recognition Threshold

25-5 [This Subtopic requires the application of a more-likely-than-not recognition criterion to a **tax position** before and separate from the measurement of a tax position [FIN 48, paragraph B28, sequence 151.1]] for entities within the scope of this Topic (see paragraph 740-10-15-2A). See paragraph 740-10-55-3 for guidance related to this two-step process.

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 740-10-65-1**

[This Subtopic requires the application of a more-likely-than-not recognition criterion to a **tax position** before and separate from the measurement of a tax position. [FIN 48, paragraph B28, sequence 151.1]] See paragraph 740-10-55-3 for guidance related to this two-step process.

25-6 [An entity shall initially recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. The term *more likely than not* means a likelihood of more than 50 percent; the terms *examined* and *upon examination* also include resolution of the related appeals or litigation processes, if any. [FIN 48, paragraph 6, sequence 28.1]] [For example, if an entity determines that it is certain that the entire cost of an acquired asset is fully deductible, the more-likely-than-not recognition threshold has been met. [FIN 48, paragraph A29, sequence 107.2.1]] [The more-likely-than-not recognition threshold is a positive assertion that an entity believes it is entitled to the economic benefits associated with a tax position. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold shall consider the facts, circumstances, and information available at the reporting date. [FIN 48, paragraph 6, sequence 28.2]] [The level of evidence that is necessary and appropriate to support an entity's assessment of the technical merits of a tax position is a matter of judgment that depends on all available information. [FIN 48, paragraph B34, sequence 160.2]]

25-7 [In making the required assessment of the more-likely-than-not criterion: [FIN 48, paragraph 7, sequence 29]]

- a. [It shall be presumed that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information. [FIN 48, paragraph 7, sequence 30]]
- b. [Technical merits of a tax position derive from sources of authorities in the tax law (legislation and statutes, legislative intent, regulations, rulings, and case law) and their applicability to the facts and circumstances of the tax position. When the past administrative practices and precedents of the taxing authority in its dealings with the entity or similar entities are widely understood, for example, by preparers, tax practitioners and auditors, those practices and precedents shall be taken into account. [FIN 48, paragraph 7, sequence 31]]
- c. [Each tax position shall be evaluated without consideration of the possibility of offset or aggregation with other positions. [FIN 48, paragraph 7, sequence 32]]

25-8 [If the more-likely-than-not recognition threshold is not met in the period for which a tax position is taken or expected to be taken, an entity shall recognize the benefit of the tax position in the first interim period that meets any one of the following conditions: [FIN 48, paragraph 10, sequence 36]]

- a. [The more-likely-than-not recognition threshold is met by the reporting date. [FIN 48, paragraph 10, sequence 37]]
- b. [The tax position is effectively settled through examination, negotiation or litigation. [FIN 48, paragraph 10, sequence 38]]
- c. [The statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired. [FIN 48, paragraph 10, sequence 39]]

[Accordingly, a change in facts subsequent to the reporting date but prior to the issuance of the financial statements shall be recognized in the period in which the change in facts occurs. [FIN 48, paragraph B38, sequence 164.2]]

25-9 [A tax position could be effectively settled upon examination by a taxing authority. Assessing whether a tax position is effectively settled is a matter of judgment because examinations occur in a variety of ways. In determining whether a tax position is effectively settled, an entity shall make the assessment on a position-by-position basis, but an entity could conclude that all positions in a particular tax year are effectively settled. [FSP FIN48-1, paragraph 3, sequence 7]]

25-10 [As required by paragraph 740-10-25-8(b) an entity shall recognize the benefit of a tax position when it is effectively settled. An entity shall evaluate all of the following conditions when determining effective settlement: [FIN 48, paragraph 10A, sequence 39.1]]

- a. [The taxing authority has completed its examination procedures including all appeals and administrative reviews that the taxing authority is required and expected to perform for the tax position. [FIN 48, paragraph 10A, sequence 39.2]]
- b. [The entity does not intend to appeal or litigate any aspect of the tax position included in the completed examination. [FIN 48, paragraph 10A, sequence 39.3]]
- c. [It is remote that the taxing authority would examine or reexamine any aspect of the tax position. In making this assessment management shall consider the taxing authority's policy on reopening closed examinations and the specific facts and circumstances of the tax position. Management shall presume the relevant taxing authority has full knowledge of all relevant information in making the assessment on whether the taxing authority would reopen a previously closed examination. [FIN 48, paragraph 10A, sequence 39.4]]

25-11 [In the tax years under examination, a tax position does not need to be specifically reviewed or examined by the taxing authority to be considered effectively settled through examination. Effective settlement of a position subject to an examination does not result in effective settlement of similar or identical tax positions in periods that have not been examined. [FIN 48, paragraph 10A, sequence 39.5]]

25-12 [An entity may obtain information during the examination process that enables that entity to change its assessment of the technical merits of a tax position or of similar tax positions taken in other periods. However, the effectively settled conditions in paragraph 740-10-25-10 do not provide any basis for the entity to change its assessment of the technical merits of any tax position in other periods. [FIN 48, paragraph 10C, sequence 39.7]]

25-13 [The appropriate unit of account for determining what constitutes an individual tax position, and whether the more-likely-than-not recognition threshold is met for a tax position, is a matter of judgment based on the individual facts and circumstances of that position evaluated in light of all available evidence. The determination of the unit of account to be used shall consider the manner in which the entity prepares and supports its income tax return and the approach the entity anticipates the taxing authority will take during an examination. [FIN 48, paragraph 5, sequence 27]] [Because the individual facts and circumstances of a tax position and of an entity taking that position will determine the appropriate unit of account, a single defined unit of account would not be applicable to all situations. [FIN 48, paragraph B13, sequence 136.2]]

25-14 [Subsequent recognition shall be based on management's best judgment given the facts, circumstances, and information available at the reporting date. [FIN 48, paragraph 12, sequence 42.1]] [A tax position need not be legally extinguished and its resolution need not be certain to subsequently recognize the position. [FIN 48, paragraph 12, sequence 42.2.1]] [Subsequent changes in judgment that lead to changes in recognition shall result from the evaluation of new information and not from a new evaluation or new interpretation by management of information that was available in a previous financial reporting period. [FIN 48, paragraph 12, sequence 42.2.2]] See Sections 740-10-35 and 740-10-40 for guidance on changes in judgment leading to derecognition of and measurement changes for a tax position.

25-15 [A change in judgment that results in subsequent recognition, derecognition, or change in measurement of a tax position taken in a prior annual period (including any related interest and penalties) shall be recognized as a discrete item in the period in which the change occurs. [FIN 48, paragraph 13, sequence 43.1]] Paragraph 740-270-35-6 addresses the different accounting required for such changes in a prior interim period within the same fiscal year.

25-16 [The amount of benefit recognized in the statement of financial position may differ from the amount taken or expected to be taken in a tax return for the current year. [FIN 48, paragraph 17, sequence 47.1.1]] [These differences represent unrecognized tax benefits. [FIN 48, paragraph 17, sequence 47.1.2.1]] For entities within the scope of this Topic (see paragraph 740-10-15-2A) [a liability is created (or the amount of a net operating loss carryforward or amount refundable is reduced) for an **unrecognized tax benefit** because it represents an entity's potential future obligation to the taxing authority for a tax position that was not recognized under the requirements of this Subtopic. [FIN 48, paragraph 17, sequence 47.1.2.2]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 740-10-65-1**

[The amount of benefit recognized in the statement of financial position may differ from the amount taken or expected to be taken in a tax return for the current year. [FIN 48, paragraph 17, sequence 47.1.1]] [These differences represent unrecognized tax benefits. [FIN 48, paragraph 17, sequence 47.1.2.1]] [A liability is created (or the amount of a net operating loss carryforward or amount refundable is reduced) for an **unrecognized tax benefit** because it represents an entity's potential future obligation to the taxing authority for a tax position that was not recognized under the requirements of this Subtopic. [FIN 48, paragraph 17, sequence 47.1.2.2]]

25-17 [A tax position recognized in the financial statements may also affect the tax bases of assets or liabilities and thereby change or create **temporary differences**. A **taxable** and **deductible temporary difference** is a difference between the reported amount of an item in the financial statements and the tax basis of an item as determined by applying this Subtopic's recognition threshold and measurement provisions for tax positions. [FIN 48, paragraph 18, sequence 48.1]] See paragraph 740-10-30-7 for measurement requirements.

> Temporary Differences

25-18 [Income taxes currently payable for a particular year usually include the **tax consequences** of most events that are recognized in the financial statements for that year. [FAS 109, paragraph 10, sequence 209.1]]

25-19 [However, because tax laws and financial accounting standards differ in their recognition and measurement of assets, liabilities, equity, revenues, expenses, gains, and losses, differences arise between: [FAS 109, paragraph 10, sequence 209.2]]

- a. [The amount of **taxable income** and pretax financial income for a year [FAS 109, paragraph 10, sequence 211]]
- b. [The tax bases of assets or liabilities and their reported amounts in financial statements. [FAS 109, paragraph 10, sequence 212]]

[Guidance for computing the tax bases of assets and liabilities for financial reporting purposes is provided in this Subtopic. [FAS 109, paragraph 10, sequence 212.1]]

25-20 [An assumption inherent in an entity's statement of financial position prepared in accordance with generally accepted accounting principles (GAAP) is that the reported amounts of assets and liabilities will be recovered and settled, respectively. Based on that assumption, a difference between the tax basis of an asset or a liability and its reported amount in the statement of financial position will result in taxable or deductible amounts in some future year(s) when the reported amounts of assets are recovered and the reported amounts of liabilities are settled. Examples include the following: [FAS 109, paragraph 11, sequence 213]]

- a. [Revenues or gains that are taxable after they are recognized in financial income. An asset (for example, a receivable from an installment sale) may be recognized for revenues or gains that will result in future taxable amounts when the asset is recovered. [FAS 109, paragraph 11, sequence 214]]
- b. [Expenses or losses that are deductible after they are recognized in financial income. A liability (for example, a product warranty liability) may be recognized for expenses or losses that will result in future tax

deductible amounts when the liability is settled. [FAS 109, paragraph 11, sequence 215]]

- c. [Revenues or gains that are taxable before they are recognized in financial income. A liability (for example, subscriptions received in advance) may be recognized for an advance payment for goods or services to be provided in future years. For tax purposes, the advance payment is included in taxable income upon the receipt of cash. Future sacrifices to provide goods or services (or future refunds to those who cancel their orders) will result in future tax deductible amounts when the liability is settled. [FAS 109, paragraph 11, sequence 216]]

- d. [Expenses or losses that are deductible before they are recognized in financial income. The cost of an asset (for example, depreciable personal property) may have been deducted for tax purposes faster than it was depreciated for financial reporting. Amounts received upon future recovery of the amount of the asset for financial reporting will exceed the remaining tax basis of the asset, and the excess will be taxable when the asset is recovered. [FAS 109, paragraph 11, sequence 217]]

- e. [A reduction in the tax basis of depreciable assets because of tax credits. Amounts received upon future recovery of the amount of the asset for financial reporting will exceed the remaining tax basis of the asset, and the excess will be taxable when the asset is recovered. [FAS 109, paragraph 11, sequence 218]] [For example, a tax law may provide taxpayers with the choice of either taking the full amount of depreciation deductions and a reduced tax credit (that is, investment tax credit and certain other tax credits) or taking the full tax credit and a reduced amount of depreciation deductions. [FAS 109, paragraph 11, sequence 219]]

- f. [Investment tax credits accounted for by the deferral method. Under the deferral method as established in paragraph 740-10-25-46, investment tax credits are viewed and accounted for as a reduction of the cost of the related asset (even though, for financial statement presentation, deferred investment tax credits may be reported as deferred income). Amounts received upon future recovery of the reduced cost of the asset for financial reporting will be less than the tax basis of the asset, and the difference will be tax deductible when the asset is recovered. [FAS 109, paragraph 11, sequence 220]]

- g. [An increase in the tax basis of assets because of indexing whenever the local currency is the functional currency. The tax law for a particular tax jurisdiction might require adjustment of the tax basis of a depreciable (or other) asset for the effects of inflation. The inflation-adjusted tax basis of the asset would be used to compute future tax deductions for depreciation or to compute gain or loss on sale of the asset. Amounts received upon future recovery of the local currency historical cost of the asset will be less than the remaining tax basis of the asset, and the difference will be tax deductible when the asset is recovered. [FAS 109, paragraph 11, sequence 221]]

- h. [Business combinations. There may be differences between the assigned values and the tax bases of the assets and liabilities recognized in a business combination. Those differences will result in taxable or deductible amounts when the reported amounts of the assets and liabilities are recovered and settled, respectively. [FAS 109, paragraph 11, sequence 222]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

[An assumption inherent in an entity's statement of financial position prepared in accordance with generally accepted accounting principles (GAAP) is that the reported amounts of assets and liabilities will be recovered and settled, respectively. Based on that assumption, a difference between the tax basis of an asset or a liability and its reported amount in the statement of financial position will result in taxable or deductible amounts in some future year(s) when the reported amounts of assets are recovered and the reported amounts of liabilities are settled. Examples include the following: [FAS 109, paragraph 11, sequence 213]]

- a. [Revenues or gains that are taxable after they are recognized in financial income. An asset (for example, a receivable from an installment sale) may be recognized for revenues or gains that will result in future taxable amounts when the asset is recovered. [FAS 109, paragraph 11, sequence 214]]

- b. [Expenses or losses that are deductible after they are recognized in financial income. A liability (for example, a product warranty liability) may be recognized for expenses or losses that will result in future tax deductible amounts when the liability is settled. [FAS 109, paragraph 11, sequence 215]]

- c. [Revenues or gains that are taxable before they are recognized in financial income. A liability (for example, subscriptions received in advance) may be recognized for an advance payment for goods or services to be provided in future years. For tax purposes, the advance payment is included in taxable income upon the receipt of cash. Future sacrifices to provide goods or services (or future refunds to those who cancel their orders) will result in future tax deductible amounts when the liability is settled. [FAS 109, paragraph 11, sequence 216]]

- d. [Expenses or losses that are deductible before they are recognized in financial income. The cost of an asset (for example, depreciable personal property) may have been deducted for tax purposes faster than it was depreciated for financial reporting. Amounts received upon future recovery of the amount of the asset for financial reporting will exceed the remaining tax basis of the asset, and the excess will be taxable when the asset is recovered. [FAS 109, paragraph 11, sequence 217]]

- e. [A reduction in the tax basis of depreciable assets because of tax credits. Amounts received upon future recovery of the amount of the asset for financial reporting will exceed the remaining tax basis of the asset, and the excess will be taxable when the asset is recovered. [FAS 109, paragraph 11, sequence 218]] [For example, a tax law may provide taxpayers with the choice of either taking the full amount of depreciation deductions and a reduced tax credit (that is, investment tax credit and certain other tax credits) or taking the full tax credit and a reduced amount of depreciation deductions. [FAS 109, paragraph 11, sequence 219]]

- f. [Investment tax credits accounted for by the deferral method. Under the deferral method as established in paragraph 740-10-25-46, investment tax credits are viewed and accounted for as a reduction of the cost of the related asset (even though, for financial statement presentation, deferred investment tax credits may be reported as deferred income). Amounts received upon future recovery of the reduced cost of the asset for financial reporting will be less than the tax basis of the asset, and the difference will be tax deductible when the asset is recovered. [FAS 109, paragraph 11, sequence 220]]

- g. [An increase in the tax basis of assets because of indexing whenever the local currency is the functional currency. The tax law for a particular tax jurisdiction might require adjustment of the tax basis of a depreciable (or other) asset for the effects of inflation. The inflation-adjusted tax basis of the asset would be used to compute future tax deductions for depreciation or to compute gain or loss on sale of the asset. Amounts received upon future recovery of the local currency historical cost of the asset will be less than the remaining tax basis of the asset, and the difference will be tax deductible when the asset is recovered. [FAS 109, paragraph 11, sequence 221]]

- h. [Business combinations. There may be differences between the tax bases and the recognized values of assets acquired and liabilities assumed in a business combination. Those differences will result in taxable or deductible amounts when the reported amounts of the assets or liabilities are recovered or settled, respectively. [FAS 109, paragraph 11, sequence 222]]

25-21 [The examples in (a) through (d) in the preceding paragraph illustrate revenues, expenses, gains, or losses that are included in taxable income of an earlier or later year than the year in which they are recognized in pretax financial income. Those differences between taxable income and pretax financial income also create differences (sometimes accumulating over more than one year) between the tax basis of an asset or liability and its reported amount in the financial statements. The examples in (e) through (h) in the preceding paragraph illustrate other events that create differences between the tax basis of an asset or liability and its reported amount in the financial statements. For all eight examples, the differences result in taxable or deductible amounts when the reported amount of an asset or liability in the financial statements is recovered or settled, respectively. [FAS 109, paragraph 12, sequence 223]]

25-22 [This Topic refers collectively to the types of differences illustrated by those eight examples and to the ones described in paragraph 740-10-25-24 as temporary differences. [FAS 109, paragraph 13, sequence 224.1]]

25-23 [Temporary differences that will result in taxable amounts in future years when the related asset or liability is recovered or settled are often referred to as taxable temporary differences (the examples in paragraph 740-10-25-20(a); (d); and (e) are taxable temporary differences). Likewise, temporary differences that will result in deductible amounts in future years are often referred to as deductible temporary differences (the examples in paragraph 740-10-25-20(b); (c); (f); and (g) are deductible temporary differences). Business combinations (the example in paragraph 740-10-25-20(h)) may give rise to both taxable and deductible temporary differences. [FAS 109, paragraph 13, sequence 224.2]]

25-24 [Some temporary differences are deferred taxable income or tax deductions and have balances only on the income tax balance sheet and therefore cannot be identified with a particular asset or liability for financial reporting. [FAS 109, paragraph 15, sequence 226.1.1]]

25-25 [That occurs, for example, when a long-term contract is accounted for by the percentage-of-completion method for financial reporting and by the completed-contract method for tax purposes. The temporary difference (income on the contract) is deferred income for tax purposes that becomes taxable when the contract is completed. Another example is organizational costs that are recognized as expenses when incurred for financial reporting and are deferred and deducted in a later year for tax purposes. [FAS 109, paragraph 15, sequence 226.1.2]]

25-26 [In both instances, there is no related, identifiable asset or liability for financial reporting, but there is a temporary difference that results from an **event** that has been recognized in the financial statements and, based on provisions in the tax law, the temporary difference will result in taxable or deductible amounts in future years. [FAS 109, paragraph 15, sequence 226.2]]

25-27 [An entity might be able to delay the future reversal of taxable temporary differences by delaying the events that give rise to those reversals, for example, by delaying the recovery of related assets or the settlement of related liabilities. [FAS 109, paragraph 78, sequence 398.2.1]]

25-28 [A contention that those temporary differences will never result in taxable amounts, however, would contradict the accounting assumption inherent in the statement of financial position that the reported amounts of assets and liabilities will be recovered and settled, respectively; thereby making that statement internally inconsistent. Because of that inherent accounting assumption, the only question is when, not whether, temporary differences will result in taxable amounts in future years. [FAS 109, paragraph 78, sequence 398.2.2]]

25-29 [Except for the temporary differences addressed in paragraph 740-10-25-3, which shall be accounted for as provided in that paragraph, [FAS 109, paragraph 16, sequence 228]] [an entity shall recognize a deferred tax liability or asset for all temporary differences and operating loss and tax credit carryforwards in accordance with the measurement provisions of paragraph 740-10-30-5. [FAS 109, paragraph 16, sequence 227.1]]

> Basis Differences that Are Not Temporary Differences

25-30 [Certain basis differences may not result in taxable or deductible amounts in future years when the related asset or liability for financial reporting is recovered or settled and, therefore, may not be temporary differences for which a deferred tax liability or asset is recognized. [FAS 109, paragraph 14, sequence 225.1]] [One example, depending on the provisions of the tax law, could be the excess of cash surrender value of life insurance over premiums paid. That excess is a temporary difference if the cash surrender value is expected to be recovered by surrendering the policy, but is not a temporary difference if the asset is expected to be recovered without tax consequence upon the death of the insured (if under provisions of the tax law there will be no taxable amount if the insurance policy is held until the death of the insured). [FAS 109, paragraph 14, sequence 225.2]]

25-31 [Tax-to-tax differences are not temporary differences. Recognition of a deferred tax asset for tax-to-tax differences is prohibited as tax-to-tax differences are not one of the exceptions identified in paragraph 740-10-25-3. [EITF D-031, paragraph , sequence 8.2]] [An example of a tax-to-tax difference is an excess of [EITF D-031, paragraph , sequence 7.1]] [the parent entity's tax basis of the stock of an acquired entity over [EITF D-031, paragraph , sequence 7.2.1]] [the tax basis of the net assets of the acquired entity. [EITF D-031, paragraph , sequence 7.2.2.1]]

> Change in Tax Status

25-32 [An entity's tax status may change from nontaxable to taxable or from taxable to nontaxable. An example is a change from a partnership to a corporation and vice versa. A deferred tax liability or asset shall be recognized for temporary differences in accordance with the requirements of this Subtopic at the date that a nontaxable entity becomes a taxable entity. [FAS 109, paragraph 28, sequence 261.1]] A decision to classify an entity as tax exempt is a tax position.

25-33 [The effect of an election for a voluntary change in tax status is recognized on the approval date or on the filing date if approval is not necessary and a change in tax status that results from a change in tax law is recognized on the enactment date. [FAS 109, paragraph 28, sequence 261.2.2.1]]

25-34 [For example, if an election to change an entity's tax status is approved by the tax authority (or filed, if approval is not necessary) early in Year 2 and before issuing financial statements for Year 1, the effect of that change in tax status shall not be recognized in the financial statements for Year 1. [QA 109, paragraph 11, sequence 49.1]]

> Tax Holidays

25-35 There are tax jurisdictions that may grant an entity a holiday from income taxes for a specified period. These are commonly referred to as tax holidays. [An entity may have an expected future reduction in taxes payable during a tax holiday. [FAS 109, paragraph 183, sequence 541.1]]

25-36 [Recognition of a deferred tax asset for any tax holiday is prohibited because of the practical problems in distinguishing unique tax holidays (if any exist) for which recognition of a deferred tax asset might be appropriate from generally available tax holidays and measuring the deferred tax asset. [FAS 109, paragraph 184, sequence 542.2]]

> Effect of Anticipated Future Special Deductions, Losses, and Tax Credits

> > Anticipated Future Special Deductions

25-37 [The tax benefit of statutory depletion and other types of special deductions such as those that may be available for certain health benefit entities and small life insurance entities in future years shall not be anticipated for purposes of offsetting a deferred tax liability for taxable temporary differences at the end of the current year. [FAS 109, paragraph 231, sequence 642.2]] [The tax benefit of special deductions ordinarily is recognized no earlier than the year in which those special deductions are deductible on the tax return. However, some portion of the future tax effects of special deductions are implicitly recognized in determining the average graduated tax rate to be used for measuring deferred taxes when graduated tax rates are a significant factor and the need for a **valuation allowance** for deferred tax assets. [FAS 109, paragraph 232, sequence 643.1]] [In those circumstances, implicit recognition is unavoidable because those special deductions are one of the determinants of future taxable income and future taxable income determines the average graduated tax rate and sometimes determines the need for a valuation allowance. [FAS 109, paragraph 232, sequence 643.2]] See Section 740-10-30 for measurement requirements related to determining tax rates and a valuation allowance for deferred tax assets.

> > Anticipation of Future Losses Not Permitted

25-38 [Conceptually, under an incremental approach as discussed in paragraph 740-10-10-3, the tax consequences of tax losses expected in future years would be anticipated for purposes of: [FAS 109, paragraph 185, sequence 543]]

- a. [Nonrecognition of a deferred tax liability for taxable temporary differences if there will be no future sacrifice because of future tax losses that otherwise would expire unused [FAS 109, paragraph 185, sequence 544]]
- b. [Recognition of a deferred tax asset for the carryback refund of taxes paid for the current or a prior year

because of future tax losses that otherwise would expire unused. [FAS 109, paragraph 185, sequence 545]]

[However, the anticipation of the tax consequences of future tax losses is prohibited. [FAS 109, paragraph 185, sequence 546.1]]

> > Anticipated Future Tax Credits

25-39 [Certain foreign jurisdictions tax corporate income at different rates depending on whether that income is distributed to shareholders. For example, while undistributed profits in a foreign jurisdiction may be subject to a corporate tax rate of 45 percent, distributed income may be taxed at 30 percent. Entities that pay dividends from previously undistributed income may receive a tax credit (or tax refund) equal to the difference between the tax computed at the undistributed rate in effect the year the income is earned (for tax purposes) and the tax computed at the distributed rate in effect the year the dividend is distributed. [EITF 95-10, paragraph ISSUE, sequence 6]]

25-40 [In the separate financial statements of an entity that pays dividends subject to the tax credit to its shareholders, a deferred tax asset shall not be recognized for the tax benefits of future tax credits that will be realized when the previously taxed income is distributed; rather, those tax benefits shall be recognized as a reduction of income tax expense in the period that the tax credits are included in the entity's tax return. [EITF 95-10, paragraph DISCUSSION, sequence 8.1]]

25-41 [The accounting required in the preceding paragraph may differ in the consolidated financial statements of a parent that includes a foreign subsidiary that receives a tax credit for dividends paid, if the parent expects to remit the subsidiary's earnings. Assume that the parent has not availed itself of the exception for foreign unremitted earnings that may be available under paragraph 740-30-25-17. [EITF 95-20, paragraph ISSUE, sequence 7]] [In that case, in the consolidated financial statements of a parent, the future tax credit that will be received when dividends are paid and the deferred tax effects related to the operations of the foreign subsidiary shall be recognized based on the distributed rate because, as assumed in that case, the parent is not applying the indefinite reversal criteria exception that may be available under that paragraph. However, the undistributed rate shall be used in the consolidated financial statements to the extent that the parent has not provided for deferred taxes on the unremitted earnings of the foreign subsidiary as a result of applying the indefinite reversal criteria recognition exception. [EITF 95-20, paragraph DISCUSSION, sequence 8]]

> Alternative Minimum Tax

25-42 The following guidance refers to provisions of the Tax Reform Act of 1986; however, it shall not be considered a definitive interpretation of the Act for any purpose.

25-43 [The Tax Reform Act of 1986 established an **alternative minimum tax** system in the United States. Under the Act, an entity's federal income tax liability is the greater of the tax computed using the regular tax system (regular tax) or the tax under the alternative minimum tax system. A credit (alternative minimum tax credit) may be earned for tax paid on an alternative minimum tax basis that is in excess of the amount of regular tax that would have otherwise been paid. With certain exceptions, the alternative minimum tax credit can be carried forward indefinitely and used to reduce regular tax, but not below the alternative minimum tax for that future year. [EITF 87-08, paragraph ISSUE, sequence 13]] [The alternative minimum tax system shall be viewed as a separate but parallel tax system that may generate a credit carryforward. Alternative minimum tax in excess of regular tax shall not be viewed as a prepayment of future regular tax to the extent that it results in alternative minimum tax credits. [EITF 87-08, paragraph ISSUE, sequence 15]]

25-44 [A deferred tax asset is recognized for alternative minimum tax credit carryforwards in accordance with the provisions of paragraphs 740-10-30-5(d) through (e). [FAS 109, paragraph 19, sequence 237.1]]

> Investment Tax Credits

25-45 [An investment credit shall be reflected in the financial statements to the extent it has been used as an offset against income taxes otherwise currently payable or to the extent its benefit is recognizable under the provisions of this Topic. [APB 02, paragraph 16, sequence 28.1]]

25-46 [While it shall be considered preferable for the allowable investment credit to be reflected in net income over the productive life of acquired property (the deferral method), treating the credit as a reduction of federal income taxes of the year in which the credit arises (the flow-through method) is also acceptable. [APB 02, paragraph 13, sequence 25]]

> Changes in Laws or Rates

25-47 [The effect of a change in tax laws or rates shall be recognized at the date of enactment. [EITF D-030, paragraph , sequence 4.1]]

25-48 [The tax effect of a retroactive change in enacted tax rates on current and deferred tax assets and liabilities shall be determined at the date of enactment using temporary differences and currently taxable income existing as of the date of enactment. [EITF 93-13, paragraph DISCUSSION, sequence 12.1]]

> Acquired Temporary Differences in Certain Purchase Transactions that Are Not Accounted for as Business Combinations

25-49 The following guidance addresses the accounting when an asset is acquired outside of a business combination and the tax basis of the asset differs from the amount paid.

25-50 [The tax basis of an asset is the amount used for tax purposes and is a question of fact under the tax law. An asset's tax basis is not determined simply by the amount that is depreciable for tax purposes. For example, in certain circumstances, an asset's tax basis may not be fully depreciable for tax purposes but would nevertheless be deductible upon sale or liquidation of the asset. In other cases, an asset may be depreciated at amounts in excess of tax basis; however, such excess deductions are subject to recapture in the event of sale. [EITF 98-11, paragraph ISSUE, sequence 12]]

25-51 [The tax effect of asset purchases that are not business combinations in which the amount paid differs from the tax basis of the asset shall not result in immediate income statement recognition. [EITF 98-11, paragraph DISCUSSION, sequence 15.1]] [The simultaneous equations method shall be used to record the assigned value of the asset and the related deferred tax asset or liability. (See Example 25, Cases A and B [paragraphs 740-10-55-171 through 55-182] for illustrations of the simultaneous equations method.) For purposes of applying this requirement, the following applies: [EITF 98-11, paragraph DISCUSSION, sequence 15.2]]

- a. [An acquired financial asset shall be recorded at fair value, an acquired asset held for disposal shall be recorded at fair value less cost to sell, and deferred tax assets shall be recorded at the amount required by this Topic. [EITF 98-11, paragraph DISCUSSION, sequence 16]]
- b. [An excess of the amounts assigned to the acquired assets over the consideration paid shall be allocated pro rata to reduce the values assigned to noncurrent assets acquired (except financial assets, assets held for disposal, and deferred tax assets). If the allocation reduces the noncurrent assets to zero, the remainder shall be classified as a deferred credit. (See Example 25, Cases C and D [paragraphs 740-10-55-183 though 55-191] for illustrations of transactions that result in a deferred credit.) The deferred credit is not a temporary difference under this Subtopic. [EITF 98-11, paragraph DISCUSSION, sequence 17]]
- c. [A reduction in the valuation allowance of the acquiring entity that is directly attributable to the asset acquisition shall be accounted for as an adjustment of the purchase price in accordance with paragraph 266 of FASB Statement 109, *Accounting for Income Taxes*, before that Statement's amendment by FASB Statement 141 (revised 2007). (See Example 25, Case E [paragraph 740-10-55-192] for an illustration of the simultaneous equations method when a preexisting valuation allowance will be reduced as a result of acquiring the asset.) [EITF 98-11, paragraph DISCUSSION, sequence 18.1]] [Subsequent accounting for an acquired valuation allowance (for example, the subsequent recognition of an acquired deferred tax asset by elimination of a valuation allowance established at the date of acquisition of the asset) would be in

accordance with paragraph 30 of FASB Statement 109, *Accounting for Income Taxes*, before that Statement's amendment by FASB Statement 141 (revised 2007), which would reduce to zero other noncurrent intangible assets related to that acquisition, if any, and recognize any remaining reductions in the valuation allowance in income. [EITF 98-11, paragraph DISCUSSION, sequence 18.2]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

[The tax effect of asset purchases that are not business combinations in which the amount paid differs from the tax basis of the asset shall not result in immediate income statement recognition. [EITF 98-11, paragraph DISCUSSION, sequence 15.1]] [The simultaneous equations method shall be used to record the assigned value of the asset and the related deferred tax asset or liability. (See Example 25, Cases A and B [paragraphs 740-10-55-171 through 55-182] for illustrations of the simultaneous equations method.) For purposes of applying this requirement, the following applies: [EITF 98-11, paragraph DISCUSSION, sequence 15.2]]

- a. [An acquired financial asset shall be recorded at fair value, an acquired asset held for disposal shall be recorded at fair value less cost to sell, and deferred tax assets shall be recorded at the amount required by this Topic. [EITF 98-11, paragraph DISCUSSION, sequence 16]]
- b. [An excess of the amounts assigned to the acquired assets over the consideration paid shall be allocated pro rata to reduce the values assigned to noncurrent assets acquired (except financial assets, assets held for disposal, and deferred tax assets). If the allocation reduces the noncurrent assets to zero, the remainder shall be classified as a deferred credit. (See Example 25, Cases C and D [paragraphs 740-10-55-183 though 55-191] for illustrations of transactions that result in a deferred credit.) The deferred credit is not a temporary difference under this Subtopic. [EITF 98-11, paragraph DISCUSSION, sequence 17]]
- c. [A reduction in the valuation allowance of the acquiring entity that is directly attributable to the asset acquisition shall be accounted for in accordance with paragraph 805-740-30-3. [EITF 98-11, paragraph DISCUSSION, sequence 18.1]] [Subsequent accounting for an acquired valuation allowance (for example, the subsequent recognition of an acquired deferred tax asset by elimination of a valuation allowance established at the date of acquisition of the asset) would be in accordance with paragraphs 805-740-25-3 and 805-740-45-2. [EITF 98-11, paragraph DISCUSSION, sequence 18.2]]

25-52 [The net tax benefit (that is, the difference between the amount paid and the deferred tax asset recognized) resulting from the purchase of future tax benefits from a third party which is not a government acting in its capacity as a taxing authority shall be recorded using the same model described in the preceding paragraph. [EITF 98-11, paragraph DISCUSSION, sequence 23.1]] [(See Example 25, Case F [paragraph 740-10-55-199] for an illustration of a purchase of future tax benefits.) [EITF 98-11, paragraph DISCUSSION, sequence 23.2]]

25-53 [Transactions directly between a taxpayer and a government (in its capacity as a taxing authority) shall be recorded directly in income (in a manner similar to the way in which an entity accounts for changes in tax laws, rates, or other tax elections under this Subtopic). [EITF 98-11, paragraph DISCUSSION, sequence 24.1]] [(See Example 26 [paragraph 740-10-55-202] for an illustration of a transaction directly with a governmental taxing authority.) [EITF 98-11, paragraph DISCUSSION, sequence 24.2.1]]

25-54 [In situations in which the tax basis step up relates to goodwill that was previously not deductible, no deferred tax asset would be recorded for the increase in basis except to the extent that the newly deductible goodwill amount exceeds the remaining balance of book goodwill. [EITF 98-11, paragraph DISCUSSION, sequence 24.2.2]]

25-55 [In the event that an entity purchases tax benefits that result from intra-entity transactions between members of a consolidated entity, paragraph 740-10-25-3(e), which prohibits recognition of a deferred tax asset for the difference between the tax basis of assets in the buyer's tax jurisdiction and the cost of those assets as reported in the consolidated financial statements, shall be applied. [EITF 98-11, paragraph DISCUSSION, sequence 25]]

> Interest and Penalties

25-56 [When the tax law requires interest to be paid on an underpayment of income taxes, an entity shall begin recognizing interest expense in the first period the interest would begin accruing according to the provisions of the relevant tax law. [FIN 48, paragraph 15, sequence 45.1]]

25-57 [If a tax position does not meet the minimum statutory threshold to avoid payment of penalties (considering the factors in paragraph 740-10-25-7), an entity shall recognize an expense for the amount of the statutory penalty in the period in which the entity claims or expects to claim the position in the tax return. If penalties were not recognized when the position was initially taken, the expense shall be recognized in the period in which the entity's judgment about meeting the minimum statutory threshold changes. [FIN 48, paragraph 16, sequence 46.1]]

740-10-30 Initial Measurement

General

30-1 This Section provides guidance on the measurement of total income tax expense. While most of this guidance focuses on the initial measurement of deferred tax assets and liabilities, including determining the appropriate tax rate to be used, the requirements for measuring current taxes payable or refundable are also established. This guidance also addresses the consideration and establishment of a **valuation allowance** for deferred tax assets. Requirements for entities that issue separate financial statements and are part of a group that files a consolidated tax return are also established in this Section.

> Basic Requirements

30-2 The following basic requirements are applied to the measurement of current and deferred **income taxes** at the date of the financial statements:

a. [The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. [FAS 109, paragraph 8, sequence 200]]

b. [The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized. [FAS 109, paragraph 8, sequence 201]]

30-3 [Total income tax expense (or benefit) for the year is the sum of **deferred tax expense (or benefit)** and **income taxes currently payable or refundable**. [FAS 109, paragraph 16, sequence 227.2.2]]

> > Deferred Tax Expense (or Benefit)

30-4 [Deferred tax expense (or benefit) is the change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets acquired in a purchase business combination during the year, it is the change since the combination date. [FAS 109, paragraph 16, sequence 227.2.1]] [Paragraph 830-740-45-1 addresses the manner of reporting the transaction gain or loss that is included in the net change in a deferred foreign tax liability or asset when the reporting currency is the functional currency. [FAS 109, paragraph 16, sequence 229]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **805-10-65-1**

[Deferred tax expense (or benefit) is the change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets recognized in a business combination during the year, it is the change since the acquisition date. [FAS 109, paragraph 16, sequence 227.2.1]] [Paragraph 830-740-45-1 addresses the manner of reporting the transaction gain or loss that is included in the net change in a deferred foreign tax liability or asset when the reporting currency is the functional currency. [FAS 109, paragraph 16, sequence 229]]

30-5 [Deferred taxes shall be determined separately for each tax-paying component (an individual entity or group of entities that is consolidated for tax purposes) in each tax jurisdiction. That determination includes the following procedures: [FAS 109, paragraph 17, sequence 230]]

a. [Identify the types and amounts of existing temporary differences and the nature and amount of each type of operating loss and tax credit carryforward and the remaining length of the carryforward period. [FAS 109, paragraph 17, sequence 231]]

b. [Measure the total **deferred tax liability** for taxable temporary differences using the applicable tax rate (see paragraph 740-10-30-8). [FAS 109, paragraph 17, sequence 232]]

c. [Measure the total **deferred tax asset** for deductible temporary differences and operating loss **carryforwards** using the applicable tax rate. [FAS 109, paragraph 17, sequence 233]]

d. [Measure deferred tax assets for each type of tax credit carryforward. [FAS 109, paragraph 17, sequence 234]]

e. [Reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance shall be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. [FAS 109, paragraph 17, sequence 235]]

> > Income Taxes Payable or Refundable (Current Tax Expense [or Benefit])

30-6 Income taxes payable or refundable (current tax expense [or benefit]) are determined under the recognition and measurement requirements for tax positions established in paragraph 740-10-25-2 for recognition and in this Section for measurement.

30-7 [A **tax position** that meets the more-likely-than-not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. Measurement of a tax position that meets the more-likely-than-not recognition threshold shall consider the amounts and probabilities of the outcomes that could be realized upon settlement using the facts, circumstances, and information available at the reporting date. As used in this Subtopic, the term *reporting date* refers to the date of the entity's most recent statement of financial position. [FIN 48, paragraph 8, sequence 33]] [For further explanation and illustration, see Examples 5 through 10 (paragraphs 740-10-55-99 through 55-116). [FIN 48, paragraph 8, sequence 34]]

> Applicable Tax Rate Used to Measure Deferred Taxes

30-8 [Paragraph 740-10-10-3 establishes that the objective is to measure a deferred tax liability or asset using the enacted tax rate(s) expected to apply to **taxable income** in the periods in which the deferred tax liability or asset is expected to be settled or realized. [FAS 109, paragraph 18, sequence 236.1]] [Deferred taxes shall not be accounted for on a discounted basis. [APB 10, paragraph 6, sequence 26.2.2]]

30-9 [Under tax law with a graduated tax rate structure, if taxable income exceeds a specified amount, all taxable income is taxed, in substance, at a single flat tax rate. That tax rate shall be used for measurement of a deferred tax liability or asset by entities for which graduated tax rates are not a significant factor. Entities for which graduated tax rates are a significant factor shall measure a deferred tax liability or asset using the average graduated tax rate applicable to the amount of estimated annual taxable income in the periods in which the deferred tax liability or asset is estimated to be settled or realized. See Example 16 (paragraph 740-10-55-136) for an illustration of the determination of the average graduated tax rate. Other provisions of enacted tax laws shall be considered when determining the tax rate to apply to certain types of temporary differences and carryforwards (for example, the tax law may provide for different tax rates on ordinary income and capital gains). If there is a phased-in change in tax rates, determination of the applicable tax rate requires knowledge about when deferred tax liabilities and assets will be settled and realized. [FAS 109, paragraph 18, sequence 236.2]]

30-10 [In the U.S. federal tax jurisdiction, the applicable tax rate is the regular tax rate, and a deferred tax asset is recognized for **alternative minimum tax** credit carryforwards in accordance with the provisions of paragraph 740-10-30-5(d) through (e). [FAS 109, paragraph 19, sequence 237.1]]

30-11 [The objective established in paragraph 740-10-10-3 relating to enacted tax rate(s) expected to apply is not achieved through measurement of deferred taxes using the lower alternative minimum tax rate if an entity currently is an alternative minimum tax taxpayer and expects to always be an alternative minimum tax taxpayer. [FAS 109, paragraph 90, sequence 413.2.1]] [No one can predict whether an entity will always be an alternative minimum tax taxpayer. Furthermore, it would be counterintuitive if the addition of alternative minimum tax provisions to the tax law were to have the effect of reducing the amount of an entity's income tax expense for financial reporting, given that the provisions of alternative minimum tax may be either neutral or adverse but never beneficial to an entity. It also would be counterintuitive to assume that an entity would permit its alternative minimum tax credit carryforward to expire unused at the end of the life of the entity, which would have to occur if that entity was always an alternative minimum tax taxpayer. [FAS 109, paragraph 90, sequence 413.2.2]] [Use of the lower alternative minimum tax rate to measure an entity's deferred tax liability could result in understatement for either of the following reasons: [FAS 109, paragraph 91, sequence 414.2]]

a. [It could be understated if the entity currently is an alternative minimum tax taxpayer because of temporary differences. Temporary differences reverse and, over the entire life of the entity, cumulative income will be taxed at regular tax rates. [FAS 109, paragraph 91, sequence 415]]

b. [It could be understated if the entity currently is an alternative minimum tax taxpayer because of preference items but does not have enough alternative minimum tax credit carryforward to reduce its deferred tax liability from the amount of regular tax on regular tax temporary differences to the amount of **tentative minimum tax** on alternative minimum tax temporary differences. In those circumstances, measurement of the deferred tax liability using alternative minimum tax rates would anticipate the tax benefit of future special deductions, such as statutory depletion, which have not yet been earned. [FAS 109, paragraph 91, sequence 416]]

30-12 [If alternative tax systems exist in jurisdictions other than the U.S. federal jurisdiction, the applicable tax rate is determined in a manner consistent with the tax law after giving consideration to any interaction (that is, a mechanism similar to the U.S. alternative minimum tax credit) between the two systems. [FAS 109, paragraph 19, sequence 237.2]]

> > Effect of Anticipated Future Special Deductions and Tax Credits on Deferred Tax Rates

> > > Anticipated Future Special Deductions

30-13 [As required by paragraph 740-10-25-37, the tax benefit of special deductions ordinarily is recognized no earlier than the year in which those special deductions are deductible on the tax return. However, some portion of the future tax effects of special deductions are implicitly recognized in determining the average graduated tax rate to be used for measuring deferred taxes when graduated tax rates are a significant factor and the need for a valuation allowance for deferred tax assets. [FAS 109, paragraph 232, sequence 643.1]] [In those circumstances, implicit recognition is unavoidable because those special deductions are one of the determinants of future taxable income and future taxable income determines the average graduated tax rate and sometimes determines the need for a valuation allowance. [FAS 109, paragraph 232, sequence 643.2]]

> > > Anticipated Future Tax Credits

30-14 Paragraph 740-10-25-39 notes that certain foreign jurisdictions may tax corporate income at different rates depending on whether that income is distributed to shareholders. Paragraph 740-10-25-40 addresses recognition of future tax credits that will be realized when the previously taxed income is distributed. [Under

ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

these circumstances, the entity shall measure the tax effects of temporary differences using the undistributed rate. [EITF 95-10, paragraph DISCUSSION, sequence 8.2]]

30-15 As noted in paragraph 740-10-25-41, the accounting required in the consolidated financial statements of a parent that includes a foreign subsidiary that receives a tax credit for dividends paid may differ from the accounting required for the subsidiary. See that paragraph for the rates required to be used to measure deferred income taxes in such consolidated financial statements.

> Establishment of a Valuation Allowance for Deferred Tax Assets

30-16 As established in paragraph 740-10-30-2(b), there is a basic requirement to reduce the measurement of deferred tax assets not expected to be realized.

30-17 [All available evidence, both positive and negative, shall be considered to determine whether, based on the weight of that evidence, a valuation allowance for deferred tax assets is needed. Information about an entity's current financial position and its results of operations for the current and preceding years ordinarily is readily available. That historical information is supplemented by all currently available information about future years. Sometimes, however, historical information may not be available (for example, start-up operations) or it may not be as relevant (for example, if there has been a significant, recent change in circumstances) and special attention is required. [FAS 109, paragraph 20, sequence 238]]

30-18 [Future realization of the tax benefit of an existing **deductible temporary difference** or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback, carryforward period available under the tax law. The following four possible sources of taxable income may be available under the tax law to realize a tax benefit for deductible temporary differences and carryforwards: [FAS 109, paragraph 21, sequence 239]]

a. [Future reversals of existing taxable temporary differences [FAS 109, paragraph 21, sequence 240]]

b. [Future taxable income exclusive of reversing temporary differences and carryforwards [FAS 109, paragraph 21, sequence 241]]

c. [Taxable income in prior carryback year(s) if carryback is permitted under the tax law [FAS 109, paragraph 21, sequence 242]]

d. [Tax-planning strategies (see paragraph 740-10-30-19) that would, if necessary, be implemented to, for example: [FAS 109, paragraph 21, sequence 243]]

    1. [Accelerate taxable amounts to utilize expiring carryforwards [FAS 109, paragraph 21, sequence 244]]

    2. [Change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss [FAS 109, paragraph 21, sequence 245]]

    3. [Switch from tax-exempt to taxable investments. [FAS 109, paragraph 21, sequence 246]]

[Evidence available about each of those possible sources of taxable income will vary for different tax jurisdictions and, possibly, from year to year. To the extent evidence about one or more sources of taxable income is sufficient to support a conclusion that a valuation allowance is not necessary, other sources need not be considered. Consideration of each source is required, however, to determine the amount of the valuation allowance that is recognized for deferred tax assets. [FAS 109, paragraph 21, sequence 247]]

30-19 [In some circumstances, there are actions (including elections for tax purposes) that: [FAS 109, paragraph 22, sequence 248.1]]

a. [Are prudent and feasible [FAS 109, paragraph 22, sequence 248.2.1]]

b. [An entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused [FAS 109, paragraph 22, sequence 248.2.2.1]]

c. [Would result in realization of deferred tax assets. [FAS 109, paragraph 22, sequence 248.2.2.2.1]]

[This Subtopic refers to those actions as tax-planning strategies. [FAS 109, paragraph 22, sequence 248.2.2.2.2.1]] [An entity shall consider tax-planning strategies in determining the amount of valuation allowance required. Significant expenses to implement a **tax-planning strategy** or any significant losses that would be recognized if that strategy were implemented (net of any recognizable tax benefits associated with those expenses or losses) shall be included in the valuation allowance. See paragraphs 740-10-55-39 through 55-48 for additional guidance. [FAS 109, paragraph 22, sequence 248.2.2.2.2.2]] [Implementation of the tax-planning strategy shall be primarily within the control of management but need not be within the unilateral control of management. [FAS 109, paragraph 107, sequence 445.2]]

30-20 [When a tax-planning strategy is contemplated as a source of future taxable income to support the realizability of a deferred tax asset, the recognition and measurement requirements for tax positions in paragraphs 740-10-25-6 through 25-7; 740-10-25-13; and 740-10-30-7 shall be applied in determining the amount of available future taxable income. [FIN 48, paragraph 9, sequence 35]]

30-21 [Forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years. [FAS 109, paragraph 23, sequence 249.1]] [Other examples of negative evidence include, but are not limited to, the following: [FAS 109, paragraph 23, sequence 249.2]]

a. [A history of operating loss or tax credit carryforwards expiring unused [FAS 109, paragraph 23, sequence 250]]

b. [Losses expected in early future years (by a presently profitable entity) [FAS 109, paragraph 23, sequence 251]]

c. [Unsettled circumstances that, if unfavorably resolved, would adversely affect future operations and profit levels on a continuing basis in future years [FAS 109, paragraph 23, sequence 252]]

d. [A carryback, carryforward period that is so brief it would limit realization of tax benefits if a significant deductible temporary difference is expected to reverse in a single year or the entity operates in a traditionally cyclical business. [FAS 109, paragraph 23, sequence 253]]

30-22 [Examples (not prerequisites) of positive evidence that might support a conclusion that a valuation allowance is not needed when there is negative evidence include, but are not limited to, the following: [FAS 109, paragraph 24, sequence 254]]

a. [Existing contracts or firm sales backlog that will produce more than enough taxable income to realize the deferred tax asset based on existing sales prices and cost structures [FAS 109, paragraph 24, sequence 255]]

b. [An excess of appreciated asset value over the tax basis of the entity's net assets in an amount sufficient to realize the deferred tax asset [FAS 109, paragraph 24, sequence 256]]

c. [A strong earnings history exclusive of the loss that created the future deductible amount (tax loss carryforward or deductible temporary difference) coupled with evidence indicating that the loss (for example, an unusual, infrequent, or extraordinary item) is an aberration rather than a continuing condition. [FAS 109, paragraph 24, sequence 257]]

30-23 [An entity shall use judgment in considering the relative impact of negative and positive evidence. The weight given to the potential effect of negative and positive evidence shall be commensurate with the extent to which it can be objectively verified. The more negative evidence that exists, [FAS 109, paragraph 25, sequence 258.1]] [the more positive evidence is necessary and [FAS 109, paragraph 25, sequence 258.2.1]] [the more difficult it is to support a conclusion that a valuation allowance is not needed for some portion or all of the deferred tax asset. [FAS 109, paragraph 25, sequence 258.2.2]] [A cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome. [FAS 109, paragraph 103, sequence 441.2.1]]

30-24 [Future realization of a tax benefit sometimes will be expected for a portion but not all of a deferred tax asset, and the dividing line between the two portions may be unclear. In those circumstances, application of judgment based on a careful assessment of all available evidence is required to determine the portion of a deferred tax asset for which it is more likely than not a tax benefit will not be realized. [FAS 109, paragraph 98, sequence 436.1]]

30-25 See paragraphs 740-10-55-34 through 55-38 for additional guidance related to **carrybacks** and carryforwards.

> Tax Rates Applicable to Items Not Included in Income from Continuing Operations

30-26 [The reported tax effect of items not included in income from continuing operations (for example, discontinued operations, extraordinary items, cumulative effects of changes in accounting principles, and items charged or credited directly to shareholders' equity) that arose during the current fiscal year and before the date of enactment of tax legislation shall be measured based on the enacted rate at the time the transaction was recognized for financial reporting purposes. [EITF 93-13, paragraph DISCUSSION, sequence 13.1]]

> Allocation of Consolidated Tax Expense to Separate Financial Statements of Members

30-27 [The consolidated amount of current and deferred tax expense for a group that files a consolidated tax return shall be allocated among the members of the group when those members issue separate financial statements. This Subtopic does not require a single allocation method. The method adopted, however, shall be systematic, rational, and consistent with the broad principles established by this Subtopic. A method that allocates current and deferred taxes to members of the group by applying this Topic to each member as if it were a separate taxpayer meets those criteria. [FAS 109, paragraph 40, sequence 306.1]] [In that situation, the sum of the amounts allocated to individual members of the group may not equal the consolidated amount. That may also be the result when there are intra-entity transactions between members of the group. The criteria are satisfied, nevertheless, after giving effect to the type of adjustments (including eliminations) normally present in preparing consolidated financial statements. [FAS 109, paragraph 40, sequence 307]]

30-28 [Examples of methods that are not consistent with the broad principles established by this Subtopic include the following: [FAS 109, paragraph 40, sequence 306.2]]

a. [A method that allocates only current taxes payable to a member of the group that has taxable temporary differences [FAS 109, paragraph 40, sequence 308]]

b. [A method that allocates deferred taxes to a member of the group using a method fundamentally different from the asset and liability method described in this Subtopic (for example, the deferred method that was used before 1989) [FAS 109, paragraph 40, sequence 309]]

c. [A method that allocates no current or deferred tax expense to a member of the group that has taxable income because the consolidated group has no current or deferred tax expense. [FAS 109, paragraph 40, sequence 310]]

> Interest and Penalties on Unrecognized Tax Benefits

30-29 Paragraph 740-10-25-56 establishes the requirements under which an entity shall accrue interest on an underpayment of income taxes. [The amount of interest expense to be recognized shall be computed by applying the applicable statutory rate of interest to the difference between the tax position recognized in accordance with the requirements of this Subtopic for tax positions and the amount previously taken or expected to be taken in a tax return. [FIN 48, paragraph 15, sequence 45.2]]

30-30 Paragraph 740-10-25-57 establishes both when an entity shall record an expense for penalties attributable to certain tax positions as well as the amount.

740-10-35 Subsequent Measurement

General

35-1 Section 740-10-30 addresses initial measurement of current and deferred income tax accounts. This Section addresses the accounting for certain changes subsequent to initial measurement. The guidance in this Section is incremental to the guidance for initial measurement.

> New Information Affecting Measurement of Tax Positions

35-2 [Subsequent measurement of a **tax position** meeting the recognition requirements of paragraph 740-10-25-6 shall be based on management's best judgment given the facts, circumstances, and information available at the reporting date. [FIN 48, paragraph 12, sequence 42.1]] Paragraph 740-10-30-7 explains that the reporting date is the date of the entity's most recent statement of financial position. [A tax position need not be legally extinguished and its resolution need not be certain to subsequently measure the position. [FIN 48, paragraph 12, sequence 42.2.1]] [Subsequent changes in judgment that lead to changes in measurement shall result from the evaluation of new information and not from a new evaluation or new interpretation by management of information that was available in a previous financial reporting period. [FIN 48, paragraph 12, sequence 42.2.2]]

35-3 [Paragraph 740-10-25-15 requires that a change in judgment that results in a change in measurement of a tax position taken in a prior annual period (including any related interest and penalties) shall be recognized as a discrete item in the period in which the change occurs. [FIN 48, paragraph 13, sequence 43.1]] Paragraph 740-270-35-6 addresses the different accounting required for such changes in a prior interim period within the same fiscal year.

> Changes in Tax Laws or Rates

35-4 [Deferred tax liabilities and assets shall be adjusted for the effect of a change in tax laws or rates. [FAS 109, paragraph 27, sequence 260.1]] A change in tax laws or rates may also require a reevaluation of a **valuation allowance** for deferred tax assets.

> Deferred Credit Arising from Asset Acquisitions that Are Not Business Combinations

35-5 A deferred credit may arise under the accounting required by paragraph 740-10-25-51 when an asset is acquired outside of a business combination. [Any deferred credit arising from the application of such accounting requirements shall be amortized to income tax expense in proportion to the realization of the tax benefits that gave rise to the deferred credit. [EITF 98-11, paragraph DISCUSSION, sequence 19.1]]

740-10-40 Derecognition

General

40-1 Section 740-10-25 addresses recognition of current and deferred income tax accounts, including accrued interest and penalties. The guidance in this Section addresses certain subsequent events that result in derecognizing previously recognized amounts and is incremental to the guidance for recognition.

> Tax Position No Longer Meets Recognition Criterion

40-2 [An entity shall derecognize a previously recognized **tax position** in the first period in which it is no longer more likely than not that the tax position would be sustained upon examination. Use of a **valuation allowance** is not a permitted substitute for derecognizing the benefit of a tax position when the more-likely-than-not recognition threshold is no longer met. [FIN 48, paragraph 11, sequence 40]] [Derecognition shall be based on management's best judgment given the facts, circumstances, and information available at the reporting date. [FIN 48, paragraph 12, sequence 42.1]] Paragraph 740-10-30-7 explains that the reporting date is the date of the entity's most recent statement of financial position. [Subsequent changes in judgment that lead to derecognition shall result from the evaluation of new information and not from a new evaluation or new interpretation by management of information that was available in a previous financial reporting period. [FIN 48, paragraph 12, sequence 42.2.2]]

40-3 [If an entity that had previously considered a tax position effectively settled becomes aware that the taxing authority may examine or reexamine the tax position or intends to appeal or litigate any aspect of the tax position, the tax position is no longer considered effectively settled and the entity shall reevaluate the tax position in accordance with the requirements of this Subtopic for tax positions. [FIN 48, paragraph 10B, sequence 39.6]]

40-4 [Paragraph 740-10-25-15 requires that a change in judgment that results in derecognition of a tax position taken in a prior annual period (including any related interest and penalties) shall be recognized as a discrete item in the period in which the change occurs. [FIN 48, paragraph 13, sequence 43.1]] Paragraph 740-270-35-6 addresses the different accounting required for such changes in a prior interim period within the same fiscal year.

> Accrued Interest and Penalties Related to Tax Positions Subsequently Meeting the Recognition Criteria

40-5 A tax position that did not meet the recognition requirements of paragraph 740-10-25-6 may have resulted in the accrual of interest and penalties under the requirements of paragraphs 740-10-25-56 through 25-57. [Previously recognized interest and penalties associated with tax positions that subsequently meet one of the conditions in paragraph 740-10-25-8 shall be derecognized in the period that condition is met. [FIN 48, paragraph 16, sequence 46.2]]

> Cessation of an Entity's Taxable Status

40-6 [A **deferred tax liability** or **asset** shall be eliminated at the date an entity ceases to be a taxable entity. [FAS 109, paragraph 28, sequence 261.2.1]] [As indicated in paragraph 740-10-25-33, the effect of an election for a voluntary change in tax status is recognized on the approval date or on the filing date if approval is not necessary and a change in tax status that results from a change in tax law is recognized on the enactment date. [FAS 109, paragraph 28, sequence 261.2.2.1]]

740-10-45 Other Presentation Matters

General

45-1 This Section provides guidance on statement of financial position and income statement classification and presentation matters applicable to all of the following:

a. Statement of financial position classification of income tax accounts

b. Income statement presentation of certain measurement changes to income tax accounts

c. Income statement classification of interest and penalties

d. Presentation matters related to investment tax credits under the deferral method.

45-2 See Subtopic 740-20 for guidance on the intraperiod allocation of total income tax expense (or benefit).

> Statement of Financial Position Classification of Income Tax Accounts

45-3 Topic 210 provides general guidance for classification of accounts in statements of financial position. The following guidance addresses classification matters applicable to income tax accounts and is incremental to the general guidance.

> > Deferred Tax Accounts

45-4 [In a classified statement of financial position, an entity shall separate deferred tax liabilities and assets into a current amount and a noncurrent amount. [FAS 109, paragraph 41, sequence 312.1.1]] [Deferred tax liabilities and assets shall be classified as current or noncurrent based on the classification of the related asset or liability for financial reporting. [FAS 109, paragraph 41, sequence 312.1.2.1]]

45-5 [The **valuation allowance** for a particular tax jurisdiction shall be allocated between current and noncurrent deferred tax assets for that tax jurisdiction on a pro rata basis. [FAS 109, paragraph 41, sequence 312.2]]

45-6 [For a particular tax-paying component of an entity and within a particular tax jurisdiction, all current deferred tax liabilities and assets shall be offset and presented as a single amount and all noncurrent deferred tax liabilities and assets shall be offset and presented as a single amount. However, an entity shall not offset deferred tax liabilities and assets attributable to different tax-paying components of the entity or to different tax jurisdictions. [FAS 109, paragraph 42, sequence 313]]

> > > Deferred Tax Accounts Related to an Asset or Liability

45-7 [A **deferred tax liability** or **asset** for a **temporary difference** that is related to an asset or liability shall be classified as current or noncurrent based on the classification of the related asset or liability. [FAS 037, paragraph 4, sequence 13.2.1.2.1]]

45-8 [A temporary difference is related to an asset or liability if reduction [FAS 037, paragraph 4, sequence 13.1]] [of the asset or liability causes the temporary difference to reverse. [FAS 037, paragraph 4, sequence 13.2.1.1]] [As used here, the term *reduction* includes amortization, sale, or other realization of an asset and amortization, payment, or other satisfaction of a liability. [FAS 037, paragraph 4, sequence 14]]

> > > Deferred Tax Accounts Not Related to an Asset or Liability

45-9 [A deferred tax liability or asset that is not related to an asset or liability for financial reporting (see paragraphs 740-10-25-24 through 25-26), including deferred tax assets related to **carryforwards**, shall be classified according to the expected reversal date of the temporary difference. [FAS 109, paragraph 41, sequence 312.1.2.2]]

45-10 [A deferred tax liability or asset for a temporary difference may not be related to an asset or liability because [FAS 037, paragraph 4, sequence 13.2.1.2.2]] [there is no associated asset or liability or [FAS 037, paragraph 4, sequence 13.2.2.1]] [reduction of an associated asset or liability will not cause the temporary difference to reverse. The classification required by the preceding paragraph disregards any additional temporary differences that may arise and is based on the criteria used for classifying other assets and liabilities. [FAS 037, paragraph 4, sequence 13.2.2.2]]

> > Tax Accounts, Other than Deferred

> > > Unrecognized Tax Benefits

45-11 [An entity that presents a classified statement of financial position shall classify a liability associated with an **unrecognized tax benefit** as a current liability (or the amount of a net operating loss carryforward or amount refundable is reduced) to the extent the entity anticipates payment (or receipt) of cash within one year or the operating cycle, if longer. The liability for unrecognized tax benefits (or reduction in amounts refundable) shall not be combined with deferred tax liabilities or assets. [FIN 48, paragraph 17, sequence 47.2]]

45-12 [A liability recognized for an unrecognized tax benefit shall not be classified as a deferred tax liability unless it arises from a **taxable temporary difference**. [FIN 48, paragraph 18, sequence 48.2]] Paragraph 740-10-25-17 explains how the recognition and measurement of a **tax position** may affect the calculation of a temporary difference.

> > > Offsetting

45-13 [The offset of cash or other assets against the tax liability or other amounts owing to governmental bodies is not acceptable except as noted in paragraph 210-20-45-6. [APB 10, paragraph 7, sequence 30.2]]

> Income Statement Presentation of Certain Measurement Changes to Income Tax Accounts

45-14 The following guidance addresses the presentation on the income statement of the effect of changes in deferred tax accounts caused by the following types of changes:

a. Changes in tax laws or rates

b. Changes in the tax status of an entity

c. Changes that impact the valuation allowance for deferred tax assets

d. Changes related to assets acquired outside of a business combination.

> > Changes in Tax Laws or Rates

45-15 When deferred tax accounts are adjusted as required by paragraph 740-10-35-4 for the effect of a change in tax laws or rates, [the effect shall be included in income from continuing operations for the period that includes the enactment date. [FAS 109, paragraph 27, sequence 260.2]]

45-16 Paragraph 740-10-25-48 provides the recognition guidance when a tax law retroactively changes tax rates. [In such cases, the cumulative tax effect is included in income from continuing operations. [EITF 93-13, paragraph DISCUSSION, sequence 12.2]]

45-17 Paragraph 740-10-30-26 provides the measurement guidance for a change in tax rates on items not included in income from continuing operations that arose during the current fiscal year and prior to the date of enactment. [In such cases, the tax effect of a retroactive change in enacted tax rates on current or deferred tax assets and liabilities related to those items is included in income from continuing operations in the period of enactment. [EITF 93-13, paragraph DISCUSSION, sequence 13.2]]

45-18 [Paragraph 740-10-25-47 requires that the effect of a change in tax laws or rates be recognized at the date of enactment. [EITF D-030, paragraph , sequence 4.1]] [Accordingly, if an entity were adopting a new accounting standard as of a date prior to the enactment date, the effect of the change in tax laws or rates would not be recognized in the cumulative effect of adopting the standard, but would be recognized in income from continuing operations for the period that includes the enactment date. This would be true regardless of whether the change was retroactive to the earlier date. [EITF D-030, paragraph , sequence 4.2]]

> > Changes in the Tax Status of an Entity

45-19 When deferred tax accounts are recognized or derecognized as required by paragraphs 740-10-25-32 and 740-10-40-6 due to a change in tax status, [the effect of recognizing or derecognizing the deferred tax liability or asset shall be included in income from continuing operations. [FAS 109, paragraph 28, sequence 261.2.2.2]]

> > Changes that Impact the Valuation Allowance for Deferred Tax Assets

45-20 [The effect of a change in the beginning-of-the-year balance of a valuation allowance that results from a change in circumstances that causes a change in judgment about the realizability of the related **deferred tax asset** in future years ordinarily shall be included in income from continuing operations. The only exceptions are the initial recognition (that is, by elimination of the valuation allowance) of certain tax benefits that are allocated as required by paragraph 30 of FASB Statement 109, *Accounting for Income Taxes*, before that Statement's amendment by FASB Statement 141 (revised 2007) related to business combinations and the items specified in paragraph 740-20-45-11(c) through (f). [FAS 109, paragraph 26, sequence 259.1]] [The effect of other changes in the balance of a valuation allowance are allocated among continuing operations and items other than continuing operations as required by paragraphs 740-20-45-2 and 740-20-45-8. [FAS 109, paragraph 26, sequence 259.2]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

[The effect of a change in the beginning-of-the-year balance of a valuation allowance that results from a change in circumstances that causes a change in judgment about the realizability of the related **deferred tax asset** in future years ordinarily shall be included in income from continuing operations. The only exceptions are changes to valuation allowances of certain tax benefits that are adjusted within the measurement period as required by paragraph 805-740-45-2 related to business combinations and the initial recognition (that is, by elimination of the valuation allowances) of tax benefits related to the items specified in paragraph 740-20-45-11(c) through (f). [FAS 109, paragraph 26, sequence 259.1]] [The effect of other changes in the balance of a valuation allowance are allocated among continuing operations and items other than continuing operations as required by paragraphs 740-20-45-2 and 740-20-45-8. [FAS 109, paragraph 26, sequence 259.2]]

45-21 [Changes in valuation allowances due to changed expectations about the realization of deferred tax assets caused by transactions among or with shareholders shall be included in the income statement. A write-off of a preexisting deferred tax asset that an entity can no longer realize as a result of a transaction among or with its shareholders shall similarly be charged to the income statement. The same net effect results from eliminating a deferred tax asset and increasing a valuation allowance to 100 percent of the amount of the related deferred tax asset. [EITF 94-10, paragraph DISCUSSION, sequence 8]]

> > Changes Related to Assets Acquired Outside of a Business Combination

45-22 Paragraph 740-10-25-51 addresses the accounting when an asset is acquired outside of a business combination and the tax basis of the asset differs from the amount paid and identifies related examples. [In the **event** that the accounting results in the recognition of a deferred tax asset and if, subsequent to the acquisition, it becomes more likely than not that some or all of the acquired deferred tax asset will not be realized, the effect of such adjustment shall be recognized in continuing operations as part of income tax expense. A proportionate share of any remaining unamortized deferred credit balance arising from the accounting required in that paragraph shall be recognized as an offset to income tax expense. [EITF 98-11, paragraph DISCUSSION, sequence 20]] [The deferred credit shall not be classified as part of deferred tax liabilities or as an offset to deferred tax assets. [EITF 98-11, paragraph DISCUSSION, sequence 19.2]]

45-23 [Income tax uncertainties that exist at the date of acquisition of the asset shall be accounted for as follows: any unfavorable adjustments shall be recognized in income and any favorable adjustments shall be applied as a reduction of other noncurrent intangible assets related to the acquisition, if any, and any remaining amount of favorable adjustments shall be recognized in income. [EITF 98-11, paragraph DISCUSSION, sequence 21]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **805-10-65-1**

[Income tax uncertainties that exist at the date of acquisition of the asset shall be accounted for in accordance with this Subtopic. [EITF 98-11, paragraph DISCUSSION, sequence 21]]

45-24 [As indicated in paragraph 740-10-25-51, subsequent accounting for an acquired valuation allowance (for example, the subsequent recognition of an acquired deferred tax asset by elimination of a valuation allowance established at the date of acquisition of the asset) would be in accordance with paragraph 30 of FASB Statement 109, *Accounting for Income Taxes*, before that Statement's amendment by FASB Statement 141 (revised 2007), which would reduce to zero other noncurrent intangible assets related to that acquisition, if any, and recognize any remaining reductions in the valuation allowance in income. [EITF 98-11, paragraph DISCUSSION, sequence 18.2]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **805-10-65-1**

[As indicated in paragraph 740-10-25-51, subsequent accounting for an acquired valuation allowance (for example, the subsequent recognition of an acquired deferred tax asset by elimination of a valuation allowance established at the date of acquisition of the asset) would be in accordance with paragraphs 805-740-25-3 through 25-4 and 805-740-45-2. [EITF 98-11, paragraph DISCUSSION, sequence 18.2]]

> Income Statement Classification of Interest and Penalties

45-25 [Interest recognized in accordance with paragraph 740-10-25-56 may be classified in the financial statements as either **income taxes** or interest expense, based on the accounting policy election of the entity. Penalties recognized in accordance with paragraph 740-10-25-57 may be classified in the financial statements as either income taxes or another expense classification, based on the accounting policy election of the entity. Those elections shall be consistently applied. [FIN 48, paragraph 19, sequence 49]]

> Investment Tax Credits Under the Deferral Method

45-26 Paragraph 740-10-25-46 describes two acceptable methods for recognizing the benefit of investment tax credits. The following guidance addresses presentation matters related to one of those methods, the deferral method.

> > Statement of Financial Position

45-27 [The reflection of the allowable credit as a reduction in the net amount at which the acquired property is stated (either directly or by inclusion in an offsetting account) may be preferable in many cases. However, it is equally appropriate to treat the credit as deferred income, provided it is amortized over the productive life of the acquired property. [APB 02, paragraph 14, sequence 26.2]]

> > Income Statement

45-28 [It is preferable that the statement of income in the year in which the allowable investment credit arises should be affected only by the results which flow from the accounting for the credit set forth in paragraph 740-10-25-46. Nevertheless, reflection of income tax provisions, in the income statement, in the amount payable (that is, after deduction of the allowable investment credit) is appropriate provided that a corresponding charge is made to an appropriate cost or expense (for example, to the provision for depreciation) and the treatment is adequately disclosed in the financial statements of the first year of its adoption. [APB 02, paragraph 15, sequence 27]]

740-10-50 Disclosure

General

50-1 This Section provides guidance on the financial statement disclosure requirements relating to **income taxes** applicable to all entities.

> Statement of Financial Position Related Disclosures

50-2 [The components of the net **deferred tax liability** or **asset** recognized in an entity's statement of financial position shall be disclosed as follows: [FAS 109, paragraph 43, sequence 314]]

- a. [The total of all deferred tax liabilities measured in paragraph 740-10-30-5(b) [FAS 109, paragraph 43, sequence 315]]
- b. [The total of all deferred tax assets measured in paragraph 740-10-30-5(c) through (d) [FAS 109, paragraph 43, sequence 316]]
- c. [The total **valuation allowance** recognized for deferred tax assets determined in paragraph 740-10-30-5(e). [FAS 109, paragraph 43, sequence 317]]

[The net change during the year in the total valuation allowance also shall be disclosed. [FAS 109, paragraph 43, sequence 318.1]]

50-3 [An entity shall disclose both of the following: [FAS 109, paragraph 48, sequence 335.1]]

- a. [The amounts and expiration dates of operating loss and tax credit **carryforwards** for tax purposes [FAS 109, paragraph 48, sequence 335.2.1]]
- b. [Any portion of the valuation allowance for deferred tax assets for which subsequently recognized tax benefits will be allocated to reduce goodwill or other noncurrent intangible assets of an acquired entity or directly to contributed capital (see paragraph 740-20-45-11 and paragraph 30 of FASB Statement 109, *Accounting for Income Taxes*, before that Statement's amendment by FASB Statement 141 (revised 2007)). [FAS 109, paragraph 48, sequence 335.2.2]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

[An entity shall disclose both of the following: [FAS 109, paragraph 48, sequence 335.1]]

- a. [The amounts and expiration dates of operating loss and tax credit **carryforwards** for tax purposes [FAS 109, paragraph 48, sequence 335.2.1]]
- b. [Any portion of the valuation allowance for deferred tax assets for which subsequently recognized tax benefits will be credited directly to contributed capital (see paragraph 740-20-45-11). [FAS 109, paragraph 48, sequence 335.2.2]]

50-4 [In the **event** that a change in an entity's tax status becomes effective after year-end in Year 2 but before the financial statements for Year 1 are issued, [QA 109, paragraph 11, sequence 48]] [the entity's financial statements for Year 1 shall disclose the change in the entity's tax status for Year 2 and the effects of that change, if material. [QA 109, paragraph 11, sequence 49.2]]

50-5 An entity's **temporary difference** and carryforward information requires additional disclosure. The additional disclosure differs for public and nonpublic entities.

> > Public Entities

50-6 [A **public entity** shall disclose the approximate tax effect of each type of temporary difference and carryforward that gives rise to a significant portion of deferred tax liabilities and deferred tax assets (before allocation of valuation allowances). [FAS 109, paragraph 43, sequence 318.2.1]]

50-7 See paragraph 740-10-50-16 for disclosure requirements applicable to a public entity that is not subject to income taxes.

> > Nonpublic Entities

50-8 [A **nonpublic entity** shall disclose the types of significant temporary differences and carryforwards but may omit disclosure of the tax effects of each type. [FAS 109, paragraph 43, sequence 318.2.2.1]]

> Income Statement Related Disclosures

50-9 [The significant components of income tax expense attributable to continuing operations for each year presented shall be disclosed in the financial statements or notes thereto. Those components would include, for example: [FAS 109, paragraph 45, sequence 324]]

- a. [**Current tax expense (or benefit)** [FAS 109, paragraph 45, sequence 325]]
- b. [**Deferred tax expense (or benefit)** (exclusive of the effects of other components listed below) [FAS 109, paragraph 45, sequence 326]]
- c. [Investment tax credits [FAS 109, paragraph 45, sequence 327]]
- d. [Government grants (to the extent recognized as a reduction of income tax expense) [FAS 109, paragraph 45, sequence 328]]
- e. [The benefits of operating loss carryforwards [FAS 109, paragraph 45, sequence 329]]
- f. [Tax expense that results from allocating certain tax benefits either directly to contributed capital or to reduce goodwill or other noncurrent intangible assets of an acquired entity [FAS 109, paragraph 45, sequence 330]]
- g. [Adjustments of a deferred tax liability or asset for enacted changes in tax laws or rates or a change in the tax status of the entity [FAS 109, paragraph 45, sequence 331]]
- h. [Adjustments of the beginning-of-the-year balance of a valuation allowance because of a change in circumstances that causes a change in judgment about the realizability of the related **deferred tax asset** in future years. [FAS 109, paragraph 45, sequence 332]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **805-10-65-1**

[The significant components of income tax expense attributable to continuing operations for each year presented shall be disclosed in the financial statements or notes thereto. Those components would include, for example: [FAS 109, paragraph 45, sequence 324]]

- a. [**Current tax expense (or benefit)** [FAS 109, paragraph 45, sequence 325]]

- b. [**Deferred tax expense (or benefit)** (exclusive of the effects of other components listed below) [FAS 109, paragraph 45, sequence 326]]
- c. [Investment tax credits [FAS 109, paragraph 45, sequence 327]]
- d. [Government grants (to the extent recognized as a reduction of income tax expense) [FAS 109, paragraph 45, sequence 328]]
- e. [The benefits of operating loss carryforwards [FAS 109, paragraph 45, sequence 329]]
- f. [Tax expense that results from allocating certain tax benefits directly to contributed capital [FAS 109, paragraph 45, sequence 330]]
- g. [Adjustments of a deferred tax liability or asset for enacted changes in tax laws or rates or a change in the tax status of the entity [FAS 109, paragraph 45, sequence 331]]
- h. [Adjustments of the beginning-of-the-year balance of a valuation allowance because of a change in circumstances that causes a change in judgment about the realizability of the related **deferred tax asset** in future years. [FAS 109, paragraph 45, sequence 332]] [For example, any acquisition-date income tax benefits or expenses recognized from changes in the acquirer's valuation allowance for its previously existing deferred tax assets as a result of a business combination (see paragraph 805-740-30-3). [FAS 109, paragraph 45, sequence 332.1]]

50-10 [The amount of **income tax expense (or benefit)** allocated to continuing operations and the amounts separately allocated to other items (in accordance with the intraperiod tax allocation provisions of paragraphs 740-20-45-2 through 45-14 and 852-740-45-3) shall be disclosed for each year for which those items are presented. [FAS 109, paragraph 46, sequence 333]]

> Income Tax Expense Compared to Statutory Expectations

50-11 The reported amount of income tax expense may differ from an expected amount based on statutory rates. The following guidance establishes the disclosure requirements for such situations and differs for public and nonpublic entities.

> > Public Entities

50-12 [A public entity shall disclose a reconciliation using percentages or dollar amounts of [FAS 109, paragraph 47, sequence 334.1]] [the reported amount of income tax expense attributable to continuing operations for the year to [FAS 109, paragraph 47, sequence 334.2.1]] [the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The statutory tax rates shall be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item shall be disclosed. [FAS 109, paragraph 47, sequence 334.2.2.1]]

> > Nonpublic Entities

50-13 [A nonpublic entity shall disclose the nature of significant reconciling items but may omit a numerical reconciliation. [FAS 109, paragraph 47, sequence 334.2.2.2.1]]

> > All Entities

50-14 [If not otherwise evident from the disclosures required by this Section, all entities shall disclose the nature and effect of any other significant matters affecting comparability of information for all periods presented. [FAS 109, paragraph 47, sequence 334.2.2.2.2]]

> Unrecognized Tax Benefit Related Disclosures

50-15 [An entity [FIN 48, paragraph 21, sequence 51]] within the scope of this Topic (see paragraph 740-10-15-2A) [shall disclose all of the following at the end of each annual reporting period presented: [FIN 48, paragraph 21, sequence 51]]

- a. [A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum: [FIN 48, paragraph 21, sequence 52]]
  - 1. [The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period [FIN 48, paragraph 21, sequence 53]]
  - 2. [The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period [FIN 48, paragraph 21, sequence 54]]
  - 3. [The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities [FIN 48, paragraph 21, sequence 55]]
  - 4. [Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations. [FIN 48, paragraph 21, sequence 56]]
- b. [The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate [FIN 48, paragraph 21, sequence 57]]
- c. [The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position [FIN 48, paragraph 21, sequence 58]]
- d. [For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date: [FIN 48, paragraph 21, sequence 59]]
  - 1. [The nature of the uncertainty [FIN 48, paragraph 21, sequence 60]]
  - 2. [The nature of the event that could occur in the next 12 months that would cause the change [FIN 48, paragraph 21, sequence 61]]
  - 3. [An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made. [FIN 48, paragraph 21, sequence 62]]
- e. [A description of tax years that remain subject to examination by major tax jurisdictions. [FIN 48, paragraph 21, sequence 63]]

See Example 30 (paragraph 740-10-55-217) for an illustration of disclosure about uncertainty in income taxes.

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **740-10-25-16**

[An entity shall disclose all of the following at the end of each annual reporting period presented: [FIN 48, paragraph 21, sequence 51]]

- a. [A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum: [FIN 48, paragraph 21, sequence 52]]
  - 1. [The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period [FIN 48, paragraph 21, sequence 53]]

- 2. [The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period [FIN 48, paragraph 21, sequence 54]]
- 3. [The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities [FIN 48, paragraph 21, sequence 55]]
- 4. [Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations. [FIN 48, paragraph 21, sequence 56]]

- b. [The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate [FIN 48, paragraph 21, sequence 57]]
- c. [The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position [FIN 48, paragraph 21, sequence 58]]
- d. [For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date: [FIN 48, paragraph 21, sequence 59]]
  - 1. [The nature of the uncertainty [FIN 48, paragraph 21, sequence 60]]
  - 2. [The nature of the event that could occur in the next 12 months that would cause the change [FIN 48, paragraph 21, sequence 61]]
  - 3. [An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made. [FIN 48, paragraph 21, sequence 62]]
- e. [A description of tax years that remain subject to examination by major tax jurisdictions. [FIN 48, paragraph 21, sequence 63]]

See Example 30 (paragraph 740-10-55-217) for an illustration of disclosure about uncertainty in income taxes.

> Public Entities Not Subject to Income Taxes

50-16 [A public entity that is not subject to income taxes because its income is taxed directly to its owners shall disclose that fact and the net difference between the tax bases and the reported amounts of the entity's assets and liabilities. [FAS 109, paragraph 43, sequence 318.2.2.2]]

> Entities with Separately Issued Financial Statements that Are Members of a Consolidated Tax Return

50-17 [An entity that is a member of a group that files a consolidated tax return shall disclose in its separately issued financial statements: [FAS 109, paragraph 49, sequence 336]]

- a. [The aggregate amount of current and deferred tax expense for each statement of earnings presented and the amount of any tax-related balances due to or from affiliates as of the date of each statement of financial position presented [FAS 109, paragraph 49, sequence 337]]
- b. [The principal provisions of the method by which the consolidated amount of current and deferred tax expense is allocated to members of the group and the nature and effect of any changes in that method (and in determining related balances to or from affiliates) during the years for which the above disclosures are presented. [FAS 109, paragraph 49, sequence 338]]

> Policy Related Disclosures

50-18 Alternative acceptable policy choices available to an entity require disclosure as follows.

> > Interest and Penalty Recognition Policies

50-19 [An entity shall disclose its policy on classification of interest and penalties in accordance with the alternatives permitted in paragraph 740-10-45-25 in the notes to the financial statements. [FIN 48, paragraph 20, sequence 50]]

> > Investment Tax Credit Recognition Policy

50-20 Paragraph 740-10-25-46 identifies the deferral method and the flow-through method as acceptable methods of accounting for investment tax credits. [Whichever method of accounting for the investment credit is adopted, it is essential that full disclosure be made of the method followed and amounts involved, when material. [APB 04, paragraph 11, sequence 25]]

> Other Disclosures

50-21 In addition to disclosures required by this Subtopic, disclosures regarding estimates meeting certain criteria are established in paragraph 275-10-50-8 for nongovernmental entities. See Example 31 (paragraph 740-10-55-218) for an illustration of disclosure relating to the realizability of a deferred tax asset under the requirements of Topic 275.

740-10-55 Implementation Guidance and Illustrations

General

55-1 This Section is an integral part of the requirements of this Subtopic. [This Section provides additional guidance and illustrations that address the application of accounting requirements to specific aspects of accounting for **income taxes**, including the statement of financial position classification of deferred tax accounts and disclosures. [FAS 109, paragraph 223, sequence 615]] [The guidance and illustrations that follow, unless stated otherwise, assume that the tax law requires offsetting net deductions in a particular year against net taxable amounts in the 3 preceding years and then in the 15 succeeding years. These assumptions about the tax law are for illustrative purposes only. This Subtopic requires that the enacted tax law for a particular tax jurisdiction be used for recognition and measurement of deferred tax liabilities and assets. [FAS 109, paragraph 223, sequence 616]]

> Implementation Guidance

55-2 The following guidance is organized in three categories:

a. Application of accounting requirements for income taxes to specific situations
b. Statement of financial position classification of deferred income taxes
c. Income tax related disclosures.

> > Application of Accounting Requirements for Income Taxes to Specific Situations

> > > Recognition and Measurement of Tax Positions—a Two-Step Process

55-3 [The application of the requirements of this Subtopic related to tax positions requires a two-step process that separates recognition from measurement. The first step is determining whether a **tax position** has met the recognition threshold; the second step is measuring a tax position that meets the recognition threshold. The recognition threshold is met when the taxpayer (the reporting entity) concludes that, consistent with paragraphs 740-10-25-6 through 25-7 and 740-10-25-13, it is more likely than not that the taxpayer will sustain the benefit taken or expected to be taken in the tax return in a dispute with taxing authorities if the taxpayer takes the dispute to the court of last resort. [FIN 48, paragraph A2, sequence 78]]

55-4 [Relatively few disputes are resolved through litigation, and very few are taken to the court of last resort. Generally, the taxpayer and the taxing authority negotiate a settlement to avoid the costs and hazards of litigation. As a result, the measurement of the tax position is based on management's best judgment of the amount the taxpayer would ultimately accept in a settlement with taxing authorities. [FIN 48, paragraph A3, sequence 79]]

55-5 [The recognition and measurement requirements of this Subtopic related to tax positions require that the entity recognize the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement. [FIN 48, paragraph A4, sequence 80]]

55-6 See Examples 1 through 12 (paragraphs 740-10-55-81 through 55-123) for illustrations of this guidance.

> > > Recognition of Deferred Tax Assets and Deferred Tax Liabilities

55-7 [Subject to certain specific exceptions identified in paragraph 740-10-25-3, [FAS 109, paragraph 224, sequence 618]] [a **deferred tax liability** is recognized for all taxable temporary differences, and a **deferred tax asset** is recognized for all deductible temporary differences and operating loss and tax credit **carryforwards**. [FAS 109, paragraph 224, sequence 617.1]] [A **valuation allowance** is recognized if it is more likely than not that some portion or all of the deferred tax asset will not be realized. [FAS 109, paragraph 224, sequence 617.2]] See Example 12 (paragraph 740-10-55-120) for an illustration of this guidance.

55-8 [To the extent that evidence about one or more sources of **taxable income** is sufficient to eliminate any need for a valuation allowance, other sources need not be considered. Detailed forecasts, projections, or other types of analyses [FAS 109, paragraph 225, sequence 626.1]] [are unnecessary if expected future taxable income is more than sufficient to realize a tax benefit. [FAS 109, paragraph 225, sequence 626.2.1]]

55-9 [The terms *forecast* and *projection* refer to any process by which available evidence is accumulated and evaluated for purposes of estimating whether future taxable income will be sufficient to realize a deferred tax asset. Judgment is necessary to determine how detailed or formalized that evaluation process should be. Furthermore, information about expected future taxable income is necessary only to the extent positive evidence available from other sources (see paragraph 740-10-30-18) is not sufficient to support a conclusion that a valuation allowance is not needed. The requirements of this Subtopic do not require either a financial forecast or a financial projection within the meaning of those terms in the Statements on Standards for Accountants' Services on Prospective Financial Information issued by the Auditing Standards Board of the American Institute of Certified Public Accountants. [FAS 109, paragraph 225, sequence 627]]

55-10 See Example 12 (paragraph 740-10-55-120) for an illustration of a situation where detailed analyses are not necessary.

55-11 See Example 13 (paragraph 740-10-55-124) for an illustration of determining a valuation allowance for deferred tax assets.

> > > Offset of Taxable and Deductible Amounts

55-12 [The tax law determines whether future reversals of temporary differences will result in taxable and deductible amounts that offset each other in future years. The tax law also determines the extent to which deductible temporary differences and carryforwards will offset the **tax consequences** of income that is expected to be earned in future years. For example, the tax law may provide that capital losses are deductible only to the extent of capital gains. In that case, a tax benefit is not recognized for temporary differences that will result in future deductions in the form of capital losses unless those deductions will offset any of the following: [FAS 109, paragraph 227, sequence 638.1]]

a. [Other existing temporary differences that will result in future capital gains [FAS 109, paragraph 227, sequence 638.2.1]]

b. [Capital gains that are expected to occur in future years [FAS 109, paragraph 227, sequence 638.2.2.1]]

c. [Capital gains of the current year or prior years if carryback (of those capital loss deductions from the future reversal years) is expected. [FAS 109, paragraph 227, sequence 638.2.2.2]]

> > > Pattern of Taxable or Deductible Amounts

55-13 [The particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability. However, there are exceptions to that general rule. For example, a **temporary difference** between the tax basis and the reported amount of inventory for which cost is determined on a last-in, first-out (LIFO) basis does not reverse when present inventory is sold in future years if it is replaced by purchases or production of inventory in those same future years. A LIFO inventory temporary difference becomes taxable or deductible in the future year that inventory is liquidated and not replaced. [FAS 109, paragraph 228, sequence 639]]

55-14 [For some assets or liabilities, temporary differences may accumulate over several years and then reverse over several years. That pattern is common for depreciable assets. Future originating differences for existing depreciable assets and their subsequent reversals are a factor to be considered when assessing the likelihood of future taxable income (see paragraph 740-10-30-18(b)) for realization of a tax benefit for existing deductible temporary differences and carryforwards. [FAS 109, paragraph 229, sequence 640]]

> > > The Need to Schedule Temporary Difference Reversals

55-15 [Reversal patterns of existing temporary differences may need to be scheduled [QA 109, paragraph 1, sequence 7]] [under the requirements of this Subtopic as follows: [QA 109, paragraph 1, sequence 9]]

a. [Deferred taxes are classified as current or noncurrent based on the classification of the related asset or liability. Therefore, scheduling is required only for deferred taxes not related to a specific asset or liability. [QA 109, paragraph 1, sequence 10]]

b. [Deferred tax assets are recognized without reference to offsetting, and then an assessment is made about the need for a valuation allowance. Paragraph 740-10-30-18 lists four possible sources of taxable income that may be available to realize such deferred tax assets. In many cases it may be possible to determine without scheduling that expected future taxable income (see paragraph 740-10-30-18(b)) will be adequate to eliminate the need for a valuation allowance. Disclosure of the amounts and expiration dates (or a reasonable aggregation of expiration dates) of operating loss and tax credit carryforwards is required only on a tax basis and does not require scheduling. [QA 109, paragraph 1, sequence 11]]

c. [The adoption of a tax rate convention for measuring deferred taxes when graduated tax rates are a significant factor will, in many cases, eliminate the need for the scheduling. In addition, **alternative minimum tax** rates and laws are a factor only in considering the need for a valuation allowance for a deferred tax asset for alternative minimum tax credit carryforwards. When there is a phased-in change in tax rates, however, scheduling will often be necessary. See paragraphs 740-10-55-24; 740-10-55-31 through 55-33; and Examples 14 through 16 (paragraphs 740-10-55-129 through 55-138). [QA 109, paragraph 1, sequence 12]]

55-16 [Paragraph 740-10-30-18 lists four possible sources of taxable income that may be available to realize a future tax benefit for deductible temporary differences and carryforwards. One source is future taxable income exclusive of reversing temporary differences and carryforwards. Future originating temporary differences and their subsequent reversal are implicit in estimates of future taxable income. Where it can be easily demonstrated that future taxable income will more likely than not be adequate to realize future tax benefits of existing deferred tax assets, scheduling of reversals of existing taxable temporary differences would be unnecessary. [QA 109, paragraph 2, sequence 21.2]]

55-17 [In other cases it may be easier to demonstrate that no valuation allowance is needed by considering the reversal of existing taxable temporary differences. Even in that case, the extent of scheduling will depend on the relative magnitudes involved. For example, if existing taxable temporary differences that will reverse over a long number of future years greatly exceed deductible differences that are expected to reverse over a short number of future years, it may be appropriate to conclude, in view of a long (for example, 15 years) carryforward period for net operating losses, that realization of future tax benefits for the deductible differences is thereby more likely than not without the need for scheduling. [QA 109, paragraph 2, sequence 22]]

55-18 [A general understanding of reversal patterns is, in many cases, relevant in assessing the need for a valuation allowance. Judgment is crucial in making that assessment. The amount of scheduling, if any, that will be required will depend on the facts and circumstances of each situation. [QA 109, paragraph 1, sequence 13]]

55-19 [The following concepts however, underlie the determination of reversal patterns for existing temporary differences: [QA 109, paragraph 1, sequence 15]]

a. [The particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability (see paragraph 740-10-55-13). [QA 109, paragraph 1, sequence 16]]

b. [The tax law determines whether future reversals of temporary differences will result in taxable and deductible amounts that offset each other in future years (see paragraph 740-10-55-14). [QA 109, paragraph 1, sequence 17]]

55-20 [State income taxes are deductible for U.S. federal income tax purposes and therefore [QA 109, paragraph 7, sequence 37.1]] [a deferred state income tax liability or asset gives rise to a temporary difference for purposes of determining a deferred U.S. federal income tax asset or liability, respectively. The pattern of deductible or taxable amounts in future years for temporary differences related to deferred state income tax liabilities or assets should be determined by estimates of the amount of those state income taxes that are expected to become payable or recoverable for particular future years and, therefore, deductible or taxable for U.S. federal tax purposes in those particular future years. [QA 109, paragraph 7, sequence 38]]

55-21 [An entity may have claimed certain deductions, such as repair expenses, on its income tax returns. However, the entity may have recognized a liability (including interest) for the **unrecognized tax benefit** of those tax positions. If scheduling of future taxable or deductible differences is necessary, liabilities for unrecognized tax benefits should be considered. [QA 109, paragraph 4, sequence 25]] [Accrual of a liability for unrecognized tax benefits of expenses, such as repairs, has the effect of capitalizing those expenses for tax purposes. Those capitalized expenses are considered to result in deductible amounts in the later years, for example, as depreciation expense. If the liability for unrecognized tax benefits is based on an overall evaluation of the technical merits of the tax position, scheduling should reflect the evaluations made in determining the liability for unrecognized tax benefits that was recognized. [QA 109, paragraph 4, sequence 26]] [The effect of those evaluations may indicate a source of taxable income (see paragraph 740-10-30-18(c)) for purposes of assessing the need for a valuation allowance for deductible temporary differences. Those evaluations may also indicate lower amounts of taxable income in other years. [QA 109, paragraph 4, sequence 27]] [A deductible amount for any accrued interest related to unrecognized tax benefits would be scheduled for the future year in which that interest is expected to become deductible. [QA 109, paragraph 4, sequence 28]]

55-22 [Minimizing complexity is an appropriate consideration in selecting a method for determining reversal patterns. The methods used for determining reversal patterns should be systematic and logical. The same method should be used for all temporary differences within a particular category of temporary differences for a particular tax jurisdiction. Different methods may be used for different categories of temporary differences. If the same temporary difference exists in two tax jurisdictions (for example, U.S. federal and a state tax jurisdiction), the same method should be used for that temporary difference in both tax jurisdictions. The same method for a particular category in a particular tax jurisdiction should be used consistently from year to year. A change in method is a change in accounting principle under the requirements of Topic 250. [QA 109, paragraph 1, sequence 18]] [Two examples of a category of temporary differences are those related to liabilities for deferred compensation and investments in direct financing and sales-type leases. [QA 109, paragraph 1 FN2, sequence 19]]

> > > Measurement of Deferred Tax Liabilities and Assets

55-23 [The tax rate or rates that are used to measure deferred tax liabilities and deferred tax assets are the enacted tax rates expected to apply to taxable income in the years that the liability is expected to be settled or the asset recovered. Measurements are based on elections (for example, an election for loss carryforward instead of carryback) that are expected to be made for tax purposes in future years. Presently enacted changes in tax laws and rates that become effective for a particular future year or years must be considered when determining the tax rate to apply to temporary differences reversing in that year or years. Tax laws and rates for the current year are used if no changes have been enacted for future years. An asset for deductible temporary differences that are expected to be realized in future years through carryback of a future loss to the current or a prior year (or a liability for taxable temporary differences that are expected to reduce the refund claimed for the carryback of a future loss to the current or a prior year) is measured using tax laws and rates for the current or a prior year, that is, the year for which a refund is expected to be realized based on loss carryback provisions of the tax law. [FAS 109, paragraph 233, sequence 644]] See Examples 14 through 16 (paragraphs 740-10-55-129 through 55-138) for illustrations of this guidance.

55-24 [Deferred tax liabilities and assets are measured using enacted tax rates applicable to capital gains, ordinary income, and so forth, based on the expected type of taxable or deductible amounts in future years. For example, evidence based on all facts and circumstances should determine whether an investor's liability for the tax consequences of temporary differences related to its equity in the earnings of an investee should be measured using enacted tax rates applicable to a capital gain or a dividend. Computation of a deferred tax liability for undistributed earnings based on dividends should also reflect any related dividends received deductions or foreign tax credits, and taxes that would be withheld from the dividend. [FAS 109, paragraph 237, sequence 661]]

> > > > State and Local Income Taxes

55-25 [If deferred tax assets or liabilities for a state or local tax jurisdiction are significant, this Subtopic requires a separate deferred tax computation when there are significant differences between the tax laws of that and other tax jurisdictions that apply to the entity. In the United States, however, many state or local income taxes are based on U.S. federal taxable income, and aggregate computations of deferred tax assets and liabilities for at least some of those state or local tax jurisdictions might be acceptable. In assessing whether an aggregate calculation is appropriate, matters such as differences in tax rates or the loss carryback and carryforward periods in those state or local tax jurisdictions should be considered. Also, the provisions of paragraph 740-10-45-6 about offset of deferred tax liabilities and assets of different tax jurisdictions should be considered. In assessing the significance of deferred tax expense for a state or local tax jurisdiction, it is appropriate to consider the **deferred tax consequences** that those deferred state or local tax assets or liabilities have on other tax jurisdictions, for example, on deferred federal income taxes. [QA 109, paragraph 3, sequence 24]]

55-26 [Local (including franchise) taxes based on income are within the scope of this Topic. [EITF 91-08, paragraph ISSUE, sequence 8.2]] [A tax, to the extent it is based on capital, is a franchise tax. As indicated in paragraph 740-10-15-4(a), if there is an additional tax based on income, that excess is considered an income tax. [EITF 91-08, paragraph DISCUSSION, sequence 13.2]] A historical example that illustrates this guidance is presented in Example 17 (see paragraph 740-10-55-139).

> > > > Special Deductions - Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004

55-27 [The following discussion and Example 18 (see paragraph 740-10-55-145) refer to and describe a provision within the American Jobs Creation Act of 2004; however, they shall not be considered a definitive interpretation of any provision of the Act for any purpose. [FSP FAS109-1, paragraph 1 FN1, sequence 3]]

55-28 [On October 22, 2004, the Act was signed into law by the president. This Act includes a tax deduction of up to 9 percent (when fully phased-in) of the lesser of qualified production activities income, as defined in the Act, or taxable income (after the deduction for the utilization of any net operating loss carryforwards). This tax deduction is limited to 50 percent of W-2 wages paid by the taxpayer. [FSP FAS109-1, paragraph 2, sequence 5]]

55-29 [The qualified production activities deduction's characteristics are similar to special deductions discussed in paragraph 740-10-25-37 because the qualified production activities deduction is contingent upon the future performance of specific activities, including the level of wages. Accordingly, the deduction should be accounted for as a special deduction in accordance with that paragraph. [FSP FAS109-1, paragraph 4, sequence 8]]

55-30 [The special deduction should be considered by an entity in measuring deferred taxes when graduated tax rates are a significant factor and assessing whether a valuation allowance is necessary as required by paragraph 740-10-25-37. Example 18 (see paragraph 740-10-55-145) illustrates the application of the requirements of this Subtopic for the impact of the qualified production activities deduction upon enactment of the Act in 2004. [FSP FAS109-1, paragraph 5, sequence 9]]

> > > Alternative Minimum Tax

55-31 [Temporary differences such as depreciation differences are one reason why **tentative minimum tax** may exceed regular tax. Temporary differences, however, ultimately reverse and, absent a significant amount of preference items, total taxes paid over the entire life of the entity will be based on the regular tax system. Preference items are another reason why tentative minimum tax may exceed regular tax. If preference items are large enough, an entity could be subject, over its lifetime, to the alternative minimum tax system; and the cumulative amount of alternative minimum tax credit carryforwards would expire unused. No one can know beforehand which scenario will prevail because that determination can only be made after the fact. In the meantime, this Subtopic requires procedures that provide a practical solution to that problem. [FAS 109, paragraph 238, sequence 662]]

55-32 [Under the requirements of this Subtopic, an entity shall: [FAS 109, paragraph 239, sequence 663]]

a. [Measure the total deferred tax liability and asset for regular tax temporary differences and carryforwards using the regular tax rate [FAS 109, paragraph 239, sequence 664]]

b. [Measure the total deferred tax asset for all alternative minimum tax credit carryforward [FAS 109, paragraph 239, sequence 665]]

c. [Reduce the deferred tax asset for alternative minimum tax credit carryforward by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of that deferred tax asset will not be realized. [FAS 109, paragraph 239, sequence 666]]

55-33 [Paragraph 740-10-30-18 identifies four sources of taxable income that shall be considered in determining the need for and amount of a valuation allowance. No valuation allowance is necessary if the deferred tax asset for alternative minimum tax credit carryforward can be realized in any of the following ways: [FAS 109, paragraph 239, sequence 667]]

a. [Under paragraph 740-10-30-18(a), by reducing a deferred tax liability from the amount of regular tax on regular tax temporary differences to not less than the amount of tentative minimum tax on alternative minimum taxable temporary differences [FAS 109, paragraph 239, sequence 668]]

b. [Under paragraph 740-10-30-18(b), by reducing taxes on future income from the amount of regular tax on regular taxable income to not less than the amount of tentative minimum tax on alternative minimum taxable income [FAS 109, paragraph 239, sequence 669]]

c. [Under paragraph 740-10-30-18(c), by loss carryback [FAS 109, paragraph 239, sequence 670]]

d. [Under paragraph 740-10-30-18(d), by a **tax-planning strategy** such as switching from tax-exempt to taxable interest income. [FAS 109, paragraph 239, sequence 671]]

> > > Operating Loss and Tax Credit Carryforwards and Carrybacks

> > > > Recognition of a Tax Benefit for Carrybacks

55-34 [An operating loss, certain deductible items that are subject to limitations, and some tax credits arising but not utilized in the current year may be carried back for refund of taxes paid in prior years or carried forward to reduce taxes payable in future years. A receivable, to the extent it meets the recognition requirements of this Subtopic for tax positions, is recognized for the amount of taxes paid in prior years that is refundable by carryback of an operating loss or unused tax credits of the current year. [FAS 109, paragraph 240, sequence 672]]

> > > > Recognition of a Tax Benefit for Carryforwards

55-35 [A deferred tax asset, to the extent it meets the recognition requirements of this Subtopic for tax positions and paragraph 718-740-25-10 for certain share option exercises, is recognized for an operating loss or tax credit carryforward. [FAS 109, paragraph 241, sequence 673.1]] [This requirement pertains to all investment tax credit carryforwards regardless of whether the flow-through or deferral method is used to account for investment tax credits. [FAS 109, paragraph 241, sequence 674]]

55-36 [In assessing the need for a valuation allowance, provisions in the tax law that limit utilization of an operating loss or tax credit carryforward are applied in determining whether it is more likely than not that some portion or all of the deferred tax asset will not be realized by reduction of taxes payable on taxable income during the carryforward period. [FAS 109, paragraph 241, sequence 673.2]] Example 19 (see paragraph 740-10-55-149) illustrates recognition of the tax benefit of an operating loss in the loss year and in subsequent carryforward years when a valuation allowance is necessary in the loss year.

55-37 [An operating loss or tax credit carryforward from a prior year (for which the deferred tax asset was offset by a valuation allowance) may sometimes reduce taxable income and taxes payable that are attributable to certain revenues or gains that the tax law requires be included in taxable income for the year that cash is received. For financial reporting, however, there may have been no revenue or gain and a liability is recognized for the cash received. Future sacrifices to settle the liability will result in deductible amounts in future years. Under those circumstances, the reduction in taxable income and taxes payable from utilization of the operating loss or tax credit carryforward gives no cause for recognition of a tax benefit because, in effect, the operating loss or tax credit carryforward has been replaced by temporary differences that will result in deductible amounts when a nontax liability is settled in future years. The requirements for recognition of a tax benefit for deductible temporary differences and for operating loss carryforwards are the same, and the manner of reporting the eventual tax benefit recognized (that is, in income or as required by paragraph 740-20-45-3) is not affected by the intervening transaction reported for tax purposes. [FAS 109, paragraph 243, sequence 691]] Example 20 (see paragraph 740-10-55-156) illustrates recognition of the tax benefit of an operating loss in the loss year and in subsequent carryforward years when a valuation allowance is necessary in the loss year.

> > > > Reporting the Tax Benefit of Operating Loss Carryforwards or Carrybacks

55-38 [Except as noted in paragraph 740-20-45-3, the manner of reporting the tax benefit of an operating loss carryforward or carryback is determined by the source of the income or loss in the current year and not by the source of the operating loss carryforward or taxes paid in a prior year or the source of expected future income that will result in realization of a deferred tax asset for an operating loss carryforward from the current year. **Deferred tax expense (or benefit)** that results because a change in circumstances causes a change in judgment about the future realization of the tax benefit of an operating loss carryforward is allocated to continuing operations (see paragraph 740-10-45-20). Thus, for example: [FAS 109, paragraph 245, sequence 697]]

a. [The tax benefit of an operating loss carryforward that resulted from an extraordinary loss in a prior year and that is first recognized in the financial statements for the current year: [FAS 109, paragraph 245, sequence 698]]

    1. [Is allocated to continuing operations if it offsets the current or deferred tax consequences of income from continuing operations [FAS 109, paragraph 245, sequence 699]]

2. [Is allocated to an extraordinary gain if it offsets the current or deferred tax consequences of that extraordinary gain [FAS 109, paragraph 245, sequence 700]]

3. [Is allocated to continuing operations if it results from a change in circumstances that causes a change in judgment about future realization of a tax benefit. [FAS 109, paragraph 245, sequence 701]]

b. [The current or deferred tax benefit of a loss from continuing operations in the current year is allocated to continuing operations regardless of whether that loss offsets the current or deferred tax consequences of an extraordinary gain that: [FAS 109, paragraph 245, sequence 702]]

1. [Occurred in the current year [FAS 109, paragraph 245, sequence 703]]

2. [Occurred in a prior year (that is, if realization of the tax benefit will be by carryback refund) [FAS 109, paragraph 245, sequence 704]]

3. [Is expected to occur in a future year. [FAS 109, paragraph 245, sequence 705]]

> > > Tax-Planning Strategies

55-39 [Expectations about future taxable income incorporate numerous assumptions about actions, elections, and strategies to minimize income taxes in future years. For example, an entity may have a practice of deferring taxable income whenever possible by structuring sales to qualify as installment sales for tax purposes. Actions such as that are not tax-planning strategies, as that term is used in this Topic because they are actions that management takes in the normal course of business. For purposes of applying the requirements of this Subtopic, a tax-planning strategy is an action that management ordinarily might not take but would take, if necessary, to realize a tax benefit for a carryforward before it expires. For example, a strategy to sell property and lease it back for the expressed purpose of generating taxable income to utilize a carryforward before it expires is not an action that management takes in the normal course of business. A qualifying tax-planning strategy is an action that: [FAS 109, paragraph 246, sequence 706]]

a. [Is prudent and feasible. Management must have the ability to implement the strategy and expect to do so unless the need is eliminated in future years. For example, management would not have to apply the strategy if income earned in a later year uses the entire amount of carryforward from the current year. [FAS 109, paragraph 246, sequence 707]]

b. [An entity ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused. All of the various strategies that are expected to be employed for business or tax purposes other than utilization of carryforwards that would otherwise expire unused are, for purposes of this Subtopic, implicit in management's estimate of future taxable income and, therefore, are not tax-planning strategies as that term is used in this Topic. [FAS 109, paragraph 246, sequence 708]]

c. [Would result in realization of deferred tax assets. The effect of qualifying tax-planning strategies must be recognized in the determination of the amount of a valuation allowance. Tax-planning strategies need not be considered, however, if positive evidence available from other sources (see paragraph 740-10-30-18) is sufficient to support a conclusion that a valuation allowance is not necessary. [FAS 109, paragraph 246, sequence 709]]

55-40 [Paragraph 740-10-30-19 indicates that tax-planning strategies include elections for tax purposes. [QA 109, paragraph 25, sequence 165]] [The following are some examples of elections under current U.S. federal tax law that, if they meet the criteria for tax-planning strategies, should be considered in determining the amount, if any, of valuation allowance required for deferred tax assets: [QA 109, paragraph 25, sequence 166]]

a. [The election to file a consolidated tax return [QA 109, paragraph 25, sequence 167]]

b. [The election to claim either a deduction or a tax credit for foreign taxes paid [QA 109, paragraph 25,

sequence 168]]

c. [The election to forgo carryback and only carry forward a net operating loss. [QA 109, paragraph 25, sequence 169]]

55-41 [Because the effects of known qualifying tax-planning strategies must be recognized (see Example 22 [paragraph 740-10-55-163]), [QA 109, paragraph 27, sequence 172]] [management should make a reasonable effort to identify those qualifying tax-planning strategies that are significant. Management's obligation to apply qualifying tax-planning strategies in determining the amount of valuation allowance required is the same as its obligation to apply the requirements of other Topics for financial accounting and reporting. However, if there is sufficient evidence that taxable income from one of the other sources of taxable income listed in paragraph 740-10-30-18 will be adequate to eliminate the need for any valuation allowance, a search for tax-planning strategies is not necessary. [QA 109, paragraph 27, sequence 173]]

55-42 [Tax-planning strategies may shift estimated future taxable income between future years. For example, assume that an entity has a $1,500 operating loss carryforward that expires at the end of next year and that its estimate of taxable income exclusive of the future reversal of existing temporary differences and carryforwards is approximately $1,000 per year for each of the next several years. That estimate is based, in part, on the entity's present practice of making sales on the installment basis and on provisions in the tax law that result in temporary deferral of gains on installment sales. A tax-planning strategy to increase taxable income next year and realize the full tax benefit of that operating loss carryforward might be to structure next year's sales in a manner that does not meet the tax rules to qualify as installment sales. Another strategy might be to change next year's depreciation procedures for tax purposes. [FAS 109, paragraph 247, sequence 710]]

55-43 [Tax-planning strategies also may shift the estimated pattern and timing of future reversals of temporary differences. For example, if an operating loss carryforward otherwise would expire unused at the end of next year, a tax-planning strategy to sell the entity's installment sale receivables next year would accelerate the future reversal of taxable temporary differences for the gains on those installment sales. In other circumstances, a tax-planning strategy to accelerate the future reversal of deductible temporary differences in time to offset taxable income that is expected in an early future year might be the only means to realize a tax benefit for those deductible temporary differences if they otherwise would reverse and provide no tax benefit in some later future year(s). Examples of actions that would accelerate the future reversal of deductible temporary differences include the following: [FAS 109, paragraph 248, sequence 711]]

a. [An annual payment that is larger than an entity's usual annual payment to reduce a long-term pension obligation (recognized as a liability in the financial statements) might accelerate a tax deduction for pension expense to an earlier year than would otherwise have occurred. [FAS 109, paragraph 248, sequence 712]]

b. [Disposal of obsolete inventory that is reported at net realizable value in the financial statements would accelerate a tax deduction for the amount by which the tax basis exceeds the net realizable value of the inventory. [FAS 109, paragraph 248, sequence 713]]

c. [Sale of loans at their reported amount (that is, net of an allowance for bad debts) would accelerate a tax deduction for the allowance for bad debts. [FAS 109, paragraph 248, sequence 714]]

55-44 [A significant expense might need to be incurred to implement a particular tax-planning strategy, or a significant loss might need to be recognized as a result of implementing a particular tax-planning strategy. In either case, that expense or loss (net of any future tax benefit that would result from that expense or loss) reduces the amount of tax benefit that is recognized for the expected effect of a qualifying tax-planning strategy. For that purpose, the future effect of a differential in interest rates (for example, between the rate that would be earned on installment sale receivables and the rate that could be earned on an alternative investment if the tax-planning strategy is to sell those receivables to accelerate the future reversal of related taxable temporary differences) is not considered. [FAS 109, paragraph 249, sequence 715]]

55-45 Example 21 (see paragraph 740-10-55-159) illustrates recognition of a deferred tax asset based on the expected effect of a qualifying tax-planning strategy when a significant expense would be incurred to implement the strategy.

55-46 [Under this Subtopic, the requirements for consideration of tax-planning strategies pertain only to the determination of a valuation allowance for a deferred tax asset. A deferred tax liability ordinarily is recognized for all taxable temporary differences. The only exceptions are identified in paragraph 740-10-25-3. Certain seemingly taxable temporary differences, however, may or may not result in taxable amounts when those differences reverse in future years. One example is an excess of cash surrender value of life insurance over premiums paid (see paragraph 740-10-25-30). Another example is an excess of the book over the tax basis of an investment in a domestic subsidiary (see paragraph 740-30-25-7). The determination of whether those differences are taxable temporary differences does not involve a tax-planning strategy as that term is used in this Topic. [FAS 109, paragraph 251, sequence 727]]

55-47 Example 22 (see paragraph 740-10-55-163) provides an example where an entity has identified multiple tax-planning strategies.

55-48 [Under current U.S. federal tax law, approval of an entity's change from taxable C corporation status to nontaxable S corporation status is automatic if the criteria for S corporation status are met. [QA 109, paragraph 28, sequence 174.1]] [If an entity meets those criteria but has not changed to S corporation status, a strategy to change to nontaxable S corporation status would not permit an entity to not recognize deferred taxes because [QA 109, paragraph 28, sequence 174.2]] [a change in tax status is a discrete **event**. Paragraph 740-10-25-32 requires that the effect of a change in tax status be recognized at the date that the change in tax status occurs, that is, at the date that the change is approved by the tax authority (or on the date of filing the change if approval is not necessary). [QA 109, paragraph 28, sequence 175.2.1]] [For example, as required by paragraph 740-10-25-34, if an election to change an entity's tax status is approved by the tax authority (or filed, if approval is not necessary) early in Year 2 and prior to issuing financial statements for Year 1, the effect of that change in tax status shall not be recognized in the financial statements for Year 1. [QA 109, paragraph 11, sequence 49.1]]

> > > Examples of Temporary Differences

55-49 The following guidance presents examples of temporary differences. These examples are intended to be illustrative and not all-inclusive. Any references to various tax laws shall not be considered definitive interpretations of such laws for any purpose.

> > > > Premiums and Discounts

55-50 [Differences between the recognition for financial accounting purposes and income tax purposes of discount or premium resulting from determination of the present value of a note should be treated as temporary differences in accordance with this Topic. [APB 21, paragraph 15, sequence 45]]

> > > > Beneficial Conversion Features

55-51 [The issuance of convertible debt with a beneficial conversion feature results in a basis difference for purposes of applying this Topic. The recognition of a beneficial conversion feature effectively creates two separate instruments-a debt instrument and an equity instrument-for financial statement purposes while it is accounted for as a debt instrument, for example, under the U.S. Federal Income Tax Code. Consequently, the reported amount in the financial statements (book basis) of the debt instrument is different from the tax basis of the debt instrument. [EITF 05-08, paragraph DISCUSSION, sequence 14]] [The basis difference that results from the issuance of convertible debt with a beneficial conversion feature is a temporary difference for purposes of applying this Topic because that difference will result in a taxable amount when the reported amount of the liability is recovered or settled. That is, the liability is presumed to be settled at its current carrying amount (reported amount). [EITF 05-08, paragraph DISCUSSION, sequence 15]] [The recognition of deferred taxes for the temporary difference of the convertible debt with a beneficial conversion feature should be recorded as an adjustment to additional paid-in capital. Because the beneficial conversion feature (an allocation to additional paid-in capital) created the basis difference in the debt instrument, the provisions of paragraph 740-20-45-11(c) apply and therefore the establishment of the deferred tax liability for the basis difference should result in an adjustment to the related components of shareholders' equity. [EITF 05-08, paragraph DISCUSSION, sequence 16]]

> > > > LIFO Inventory of Subsidiary

55-52 An entity may use the LIFO method to value inventories for tax purposes which may result in LIFO inventory temporary differences, that is, for the excess of the amount of LIFO inventory for financial reporting over its tax basis.

55-53 [Even though a deferred tax liability for the LIFO inventory of a subsidiary will not be settled if that subsidiary is sold before the LIFO inventory temporary difference reverses, [EITF D-031, paragraph , sequence 5.1]] [recognition of a deferred tax liability is required regardless of whether the LIFO inventory happens to belong to the parent entity or one of its subsidiaries. [EITF D-031, paragraph , sequence 6.2]]

> > > > Accrued Postretirement Benefit Cost and the Effect of the Nontaxable Subsidy Arising from the Medicare Prescription Drug, Improvement, and Modernization Act of 2003

55-54 The following guidance and Example 23 (see paragraph 740-10-55-165) refer to provisions of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003; however, they shall not be considered definitive interpretations of the Act for any purpose. That Example provides a simple illustration of this guidance.

55-55 [As indicated in paragraph 715-60-05-9, on December 8, 2003, the president signed the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 into law. The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. [FSP FAS106-2, paragraph 5, sequence 9.1]] [An employer's eligibility for the 28 percent subsidy depends on whether the prescription drug benefit available under its plan is at least actuarially equivalent to the Medicare Part D benefit. [FSP FAS106-2, paragraph 9, sequence 21.1]]

55-56 [The Act excludes receipt of the subsidy from the taxable income of the employer for federal income tax purposes. That provision affects the accounting for the temporary difference related to the employer's accrued postretirement benefit cost under the requirements of this Topic. [FSP FAS106-2, paragraph 12, sequence 28]]

55-57 [In the periods in which the subsidy affects the employer's accounting for the plan, it shall have no effect on any plan-related temporary difference accounted for under this Topic because the subsidy is exempt from federal taxation. That is, the measure of any temporary difference shall continue to be determined as if the subsidy did not exist. Example 23 (see paragraph 740-10-55-165) provides a simple illustration of this guidance. [FSP FAS106-2, paragraph 19, sequence 42]]

> > > > Changes in Accounting Methods for Tax Purposes

55-58 The following guidance refers to provisions of the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1987; however, it shall not be considered a definitive interpretation of the Acts for any purpose.

55-59 [A change in tax law may require a change in accounting method for tax purposes, for example, the uniform cost capitalization rules required by the Tax Reform Act of 1986. For calendar-year taxpayers, inventories on hand at the beginning of 1987 are revalued as though the new rules had been in effect in prior years. That initial catch-up adjustment is deferred and taken into taxable income over not more than four years. This deferral of the initial catch-up adjustment for a change in accounting method for tax purposes gives rise to two temporary differences. [QA 109, paragraph 5, sequence 29]]

55-60 [One temporary difference is related to the additional amounts initially capitalized into inventory for tax purposes. As a result of those additional amounts, the tax basis of the inventory exceeds the amount of the inventory for financial reporting. That temporary difference is considered to result in a deductible amount when the inventory is expected to be sold. Therefore, the excess of the tax basis of the inventory over the amount of the inventory for financial reporting as of December 31, 1986, is considered to result in a deductible amount in 1987 when the inventory turns over. As of subsequent year-ends, the **deductible temporary difference** to be considered would be the amount capitalized for tax purposes and not for financial reporting as of those year-ends. [QA 109, paragraph 5, sequence 31]] [The expected timing of the deduction for the additional amounts capitalized in this example assumes that the inventory is not measured on a LIFO basis; temporary differences related to

LIFO inventories reverse when the inventory is sold and not replaced as provided in paragraph 740-10-55-13. [QA 109, paragraph 5 FN3, sequence 32]]

55-61 [The other temporary difference is related to the deferred income for tax purposes that results from the initial catch-up adjustment. As stated above, that deferred income likely will be included in taxable income over four years. Ordinarily, the reversal pattern for this temporary difference should be considered to follow the tax pattern and would also be four years. This assumes that it is expected that inventory sold will be replaced. However, under the tax law, if there is a one-third reduction in the amount of inventory for two years running, any remaining balance of that deferred income is included in taxable income for the second year. If such inventory reductions are expected, then the reversal pattern will be less than four years. [QA 109, paragraph 5, sequence 34]]

55-62 [Paragraph 740-10-35-4 requires recognition of the effect of a change in tax law or rate in the period that includes the enactment date. For example, the Tax Reform Act of 1986 was enacted in 1986. Therefore, the effects are recognized in a calendar-year entity's 1986 financial statements. [QA 109, paragraph 5 FN4, sequence 33]]

55-63 [The Omnibus Budget Reconciliation Act of 1987 requires family-owned farming businesses to use the accrual method of accounting for tax purposes. The initial catch-up adjustment to change from the cash to the accrual method of accounting is deferred. It is included in taxable income if the business ceases to be family-owned (for example, it goes public). It also is included in taxable income if gross receipts from farming activities in future years drop below certain 1987 levels as set forth in the tax law. The deferral of the initial catch-up adjustment for that change in accounting method for tax purposes gives rise to a temporary difference because [QA 109, paragraph 6, sequence 35]] [an assumption inherent in an entity's statement of financial position is that the reported amounts of assets and liabilities will be recovered and settled. Under the requirements of this Topic, deferred tax liabilities may not be eliminated or reduced because an entity may be able to delay the settlement of those liabilities by delaying the events that would cause taxable temporary differences to reverse. Accordingly, the deferred tax liability is recognized. If the events that trigger the payment of the tax are not expected in the foreseeable future, the reversal pattern of the related temporary difference is indefinite and the deferred tax liability should be classified as noncurrent. [QA 109, paragraph 6, sequence 36.2]]

> > > > Built-in Gains of Nontaxable S Corporations

55-64 [An entity may change from taxable C corporation status to nontaxable S corporation status. [QA 109, paragraph 12, sequence 50]] [An entity that makes that status change shall continue to recognize a deferred tax liability to the extent that the entity would be subject to a corporate-level tax on net unrecognized built-in gains. [QA 109, paragraph 12, sequence 51]]

55-65 [A C corporation that has temporary differences as of the date of change to S corporation status shall determine its deferred tax liability in accordance with the tax law. Since the timing of realization of a built-in gain can determine whether it is taxable, and therefore significantly affect the deferred tax liability to be recognized, actions and elections that are expected to be implemented shall be considered. For purposes of determining that deferred tax liability, the lesser of an unrecognized built-in gain (as defined by the tax law) or an existing temporary difference is used in the computations described in the tax law to determine the amount of the tax on built-in gains. [QA 109, paragraph 12, sequence 52]] Example 24 (see paragraph 740-10-55-168) illustrates this guidance.

> > > > Unrecognized Gains or Losses from Involuntary Conversions

55-66 [Gain or loss resulting from an involuntary conversion of a nonmonetary asset to monetary assets that is not recognized for income tax reporting purposes in the same period in which the gain or loss is recognized for financial reporting purposes is a temporary difference for which comprehensive interperiod tax allocation, as required by this Subtopic, is required. [FIN 30, paragraph 5, sequence 13]]

> > > Treatment of Certain Payments to Taxing Authorities

55-67 An entity may make payments to taxing authorities for different reasons. The following guidance addresses certain of these payments.

> > > > Payment Made to Taxing Authority to Retain Fiscal Year

55-68 The following guidance refers to provisions of the Tax Reform Act of 1986 and the Revenue Act of 1987; however, it shall not be considered a definitive interpretation of the Acts for any purpose.

55-69 The guidance addresses [how a payment should be recorded in the financial statements of an entity for a payment to a taxing authority to retain their fiscal year. [EITF 88-04, paragraph ISSUE, sequence 4]]

55-70 [On December 22, 1987, the Revenue Act of 1987 was enacted, which allowed partnerships and S corporations to elect to retain their fiscal year rather than adopt a calendar year for tax purposes as previously required by the Tax Reform Act of 1986. Entities that elected to retain a fiscal year are required to make an annual payment in a single installment each year that approximates the income tax that the partners-owners would have paid on the short-period income had the entity switched to a calendar year. [EITF 88-04, paragraph ISSUE, sequence 3]] [The payment is made by the entity and is not identified with individual partners-owners. Additionally the amount is not adjusted if a partner-owner leaves the entity. [EITF 88-04, paragraph DISCUSSION, sequence 5.2]]

55-71 [In this fact pattern, partnerships and S corporations should account for the payment as an asset since the payment is viewed as a deposit that is adjusted annually and will be realized when the entity liquidates, its income declines to zero, or it converts to a calendar year-end. [EITF 88-04, paragraph DISCUSSION, sequence 5.1]]

> > > > Payment Made Based on Dividends Distributed

55-72 The following guidance refers to provisions which may be present in the French tax structure; however, it shall not be considered a definitive interpretation of the historical or current French tax structure for any purpose.

55-73 [The French income tax structure is based on the concept of an integrated tax system. The system utilizes a tax credit at the shareholder level to eliminate or mitigate the double taxation that would otherwise apply to a dividend. The tax credit is automatically available to a French shareholder receiving a dividend from a French corporation. The precompte mobilier (or precompte) is a mechanism that provides for the integration of the tax credit to the shareholder with the taxes paid by the corporation. The precompte is a tax paid by the corporation at the time of a dividend distribution that is equal to the difference between a tax based on the regular corporation tax rate applied to the amount of the declared dividend and taxes previously paid by the corporation on the income being distributed. In addition, if a corporation pays a dividend from earnings that have been retained for more than five years, the corporation loses the benefit of any taxes previously paid in the computation of the precompte. [EITF 95-09, paragraph ISSUE, sequence 6]]

55-74 Paragraph 740-10-15-4(b) sets forth criteria for determining whether a tax that is assessed on an entity based on dividends distributed is, in effect, a withholding tax for the benefit of recipients of the dividend to be recorded in equity as part of the dividend distribution in that entity's separate financial statements. [A tax that is assessed on a corporation based on dividends distributed that meets the criteria in that paragraph, such as the French precompte tax, should be considered to be in effect a withholding of tax for the recipient of the dividend and recorded in equity as part of the dividend paid to shareholders. [EITF 95-09, paragraph ISSUE, sequence 7]]

> > > > Excise Tax on Withdrawal of Excess Pension Plan Assets

55-75 [An employer that withdraws excess plan assets from its pension plan may be subject to an excise tax. [QA 088, paragraph 66, sequence 350]] [If the excise tax is independent of taxable income, that is, it is a tax due on a specific transaction regardless of whether there is any taxable income for the period in which the transaction occurs, it is not an income tax and the employer should recognize it as an expense (not classified as income taxes) in the period of the withdrawal. [QA 088, paragraph 66, sequence 352.2]]

> > > > Other Direct Payments to Taxing Authorities

55-76 [Example 26 (see paragraph 740-10-55-202) illustrates a transaction directly with a governmental taxing authority. [EITF 98-11, paragraph Exhibit 98-11A Example 7, sequence 98.2]]

> > Statement of Financial Position Classification of Deferred Income Taxes

> > > Accounting Change for Tax Purposes

55-77 [The deferred tax liability or asset associated with an accounting change for tax purposes would be classified like the associated asset or liability if reduction of that associated asset or liability will cause the temporary difference to reverse. If there is no associated asset or liability or if the temporary difference will reverse only over a period of time, the deferred tax liability or asset would be classified based on the expected reversal date of the specific temporary difference. [FAS 037, paragraph 19, sequence 42]] Example 27 (see paragraph 740-10-55-205) illustrates this guidance.

> > > Method of Reporting Construction Contracts Differs for Tax and Book

55-78 [An entity reports profits on construction contracts on the completed contract method for tax purposes and the percentage-of-completion method for financial reporting purposes. The temporary differences do not relate to an asset or liability that appears on the entity's statement of financial position; the temporary differences will only reverse when the contracts are completed. Receivables that result from progress billings can be collected with no effect on the temporary differences; likewise, contract retentions can be collected with no effect on the temporary differences, and the temporary differences will reverse when the contracts are deemed to be complete even if there is a waiting period before retentions will be received. Accordingly, the entity would classify the deferred tax liability based on the estimated reversal of the related temporary differences. Deferred tax liabilities related to temporary differences that will reverse within the same time period used in classifying other contract-related assets and liabilities as current (for example, an operating cycle) would be classified as current. [FAS 037, paragraph 22, sequence 46]]

> > Income Tax Related Disclosures

55-79 [Paragraph 740-10-50-9 requires disclosure of the significant components of income tax expense attributable to continuing operations. [QA 109, paragraph 18, sequence 122.1]] [The sum of the amounts disclosed for the components of tax expense should equal the amount of tax expense that is reported in the statement of earnings for continuing operations. Insignificant components that are not separately disclosed should be combined and disclosed as a single amount so that the sum of the amounts disclosed will equal total income tax expense attributable to continuing operations. [QA 109, paragraph 18, sequence 123]] [Separate disclosure of the tax benefit of operating loss carryforwards and tax credits and tax credit carryforwards that have been recognized as a reduction of current tax expense and deferred tax expense is required. There are a number of ways to satisfy that disclosure requirement. Three acceptable approaches, referred to as the gross method, the net method, and the statutory tax rate reconciliation method, are illustrated in Example 29 (see paragraph 740-10-55-212). [QA 109, paragraph 18, sequence 124.1]]

55-80 [Income tax expense is defined as the sum of current and deferred tax expense, and the amount to be disclosed under any of the above approaches is only the amount by which total income tax expense from continuing operations has been reduced by tax credits or an operating loss carryforward. For example, assume that a tax benefit is recognized for an operating loss or tax credit carryforward by recognizing a deferred tax asset in Year 1, with no valuation allowance required because of an existing deferred tax liability. Further, assume that the carryforward is realized on the tax return in Year 2. For financial reporting in Year 2: [QA 109, paragraph 18, sequence 133]]

a. [Current tax expense will be reduced for the tax benefit of the operating loss or tax credit carryforward realized on the tax return. [QA 109, paragraph 18, sequence 134]]

b. [Deferred tax expense will be larger (or a deferred tax benefit will be smaller) by the same amount. [QA 109, paragraph 18, sequence 135]]

[In those circumstances, the operating loss or tax credit carryforward affects only income tax expense (the sum of current and deferred tax expense) in Year 1 when a tax asset (with no valuation allowance) is recognized. There is no effect on income tax expense in Year 2 because the separate effects on current and deferred tax expense offset each other. Accordingly, the requirement for separate disclosure of the effects of tax credits or an operating loss carryforward is not applicable for Year 2. However, that disclosure requirement applies to financial statements for Year 1 that are presented for comparative purposes. [QA 109, paragraph 18, sequence 136]]

> Illustrations

> > Example 1: The Unit of Account for a Tax Position

55-81 This Example illustrates the initial and subsequent determination by an entity of the unit of account for a tax position. Paragraph 740-10-25-13 requires an entity to determine an appropriate unit of account for an individual tax position. The following Cases illustrate:

a. The determination of the unit of account (Case A)

b. A change in the unit of account (Case B).

55-82 Cases A and B share all of the following assumptions.

55-83 [An entity anticipates claiming a $1 million research and experimentation credit on its tax return for the current fiscal year. The credit comprises equal spending on 4 separate projects (that is, $250,000 of tax credit per project). The entity expects to have sufficient taxable income in the current year to fully utilize the $1 million credit. Upon review of the supporting documentation, management believes it is more likely than not that the entity will ultimately sustain a benefit of approximately $650,000. The anticipated benefit consists of approximately $200,000 per project for the first 3 projects and $50,000 for the fourth project. [FIN 48, paragraph A5, sequence 81]]

> > > Case A: Determining the Unit of Account — A Prerequisite to Recognition Assessment

55-84 This Case illustrates an entity's initial determination of the unit of account for a tax position.

55-85 [In its evaluation of the appropriate amount to recognize, management first determines the appropriate unit of account for the tax position. Because of the magnitude of expenditures in each project, management concludes that the appropriate unit of account is each individual research project. In reaching this conclusion, management considers both the level at which it accumulates information to support the tax return and the level at which it anticipates addressing the issue with taxing authorities. In this Case, upon review of the four projects including the magnitude of expenditures, management determines that it accumulates information at the project level. Management also anticipates the taxing authority will address the issues during an examination at the level of individual projects. [FIN 48, paragraph A6, sequence 82]]

55-86 [In evaluating the projects for recognition, management determines that three projects meet the more-likely-than-not recognition threshold. However, due to the nature of the activities that constitute the fourth project, it is uncertain that the tax benefit related to this project will be allowed. Because the tax benefit related to that fourth project does not meet the more-likely-than-not recognition threshold, it should not be recognized in the financial statements, even though tax positions associated with that project will be included in the tax return. The entity would recognize a $600,000 financial statement benefit related to the first 3 projects but would not recognize a financial statement benefit related to the fourth project. [FIN 48, paragraph A7, sequence 83]]

> > > Case B: Change in the Unit of Account

55-87 This Case illustrates a change in an entity's initial determination of the unit of account for a tax position.

55-88 [In Year 2, the entity increases its spending on research and experimentation projects and anticipates claiming significantly larger research credits in its Year 2 tax return. In light of the significant increase in expenditures, management reconsiders the appropriateness of the unit of account and concludes that the project level is no longer the appropriate unit of account for research credits. This conclusion is based on the magnitude of spending and anticipated claimed credits and on previous experience and is consistent with the advice of external tax advisors. Management anticipates the taxing authority will focus the examination on functional expenditures when examining the Year 2 return and thus needs to evaluate whether it can change the unit of account in subsequent years' tax returns. [FIN 48, paragraph A8, sequence 84]]

55-89 [Determining the unit of account requires evaluation of the entity's facts and circumstances. In making that determination, management evaluates the manner in which it prepares and supports its income tax return and the manner in which it anticipates addressing issues with taxing authorities during an examination. The unit of account should be consistently applied to similar positions from period to period unless a change in facts and circumstances indicates that a different unit of account is more appropriate. Because of the significant change in the tax position in Year 2, management's conclusion that the taxing authority will likely examine tax credits in the Year 2 tax return at a more detailed level than the individual project is reasonable and appropriate. Accordingly, the entity should reevaluate the unit of account for the Year 2 financial statements based on the new facts and circumstances. [FIN 48, paragraph A9, sequence 85]]

> > Example 2: Administrative Practices—Asset Capitalization

55-90 The guidance in paragraph 740-10-25-7(b) on evaluating a taxing authority's widely understood administrative practices and precedents shall be taken into account when assessing the more-likely-than-not recognition threshold established in paragraph 740-10-25-6. This Example illustrates such consideration.

55-91 [An entity has established a capitalization threshold of $2,000 for its tax return for routine property and equipment purchases. Assets purchased for less than $2,000 are claimed as expenses on the tax return in the period they are purchased. The tax law does not prescribe a capitalization threshold for individual assets, and there is no materiality provision in the tax law. The entity has not been previously examined. Management believes that based on previous experience at a similar entity and current discussions with its external tax advisors, the taxing authority will not disallow tax positions based on that capitalization policy and the taxing authority's historical administrative practices and precedents. [FIN 48, paragraph A12, sequence 88]]

55-92 [Some might deem the entity's capitalization policy a technical violation of the tax law, since that law does not prescribe capitalization thresholds. However, in this situation the entity has concluded that the capitalization policy is consistent with the demonstrated administrative practices and precedents of the taxing authority and the practices of other entities that are regularly examined by the taxing authority. Based on its previous experience with other entities and consultation with its external tax advisors, management believes the administrative practice is widely understood. Accordingly, because management expects the taxing authority to allow this position when and if examined, the more-likely-than-not recognition threshold has been met. [FIN 48, paragraph A13, sequence 89]]

> > Example 3: Administrative Practices—Nexus

55-93 The guidance in paragraph 740-10-25-7(b) on evaluating a taxing authority's widely understood administrative practices and precedents shall be taken into account when assessing the more-likely-than-not recognition threshold established in paragraph 740-10-25-6. This Example illustrates such consideration.

55-94 [An entity has been incorporated in Jurisdiction A for 50 years; it has filed a tax return in Jurisdiction A in each of those 50 years. The entity has been doing business in Jurisdiction B for approximately 20 years and has filed a tax return in Jurisdiction B for each of those 20 years. However, the entity is not certain of the exact date it began doing business, or the date it first had nexus, in Jurisdiction B. [FIN 48, paragraph A14, sequence 90]]

55-95 [The entity understands that if a tax return is not filed, the statute of limitations never begins to run; accordingly, failure to file a tax return effectively means there is no statute of limitations. The entity has become familiar with the administrative practices and precedents of Jurisdiction B and understands that Jurisdiction B will look back only six years in determining if there is a tax return due and a deficiency owed. Because of the administrative practices of the taxing authority and the facts and circumstances, the entity believes it is more likely than not that a tax return is not required to be filed in Jurisdiction B at an earlier date and that a liability for tax exposures for those periods is not required. [FIN 48, paragraph A15, sequence 91]]

> > Example 4: Valuation Allowance and Tax-Planning Strategies

55-96 Paragraph 740-10-30-20 requires that entities determine the amount of available future taxable income from a tax-planning strategy based on the application of the recognition and measurement requirements of this Subtopic for tax positions. This Example illustrates the recognition aspect of that requirement.

55-97 [An entity has a wholly owned subsidiary with certain deferred tax assets as a result of several years of losses from operations. Management has determined that it is more likely than not that sufficient future taxable income will not be available to realize those deferred tax assets. Therefore, management recognizes a full valuation allowance for those deferred tax assets both in the separate financial statements of the subsidiary and in the consolidated financial statements of the entity. [FIN 48, paragraph A16, sequence 92]]

55-98 [Management has identified certain tax-planning strategies that might enable the realization of those deferred tax assets. Management has determined that the strategies will meet the minimum statutory threshold to avoid penalties and that it is not more likely than not that the strategies would be sustained upon examination based on the technical merits. [FIN 48, paragraph A17, sequence 93]] [Accordingly, those strategies may not be used to reduce the valuation allowance on the deferred tax assets. Only a tax-planning strategy that meets the more-likely-than-not recognition threshold would be considered in evaluating the sufficiency of future taxable income for realization of deferred tax assets. [FIN 48, paragraph A18, sequence 94]]

> > Example 5: Highly Certain Tax Positions

55-99 This Example illustrates the recognition and measurement criteria of this Subtopic to tax positions where the tax law is unambiguous. The recognition and measurement criteria of this Subtopic applicable to tax positions begin in paragraph 740-10-25-5 for recognition and paragraph 740-10-30-7 for measurement.

55-100 [An entity has taken a tax position that it believes is based on clear and unambiguous tax law for the payment of salaries and benefits to employees. The class of salaries being evaluated in this tax position is not subject to any limitations on deductibility (for example, executive salaries are not included), and none of the expenditures are required to be capitalized (for example, the expenditures do not pertain to the production of inventories); all amounts accrued at year-end were paid within the statutorily required time frame subsequent to the reporting date. Management concludes that the salaries are fully deductible. [FIN 48, paragraph A19, sequence 95]]

55-101 [All tax positions are subject to the requirements of this Subtopic. However, because the deduction is based on clear and unambiguous tax law, management has a high confidence level in the technical merits of this position. Accordingly, the tax position clearly meets the recognition criterion and should be evaluated for measurement. In determining the amount to measure, management is highly confident that the full amount of the deduction will be allowed and it is clear that it is greater than 50 percent likely that the full amount of the tax position will be ultimately realized. Accordingly, the entity would recognize the full amount of the tax position in the financial statements. [FIN 48, paragraph A20, sequence 96]]

> > Example 6: Measurement with Information About the Approach to Settlement

55-102 This Example demonstrates an application of the measurement requirements of paragraph 740-10-30-7 for a tax position that meets the paragraph 740-10-25-6 requirements for recognition. Measurement in this Example is based on identified information about settlement.

55-103 [In applying the recognition criterion of this Subtopic for tax positions, an entity has determined that a tax position resulting in a benefit of $100 qualifies for recognition and should be measured. The entity has considered the amounts and probabilities of the possible estimated outcomes as follows. [FIN 48, paragraph A21, sequence 97]]

Possible Estimated Outcome	Individual Probability of Occurring (%)	Cumulative Probability of Occurring (%)
$ 100	5	5
80	25	30
60	25	55
50	20	75
40	10	85
20	10	95
-	5	100

[FIN 48, paragraph A21, sequence 98]

55-104 [Because $60 is the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement, the entity would recognize a tax benefit of $60 in the financial statements. [FIN 48, paragraph A22, sequence 99]]

> > Example 7: Measurement with More Limited Information About the Approach to Settlement

55-105 As in the preceding Example, this Example also demonstrates an application of the measurement requirements of paragraph 740-10-30-7 for a tax position determined to meet recognition requirements. While measurement in this Example is also based on identified information about settlement, the information is more limited than in the preceding Example.

55-106 [In applying the recognition criterion of this Subtopic for tax positions an entity has determined that a tax position resulting in a benefit of $100 qualifies for recognition and should be measured. There is limited information about how a taxing authority will view the position. After considering all relevant information, management's confidence in the technical merits of the tax position exceeds the more-likely-than-not recognition threshold, but management also believes it is likely it would settle for less than the full amount of the entire position when examined. Management has considered the amounts and the probabilities of the possible estimated outcomes. [FIN 48, paragraph A23, sequence 100]]

Possible Estimated Outcome	Individual Probability of Occurring (%)	Cumulative Probability of Occurring (%)
$ 100	25	25
75	50	75
50	25	100

[FIN 48, paragraph A23, sequence 101]

55-107 [Because $75 is the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement, the entity would recognize a tax benefit of $75 in the financial statements. [FIN 48, paragraph A24, sequence 102]]

> > Example 8: Measurement of a Tax Position After Settlement of a Similar Position

55-108 This Example demonstrates an application of the measurement requirements of paragraph 740-10-30-7 for a tax position that meets the paragraph 740-10-25-6 requirements for recognition. Measurement in this Example is based on settlement of a similar tax position with the taxing authority.

55-109 [In applying the recognition criterion of this Subtopic for tax positions, an entity has determined that a tax position resulting in a benefit of $100 qualifies for recognition and should be measured. In a recent settlement with the taxing authority, the entity has agreed to the treatment for that position for current and future years. There are no recently issued relevant sources of tax law that would affect the entity's assessment. The entity has not changed any assumptions or computations, and the current tax position is consistent with the position that was recently settled. In this case, the entity would have a very high confidence level about the amount that will be ultimately realized and little information about other possible outcomes. Management will not need to evaluate other possible outcomes because it can be confident of the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement without that evaluation. [FIN 48, paragraph A25, sequence 103]]

> > Example 9: Differences Relating to Timing of Deductibility

55-110 This Example demonstrates an application of the measurement requirements of paragraph 740-10-30-7 for a tax position that meets the paragraph 740-10-25-6 requirements for recognition. Measurement in this Example is based on the timing of the deduction.

55-111 [In Year 1, an entity acquired a separately identifiable intangible asset for $15 million that has an indefinite life for financial statement purposes and is, therefore, not subject to amortization. Based on some uncertainty in the tax code, the entity decides for tax purposes to deduct the entire cost of the asset in Year 1. While the entity is certain that the full amount of the intangible is ultimately deductible for tax purposes, the timing of deductibility is uncertain under the tax code. In applying the recognition criterion of this Subtopic for tax positions, the entity has determined that the tax position qualifies for recognition and should be measured. The entity believes it is 25 percent likely it would be able to realize immediate deduction upon settlement, and it is certain it could sustain a 15-year amortization for tax purposes. Thus, the largest Year 1 benefit that is greater than 50 percent likely of being realized upon settlement is the tax effect of $1 million (the Year 1 deduction from straight-line amortization of the asset over 15 years). [FIN 48, paragraph A26, sequence 104]]

55-112 [At the end of Year 1, the entity should reflect a deferred tax liability for the tax effect of the temporary difference created by the difference between the financial statement basis of the asset ($15 million) and the tax basis of the asset computed in accordance with the guidance in this Subtopic for tax positions ($14 million, the cost of the asset reduced by $1 million of amortization). The entity also should reflect a tax liability for the tax-effected difference between the as-filed tax position ($15 million deduction) and the amount of the deduction that is considered more likely than not of being sustained ($1 million). The entity should evaluate the tax position for accrual of statutory penalties as well as interest expense on the difference between the amounts reported in the financial statements and the tax position taken in the tax return. [FIN 48, paragraph A27, sequence 105]]

> > Example 10: Change in Timing of Deductibility

55-113 This Example demonstrates an application of the measurement requirements of paragraph 740-10-30-7 for a tax position that meets the paragraph 740-10-25-6 requirements for recognition. Measurement in this Example is based on a change in timing of deductibility.

55-114 [In 20X1 an entity took a tax position in which it amortizes the cost of an acquired asset on a straight-line basis over three years, while the amortization period for financial reporting purposes is seven years. After one year, the entity has deducted one-third of the cost of the asset in its income tax return and one-seventh of the cost in the financial statements and, consequently, has a deferred tax liability for the difference between the financial reporting and tax bases of the asset. [FIN 48, paragraph A28, sequence 106]]

55-115 [In accordance with the requirements of this Subtopic, the entity evaluates the tax position as of the reporting date of the financial statements. [FIN 48, paragraph A29, sequence 107.1]] [In 20X2, the entity determines that it is still certain that the entire cost of the acquired asset is fully deductible, so the more-likely-than-not recognition threshold has been met according to paragraph 740-10-25-6. [FIN 48, paragraph A29, sequence 107.2.1]] [However, in 20X2, the entity now believes based on new information that the largest benefit that is greater than 50 percent likely of being realized upon settlement is straight-line amortization over 7 years. [FIN 48, paragraph A29, sequence 107.2.2]]

55-116 [In this Example, the entity would recognize a liability for unrecognized tax benefits based on the difference between the three- and seven-year amortization. In 20X2, no deferred tax liability should be recognized, as there is no longer a temporary difference between the financial statement carrying value of the asset and the tax basis of the asset based on this Subtopic's measurement requirements for tax positions. Additionally, the entity should evaluate the need to accrue interest and penalties, if applicable under the tax law. [FIN 48, paragraph A30, sequence 108]]

> > Example 11: Information Becomes Available Before Issuance of Financial Statements

55-117 Paragraphs 740-10-25-6 and 740-10-25-8 require that tax positions be recognized and measured based on information available at the reporting date. This Example demonstrates the effect of information becoming available after the reporting date but before the issuance of the financial statements.

55-118 [Entity A has evaluated a tax position at its most recent reporting date and has concluded that the position meets the more-likely-than-not recognition threshold. In evaluating the tax position for recognition, Entity A considered all relevant sources of tax law, including a court case in which the taxing authority has fully disallowed a similar tax position with an unrelated entity (Entity B). The taxing authority and Entity B are aggressively litigating the matter. Although Entity A was aware of that court case at the recent reporting date, management determined that the more-likely-than not recognition threshold had been met. Subsequent to the reporting date, but prior to the issuance of the financial statements, the taxing authority prevailed in its litigation with Entity B, and Entity A concludes that it is no longer more likely than not that it will sustain the position. [FIN 48, paragraph A31, sequence 109]]

55-119 [Paragraph 740-10-40-2 provides the guidance that an entity shall derecognize a previously recognized tax position in the first period in which it is no longer more likely than not that the tax position would be sustained upon examination, and paragraphs 740-10-25-14; 740-10-35-2; and740-10-40-2 establish that subsequent recognition, derecognition, and measurement shall be based on management's best judgment given the facts, circumstances, and information available at the reporting date. Because the resolution of Entity B's litigation with the taxing authority is the information that caused Entity A to change its judgment about the sustainability of the position and that information was not available at the reporting date, the change in judgment would be recognized in the first quarter of the current fiscal year. [FIN 48, paragraph A32, sequence 110]]

> > Example 12: Basic Deferred Tax Recognition

55-120 [This Example illustrates the guidance in paragraphs 740-10-55-7 through 55-9 relating to recognition of deferred tax assets and liabilities, including when a detailed analysis of sources of taxable income may not be necessary in considering the need for a valuation allowance for deferred tax assets. In this Example, an entity has $2,400 of deductible temporary differences and $1,500 of taxable temporary differences at the end of Year 3 (the current year). [FAS 109, paragraph 225, sequence 619]]

55-121 [A deferred tax liability is recognized at the end of Year 3 for the $1,500 of taxable temporary differences, and deferred tax asset is recognized for the $2,400 of deductible temporary differences. All available evidence, both positive and negative, is considered to determine whether, based on the weight of that evidence, a valuation allowance is needed for some portion or all of the deferred tax asset. If evidence about one or more sources of taxable income (see paragraph 740-10-30-18) is sufficient to support a conclusion that a valuation allowance is not needed, other sources of taxable income need not be considered. For example, if the weight of available evidence indicates that taxable income will exceed $2,400 in each future year, a conclusion that no valuation allowance is needed can be reached without considering the pattern and timing of the reversal of the temporary differences, the existence of qualifying tax-planning strategies, and so forth. [FAS 109, paragraph 225, sequence 620]]

55-122 [Similarly, if the deductible temporary differences will reverse within the next 3 years and taxable income in the current year exceeds $2,400, nothing needs to be known about future taxable income exclusive of reversing temporary differences because the deferred tax asset could be realized by carryback to the current year. A valuation allowance is needed, however, if the weight of available evidence indicates that some portion or all of the $2,400 of tax deductions from future reversals of the deductible temporary differences will not be realized by offsetting any of the following: [FAS 109, paragraph 225, sequence 621]]

a. [The $1,500 of taxable temporary differences and $900 of future taxable income exclusive of reversing temporary differences [FAS 109, paragraph 225, sequence 622]]

b. [$2,400 of future taxable income exclusive of reversing temporary differences [FAS 109, paragraph 225, sequence 623]]

c. [$2,400 of taxable income in the current or prior years by loss carryback to those years [FAS 109, paragraph 225, sequence 624]]

ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

d. [$2,400 of taxable income in one or more of the circumstances described above and as a result of a qualifying tax-planning strategy (see paragraphs 740-10-55-39 through 55-48). [FAS 109, paragraph 225, sequence 625]]

Paragraph 740-10-55-8 provides guidance on when a detailed analysis of sources of taxable income may not be necessary in considering the need for a valuation allowance for deferred tax assets.

55-123 [Detailed analyses are not necessary, for example, if the entity earned $500 of taxable income in each of Years 1-3 and there is no evidence to suggest it will not continue to earn that level of taxable income in future years. That level of future taxable income is more than sufficient to realize the tax benefit of $2,400 of tax deductions over a period of at least 19 years (the year(s) of the deductions, 3 carryback years, and 15 carryforward years) in the U.S. federal tax jurisdiction. [FAS 109, paragraph 225, sequence 626.2.2]]

> > Example 13: Valuation Allowance for Deferred Tax Assets

55-124 [This Example illustrates the guidance in paragraphs 740-10-55-7 through 55-9 relating to recognition of a valuation allowance for a portion of a deferred tax asset in one year and a subsequent change in circumstances that requires adjustment of the valuation allowance at the end of the following year. This Example has the following assumptions: [FAS 109, paragraph 226, sequence 628]]

a. [At the end of the current year (Year 3), an entity's only temporary differences are deductible temporary differences in the amount of $900. [FAS 109, paragraph 226, sequence 629]]

b. [Pretax financial income, taxable income, and taxes paid for each of Years 1-3 are all positive, but relatively negligible, amounts. [FAS 109, paragraph 226, sequence 630]]

c. [The enacted tax rate is 40 percent for all years. [FAS 109, paragraph 226, sequence 631]]

55-125 [A deferred tax asset in the amount of $360 ($900 at 40 percent) is recognized at the end of Year 3. If management concludes, based on an assessment of all available evidence (see guidance in paragraphs 740-10-30-17 through 30-24), that it is more likely than not that future taxable income will not be sufficient to realize a tax benefit for $400 of the $900 of deductible temporary differences at the end of the current year, a $160 valuation allowance ($400 at 40 percent) is recognized at the end of Year 3. [FAS 109, paragraph 226, sequence 632]]

55-126 [Assume that pretax financial income and taxable income for Year 4 turn out to be as follows. [FAS 109, paragraph 226, sequence 633]]

Pretax financial loss	$ (50)
Reversing deductible temporary differences	(300)
Loss carryforward for tax purposes	$ (350)

[FAS 109, paragraph 226, sequence 634]

55-127 [The $50 pretax loss in Year 4 is additional negative evidence that must be weighed against available positive evidence to determine the amount of valuation allowance necessary at the end of Year 4. Deductible temporary differences and carryforwards at the end of Year 4 are as follows. [FAS 109, paragraph 226, sequence 635]]

Loss carryforward from Year 4 for tax purposes (see above)	$ 350
Unreversed deductible temporary differences ($900 - $300)	600
	$ 950

[FAS 109, paragraph 226, sequence 636]

55-128 [The $360 deferred tax asset recognized at the end of Year 3 is increased to $380 ($950 at 40 percent) at the end of Year 4. Based on an assessment of all evidence available at the end of Year 4, management concludes that it is more likely than not that $240 of the deferred tax asset will not be realized and, therefore, that a $240 valuation allowance is necessary. The $160 valuation allowance recognized at the end of Year 3 is increased to $240 at the end of Year 4. The $60 net effect of those 2 adjustments (the $80 increase in the valuation allowance less the $20 increase in the deferred tax asset) results in $60 of deferred tax expense that is recognized in Year 4. [FAS 109, paragraph 226, sequence 637]]

> > Example 14: Phased-In Change in Tax Rates

55-129 [This Example illustrates the guidance in paragraph 740-10-55-23 for determination of the tax rate for measurement of a deferred tax liability for taxable temporary differences when there is a phased-in change in tax rates. At the end of Year 3 (the current year), an entity has $2,400 of taxable temporary differences, which are expected to result in taxable amounts of approximately $800 on the future tax returns for each of Years 4-6. Enacted tax rates are 35 percent for Years 1-3, 40 percent for Years 4-6, and 45 percent for Year 7 and thereafter. [FAS 109, paragraph 234, sequence 645]]

55-130 [The tax rate that is used to measure the deferred tax liability for the $2,400 of taxable temporary differences differs depending on whether the tax effect of future reversals of those temporary differences is on taxes payable for Years 1-3, Years 4-6, or Year 7 and thereafter. The tax rate for measurement of the deferred tax liability is 40 percent whenever taxable income is expected in Years 4-6. If tax losses are expected in Years 4-6, however, the tax rate is: [FAS 109, paragraph 234, sequence 646]]

a. [35 percent if realization of a tax benefit for those tax losses in Years 4-6 will be by loss carryback to Years 1-3 [FAS 109, paragraph 234, sequence 647]]

b. [45 percent if realization of a tax benefit for those tax losses in Years 4-6 will be by loss carryforward to Year 7 and thereafter. [FAS 109, paragraph 234, sequence 648]]

> > Example 15: Change in Tax Rates

55-131 [This Example illustrates the guidance in paragraph 740-10-55-23 for determination of the tax rate for measurement of a deferred tax asset for deductible temporary differences when there is a change in tax rates. This Example has the following assumptions: [FAS 109, paragraph 235, sequence 649]]

a. [Enacted tax rates are 30 percent for Years 1-3 and 40 percent for Year 4 and thereafter. [FAS 109, paragraph 235, sequence 650]]

b. [At the end of Year 3 (the current year), an entity has $900 of deductible temporary differences, which are expected to result in tax deductions of approximately $300 on the future tax returns for each of Years 4-6. [FAS 109, paragraph 235, sequence 651]]

55-132 [The tax rate is 40 percent if the entity expects to realize a tax benefit for the deductible temporary differences by offsetting taxable income earned in future years. Alternatively, the tax rate is 30 percent if the entity expects to realize a tax benefit for the deductible temporary differences by loss carryback refund. [FAS 109, paragraph 235, sequence 652]]

55-133 [Further assume for this Example both of the following: [FAS 109, paragraph 235, sequence 653.1]]

a. [The entity recognizes a $360 ($900 at 40 percent) deferred tax asset to be realized by offsetting taxable income in future years. [FAS 109, paragraph 235, sequence 653.2.1]]

b. [Taxable income and taxes payable in each of Years 1-3 were $300 and $90, respectively. [FAS 109, paragraph 235, sequence 653.2.2.1]]

55-134 [Realization of a tax benefit of at least $270 ($900 at 30 percent) is assured because carryback refunds totaling $270 may be realized even if no taxable income is earned in future years. Recognition of a valuation allowance for the other $90 ($360 - $270) of the deferred tax asset depends on management's assessment of whether, based on the weight of available evidence, a portion or all of the tax benefit of the $900 of deductible temporary differences will not be realized at 40 percent tax rates in future years. [FAS 109, paragraph 235, sequence 653.2.2.2]]

55-135 [Alternatively, if enacted tax rates are 40 percent for Years 1-3 and 30 percent for Year 4 and thereafter, measurement of the deferred tax asset at a 40 percent tax rate could only occur if tax losses are expected in future Years 4-6. [FAS 109, paragraph 235, sequence 654]]

> > Example 16: Graduated Tax Rates

55-136 [This Example illustrates the guidance in paragraph 740-10-55-23 for determination of the average graduated tax rate for measurement of deferred tax liabilities and assets by an entity for which graduated tax rates ordinarily are a significant factor. At the end of Year 3 (the current year), an entity has $1,500 of taxable temporary differences and $900 of deductible temporary differences, which are expected to result in net taxable amounts of approximately $200 on the future tax returns for each of Years 4-6. Enacted tax rates are 15 percent for the first $500 of taxable income, 25 percent for the next $500, and 40 percent for taxable income over $1,000. This Example assumes that there is no income (for example, capital gains) subject to special tax rates. [FAS 109, paragraph 236, sequence 655]]

55-137 [The deferred tax liability and asset for those reversing taxable and deductible temporary differences in Years 4-6 are measured using the average graduated tax rate for the estimated amount of annual taxable income in future years. Thus, the average graduated tax rate will differ depending on the expected level of annual taxable income (including reversing temporary differences) in Years 4-6. The average tax rate will be: [FAS 109, paragraph 236, sequence 656]]

a. [15 percent if the estimated annual level of taxable income in Years 4-6 is $500 or less [FAS 109, paragraph 236, sequence 657]]

b. [20 percent if the estimated annual level of taxable income in Years 4-6 is $1,000 [FAS 109, paragraph 236, sequence 658]]

c. [30 percent if the estimated annual level of taxable income in Years 4-6 is $2,000. [FAS 109, paragraph 236, sequence 659]]

55-138 [Temporary differences usually do not reverse in equal annual amounts as in the Example above, and a different average graduated tax rate might apply to reversals in different future years. However, a detailed analysis to determine the net reversals of temporary differences in each future year usually is not warranted. It is not warranted because the other variable (that is, taxable income or losses exclusive of reversing temporary differences in each of those future years) for determination of the average graduated tax rate in each future year is no more than an estimate. For that reason, an aggregate calculation using a single estimated average graduated tax rate based on estimated average annual taxable income in future years is sufficient. Judgment is permitted, however, to deal with unusual situations, for example, an abnormally large temporary difference that will reverse in a single future year, or an abnormal level of taxable income that is expected for a single future year. The lowest graduated tax rate should be used whenever the estimated average graduated tax rate otherwise would be zero. [FAS 109, paragraph 236, sequence 660]]

> > Example 17: Determining Whether a Tax Is an Income Tax

55-139 The guidance in paragraph 740-10-55-26 addressing when a tax is an income tax is illustrated using the following historical example.

55-140 [In August 1991, a state amended its franchise tax statute to include a tax on income apportioned to the state based on the federal tax return. The new tax was effective January 1, 1992. [EITF 91-08, paragraph ISSUE, sequence 8.1]] [The amount of franchise tax on each corporation was set at the greater of 0.25 percent of the corporation's net taxable capital and 4.5 percent of the corporation's net taxable earned surplus. Net taxable earned surplus was a term defined by the tax statute for federal taxable income. [EITF 91-08, paragraph ISSUE, sequence 9]]

55-141 [In this Example, the total computed tax is an income tax only to the extent that the tax exceeds the capital-based tax in a given year. [EITF 91-08, paragraph DISCUSSION, sequence 11.1.1.1]]

55-142 [A deferred tax liability is required to be recognized under this Subtopic for the amount by which the income-based tax payable on net reversing temporary differences in each future year exceeds the capital-based tax computed for each future year based on the level of capital that exists as of the end of the year for which deferred taxes are being computed. [EITF 91-08, paragraph DISCUSSION, sequence 11.1.2.1]]

55-143 [The portion of the current tax liability based on income is required to be accrued with a charge to income during the period in which the income is earned. The portion of the deferred tax liability related to temporary differences is required to be recognized as of the date of the statement of financial position for temporary differences that exist as of the date of the statement of financial position. [EITF 91-08, paragraph DISCUSSION, sequence 11.2.2.2]]

55-144 [Because the state tax is an income tax only to the extent that the tax exceeds the capital-based tax in a given year, under the requirements of this Subtopic, deferred taxes are recognized for temporary differences that will reverse in future years for which annual taxable income is expected to exceed 5.5% (.25% of net taxable capital/4.5% of taxable income) of expected net taxable capital. [EITF 91-08, paragraph STATUS, sequence 16.1]] [In measuring deferred taxes, see paragraph 740-10-55-138 to determine whether a detailed analysis of the net reversals of temporary differences in each future year is warranted. [EITF 91-08, paragraph STATUS, sequence 16.2]] [While the tax statutes of states differ, the accounting described above would be appropriate if the tax structure of another state was essentially the same as in this Example. [EITF 91-08, paragraph DISCUSSION, sequence 12]]

> > Example 18: Special Deductions

55-145 Paragraph 740-10-55-27 introduces guidance relating to a special deduction for qualified production activities that may be available to an entity under the American Jobs Creation Act of 2004.

55-146 [This Example illustrates how an entity with a calendar year-end would apply paragraphs 740-10-25-37 and 740-10-35-4 to the qualified production activities deduction at December 31, 2004. In particular, this Example illustrates the methodology used to evaluate the qualified production activities deduction's effect on determining the need for a valuation allowance on an entity's existing net deferred tax assets. [FSP FAS109-1, paragraph Appendix A, sequence 15]] [This Example intentionally is not comprehensive (for example, it excludes state and local taxes). [FSP FAS109-1, paragraph Appendix A FN2, sequence 16]]

55-147 [This Example has the following assumptions: [FSP FAS109-1, paragraph Appendix A, sequence 17.1]]

a. [Expected taxable income (excluding the qualified production activities deduction and net operating loss carryforwards) for 2005: $21,000 [FSP FAS109-1, paragraph Appendix A, sequence 17.2.1]]

b. [Expected qualified production activities income for 2005: $50,000 [FSP FAS109-1, paragraph Appendix A, sequence 17.2.2.1]]

c. [Net operating loss carryforwards at December 31, 2004, which expire in 2005: $20,000 [FSP FAS109-1, paragraph Appendix A, sequence 17.2.2.2.1]]

d. [Expected W-2 wages for 2005: $10,000 [FSP FAS109-1, paragraph Appendix A, sequence 17.2.2.2.2.1]]

e. [Assumed statutory income tax rate: 35% [FSP FAS109-1, paragraph Appendix A, sequence 17.2.2.2.2.2.1]]

f. [Qualified production activities deduction: 3% of the lesser of qualified production activities income or taxable income (after deducting the net operating loss carryforwards); limited to 50% of W-2 wages: $30. [FSP FAS109-1, paragraph Appendix A, sequence 17.2.2.2.2.2.2]]

55-148 [Based on these assumptions, [FSP FAS109-1, paragraph Appendix A, sequence 18]] [the entity would not recognize a valuation allowance for the net operating loss carryforwards at December 31, 2004, because expected taxable income in 2005 (after deducting the qualified production activities deduction) exceeds the net operating loss carryforwards, as follows. [FSP FAS109-1, paragraph Appendix A, sequence 19]]

Analysis to compute the qualified production activities deduction

Expected taxable income (excluding the qualified production activities deduction and net operating loss carryforwards) for the year 2005	$21,000
Less net operating loss carryforwards [(a)]	20,000
Expected taxable income (after deducting the net operating loss carryforwards)	$ 1,000
Qualified production activities deduction	$ 30

(a) The Act requires that net operating loss carryforwards be deducted from the taxable income in determining the qualified production activities deduction. Therefore, the qualified production activities deduction will not result in a need for a valuation allowance for an entity's deferred tax asset for net operating loss carryforwards. However, certain types of tax credit carryforwards are not deducted in determining the qualified production activities deduction and, therefore, could require a valuation allowance.

[FSP FAS109-1, paragraph Appendix A, sequence 20]

Analysis to determine the effect of the qualified production activities deduction on the need for a valuation allowance for deferred tax assets for the net operating loss carryforwards

Expected taxable income after deducting the qualified production activities deduction	$ 20,970
Net operating loss carryforwards	20,000
Expected taxable income exceeds the net operating loss carryforwards	$ 970

[FSP FAS109-1, paragraph Appendix A, sequence 22]

> > Example 19: Recognizing Tax Benefits of Operating Loss

55-149 [This Example illustrates the guidance in paragraphs 740-10-55-35 through 55-36 for recognition of the tax benefit of an operating loss in the loss year and in subsequent carryforward years when a valuation allowance is necessary in the loss year. This Example has the following assumptions: [FAS 109, paragraph 242, sequence 675]]

a. [The enacted tax rate is 40 percent for all years. [FAS 109, paragraph 242, sequence 676]]

b. [An operating loss occurs in Year 5. [FAS 109, paragraph 242, sequence 677]]

c. [The only difference between financial and taxable income results from use of accelerated depreciation for tax purposes. Differences that arise between the reported amount and the tax basis of depreciable assets in Years 1-7 will result in taxable amounts before the end of the loss carryforward period from Year 5. [FAS 109, paragraph 242, sequence 678]]

d. [Financial income, taxable income, and **taxes currently payable or refundable** are as follows. [FAS 109, paragraph 242, sequence 679]]

	Year 1	Years 2-4	Year 5	Year 6	Year 7
Pretax financial income (loss)	$2,000	$ 5,000	$ (8,000)	$ 2,200	$ 7,000
Depreciation differences	(800)	(2,200)	(800)	(700)	(600)
Loss carryback	-	-	2,800	-	-
Loss carryforward	-	-	-	(6,000)	(4,500)
Taxable income (loss)	$1,200	$ 2,800	$ (6,000)	$(4,500)	$ 1,900
Taxes payable (refundable)	$ 480	$ 1,120	$ (1,120)	$ -	$ 760

[FAS 109, paragraph 242, sequence 680]

e. [At the end of Year 5, profits are not expected in Years 6 and 7 and later years, and it is concluded that a valuation allowance is necessary to the extent realization of the deferred tax asset for the operating loss carryforward depends on taxable income (exclusive of reversing temporary differences) in future years. [FAS 109, paragraph 242, sequence 681]]

55-150 [The deferred tax liability for the taxable temporary differences is calculated at the end of each year as follows. [FAS 109, paragraph 242, sequence 682]]

	Year 1	Years 2–4	Year 5	Year 6	Year 7
Unreversed differences:					
Beginning amount	$ -	$ 800	$3,000	$ 3,800	$ 4,500
Additional amount	800	2,200	800	700	600
Total	$ 800	$ 3,000	$3,800	$ 4,500	$ 5,100
Deferred tax liability (40 percent)	$ 320	$ 1,200	$1,520	$ 1,800	$ 2,040

[FAS 109, paragraph 242, sequence 683]

55-151 [The deferred tax asset and related valuation allowance for the loss carryforward are calculated at the end of each year as follows. [FAS 109, paragraph 242, sequence 684]]

	Year 1	Years 2–4	Year 5	Year 6	Year 7
Loss carryforward for tax purposes	$ -	$ -	$ 6,000	$4,500	$ -
Deferred tax asset (40 percent)	$ -	$ -	$ 2,400	$1,800	$ -
Valuation allowance equal to the amount by which the deferred tax asset exceeds the deferred tax liability	-	-	(880)	-	-
Net deferred tax asset	$ -	$ -	$ 1,520	$1,800	$ -

[FAS 109, paragraph 242, sequence 685]

55-152 [Total tax expense for each period is as follows. [FAS 109, paragraph 242, sequence 686]]

	Year 1	Years 2–4	Year 5	Year 6	Year 7
Deferred tax expense (benefit):					
Increase in deferred tax liability	$ 320	$ 880	$ 320	$ 280	$ 240
(Increase) decrease in net deferred tax asset	-	-	(1,520)	(280)	1,800
	320	880	(1,200)	-	2,040
Currently payable (refundable)	480	1,120	(1,120)	-	760
Total tax expense (benefit)	$ 800	$ 2,000	$(2,320)	$ -	$ 2,800

[FAS 109, paragraph 242, sequence 687]

55-153 [In Year 5, $2,800 of the loss is carried back to reduce taxable income in Years 2-4, and $1,120 of taxes paid for those years is refunded. In addition, a $1,520 deferred tax liability is recognized for $3,800 of taxable temporary differences, and a $2,400 deferred tax asset is recognized for the $6,000 loss carryforward. However, based on the conclusion described in paragraph 740-10-55-149(e), a valuation allowance is recognized for the amount by which that deferred tax asset exceeds the deferred tax liability. [FAS 109, paragraph 242,

sequence 688]]

55-154 [In Year 6, a portion of the deferred tax asset for the loss carryforward is realized because taxable income is earned in that year. The remaining balance of the deferred tax asset for the loss carryforward at the end of Year 6 equals the deferred tax liability for the taxable temporary differences. A valuation allowance is not needed. [FAS 109, paragraph 242, sequence 689]]

55-155 [In Year 7, the remaining balance of the loss carryforward is realized, and $760 of taxes are payable on net taxable income of $1,900. A $2,040 deferred tax liability is recognized for the $5,100 of taxable temporary differences. [FAS 109, paragraph 242, sequence 690]]

> > Example 20: Interaction of Loss Carryforwards and Temporary Differences

55-156 [This Example illustrates the guidance in paragraph 740-10-55-37 for the interaction of loss carryforwards and temporary differences that will result in net deductible amounts in future years. This Example has the following assumptions: [FAS 109, paragraph 244, sequence 692]]

a. [The financial loss and the loss reported on the tax return for an entity's first year of operations are the same. [FAS 109, paragraph 244, sequence 693]]

b. [In Year 2, a gain of $2,500 from a transaction that is a sale for tax purposes but a sale and leaseback for financial reporting is the only difference between pretax financial income and taxable income. [FAS 109, paragraph 244, sequence 694]]

55-157 Financial and taxable income in this Example are as follows.

	Financial Income	Taxable Income
Year 1: Income (loss) from operations	$ (4,000)	$ (4,000)
Year 2: Income (loss) from operations	$ -	$ -
Taxable gain on sale		2,500
Taxable income before loss carryforward		2,500
Loss carryforward from Year 1		(4,000)
Taxable income		$ -

[FAS 109, paragraph 244, sequence 695]

55-158 [The $4,000 operating loss carryforward at the end of Year 1 is reduced to $1,500 at the end of Year 2 because $2,500 of it is used to reduce taxable income. The $2,500 reduction in the loss carryforward becomes $2,500 of deductible temporary differences that will reverse and result in future tax deductions when lease payments are made. The entity has no deferred tax liability to be offset by those future tax deductions, the future tax deductions cannot be realized by loss carryback because no taxes have been paid, and the entity has had pretax losses for financial reporting since inception. Unless positive evidence exists that is sufficient to overcome the negative evidence associated with those losses, a valuation allowance is recognized at the end of Year 2 for the full amount of the deferred tax asset related to the $2,500 of deductible temporary differences and the remaining $1,500 of operating loss carryforward. [FAS 109, paragraph 244, sequence 696]]

> > Example 21: Tax-Planning Strategy with Significant Implementation Cost

55-159 [This Example illustrates the guidance in paragraph 740-10-55-44 for recognition of a deferred tax asset based on the expected effect of a qualifying tax-planning strategy when a significant expense would be incurred to implement the strategy. This Example has the following assumptions: [FAS 109, paragraph 250, sequence 716]]

a. [A $900 operating loss carryforward expires at the end of next year. [FAS 109, paragraph 250, sequence 717]]

b. [Based on historical results and the weight of other available evidence, the estimated level of taxable income exclusive of the future reversal of existing temporary differences and the operating loss carryforward next year is $100. [FAS 109, paragraph 250, sequence 718]]

c. [Taxable temporary differences in the amount of $1,200 ordinarily would result in taxable amounts of approximately $400 in each of the next 3 years. [FAS 109, paragraph 250, sequence 719]]

d. [There is a qualifying tax-planning strategy to accelerate the future reversal of all $1,200 of taxable temporary differences to next year. [FAS 109, paragraph 250, sequence 720]]

e. [Estimated legal and other expenses to implement that tax-planning strategy are $150. [FAS 109, paragraph 250, sequence 721]]

f. [The enacted tax rate is 40 percent for all years. [FAS 109, paragraph 250, sequence 722]]

55-160 [Without the tax-planning strategy, only $500 of the $900 operating loss carryforward could be realized next year by offsetting $100 of taxable income exclusive of reversing temporary differences and $400 of reversing taxable temporary differences. The other $400 of operating loss carryforward would expire unused at the end of next year. Therefore, the $360 deferred tax asset ($900 at 40 percent) would be offset by a $160 valuation allowance ($400 at 40 percent), and a $200 net deferred tax asset would be recognized for the operating loss carryforward. [FAS 109, paragraph 250, sequence 723]]

55-161 [With the tax-planning strategy, the $900 operating loss carryforward could be applied against $1,300 of taxable income next year ($100 of taxable income exclusive of reversing temporary differences and $1,200 of reversing taxable temporary differences). The $360 deferred tax asset is reduced by a $90 valuation allowance recognized for the net-of-tax expenses necessary to implement the tax-planning strategy. The amount of that valuation allowance is determined as follows. [FAS 109, paragraph 250, sequence 724]]

Legal and other expenses to implement the tax-planning strategy	$ 150
Future tax benefit of those legal and other expenses—$150 at 40 percent	60
	$ 90

[FAS 109, paragraph 250, sequence 725]

55-162 [In summary, a $480 deferred tax liability is recognized for the $1,200 of taxable temporary differences, a $360 deferred tax asset is recognized for the $900 operating loss carryforward, and a $90 valuation allowance is recognized for the net-of-tax expenses of implementing the tax-planning strategy. [FAS 109, paragraph 250, sequence 726]]

> > Example 22: Multiple Tax-Planning Strategies Available

55-163 This Example illustrates the guidance in paragraphs 740-10-55-39 through 55-48 relating to tax-planning strategies. [An entity might identify several qualifying tax-planning strategies that would either reduce or eliminate the need for a valuation allowance for a deferred tax asset. For example, assume that an entity's required valuation allowance would be reduced $5,000 based on Strategy A, $7,000 based on Strategy B, and $12,000 based on both strategies. The entity may not recognize the effect of one of those strategies in the current year and postpone recognition of the effect of the other strategy to a later year. [QA 109, paragraph 26, sequence 170]]

55-164 [The entity should recognize the effect of both tax-planning strategies and reduce the valuation allowance by $12,000 at the end of the current year. Paragraph 740-10-30-19 provides guidance on tax-planning strategies and establishes the requirement that strategies meeting the criteria set forth in that paragraph shall be considered in determining the required valuation allowance. [QA 109, paragraph 26, sequence 171]]

> > Example 23: Effects of Subsidy on Temporary Difference

55-165 Paragraph 740-10-55-54 introduces guidance relating to a nontaxable subsidy that may be available to an entity under the Medicare Prescription Drug, Improvement, and Modernization Act of 2003. This Example illustrates that guidance.

55-166 [Before the accounting for the effects of the Act, an employer's carrying amount of accrued postretirement benefit cost (the amount recognized in the statement of financial position) is $100 for a noncontributory, unfunded prescription drug benefit plan with only inactive participants who are not yet eligible to collect benefits. Assuming a tax rate of 35 percent and no corresponding tax basis for the accrued postretirement benefit cost, the employer would report a $35 deferred tax asset related to that $100 deductible temporary difference. Because the employer has a policy of amortizing gains and losses under paragraph 715-60-35-29, upon recognition of a $28 actuarial gain resulting from the estimate of the expected subsidy, neither the carrying amount of accrued postretirement benefit cost nor the deferred tax asset would change. Subsequently, ignoring interest on the accumulated postretirement benefit obligation (which includes interest on the subsidy), as the actuarial gain related to the subsidy is amortized as a component of net periodic postretirement benefit cost, the carrying amount of accrued postretirement cost would be reduced. However, the associated temporary difference and deferred tax asset would remain unchanged. That is, after the gain related to the subsidy is amortized in its entirety, the carrying amount of accrued postretirement benefit cost would be $72, and the deferred tax asset would remain at $35. [FSP FAS106-2, paragraph 19, sequence 43]]

55-167 [For purposes of simplicity, this Example ignores complexities regarding the amount and timing of the subsidies reflected in the carrying amount of accrued postretirement benefit cost arising from any of the following: [FSP FAS106-2, paragraph 19, sequence 44.1.1]]

a. [Netting gains and losses and application of the corridor amortization approach described in paragraph 715-60-35-29 [FSP FAS106-2, paragraph 19, sequence 44.1.2.1]]

b. [Recognition of additional subsidies through amortization of prior service costs that include effects of the subsidy [FSP FAS106-2, paragraph 19, sequence 44.1.2.2.1]]

c. [Reduction in future service and interest costs. [FSP FAS106-2, paragraph 19, sequence 44.1.2.2.2.1]]

[Those complexities must be considered in determining the temporary difference on which the deferred tax effects under this Topic will be based. [FSP FAS106-2, paragraph 19, sequence 44.1.2.2.2.2]]

> > Example 24: Built-In Gains of S Corporation

55-168 This Example illustrates an entity's change from taxable C corporation status to nontaxable S corporation status, in accordance with the guidance provided in paragraph 740-10-55-65. This Example has the following assumptions:

a. [An entity's S corporation election is effective for calendar-year 1990 and that at the conversion date its assets comprise marketable securities, finished goods inventory, and depreciable assets as follows. [QA 109, paragraph 12, sequence 53]]

	Fair Market Value	Tax Basis	Reported Amount	Temporary Differences	Topic 740 Built-in Gain (Loss)
Marketable securities	$ 90	$100	$ 80	$ (20)	$ (10)
Inventory, (first-in first-out [FIFO])	100	50	100	50	50
Depreciable assets	95	80	90	10	10
	$ 285	$230	$ 270	$ 40	$ 50

[QA 109, paragraph 12, sequence 54]

b. [The entity has no tax loss or credit carryforwards available to offset the built-in gains. [QA 109, paragraph 12, sequence 55.2.1]]

c. [The depreciable assets will be recovered by use in operations (and, therefore, will not result in a taxable amount pursuant to the tax law applied to built-in gains). [QA 109, paragraph 12, sequence 55.2.2.1]]

d. [The marketable securities will be sold in the same year that the inventory is sold, the $50 built-in gain on the inventory is reduced by the $10 built-in loss on the marketable securities, and $40 would be taxed in the year that the inventory turns over and the securities are sold. Accordingly, the entity should continue to display in its statement of financial position a deferred tax liability for that $40 net taxable amount. [QA 109, paragraph 12, sequence 55.2.2.2]]

55-169 [At subsequent financial statement dates until the end of the 10 years following the conversion date, the entity should remeasure the deferred tax liability for net built-in gains based on the provisions of the tax law. Deferred tax expense (or benefit) should be recognized for any change in that deferred tax liability. [QA 109, paragraph 12, sequence 56]]

> > Example 25: Purchase Transactions that Are Not Accounted for as Business Combinations

55-170 Paragraph 740-10-25-51 addresses the accounting when an asset is acquired outside of a business combination and the tax basis of the asset differs from the amount paid. The following Cases illustrate the required accounting for purchase transactions that are not accounted for as business combinations in the following circumstances:

a. The amount paid is less than the tax basis of the asset (Case A).

b. The amount paid is more than the tax basis of the asset (Case B).

c. The transaction results in a deferred credit (Case C).

d. A deferred credit is created by a financial asset (Case D).

e. The simultaneous equation method reduces a preexisting valuation allowance (Case E).

f. The result is a purchase of future tax benefits (Case F).

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

Paragraph 740-10-25-51 addresses the accounting when an asset is acquired outside of a business combination and the tax basis of the asset differs from the amount paid. The following Cases illustrate the required accounting for purchase transactions that are not accounted for as business combinations in the following circumstances:

a. The amount paid is less than the tax basis of the asset (Case A).

b. The amount paid is more than the tax basis of the asset (Case B).

c. The transaction results in a deferred credit (Case C).

d. A deferred credit is created by a financial asset (Case D).

e. Paragraph superseded by Codification Update 2008–006.

f. The result is a purchase of future tax benefits (Case F).

> > > Case A: Amount Paid Is Less than Tax Basis of Asset

55-171 [This Case illustrates an asset purchase that is not a business combination in which the amount paid differs from the tax basis of the asset (tax basis is greater). [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 29]

]

55-172 [As an incentive for acquiring specific types of equipment in certain sectors, a foreign jurisdiction permits a deduction, for tax purposes, of an amount in excess of the cost of the acquired asset. To illustrate, assume that Entity A purchases a machine for $100 and its tax basis is automatically increased to $150. Upon sale of the asset, there is no recapture of the extra tax deduction. The tax rate is 35 percent. [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 30]]

55-173 [In accordance with paragraph 740-10-25-51, the amounts assigned to the equipment and the related deferred tax asset should be determined using the simultaneous equations method as follows (where FBB is Final Book Basis; CPP is Cash Purchase Price; and DTA is Deferred Tax Asset): [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 31]]

[Equation A (determine the final book basis of the equipment): [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 32]]

[FBB - [Tax Rate × (FBB - Tax Basis)] = CPP [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 33]]

[Equation B (determine the amount assigned to the deferred tax asset): [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 34]]

[(Tax Basis - FBB) × Tax Rate = DTA. [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 35]]

55-174 [In this Case, the following variables are known: [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 36]]

a. [Tax Basis = $150 [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 37]]

b. [Tax Rate = 35 percent [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 38]]

c. [CPP = $100. [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 39]]

55-175 [The unknown variables (FBB and DTA) are solved as follows: [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 40]]

[Equation A: FBB = $73 [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 41]]

[Equation B: DTA = $27. [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 42]]

55-176 [Accordingly, the entity would record the following journal entry. [EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 43]]

Equipment	$ 73	
Deferred tax asset	27	
Cash		$ 100

[EITF 98-11, paragraph Exhibit 98-11A Example 1, sequence 44.1]

> > > Case B: Amount Paid Is More than Tax Basis of Asset

55-177 [This Case illustrates an asset purchase that is not a business combination in which the amount paid differs from the tax basis of the asset (tax basis is less). [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 44.2]]

55-178 [Assume that an entity pays $1,000,000 for the stock of an entity in a nontaxable acquisition (that is, carryover basis for tax purposes). The acquired entity's sole asset is a Federal Communications Commission (FCC) license that has a tax basis of zero. Since the acquisition of the entity is in substance the acquisition of an FCC license, no goodwill is recognized. A deferred tax liability would need to be recorded for the temporary difference (in this Case, the entire $1,000,000 plus the tax-on-tax effect from increasing the carrying amount of the FCC license acquired) related to the FCC license. The tax rate is 35 percent. [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 45]]

55-179 [In accordance with paragraph 740-10-25-51, the amounts assigned to the FCC license and the related deferred tax liability should be determined using the simultaneous equations method as follows (where FBB is Final Book Basis; CPP is Cash Purchase Price; and DTL is Deferred Tax Liability): [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 46]]

[Equation A (determine the FBB of the FCC license): [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 47]]

[FBB - [Tax Rate × (FBB - Tax Basis)] = CPP [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 48]]

[Equation B (determine the amount assigned to the DTL): [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 49]]

[(FBB - Tax Basis) × Tax Rate = DTL. [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 50]]

55-180 [In this Case, the following variables are known: [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 51]]

a. [Tax Basis = $0 [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 52]]

b. [Tax Rate = 35 percent [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 53]]

c. [CPP = $1,000,000. [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 54]]

55-181 [The unknown variables (FBB and DTL) are solved as follows: [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 55]]

[Equation A: FBB = $1,538,462 [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 56]]

[Equation B: DTL = $538,462. [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 57]]

55-182 [Accordingly, the entity would record the following journal entry. [EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 58]]

FCC license	$ 1,538,462	
Deferred tax liability		$ 538,462
Cash		$ 1,000,000

[EITF 98-11, paragraph Exhibit 98-11A Example 2, sequence 59.1]

> > > Case C: Transaction Results In Deferred Credit

55-183 [This Case provides an illustration of a transaction that results in a deferred credit. [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 59.2]]

55-184 [Entity A buys a machine for $50 with a tax basis of $200. The tax rate is 35 percent. [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 60]]

55-185 [In accordance with paragraph 740-10-25-51, the amounts assigned to the machine and the deferred tax asset should be determined using the simultaneous equations method as follows (where FBB is Final Book Basis; CPP is Cash Purchase Price; and DTA is Deferred Tax Asset): [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 61]]

[Equation A (determine the FBB of the machine): [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 62]]

[FBB - [Tax Rate × (FBB - Tax Basis)] = CPP [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 63]]

[Equation B (determine the amount assigned to the DTA): [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 64]]

[(Tax Basis - FBB) × Tax Rate = DTA. [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 65]]

55-186 [In this Case, the following variables are known: [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 66]]

a. [Tax Basis = $200 [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 67]]

b. [Tax Rate = 35 percent [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 68]]

c. [CPP = $50. [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 69]]

55-187 [The unknown variables (FBB and DTA) are solved as follows: [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 70]]

[Equation A: FBB = $(31). [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 71]] [However, because the FBB cannot be less than zero, the FBB is recorded at zero. [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 72]]

[Equation B: DTA = $70. [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 73]]

55-188 [The excess of the amount assigned to the deferred tax asset over the cash purchase price paid for the machine is recorded as a deferred credit. Accordingly, the entity would record the following journal entry. [EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 74]]

Machine	$ -	
Deferred tax asset	70	
Deferred credit		$ 20
Cash		$ 50

[EITF 98-11, paragraph Exhibit 98-11A Example 3, sequence 75.1]

> > > Case D: Deferred Credit Created by Financial Asset

55-189 [This Case provides an illustration of a deferred credit created by the acquisition of a financial asset. [EITF 98-11, paragraph Exhibit 98-11A Example 4, sequence 75.2]]

55-190 [Entity A acquires the stock of another corporation for $250. The principal asset of the corporation is a marketable equity security with a readily determinable fair value of $200 and a tax basis of $500. The tax rate is 35 percent. The acquired entity has no operations and so the acquisition is accounted for as an asset purchase and not as a business combination. [EITF 98-11, paragraph Exhibit 98-11A Example 4, sequence 76]]

55-191 [In accordance with paragraph 740-10-25-51, the acquired financial asset should be recognized at fair value, and a deferred tax asset should be recorded at the amount required by this Subtopic. The excess of the fair value of the financial asset and the deferred tax asset recorded over the cash purchase price should be recorded as a deferred credit. Accordingly, the entity would record the following journal entry. [EITF 98-11, paragraph Exhibit 98-11A Example 4, sequence 77]]

Marketable equity security	$ 200	
Deferred tax asset (300 x .35)	105	
Deferred credit		$ 55
Cash		$ 250

[EITF 98-11, paragraph Exhibit 98-11A Example 4, sequence 78.1]

> > > Case E: Simultaneous Equations Method and Reduction in Preexisting Valuation Allowance

55-192 [This Case provides an illustration of the simultaneous equations method when there is a contemporaneous reduction in a preexisting valuation allowance. [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 78.2]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

Paragraph superseded by Codification Update 2008–006.

55-193 [An entity acquires the stock of another corporation for $7,000,000. The principal asset of the corporation is a license with a tax basis of $2,000,000. The acquired entity had no operations and so the acquisition is accounted for as an asset purchase and not as a business combination. [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 79]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

Paragraph superseded by Codification Update 2008–006.

55-194 [The acquirer has a deferred tax asset of $1,500,000 and a valuation allowance of $1,500,000. As a result of acquiring the license, the acquirer now has a **taxable temporary difference** that is expected to reverse during the same period that the acquirer's deductible temporary difference is expected to reverse. (It is assumed that the taxes that otherwise would be payable upon the reversal of the acquired corporation's taxable temporary difference will be reduced as the result of the acquiring entity's preexisting deferred tax asset.) Therefore, the valuation allowance of $1,500,000 is no longer required. The tax rate is 35 percent. [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 80]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

Paragraph superseded by Codification Update 2008–006.

55-195 [In accordance with paragraph 740-10-25-5, the amounts assigned to the license, the deferred tax liability, and the amount of the valuation allowance for deferred tax assets released (VAR) should be determined using the simultaneous equations method as follows (where FBB is Final Book Basis; CPP is Cash Purchase Price; and DTL is Deferred Tax Liability): [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 81]]

[Equation A (determine the FBB of the license): [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 82]]

[FBB - [Tax Rate × (FBB - Tax Basis)] + VAR = CPP [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 83]]

[Equation B (determine the amount assigned to the DTL): [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 84]]

[(FBB - Tax Basis) × Tax Rate = DTL. [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 85]]

Pending Content:
Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

Paragraph superseded by Codification Update 2008–006.

55-196 [In this Case, the following variables are known: [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 86]]

a. [Tax Basis = $2,000,000 [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 87]]

b. [Tax Rate = 35 percent [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 88]]

c. [CPP = $7,000,000 [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 89]]

d. [VAR = $1,500,000. [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 90]]

Pending Content:
Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

Paragraph superseded by Codification Update 2008–006.

55-197 [The unknown variables (FBB and DTL) are solved as follows: [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 91]]

[Equation A: FBB = $7,384,615 [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 92]]

[Equation B: DTL = $1,884,615. [EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 93]]

Pending Content:
Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

Paragraph superseded by Codification Update 2008–006.

55-198 [Accordingly, the entity would record the following journal entry. [EITF 98-11, paragraph Exhibit 98-11A

Example 5, sequence 94]]

Deferred tax asset valuation	$ 1,500,000	
License	7,384,615	
Deferred tax liability		$ 1,884,615
Cash		$ 7,000,000

[EITF 98-11, paragraph Exhibit 98-11A Example 5, sequence 95.1]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance: 805-10-65-1**

Paragraph superseded by Codification Update 2008–006.

> > > Case F: Purchase of Future Tax Benefits

55-199 [This Case provides an illustration of the purchase of future tax benefits. [EITF 98-11, paragraph Exhibit 98-11A Example 6, sequence 95.2]]

55-200 [A foreign entity that has nominal assets other than its net operating loss carryforwards is acquired by a foreign subsidiary of a U.S. entity for the specific purpose of utilizing the net operating loss carryforwards (this type of transaction is often referred to as a tax loss acquisition). It is presumed that this transaction does not constitute a business combination, since the acquired entity has no operations and is merely a shell entity. As a result of the time value of money and because the target entity is in financial difficulty and has ceased operations, the foreign subsidiary is able to acquire the shell entity at a discount from the amount corresponding to the gross deferred tax asset for the net operating loss carryforwards. Assume, for example, that $2,000,000 is paid for net operating loss carryforwards having a deferred tax benefit of $5,000,000 for which it is more likely than not that the full benefit will be realized. The tax rate is 35 percent. [EITF 98-11, paragraph Exhibit 98-11A Example 6, sequence 96]]

55-201 [In accordance with paragraph 740-10-25-51, the amount assigned to the deferred tax asset should be recorded at its gross amount (in accordance with this Subtopic) and the excess of the amount assigned to the deferred tax asset over the purchase price should be recorded as a deferred credit as follows. [EITF 98-11, paragraph Exhibit 98-11A Example 6, sequence 97]]

Deferred tax asset	$ 5,000,000	
Deferred credit		$ 3,000,000
Cash		$ 2,000,000

[EITF 98-11, paragraph Exhibit 98-11A Example 6, sequence 98.1]

> > Example 26: Direct Transaction with Governmental Taxing Authority

55-202 Guidance is provided on various types of payments made to taxing authorities in paragraphs 740-10-55-67 through 55-75. This Example illustrates one possible payment situation.

55-203 [In this Example, tax laws in a foreign country enable corporate taxpayers to elect to step up the tax basis for certain fixed assets ($1,000,000) to fair value ($2,000,000) in exchange for a current payment to the government of 3 percent of the step-up ($30,000). An entity would be expected to avail itself of this election (and make the upfront payment) as long as it believed that it was likely that it would be able to utilize the additional deductions (at a tax rate of 35 percent) that were created as a result of the step-up to reduce future taxable income and that the timing and amount of the resulting future tax savings justified the current payment. (For purposes of this Example, it is assumed that the transaction that accomplishes this step-up for tax purposes does not create a taxable temporary difference and is not an intra-entity transaction as discussed in paragraph 740-10-25-3(e). A taxable temporary difference would exist, for example, if the tax benefit associated with the transaction with the governmental taxing authority becomes taxable in certain situations, such as those described in paragraph 830-740-25-7). [EITF 98-11, paragraph Exhibit 98-11A Example 7, sequence 99]]

55-204 [In this Example, the tax effects of transactions directly with a taxing authority are recorded directly in income as follows. [EITF 98-11, paragraph Exhibit 98-11A Example 7, sequence 100]]

Deferred tax asset	$ 350,000	
Deferred income tax benefit		$ 320,000
Cash		$ 30,000

[EITF 98-11, paragraph Exhibit 98-11A Example 7, sequence 101]

>> Example 27: Accounting Change for Tax Purposes

55-205 [This Example illustrates the statement of financial position classification guidance in 740-10-55-77 for certain types of deferred income taxes but does not encompass all possible circumstances. [FAS 037, paragraph 16, sequence 38.1]]

55-206 [An entity changes its method of handling bad debts for tax purposes from the cash method to the reserve method. Ten percent of the effect of the change at the beginning of calendar year 19X1 will be included as a deduction from taxable income each year for 10 years. The entity uses a one-year time period as the basis for classifying current assets and current liabilities on its statement of financial position. At December 31, 19X1, the amount of the effect of the change that is yet to be included as a deduction from taxable income and the balance of the related deferred income taxes are as follows. [FAS 037, paragraph 20, sequence 43]]

Amount of the effect of the change that is yet to be included as a deduction from taxable income (9/10 of total effect of the change)	$ 5,125,000
Deferred tax asset (40 percent is the enacted tax rate—no valuation allowance deemed necessary)	$ 2,050,000

[FAS 037, paragraph 20, sequence 44]

55-207 [The deferred tax asset does not relate to trade receivables or provisions for doubtful accounts because collection or write-off of the receivables will not cause the temporary differences to reverse; the temporary differences will reverse over time. Accordingly, the entity would classify the deferred tax asset based on the scheduled reversal of the related temporary differences. One-ninth of the remaining temporary differences are scheduled to reverse in 19X2, so one-ninth of the related deferred tax asset would be classified as current at December 31, 19X1 ($227,778). [FAS 037, paragraph 21, sequence 45]]

>> Example 28: Unremitted Earnings of Foreign Subsidiaries

55-208 This Example illustrates the statement of financial position classification guidance in Section 740-10-45 for certain types of deferred income taxes but does not encompass all possible circumstances.

55-209 [An entity provides U.S. income taxes on the portion of its unremitted foreign earnings that are not considered to be permanently reinvested in its consolidated foreign subsidiary. The foreign earnings are included in U.S. taxable income in the year in which dividends are paid. The entity uses a one-year time period as the basis for classifying current assets and current liabilities on its statement of financial position. At December 31, 19X1, the accumulated amount of unremitted earnings on which taxes have been provided and the balance of the related deferred income taxes are as follows. [FAS 037, paragraph 23, sequence 47]]

Accumulated unremitted earnings on which taxes have been provided:	
Expected to be remitted within one year	$ 9,800,000
Not expected to be remitted within one year	2,700,000
Total	$ 12,500,000
Accumulated deferred tax liability related to unremitted earnings	$ 1,250,000

[FAS 037, paragraph 23, sequence 48]

55-210 [The deferred tax liability does not relate to an asset or liability on the consolidated statement of financial position; the temporary difference will only reverse when the unremitted earnings are received from the foreign subsidiary by the parent. A payment between consolidated affiliates does not change the consolidated statement of financial position, so no item on the consolidated statement of financial position would be liquidated. Unremitted earnings expected to be remitted within the next year represent 78 percent of the total unremitted earnings for which tax has been provided ($9,800,000/$12,500,000). Therefore, 78 percent of the related deferred tax liability would be classified as current on the consolidated statement of financial position ($975,000). [FAS 037, paragraph 24, sequence 49]]

55-211 [If the subsidiary were accounted for on the equity method rather than consolidated (for example, a subsidiary reported on the equity method in separate parent entity financial statements), the deferred income taxes would relate to the recorded investment in the subsidiary. The payment of dividends that causes the reversal of the temporary difference would be accompanied by a reduction of the recorded investment in the subsidiary. Therefore, the deferred tax liability would be classified the same as the related investment in the subsidiary. [FAS 037, paragraph 25, sequence 50]]

> > Example 29: Disclosure Related to Components of Income Taxes Attributable to Continuing Operations

55-212 Paragraph 740-10-55-79 provides guidance on satisfying the required disclosure of the significant components of income taxes and identifies three acceptable approaches illustrated in this Example:

a. The gross method (Case A)

b. The net method (Case B)

c. The statutory tax rate reconciliation method (Case C).

55-213 [Cases A, B, and C share the following assumptions: [QA 109, paragraph 18, sequence 124.2]]

a. [An entity has $1,588 of taxable income and $100 of investment tax credits for the current year. The $100 deferred tax asset for $295 of operating loss carryforwards was fully reserved at the beginning of the current year. [QA 109, paragraph 18, sequence 125]]

b. Pretax financial income from continuing operations is $5,000.

c. Income tax expense from continuing operations is $1,500.

d. Effective tax rate is 30%.

e. Statutory tax rate is 34%.

> > > Case A: Gross Method

55-214 [The first acceptable approach, illustrated as follows, to disclosure of components of income tax expense from continuing operations is referred to as the gross method. [QA 109, paragraph 18, sequence 127]]

	Current	Deferred
Tax expense before application of investment tax credits and operating loss carryforwards	$ 540	$ 1,160
Investment tax credits	(100)	-
Tax benefit of operating loss carryforwards	(100)	-
Tax expense from continuing operations	$ 340	$ 1,160

[QA 109, paragraph 18, sequence 128]

> > > Case B: Net Method

55-215 [The second acceptable approach, illustrated as follows, to disclosure of components of income tax expense from continuing operations is referred to as the net method. [QA 109, paragraph 18, sequence 129]]

Current tax expense (net of $100 investment tax credits and $100 tax benefit of operating loss carryforwards)	$ 340
Deferred tax expense	1,160
Tax expense from continuing operations	$1,500

[QA 109, paragraph 18, sequence 130]

> > > Case C: Statutory Tax Rate Reconciliation Method

55-216 [The third acceptable approach, illustrated as follows, to disclosure of components of income tax expense from continuing operations is referred to as the statutory tax rate reconciliation method. [QA 109, paragraph 18, sequence 131]]

Current tax expense	$ 340
Deferred tax expense	1,160
Tax expense from continuing operations	$1,500
Tax expense at statutory rate	$1,700
Benefit of investment tax credits	(100)
Benefit of operating loss carryforwards	(100)
Tax expense from continuing operations	$1,500

[QA 109, paragraph 18, sequence 132]

> > Example 30: Disclosure Relating to Uncertainty in Income Taxes

55-217 [This Example illustrates the guidance in paragraph 740-10-50-15 for disclosures about uncertainty in income taxes. [FIN 48, paragraph A33, sequence 111.1]]

[The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 20X1. The Internal Revenue Service (IRS) commenced an examination of the Company's U.S. income tax returns for 20X2 through 20X4 in the first quarter of 20X7 that is anticipated to be completed by the end of 20X8. As of December 31, 20X7, the IRS has proposed certain significant adjustments to the Company's transfer pricing and research credits tax positions. Management is currently evaluating those proposed adjustments to determine if it agrees, but if accepted, the Company does not anticipate the adjustments would result in a material change to its financial position. However, the Company anticipates that it is reasonably possible that an additional payment in the range of $80 to $100 million will be made by the end of 20X8. [FIN 48, paragraph A33, sequence 112]] [A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows. [FIN 48, paragraph A33, sequence 113.2]]

	20X7	20X6	20X5
		(in thousands)	
Balance at January 1	$ 370,000	380,000	415,000
Additions based on tax positions related to the current year	10,000	5,000	10,000
Additions for tax positions of prior years	30,000	10,000	5,000
Reductions for tax positions of prior years	(60,000)	(20,000)	(30,000)
Settlements	(40,000)	(5,000)	(20,000)
Balance at December 31	$ 310,000	370,000	380,000

[FIN 48, paragraph A33, sequence 114]

[At December 31, 20X7, 20X6, and 20X5, there are $60, $55, and $40 million of unrecognized tax benefits that if recognized would affect the annual effective tax rate. [FIN 48, paragraph A33, sequence 115]]

[The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. During the years ended December 31, 20X7, 20X6, and 20X5, the Company recognized approximately $10, $11, and $12 million in interest and penalties. The Company had approximately $60 and $50 million for the payment of interest and penalties accrued at December 31, 20X7, and 20X6, respectively. [FIN 48, paragraph A33, sequence 116]]

> > Example 31: Disclosure Relating to Realizability Estimates of Deferred Tax Asset

55-218 This Example illustrates the guidance in paragraph 275-10-50-8 for disclosure relating to the realizability estimates of a deferred tax asset.

55-219 [In this Example, Entity A develops, manufactures, and markets limited-use vaccines. The entity has a dominant share of the narrow market it serves. As of December 31, 19X4, the entity has no temporary differences and has aggregate loss carryforwards of $12 million that originated in prior years and that expire in varying amounts between 19X5 and 19X7. As of December 31, 19X4, the entity has a deferred tax asset of $4.8 million that represents the benefit of the remaining $12 million in loss carryforwards, and it has concluded at that date that a valuation allowance is unnecessary. The loss carryforwards arose during the entity's development stage when it incurred high levels of research and development expenses prior to commencing sales. While the entity has earned, on average, $6 million income before tax (taxable income before carryforwards) in each of the last 5 years, future profitability in this competitive industry depends on continually developing new products. The entity has a number of promising new vaccines under development, but it is aware that other entities recently began testing vaccines that would compete with the vaccines being developed by the entity as well as products that will compete with the vaccines that are currently generating the entity's profits. Rapid introduction of competing products or failure of the entity's development efforts could reduce estimates of future profitability in the near term, which could affect the entity's ability to fully utilize its loss carryforward. [SOP 94-6, paragraph A-43, sequence 144]]

55-220 Illustrative disclosure for the entity follows.

[The entity has recorded a deferred tax asset of $4.8 million reflecting the benefit of $12 million in loss carryforwards, which expire in varying amounts between 19X5 and 19X7. Realization is dependent on generating sufficient taxable income prior to expiration of the loss carryforwards. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. [SOP 94-6, paragraph A-44, sequence 145]]

55-221 [In addition to other disclosures, information as to the amount of loss carryforwards and their expiration dates and the amount of any valuation allowance with respect to the recorded deferred tax asset is required under This Subtopic. [SOP 94-6, paragraph A-44 FN22, sequence 146]]

55-222 [The disclosure in this Example informs users that: [SOP 94-6, paragraph A-45, sequence 147.1]]

a. [Realization of the deferred tax asset depends on achieving a certain minimum level of future taxable income within the next three years. [SOP 94-6, paragraph A-45, sequence 147.2.1]]

b. [Although management currently believes that achievement of the required future taxable income is more likely than not, it is at least reasonably possible that this belief could change in the near term, resulting in establishment of a valuation allowance. [SOP 94-6, paragraph A-45, sequence 147.2.2]]

740-10-60 Relationships

General

> Compensation—Retirement Benefits

60-1 For treatment of the [difference between net periodic pension income and the amount deductible for tax purposes, see Subtopic 715-30. [QA 087, paragraph 9, sequence 84]]

> Stock Compensation

60-1A For the required accounting for income taxes in connection with stock compensation, see Subtopic 718-740.

> Business Combinations

60-2 For the required accounting for **income taxes** in connection with business combinations, see Subtopic 805-740.

> Reorganizations

60-3 For the required accounting for income taxes in connection with reorganizations, see Topic 852.

> Leases

60-4 For the specific requirements for accounting for income taxes related to leveraged leases, see Subtopic 840-30.

740-10-65 Transition and Open Effective Date Information

General

> Transition Related to FASB Staff Position FIN 48-3, Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises

65-1 The following represents the transition and effective date information related to FASB Staff Position FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises.*

- a. The Guidance in the FASB Accounting Standards Codification[TM] related to Income Taxes has been prepared on the basis of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109,* being fully effective for all entities.
- b. [FASB Staff Position FIN 48-3 issued in December 2008, deferred the effective date of Interpretation 48 for **nonpublic entities** [FSP FIN48-3, paragraph 11, sequence 11.1]]
  - 1. [The entity is not consolidated with a **public entity** that applies U.S. generally accepted accounting principles (GAAP). [FSP FIN48-3, paragraph 9, sequence 9.2]]
  - 2. [The entity has not already adopted the recognition, measurement, and disclosure provisions of that Interpretation in a full set of annual financial statements issued before December 30, 2008. [FSP FIN48-3, paragraph 9, sequence 9.3]]

- c. An entity meeting the conditions for and electing to use the deferral should refer to authoritative literature applicable to accounting for income taxes without consideration of the effects of Interpretation 48. That literature is not presented in the FASB Accounting Standards Codification™.
- d. [A nonpublic entity that qualifies for and elects to defer the application of Interpretation 48 in accordance with FASB Staff Position FIN 48-3 shall explicitly disclose that fact and shall disclose its accounting policy for evaluating uncertain tax positions for each set of financial statements where the deferral applies. [FSP FIN48-3, paragraph 10, sequence 10]]
- e. [The effective date of Interpretation 48 for entities meeting the conditions of and electing to use the deferral in FASB Staff Position FIN 48-3 is for annual financial statements for fiscal years beginning after December 15, 2008. [FSP FIN48-3, paragraph 11, sequence 11.2]]
- f. [Once effective, the guidance in Interpretation 48 shall be applied, including its application to acquired income tax positions in Subtopic 805-740, as of the beginning of the entity's fiscal year. [FSP FIN48-3, paragraph 11, sequence 11.3]]

740-10-S20 Glossary

Applicable Statutory Federal Income Tax Rate

[See paragraph 740-10-S99-1, SAB Topic 6.I.1, Question 2, for the definition of applicable statutory Federal income tax rate. [SAB TOPIC 6.I, paragraph 1 Q2, sequence 114]]

740-10-S25 Recognition

General

> Acquired Temporary Differences in Certain Purchase Transactions that Are Not Accounted for as Business Combinations

S25-1 [See paragraph 740-10-S99-3, SEC Observer Comment: Accounting for Acquired Temporary Difference in Certain Purchase Transactions that Are Not Accounted for as Business Combinations, for SEC Staff views on accounting for such transactions. [EITF 98-11, paragraph DISCUSSION, sequence 22]]

740-10-S50 Disclosure

General

> Income Tax Disclosures

S50-1 [See paragraph 235-10-S99-1, Regulation S-X Rule 4-08(h), for required disclosures related to income taxes. [SX 210.4–08, paragraph (h), sequence 22]]

S50-2 [See paragraph 740-10-S99-2, SAB Topic 11.C, for SEC Staff views on disclosures related to income tax holidays. [SAB TOPIC 11.C, paragraph Question, sequence 8]]

740-10-S55 Implementation Guidance and Illustrations

General

> Statutory to Effective Tax Rate Reconciliation

S55-1 [See paragraph 740-10-S99-1, SAB Topic 6.I.1, for SEC Staff views on the rate used in the federal income tax rate to effective tax rate reconciliation. [SAB TOPIC 6.I, paragraph 1 Q1, sequence 112]]

> Equity Method Investee Income Taxes

S55-2 [See paragraph 740-10-S99-1, SAB Topic 6.I.2, for SEC Staff views concerning required disclosures pertaining to the income taxes of an equity method investee. [SAB TOPIC 6.I, paragraph 2 Q, sequence 116]]

> Disclosures When an Item Is Presented on a Net of Tax Basis

S55-3 [See paragraph 740-10-S99-1, SAB Topic 6.I.3, for SEC Staff views on disclosures when certain items are presented net of tax on the income statement. [SAB TOPIC 6.I, paragraph 3 Q, sequence 119]]

> Reconciliation of Tax Recovery in a Loss Year

S55-4 [See paragraph 740-10-S99-1, SAB Topic 6.I.4, for SEC Staff views on whether a reconciliation of a tax recovery is required in a loss year. [SAB TOPIC 6.I, paragraph 4 Q, sequence 121]]

> Foreign Registrants

S55-5 [See paragraph 740-10-S99-1, SAB Topic 6.I.5, for SEC Staff views on required disclosures for foreign registrants. [SAB TOPIC 6.I, paragraph 5 Q1, sequence 123]]

> Reconciliation of Certain Securities Gains and Losses to the Statutory Federal Income Tax Rate

S55-6 [See paragraph 740-10-S99-1, SAB Topic 6.I.6, for SEC Staff views on the necessity of a reconciliation of certain securities gains and losses to the statutory federal income tax rate. [SAB TOPIC 6.I, paragraph 6 Q, sequence 127]]

> Disclosure When Income Tax Expense Is Allocated to More than One Financial Statement Caption

S55-7 [See paragraph 740-10-S99-1, SAB Topic 6.I.7, for SEC Staff views on whether an overall presentation is acceptable when income tax expense is allocated to more than one caption in the financial statements. [SAB TOPIC 6.I, paragraph 7 Facts, sequence 129]]

740-10-S99 SEC Materials

General

> SEC Staff Guidance

> > Staff Accounting Bulletins

> > > SAB Topic 6.I, Accounting Series Release 149—Improved Disclosure of Income Tax Expense (Adopted November 28, 1973 and Modified by ASR 280 Adopted on September 2, 1980)

S99-1 The following is the text of SAB Topic 6.I, Accounting Series Release 149—Improved Disclosure of Income Tax Expense (Adopted November 28, 1973 and Modified by ASR 280 Adopted on September 2, 1980).

[Facts: ASR 149 and 280 amend Regulation S-X to include: [SAB TOPIC 6.I, paragraph Facts, sequence 107]]

[1. Disclosure of tax effect of timing differences comprising deferred income tax expense. [SAB TOPIC 6.I, paragraph Facts, sequence 108]]

[2. Disclosure of the components of income tax expense, including currently payable and the net tax effects of timing differences. [SAB TOPIC 6.I, paragraph Facts, sequence 109]]

[3. Disclosure of the components of income [loss] before income tax expense [benefit] as either domestic or foreign. [SAB TOPIC 6.I, paragraph Facts, sequence 110]]

[4. Reconciliation between the statutory Federal income tax rate and the effective tax rate. [SAB TOPIC 6.I, paragraph Facts, sequence 111]]

1. Tax Rate

[Question 1: In reconciling to the effective tax rate should the rate used be a combination of state and Federal income tax rates? [SAB TOPIC 6.I, paragraph 1 Q1, sequence 112]]

[Interpretive Response: No, the reconciliation should be made to the Federal income tax rate only. [SAB TOPIC 6.I, paragraph 1 Q1 Response, sequence 113]]

[Question 2: What is the "**applicable statutory Federal income tax rate**"? [SAB TOPIC 6.I, paragraph 1 Q2, sequence 114]]

[Interpretive Response: The applicable statutory Federal income tax rate is the normal rate applicable to the reporting entity. Hence, the statutory rate for a U.S. partnership is zero. If, for example, the statutory rate for U.S. corporations is 22% on the first $25,000 of taxable income and 46% on the excess over $25,000, the "normalized rate" for corporations would fluctuate in the range between 22% and 46% depending on the amount of pretax accounting income a corporation has. [SAB TOPIC 6.I, paragraph 1 Q2 Response, sequence 115]]

2. Taxes of Investee Company

[Question: If a registrant records its share of earnings or losses of a 50% or less owned person on the equity basis and such person has an effective tax rate which differs by more than 5% from the applicable statutory Federal income tax rate, is a reconciliation as required by Rule 4-08 (g) necessary? [SAB TOPIC 6.I, paragraph 2 Q, sequence 116]]

[Interpretive Response: Whenever the tax components are known and material to the investor's (registrant's) financial position or results of operations, appropriate disclosure should be made. In some instances where 50% or less owned persons are accounted for by the equity method of accounting in the financial statements of the registrant, the registrant may not know the rate at which the various components of income are taxed and it may not be practicable to provide disclosure concerning such components. [SAB TOPIC 6.I, paragraph 2 Q Response, sequence 117]]

[It should also be noted that it is generally necessary to disclose the aggregate dollar and per-share effect of situations where temporary tax exemptions or "tax holidays" exist, and that such disclosures are also applicable to 50% or less owned persons. Such disclosures should include a brief description of the factual circumstances and give the date on which the special tax status will terminate. See Topic 11.C. [SAB TOPIC 6.I, paragraph 2 Q Response, sequence 118]]

3. Net of Tax Presentation

[Question: What disclosure is required when an item is reported on a net of tax basis (e. g., extraordinary items, discontinued operations, or cumulative adjustment related to accounting change)? [SAB TOPIC 6.I, paragraph 3 Q, sequence 119]]

[Interpretive Response: When an item is reported on a net of tax basis, additional disclosure of the nature of the tax component should be provided by reconciling the tax component associated with the item to the applicable statutory Federal income tax rate or rates. [SAB TOPIC 6.I, paragraph 3 Q Response, sequence 120]]

4. Loss Years

[Question: Is a reconciliation of a tax recovery in a loss year required? [SAB TOPIC 6.I, paragraph 4 Q, sequence 121]]

[Interpretive Response: Yes, in loss years the actual book tax benefit of the loss should be reconciled to expected normal book tax benefit based on the applicable statutory Federal income tax rate. [SAB TOPIC 6.I, paragraph 4 Q Response, sequence 122]]

5. Foreign Registrants

[Question 1: Occasionally, reporting foreign persons may not operate under a normal income tax base rate such as the current U.S. Federal corporate income tax rate. What form of disclosure is acceptable in these circumstances? [SAB TOPIC 6.I, paragraph 5 Q1, sequence 123]]

[Interpretive Response: In such instances, reconciliations between year-to-year effective rates or between a weighted average effective rate and the current effective rate of total tax expense may be appropriate in meeting the requirements of Rule 4-08(h)(2). A brief description of how such a rate was determined would be required in addition to other required disclosures. Such an approach would not be acceptable for a U.S. registrant with foreign operations. Foreign registrants with unusual tax situations may find that these guidelines are not fully responsive to their needs. In such instances, registrants should discuss the matter with the staff. [SAB TOPIC 6.I, paragraph 5 Q1 Response, sequence 124]]

[Question 2: Where there are significant reconciling items that relate in significant part to foreign operations as well as domestic operations, is it necessary to disclose the separate amounts of the tax component by geographical area, e.g., statutory depletion allowances provided for by U.S. and by other foreign jurisdictions? [SAB TOPIC 6.I, paragraph 5 Q2, sequence 125]]

[Interpretive Response: It is not practicable to give an all-encompassing answer to this question. However, in many cases such disclosure would seem appropriate. [SAB TOPIC 6.I, paragraph 5 Q2 Response, sequence 126]]

6. Securities Gains and Losses

[Question: If the tax on the securities gains and losses of banks and insurance companies varies by more than 5% from the applicable statutory Federal income tax rate, should a reconciliation to the statutory rate be provided? [SAB TOPIC 6.I, paragraph 6 Q, sequence 127]]

[Interpretive Response: Yes. [SAB TOPIC 6.I, paragraph 6 Q Response, sequence 128]]

7. Tax Expense Components v. "Overall" Presentation

[Facts: Rule 4-08(h) requires that the various components of income tax expense be disclosed, e.g., currently payable domestic taxes, deferred foreign taxes, etc. Frequently income tax expense will be included in more than one caption in the financial statements. For example, income taxes may be allocated to continuing operations, discontinued operations, extraordinary items, cumulative effects of an accounting change and direct charges and credits to shareholders' equity. [SAB TOPIC 6.I, paragraph 7 Facts, sequence 129]]

[Question: In instances where income tax expense is allocated to more than one caption in the financial statements, must the components of income tax expense included in each caption be disclosed or will an "overall" presentation such as the following be acceptable? [SAB TOPIC 6.I, paragraph 7 Q, sequence 130]]

[The components of income tax expense are: [SAB TOPIC 6.I, paragraph 7 Q, sequence 131.1]]

Currently payable (per tax return):	
Federal	$ 350,000
Foreign	150,000
State	50,000
Deferred:	
Federal	125,000
Foreign	75,000
State	50,000
	$ 800,000

[SAB TOPIC 6.I, paragraph 7 Q, sequence 131.2]

[Income tax expense is included in the financial statements as follows: [SAB TOPIC 6.I, paragraph 7 Q, sequence 132.1]]

Continuing operations	$ 600,000
Discontinued operations	(200,000)
Extraordinary income	300,000
Cumulative effect of change in accounting principle	100,000
	$ 800,000

[SAB TOPIC 6.I, paragraph 7 Q, sequence 132.2]

[Interpretive Response: An overall presentation of the nature described will be acceptable. [SAB TOPIC 6.I, paragraph 7 Q Response, sequence 133]]

> > > SAB Topic 11.C, Tax Holidays

S99-2 The following is the text of SAB Topic 11.C, Tax Holidays.

[Facts: Company C conducts business in a foreign jurisdiction which attracts industry by granting a "holiday" from income taxes for a specified period. [SAB TOPIC 11.C, paragraph Facts, sequence 7]]

[Question: Does the staff generally request disclosure of this fact? [SAB TOPIC 11.C, paragraph Question, sequence 8]]

[Interpretive Response: Yes. In such event, a note must (1) disclose the aggregate dollar and per share effects of the tax holiday and (2) briefly describe the factual circumstances including the date on which the special tax status will terminate. [SAB TOPIC 11.C, paragraph Question Interpretive Response, sequence 9]]

> > Comments Made by SEC Observer at Emerging Issues Task Force (EITF) Meetings

> > > SEC Observer Comment: Accounting for Acquired Temporary Differences in Certain Purchase Transactions that Are Not Accounted for as Business Combinations

S99-3 The following is the text of SEC Observer Comment: Accounting for Acquired Temporary Differences in Certain Purchase Transactions that Are Not Accounted for as Business Combinations.

[Paragraph 740-10-25-50 provides guidance on the accounting for acquired temporary differences in purchase transactions that are not business combinations. The SEC staff would object to broadly extending this guidance to adjust the basis in an asset acquisition to situations different from those illustrated in Examples 25 through 26 (see paragraphs 740-10-55-170 through 55-204) without first having a clear and complete understanding of those specific fact patterns. [EITF 98-11, paragraph DISCUSSION, sequence 22]]

May 29, 2009

740 Income Taxes
20 Intraperiod Tax Allocation

740-20-00 Status

General

00-1 No updates have been made to this subtopic.

740-20-05 Overview and Background

General

05-1 Subtopic 740-10 addresses the majority of accounting requirements for **income taxes**. That Subtopic also establishes the methods and requirements for computing total income tax expense or benefit for an entity.

05-2 This Subtopic addresses the process of intraperiod tax allocation that allocates total income tax expense or benefit of an entity for a period to different components of comprehensive income and shareholders' equity. [This includes allocating income tax expense or benefit for the year to: [FAS 109, paragraph 35, sequence 286.1.1]]

a. [Continuing operations [FAS 109, paragraph 35, sequence 286.1.2.1]]

b. [Discontinued operations [FAS 109, paragraph 35, sequence 286.1.2.2.1]]

c. [Extraordinary items [FAS 109, paragraph 35, sequence 286.1.2.2.2.1]]

d. [Other comprehensive income [FAS 109, paragraph 35, sequence 286.1.2.2.2.2.1]]

e. [Items charged or credited directly to shareholders' equity. [FAS 109, paragraph 35, sequence 286.1.2.2.2.2.2]]

This Subtopic provides guidance on the method for making those allocations of total income tax expense or benefit and provides several examples and illustrations.

740-20-15 Scope and Scope Exceptions

General

> Overall Guidance

15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 740-10-15, with specific transaction qualifications noted below.

> Transactions

15-2 The guidance in this Subtopic applies to the process of allocating total income tax expense or benefit of an entity for a period to different components of comprehensive income and shareholders' equity.

740-20-20 Glossary

Carryforwards

[Deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year; a tax credit carryforward is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried forward and the length of the carryforward period. The terms carryforward, operating loss carryforward, and tax credit carryforward refer to the amounts of those items, if any, reported in the tax return for the current year. [FAS 109, paragraph 289, sequence 1044]]

Current Tax Expense (or Benefit)

[The amount of income taxes paid or payable (or refundable) for a year as determined by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues for that year. [FAS 109, paragraph 289, sequence 1046]]

Deductible Temporary Difference

[Temporary differences that result in deductible amounts in future years when the related asset or liability is recovered or settled, respectively. See Temporary Difference. [FAS 109, paragraph 289, sequence 1048]]

Deferred Tax Asset

[The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a

ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

deferred tax asset will not be realized. [FAS 109, paragraph 289, sequence 1050]]

Deferred Tax Expense (or Benefit)

[The change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets acquired in a purchase business combination during the year, it is the change since the combination date. Income tax expense (or benefit) for the year is allocated among continuing operations, discontinued operations, extraordinary items, and items charged or credited directly to shareholders' equity. [FAS 109, paragraph 289, sequence 1054]]

Deferred Tax Liability

[The deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law. [FAS 109, paragraph 289, sequence 1056]]

Gains and Losses Included in Comprehensive Income but Excluded from Net Income

[Gains and losses included in comprehensive income but excluded from net income include certain changes in market values of investments in marketable equity securities classified as noncurrent assets, certain changes in market values of investments in industries having specialized accounting practices for marketable securities, adjustments related to pension liabilities or assets recognized within other comprehensive income, and foreign currency translation adjustments. Future changes to generally accepted accounting principles (GAAP) may change what is included in this category. [FAS 109, paragraph 289, sequence 1060]]

Income Tax Expense (or Benefit)

[The sum of current tax expense (or benefit) and deferred tax expense (or benefit). [FAS 109, paragraph 289, sequence 1066]]

Income Taxes

[Domestic and foreign federal (national), state, and local (including franchise) taxes based on income. [FAS 109, paragraph 289, sequence 1062]]

Income Taxes Currently Payable (Refundable)

[See Current Tax Expense (or Benefit). [FAS 109, paragraph 289, sequence 1064]]

Tax Consequences

[The effects on income taxes—current or deferred—of an event. [FAS 109, paragraph 289, sequence 1076]]

Taxable Income

[The excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority. [FAS 109, paragraph 289, sequence 1072]]

Taxable Temporary Difference

[Temporary differences that result in taxable amounts in future years when the related asset is recovered or the related liability is settled. See Temporary Difference. [FAS 109, paragraph 289, sequence 1074]]

Valuation Allowance

[The portion of a deferred tax asset for which it is more likely than not that a tax benefit will not be realized. [FAS 109, paragraph 289, sequence 1082]]

740-20-45 Other Presentation Matters

General

> Allocation of Income Tax Expense or Benefit for the Year

45-1 This guidance addresses the requirements to allocate total income tax expense or benefit. Subtopic 740-10 defines the requirements for computing total income tax expense or benefit for an entity. As defined by those requirements, total income tax expense or benefit includes current and deferred **income taxes**. After determining total income tax expense or benefit under those requirements, the intraperiod tax allocation guidance is used to allocate total income tax expense or benefit to different components of comprehensive income and shareholders' equity.

45-2 [Income tax expense or benefit for the year shall be allocated among: [FAS 109, paragraph 35, sequence 286.1.1]]

a. [Continuing operations [FAS 109, paragraph 35, sequence 286.1.2.1]]

b. [Discontinued operations [FAS 109, paragraph 35, sequence 286.1.2.2.1]]

c. [Extraordinary items [FAS 109, paragraph 35, sequence 286.1.2.2.2.1]]

d. [Other comprehensive income [FAS 109, paragraph 35, sequence 286.1.2.2.2.2.1]]

e. [Items charged or credited directly to shareholders' equity. [FAS 109, paragraph 35, sequence 286.1.2.2.2.2.2]]

45-3 [The tax benefit of an operating loss carryforward or carryback (other than for the exceptions related to the **carryforwards** identified in (a) and (b)) shall be reported in the same manner as the source of the income or loss in the current year and not in the same manner as the source of the operating loss carryforward or taxes paid in a prior year or the source of expected future income that will result in realization of a **deferred tax asset** for an operating loss carryforward from the current year. The only exceptions are as follows: [FAS 109, paragraph 37, sequence 296]]

a. [Tax effects of deductible temporary differences and carryforwards that existed at the date of a purchase business combination and for which a tax benefit is initially recognized in subsequent years in accordance with the provisions of paragraph 30 of FASB Statement 109, *Accounting for Income Taxes*, before that Statement's amendment by FASB Statement 141 (revised 2007). [FAS 109, paragraph 37, sequence 297]]

b. [Tax effects of deductible temporary differences and carryforwards that are allocated to shareholders' equity in accordance with the provisions of paragraph 740-20-45-11(c) through (f). [FAS 109, paragraph 37, sequence 298]]

Pending Content:

Transition Date: *December 15, 2008* | **Transition Guidance:** **805-10-65-1**

[The tax benefit of an operating loss carryforward or carryback (other than for the exceptions related to the **carryforwards** identified at the end of this paragraph) shall be reported in the same manner as the source of the income or loss in the current year and not in the same manner as the source of the operating loss carryforward or taxes paid in a prior year or the source of expected future income that will result in realization of a **deferred tax asset** for an operating loss carryforward from the current year. The only exception is the tax effects of deductible temporary differences and carryforwards that are allocated to shareholders' equity in accordance with the provisions of paragraph 740-20-45-11(c) through (f). [FAS 109, paragraph 37, sequence 296]]

a. Paragraph superseded by Codification Update 2008–006

b. Paragraph superseded by Codification Update 2008–006.

45-4 [Paragraph 740-10-45-20 requires that changes in the beginning of the year balance of a **valuation allowance** caused by changes in judgment about the realization of deferred tax assets in future years are ordinarily allocated to continuing operations. That paragraph also identifies certain exceptions to that allocation guidance related to business combinations and the items specified in paragraph 740-20-45-11(c) through (f). The effect of other changes in the balance of a valuation allowance are allocated among continuing operations and items other than continuing operations using the general allocation methodology presented in this Section. [FAS 109, paragraph 26, sequence 259.2]]

45-5 [See Section 740-20-55 for examples of the allocation of total tax expense or benefit to continuing operations, the effect of a tax credit carryforward, and an allocation to other comprehensive income . [FAS 109, paragraph 38, sequence 304]]

> Allocation to Continuing Operations

45-6 This guidance addresses the allocation methodology for allocating total income tax expense or benefit to continuing operations. The amount of income tax expense or benefit allocated to continuing operations may include multiple components. The tax effect of pretax income or loss from current year continuing operations is always one component of the amount allocated to continuing operations.

45-7 [The tax effect of pretax income or loss from continuing operations generally should be determined by a computation that does not consider the tax effects of items that are not included in continuing operations. [EITF D-032, paragraph , sequence 3]] [The exception to that incremental approach is that all items (for example, extraordinary items, discontinued operations, and so forth) be considered in determining the amount of tax benefit that results from a loss from continuing operations and that shall be allocated to continuing operations. That modification of the incremental approach is to be consistent with the approach in Subtopic 740-10 to consider the **tax consequences** of **taxable income** expected in future years in assessing the realizability of deferred tax assets. [EITF D-032, paragraph , sequence 5]] [Application of this modification makes it appropriate to consider an extraordinary gain in the current year for purposes of allocating a tax benefit to a current-year loss from continuing operations. [FAS 109, paragraph 140, sequence 495.2.1]]

45-8 [The amount allocated to continuing operations is the tax effect of the pretax income or loss from continuing operations that occurred during the year, plus or minus income tax effects of: [FAS 109, paragraph 35, sequence 286.2.1]]

a. [Changes in circumstances that cause a change in judgment about the realization of deferred tax assets in future years (see paragraph 740-10-45-20 for a discussion of exceptions to this allocation for certain items) [FAS 109, paragraph 35, sequence 286.2.2.1]]

b. [Changes in tax laws or rates (see paragraph 740-10-35-4 [FAS 109, paragraph 35, sequence 286.2.2.2.1]]

c. [Changes in tax status (see paragraphs 740-10-25-32 and 740-10-40-6) [FAS 109, paragraph 35, sequence 286.2.2.2.2.1]]

d. [Tax-deductible dividends paid to shareholders (except as set forth in paragraph 740-20-45-11(e) for dividends paid on unallocated shares held by an employee stock ownership plan or any other stock compensation arrangement). [FAS 109, paragraph 35, sequence 286.2.2.2.2.2.1]]

[The remainder is allocated to items other than continuing operations in accordance with the provisions of paragraphs 740-20-45-12 and 740-20-45-14. [FAS 109, paragraph 35, sequence 286.2.2.2.2.2.2]]

45-9 See Example 1 (paragraph 740-20-55-1) for an example of the allocation of total tax expense or benefit to continuing operations.

> Allocations to Items Other than Continuing Operations

45-10 This guidance identifies specific items outside of continuing operations that require an allocation of income tax expense or benefit. It also establishes the methodology for allocation. That methodology differs depending on whether there is only one item other than continuing operations or whether there are multiple items other than continuing operations.

45-11 [The tax effects of the following items occurring during the year shall be charged or credited directly to other comprehensive income or to related components of shareholders' equity: [FAS 109, paragraph 36, sequence 287]]

a. [Adjustments of the opening balance of retained earnings for certain changes in accounting principles or a correction of an error. Paragraph 250-10-45-8 addresses the effects of a change in accounting principle, including any related income tax effects. [FAS 109, paragraph 36, sequence 288]]

b. [**Gains and losses included in comprehensive income but excluded from net income** (for example, translation adjustments accounted for under the requirements of Topic 830 and changes in the unrealized holding gains and losses of securities classified as available-for-sale as required by Topic 320). [FAS 109, paragraph 36, sequence 289]]

c. [An increase or decrease in contributed capital (for example, deductible expenditures reported as a reduction of the proceeds from issuing capital stock). [FAS 109, paragraph 36, sequence 290]]

d. [Expenses for employee stock options recognized differently for financial reporting and tax purposes as required by Subtopic 718-740. [FAS 109, paragraph 36, sequence 293]] [An employee stock ownership plan and a stock option plan are analogous. Both are compensatory arrangements and both sometimes result in tax deductions for amounts that are not presently recognized as compensation expense in the financial statements under existing generally accepted accounting principles (GAAP). The tax benefits of both are reported as a credit to shareholders' equity. [FAS 109, paragraph 144, sequence 499.2]]

e. [Dividends that are paid on unallocated shares held by an employee stock ownership plan and that are charged to retained earnings. [FAS 109, paragraph 36, sequence 294]] [This is different from a tax deduction received for the payment of dividends on allocated shares held by an employee stock ownership plan that represents, in substance, an exemption from taxation of an equivalent amount of earnings for which the tax benefit shall be recognized as a reduction of tax expense and shall not be allocated directly to shareholders' equity. [FAS 109, paragraph 145, sequence 500]]

f. [Deductible temporary differences and carryforwards that existed at the date of a quasi reorganization. [FAS 109, paragraph 36, sequence 295]]

g. [All changes in the tax bases of assets and liabilities caused by transactions among or with shareholders shall be included in equity including the effect of valuation allowances initially required upon recognition of any related deferred tax assets. Changes in valuation allowances occurring in subsequent periods shall be included in the income statement. [EITF 94-10, paragraph DISCUSSION, sequence 9]]

> Single Item of Allocation Other than Continuing Operations

45-12 [If there is only one item other than continuing operations, the portion of income tax expense or benefit for the year that remains after the allocation to continuing operations shall be allocated to that item. [FAS 109, paragraph 38, sequence 299.1]]

45-13 See Example 2 (paragraph 740-20-55-8) for an example of the allocation of total tax expense or benefit to continuing operations and one other item.

> Multiple Items of Allocation Other than Continuing Operations

45-14 [If there are two or more items other than continuing operations, the amount that remains after the allocation to continuing operations shall be allocated among those other items in proportion to their individual effects on income tax expense or benefit for the year. When there are two or more items other than continuing operations, the sum of the separately calculated, individual effects of each item sometimes may not equal the amount of income tax expense or benefit for the year that remains after the allocation to continuing operations. In those circumstances, the procedures to allocate the remaining amount to items other than continuing operations are as follows: [FAS 109, paragraph 38, sequence 299.2]]

a. [Determine the effect on income tax expense or benefit for the year of the total net loss for all net loss items. [FAS 109, paragraph 38, sequence 300]]

b. [Apportion the tax benefit determined in (a) ratably to each net loss item. [FAS 109, paragraph 38, sequence 301]]

c. [Determine the amount that remains, that is, the difference between the amount to be allocated to all items other than continuing operations and the amount allocated to all net loss items. [FAS 109, paragraph 38, sequence 302]]

d. [Apportion the tax expense determined in (c) ratably to each net gain item. [FAS 109, paragraph 38, sequence 303]]

740-20-55 Implementation Guidance and Illustrations

General

> Illustrations

> > Example 1: Allocation to Continuing Operations

55-1 [Paragraph 740-20-45-8 states that the amount of **income tax expense or benefit** allocated to continuing operations is the tax effect of pretax income or loss from continuing operations that occurred during the year plus or minus certain adjustments. [QA 109, paragraph 19, sequence 138.1]]

55-2 [The adjustments include the tax effects of: [QA 109, paragraph 19 FN7, sequence 139.1]]

a. [Changes in circumstances that cause a change in judgment about the realization of deferred tax assets in future years [QA 109, paragraph 19 FN7, sequence 139.2.1]]

b. [Changes in tax laws or rates [QA 109, paragraph 19 FN7, sequence 139.2.2.1]]

c. [Changes in tax status [QA 109, paragraph 19 FN7, sequence 139.2.2.2.1]]

d. [Tax-deductible dividends paid to shareholders (except as set forth in paragraph 740-20-45-11 for dividends paid on unallocated shares held by an employee stock ownership plan or any other stock compensation arrangement). [QA 109, paragraph 19 FN7, sequence 139.2.2.2.2]]

55-3 [The allocation of income tax expense between pretax income from continuing operations and other items shall include deferred taxes. [QA 109, paragraph 19, sequence 138.2]]

55-4 [This Example illustrates allocation of current and **deferred tax expense**. The assumptions are as follows: [QA 109, paragraph 19, sequence 140]]

a. [Tax rates are 40 percent for Years 1, 2, and 3 and 30 percent for Year 4 and subsequent years. No valuation allowances are required for deferred tax assets. [QA 109, paragraph 19, sequence 141]]

b. [At the end of Year 1, there is a $500 **taxable temporary difference** relating to the entity's contracting operations and a $200 **deductible temporary difference** related to its other operations. Determination of the entity's deferred tax assets and liabilities at the end of Year 1 is as follows. [QA 109, paragraph 19, sequence 142]]

	Future Years			
Temporary Differences	Year 2	Year 3	Year 4	Total
Contracting operations	$ -	$ -	$ 500	$500
Other operations	(100)	(100)	-	(200)
	$(100)	$(100)	$ 500	$300
Enacted tax rate for future years	40%	40%	30%	
Deferred tax liability (asset)	$ (40)	$ (40)	$ 150	$ 70

[QA 109, paragraph 19, sequence 143]

c. [During Year 2, the entity decides that it will sell its contracting operations in Year 3. As a result, all temporary differences related to the contracting operations (the $500 taxable temporary difference that existed at the end of Year 1, plus an additional $200 taxable temporary difference that arose during Year 2) are now considered to result in taxable amounts in Year 3 because the contracting operations will be sold in Year 3. [QA 109, paragraph 19, sequence 144]]

d. [At the end of Year 2, the entity also has $300 of deductible temporary differences ($100 of the temporary difference that existed at the end of Year 1, plus an additional $200 that arose during Year 2) from continuing operations. [QA 109, paragraph 19, sequence 145]]

e. [For Year 2, the entity has $50 of pretax reported income from continuing operations and $200 of pretax reported income from discontinued operations. [QA 109, paragraph 19, sequence 146]]

f. [Determination of the entity's **deferred tax asset** and **liability** at the end of Year 2 is as follows. [QA 109, paragraph 19, sequence 147]]

Temporary Differences	Future Years: Year 3	Year 4	Total
Discontinued operations	$ 700	$ -	$ 700
Continuing operations	(200)	(100)	(300)
	$ 500	$ (100)	$ 400
Enacted tax rate for future years	40%	30%	
Deferred tax liability (asset)—net	$ 200	$ (30)	$ 170

[QA 109, paragraph 19, sequence 148]

55-5 [Total deferred tax expense for Year 2 is $100 ($170 – $70). The deferred tax benefit of the deductible temporary differences related to the entity's continuing operations during Year 2 is determined as follows. [QA 109, paragraph 19, sequence 149]]

Deferred tax asset related to the entity's continuing operations at the end of Year 2 (40 percent of $200 and 30 percent of $100)	$ (110)
Deferred tax asset related to the entity's continuing operations at the beginning of Year 2 (40 percent of $200)	(80)
Deferred tax benefit for Year 2	$ (30)

[QA 109, paragraph 19, sequence 150]

55-6 [The deferred tax expense for taxable temporary differences related to the entity's discontinued operations during Year 2 is determined as follows. [QA 109, paragraph 19, sequence 151]]

Deferred tax liability at the end of Year 2 (40 percent of $700)	$280
Deferred tax liability at the end of Year 1 (30 percent of $500)	(150)
Deferred tax expense for Year 2	$130

[QA 109, paragraph 19, sequence 152]

55-7 [Total tax expense and tax expense allocated to continuing and discontinued operations for Year 2 are determined as follows. [QA 109, paragraph 19, sequence 153]]

	Discontinued Operations	Continuing Operations	Total
Pretax reported income	$ 200	$ 50	$250
Originating and reversing temporary differences, net	(200)	100	(100)
Taxable income	$ -	$ 150	$150
Current tax expense (40 percent)	$ -	$ 60	$ 60
Deferred tax expense (benefit) as determined above	130	(30)	100
Income tax expense	$ 130	$ 30	$160

[QA 109, paragraph 19, sequence 154]

> > Example 2: Allocations of Income Taxes to Continuing Operations and One Other Item

55-8 [If there is only one item other than continuing operations, the portion of income tax expense or benefit for the year that remains after the allocation to continuing operations is allocated to that item. If there are two or more items other than continuing operations, the amount that remains after the allocation to continuing operations is allocated among those other items in proportion to their individual effects on income tax expense or benefit for the year. [FAS 109, paragraph 273, sequence 846]]

55-9 The following Cases both present allocations of income tax to continuing operations when there is only one item other than income from continuing operations:

a. Loss from continuing operations with an extraordinary gain (Case A)

b. Income from continuing operations with a loss from discontinued operations (Case B).

> > > Case A: Loss from Continuing Operations with an Extraordinary Gain

55-10 [This Case illustrates allocation of income tax expense if there is only one item other than income from continuing operations. The assumptions are as follows: [FAS 109, paragraph 274, sequence 847]]

a. [The entity's pretax financial income and **taxable income** are the same. [FAS 109, paragraph 274, sequence 848]]

b. [The entity's ordinary loss from continuing operations is $500. [FAS 109, paragraph 274, sequence 849]]

c. [The entity also has an extraordinary gain of $900 that is a capital gain for tax purposes. [FAS 109, paragraph 274, sequence 850]]

d. [The tax rate is 40 percent on ordinary income and 30 percent on capital gains. **Income taxes currently payable** are $120 ($400 at 30 percent). [FAS 109, paragraph 274, sequence 851]]

55-11 [Income tax expense is allocated between the pretax loss from operations and the extraordinary gain as follows. [FAS 109, paragraph 274, sequence 852]]

Total income tax expense	$ 120
Tax benefit allocated to the loss from operations	(150)
Incremental tax expense allocated to the extraordinary gain	$ 270

[FAS 109, paragraph 274, sequence 853]

55-12 [The effect of the $500 loss from continuing operations was to offset an equal amount of capital gains that otherwise would be taxed at a 30 percent tax rate. Thus, $150 ($500 at 30 percent) of tax benefit is allocated to continuing operations. The $270 incremental effect of the extraordinary gain is the difference between $120 of total tax expense and the $150 tax benefit from continuing operations. [FAS 109, paragraph 274, sequence 854]]

> > > Case B: Income from Continuing Operations with a Loss from Discontinued Operations

55-13 This Case further illustrates the general requirement to determine the tax effects of pretax income from continuing operations by a computation that does not consider the tax effects of items that are not included in continuing operations.

55-14 [To illustrate, assume that in the current year an entity has $1,000 of income from continuing operations and a $1,000 loss from discontinued operations. At the beginning of the year, the entity has a $2,000 net operating loss carryforward for which the deferred tax asset, net of its **valuation allowance**, is zero, and the entity did not reduce that valuation allowance during the year. No tax expense should be allocated to income from continuing operations because the $2,000 loss carryforward is sufficient to offset that income. Thus, no tax benefit is allocated to the loss from discontinued operations. [EITF D-032, paragraph , sequence 4]] See paragraph 740-20-45-7 for the exception to the general requirement when an entity has a loss from continuing operations.

> > Example 3: Allocation of the Benefit of a Tax Credit Carryforward

55-15 [This Example illustrates the guidance in paragraphs 740-20-45-7 through 45-8 for allocation of the tax benefit of a tax credit carryforward that is recognized as a deferred tax asset in the current year. The assumptions are as follows: [FAS 109, paragraph 275, sequence 855]]

a. [The entity's pretax financial income and taxable income are the same. [FAS 109, paragraph 275, sequence 856]]

b. [Pretax financial income for the year comprises $300 from continuing operations and $400 from an extraordinary gain. [FAS 109, paragraph 275, sequence 857]]

c. [The tax rate is 40 percent. Taxes payable for the year are zero because $330 of tax credits that arose in the current year more than offset the $280 of tax otherwise payable on $700 of taxable income. [FAS 109, paragraph 275, sequence 858]]

d. [A $50 deferred tax asset is recognized for the $50 ($330 - $280) tax credit carryforward. Based on the weight of available evidence, management concludes that no valuation allowance is necessary. [FAS 109, paragraph 275, sequence 859]]

55-16 [Income tax expense or benefit is allocated between pretax income from continuing operations and the extraordinary gain as follows. [FAS 109, paragraph 275, sequence 860]]

Total income tax benefit		$ (50)
Tax expense (benefit) allocated to income from continuing operations:		
Tax (before tax credits) on $300 of taxable income at 40 percent	$120	
Tax credits	(330)	(210)
Tax expense allocated to the extraordinary gain		$160

[FAS 109, paragraph 275, sequence 861]

55-17 [Absent the extraordinary gain and assuming it was not the deciding factor in reaching a conclusion that a valuation allowance is not needed, the entire tax benefit of the $330 of tax credits would be allocated to continuing operations. The presence of the extraordinary gain does not change that allocation. [FAS 109, paragraph 275, sequence 862]]

>> Example 4: Allocation to Other Comprehensive Income

55-18 [Income taxes are sometimes allocated directly to shareholders' equity or to other comprehensive income. This Example illustrates the allocation of income taxes for translation adjustments under the requirements of Subtopic 830-30 to other comprehensive income. [FAS 109, paragraph 276, sequence 863]] In this Example, FC represents units of foreign currency.

55-19 [A foreign subsidiary has earnings of FC 600 for Year 2. Its net assets (and unremitted earnings) are FC 1,000 and FC 1,600 at the end of Years 1 and 2, respectively. [FAS 109, paragraph 276, sequence 864]]

55-20 [The foreign currency is the functional currency. For Year 2, translated amounts are as follows. [FAS 109, paragraph 276, sequence 865]]

	Foreign Currency	Exchange Rate	Dollars
Unremitted earnings, beginning of year	1,000	FC1 = $1.20	$1,200
Earnings for the year	600	FC1 = $1.10	660
Unremitted earnings, end of year	1,600	FC1 = $1.00	$1,600

[FAS 109, paragraph 276, sequence 866]

55-21 [A $260 translation adjustment ($1,200 + $660 - $1,600) is reported in other comprehensive income and accumulated in shareholders' equity for Year 2. [FAS 109, paragraph 276, sequence 867]]

55-22 [The U.S. parent expects that all of the foreign subsidiary's unremitted earnings will be remitted in the foreseeable future, and under the requirements of Subtopic 740-30, a deferred U.S. tax liability is recognized for those unremitted earnings. [FAS 109, paragraph 276, sequence 868]]

55-23 [The U.S. parent accrues the **deferred tax liability** at a 20 percent tax rate (that is, net of foreign tax credits, foreign tax credit **carryforwards**, and so forth). An analysis of the net investment in the foreign subsidiary and the related deferred tax liability for Year 2 is as follows. [FAS 109, paragraph 276, sequence 869]]

	Net Investment	Deferred Tax Liability
Balances, beginning of year	$ 1,200	$ 240
Earnings and related taxes	660	132
Translation adjustment and related taxes	(260)	(52)
Balances, end of year	$ 1,600	$ 320

[FAS 109, paragraph 276, sequence 870]

55-24 [For Year 2, $132 of deferred taxes are charged against earnings, and $52 of deferred taxes are reported in other comprehensive income and accumulated in shareholders' equity. [FAS 109, paragraph 276, sequence 871]]

740-20-60 Relationships

General

> Investments—Debt and Equity Securities

60-1 For the required accounting for the offsetting entry to the **valuation allowance** for deferred tax assets when the valuation allowance is directly related to the unrealized holding loss on available-for-sale securities, see Section 320-10-45.

May 29, 2009

740 Income Taxes
30 Other Considerations or Special Areas

740-30-00 Status

General

00-1 No updates have been made to this subtopic.

740-30-05 Overview and Background

General

> Undistributed Earnings of Subsidiaries and Corporate Joint Ventures

05-1 Subtopic 740-10 addresses the majority of tax accounting issues. That Subtopic addresses the majority of differences between the financial reporting (or book) basis and tax basis of assets and liabilities (basis differences) and the requirements to record deferred **income taxes** on those differences. It also identifies specific and limited exceptions to the otherwise required recognition of deferred taxes on basis differences.

05-2 This Subtopic provides the required accounting and disclosure guidance for certain of the specific limited exceptions identified in Subtopic 740-10 to the requirements to record deferred taxes on specific basis differences related to investments in subsidiaries and corporate joint ventures arising from undistributed earnings or other causes.

05-3 The accounting addressed in this Subtopic represents, in some situations, an exception to the otherwise required comprehensive recognition of deferred income taxes for temporary differences.

05-4 [A domestic or foreign **subsidiary** remits earnings to a parent entity after the parties consider numerous factors, including the following: [APB 23, paragraph 8, sequence 40]]

a. [Financial requirements of the parent entity [APB 23, paragraph 8, sequence 41]]

b. [Financial requirements of the subsidiary [APB 23, paragraph 8, sequence 42]]

c. [Operational and fiscal objectives of the parent entity, both long-term and short-term [APB 23, paragraph 8, sequence 43]]

d. [Remittance restrictions imposed by governments [APB 23, paragraph 8, sequence 44]]

e. [Remittance restrictions imposed by lease or financing agreements of the subsidiary [APB 23, paragraph 8, sequence 45]]

f. [**Tax consequences** of the remittance. [APB 23, paragraph 8, sequence 46]]

05-5 [Remittance of earnings of a subsidiary may sometimes be indefinite because of the specific long-term investment plans and objectives of the parent entity. Even in the absence of long-term investment plans, the flexibility inherent in the U.S. Internal Revenue Code may permit a parent entity to postpone income taxes on the earnings of a subsidiary for an extended period or may permit the ultimate distribution to be taxed at special rates applicable to the nature of the distribution. Other circumstances may indicate that the earnings will probably be remitted in the foreseeable future. However, the parent entity may control the events that create the tax consequences in either circumstance. [APB 23, paragraph 8, sequence 47]]

05-6 [**Corporate joint ventures** are of two kinds: those essentially permanent in duration and those that have a life limited by the nature of the venture or other business activity. [APB 23, paragraph 15, sequence 60.1]]

05-7 [Unless characteristics indicate a limited life, a corporate joint venture has many of the characteristics of a subsidiary. The investors usually participate in the management of the joint venture, consider the factors set forth in paragraph 740-30-05-4, and agree (frequently before forming the venture) as to plans for long-term investment, for utilizing the flexibility inherent in the U.S. Internal Revenue Code, and for planned remittances. [APB 23, paragraph 16, sequence 61]]

740-30-15 Scope and Scope Exceptions

General

> Overall Guidance

15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 740-10-15, with specific transaction qualifications noted below.

> Transactions

15-2 The guidance in this Subtopic applies to basis differences arising from investments in subsidiaries and corporate joint ventures.

15-3 The basis differences addressed in this Subtopic represent situations where there are exceptions to the general requirements established in the Overall Subtopic for the comprehensive recognition of deferred **income taxes** on temporary differences.

15-4 There are other exceptions to the comprehensive recognition of deferred income taxes on temporary differences specifically addressed in other Subtopics. However; the provisions of this Subtopic [shall not be applied to analogous types of temporary differences. [FAS 109, paragraph 31, sequence 275]]

740-30-20 Glossary

Benefit

See Tax (or Benefit).

Carryforwards

[Deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year; a tax credit carryforward is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried forward and the length of the carryforward period. The terms carryforward, operating loss carryforward, and tax credit carryforward refer to the amounts of those items, if any, reported in the tax return for the current year. [FAS 109, paragraph 289, sequence 1044]]

Consolidated Financial Statements

Note: The following definition is Pending Content; see Transition Guidance in 810-10-65-1.

[The financial statements of a consolidated group of entities that include a parent and all its subsidiaries presented as those of a single economic entity. [ARB 51, paragraph B1, sequence 79.2]]

Corporate Joint Venture

[A corporation owned and operated by a small group of entities (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. [APB 18, paragraph 3, sequence 44.1]] [A government may also be a member of the group. [APB 18, paragraph 3, sequence 44.2.1.1]] [The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. [APB 18, paragraph 3, sequence 44.2.1.2.1]] [A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. [APB 18, paragraph 3, sequence 44.2.1.2.2.1]] [Joint venturers thus have an interest or relationship other than as passive investors. [APB 18, paragraph 3, sequence 44.2.1.2.2.2]] [An entity that is a subsidiary of one of the joint venturers is not a corporate joint venture. [APB 18, paragraph 3, sequence 44.2.2.1.1]] [The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. [APB 18, paragraph 3, sequence 44.2.2.1.2]] [A minority public ownership, however, does not preclude a corporation from being a corporate joint venture. [APB 18, paragraph 3, sequence 44.2.2.2]]

Deductible Temporary Difference

[Temporary differences that result in deductible amounts in future years when the related asset or liability is recovered or settled, respectively. See Temporary Difference. [FAS 109, paragraph 289, sequence 1048]]

Deferred Tax Asset

[The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. [FAS 109, paragraph 289, sequence 1050]]

Deferred Tax Liability

[The deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law. [FAS 109, paragraph 289, sequence 1056]]

Income Taxes

[Domestic and foreign federal (national), state, and local (including franchise) taxes based on income. [FAS 109, paragraph 289, sequence 1062]]

Noncontrolling Interest

Note: The following definition is Pending Content; see Transition Guidance in 805-10-65-1 and 810-10-65-1.

[The portion of equity (net assets) in a subsidiary not attributable, directly or indirectly, to a parent. A noncontrolling interest is sometimes called a minority interest. [ARB 51, paragraph B1, sequence 79.4]]

Parent

Note: The following definition is Pending Content; see Transition Guidance in 810-10-65-1.

[An entity that has a controlling financial interest in one or more subsidiaries. (Also, an entity that is the primary beneficiary of a variable interest entity.) [ARB 51, paragraph B1, sequence 79.6]]

Subsidiary

[An entity that is controlled, directly or indirectly, by another entity. [APB 18, paragraph 3, sequence 43.1]]

Note: The following definition is Pending Content; see Transition Guidance in 810-10-65-1.

[An entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest. (Also, a variable interest entity that is consolidated by a primary beneficiary.) [ARB 51, paragraph B1, sequence 79.7]]

Tax (or Benefit)

[Tax (or benefit) is the total income tax expense (or benefit), including the provision (or benefit) for income taxes both currently payable and deferred. [FIN 18, paragraph 5, sequence 27]]

Tax Consequences

[The effects on income taxes—current or deferred—of an event. [FAS 109, paragraph 289, sequence 1076]]

Taxable Income

[The excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority. [FAS 109, paragraph 289, sequence 1072]]

Taxable Temporary Difference

[Temporary differences that result in taxable amounts in future years when the related asset is recovered or the related liability is settled. See Temporary Difference. [FAS 109, paragraph 289, sequence 1074]]

Temporary Difference

[A difference between the tax basis of an asset or liability computed pursuant to the requirements in Subtopic 740-10 for tax positions, and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. Paragraph 740-10-25-20 cites eight examples of temporary differences. Some temporary differences cannot be identified with a particular asset or liability for financial reporting (see paragraphs 740-10-05-10 and 740-10-25-24 through 25-25), but those temporary differences do meet both of the following conditions: [FAS 109, paragraph 289, sequence 1080.1]]

a. [Result from events that have been recognized in the financial statements [FAS 109, paragraph 289, sequence 1080.2.1]]

b. [Will result in taxable or deductible amounts in future years based on provisions of the tax law. [FAS 109, paragraph 289, sequence 1080.2.2.1]]

[Some events recognized in financial statements do not have tax consequences. Certain revenues are exempt from taxation and certain expenses are not deductible. Events that do not have tax consequences do not give rise to temporary differences. [FAS 109, paragraph 289, sequence 1080.2.2.2]]

Valuation Allowance

[The portion of a deferred tax asset for which it is more likely than not that a tax benefit will not be realized. [FAS 109, paragraph 289, sequence 1082]]

740-30-25 Recognition

General

> Undistributed Earnings of Subsidiaries and Corporate Joint Ventures

25-1 This Section provides guidance on the accounting for specific temporary differences related to investments in subsidiaries and **corporate joint ventures**, including differences arising from undistributed earnings. In certain situations, these temporary differences may be accounted for differently from the accounting that otherwise requires comprehensive recognition of deferred **income taxes** for temporary differences.

25-2 [Including undistributed earnings of a **subsidiary** [APB 23, paragraph 9, sequence 48.1]] [(which would include the undistributed earnings of a domestic international sales corporation eligible for tax deferral) [APB 23, paragraph 9, sequence 49]] [in the pretax accounting income of a parent entity either through consolidation or accounting for the investment by the equity method results in a **temporary difference**. [APB 23, paragraph 9, sequence 48.2]]

25-3 [It shall be presumed that all undistributed earnings of a subsidiary will be transferred to the parent entity. Accordingly, the undistributed earnings of a subsidiary included in consolidated income shall be accounted for as a temporary difference unless the tax law provides a means by which the investment in a domestic subsidiary can be recovered tax free. [APB 23, paragraph 10, sequence 50.1.2]]

25-4 [The principles applicable to undistributed earnings of subsidiaries in this Section also apply to tax effects of differences between **taxable income** and pretax accounting income attributable to earnings of corporate joint ventures that are essentially permanent in duration and are accounted for by the equity method. [APB 23, paragraph 17, sequence 62]] [Certain corporate joint ventures have a life limited by the nature of the venture, project, or other business activity. Therefore, a reasonable assumption is that a part or all of the undistributed earnings of the venture will be transferred to the investor in a taxable distribution. Deferred taxes shall be recorded, in accordance with the requirements of Subtopic 740-10 at the time the earnings (or losses) are included in the investor's income. [APB 23, paragraph 17, sequence 63]]

25-5 [A **deferred tax liability** shall be recognized for both of the following types of taxable temporary differences: [FAS 109, paragraph 32, sequence 276]]

a. [An excess of the amount for financial reporting over the tax basis of an investment in a domestic subsidiary that arises in fiscal years beginning after December 15, 1992 [FAS 109, paragraph 32, sequence 277]]
b. [An excess of the amount for financial reporting over the tax basis of an investment in a 50-percent-or-less-owned investee except as provided in paragraph 740-30-25-18 for a corporate joint venture that is essentially permanent in duration. [FAS 109, paragraph 32, sequence 278]]

Paragraphs 740-30-25-9 and 740-30-25-18 identify exceptions to the accounting that otherwise requires comprehensive recognition of deferred income taxes for temporary differences arising from investments in subsidiaries and corporate joint ventures.

25-6 [Paragraph 740-30-25-18 provides that a deferred tax liability is not recognized for either of the following: [APB 23, paragraph 10, sequence 50.2.1]]

a. [An excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary that meets the criteria in paragraph 740-30-25-17 [APB 23, paragraph 10, sequence 50.2.2.1]]

b. [Undistributed earnings of a domestic subsidiary that arose in fiscal years beginning on or before December 15, 1992, and that meet the criteria in paragraph 740-30-25-17. The criteria in that paragraph do not apply to undistributed earnings of domestic subsidiaries that arise in fiscal years beginning after December 15, 1992, and as required by the preceding paragraph, a deferred tax liability shall be recognized if the undistributed earnings are a **taxable temporary difference**. [APB 23, paragraph 10, sequence 50.2.2.2]]

> > Determining Whether a Temporary Difference Is a Taxable Temporary Difference

25-7 [Whether an excess of the amount for financial reporting over the tax basis of an investment in a more-than-50-percent-owned domestic subsidiary is a taxable temporary difference shall be assessed. It is not a taxable temporary difference if the tax law provides a means by which the reported amount of that investment can be recovered tax-free and the entity expects that it will ultimately use that means. For example, tax law may provide that: [FAS 109, paragraph 33, sequence 281]]

a. [An entity may elect to determine taxable gain or loss on the liquidation of an 80-percent-or-more-owned subsidiary by reference to the tax basis of the subsidiary's net assets rather than by reference to the **parent** entity's tax basis for the stock of that subsidiary. [FAS 109, paragraph 33, sequence 282]]

b. [An entity may execute a statutory merger whereby a subsidiary is merged into the parent entity, the minority shareholders receive stock of the parent, the subsidiary's stock is cancelled, and no taxable gain or loss results if the continuity of ownership, continuity of business entity, and certain other requirements of the tax law are met. [FAS 109, paragraph 33, sequence 283]]

25-8 [Some elections for tax purposes are available only if the parent owns a specified percentage of the subsidiary's stock. The parent sometimes may own less than that specified percentage, and the price per share to acquire a **noncontrolling interest** may significantly exceed the per-share equivalent of the amount reported as noncontrolling interest in the **consolidated financial statements**. In those circumstances, the excess of the amount for financial reporting over the tax basis of the parent's investment in the subsidiary is not a taxable temporary difference if settlement of the noncontrolling interest is expected to occur at the point in time when settlement would not result in a significant cost. That could occur, for example, toward the end of the life of the subsidiary, after it has recovered and settled most of its assets and liabilities, respectively. The fair value of the noncontrolling interest ordinarily will approximately equal its percentage of the subsidiary's net assets if those net assets consist primarily of cash. [FAS 109, paragraph 33, sequence 284]]

> > Recognition of Deferred Tax Assets

25-9 [A **deferred tax asset** shall be recognized for an excess of the tax basis over the amount for financial reporting of an investment in a subsidiary or corporate joint venture that is essentially permanent in duration only if it is apparent that the temporary difference will reverse in the foreseeable future. [FAS 109, paragraph 34, sequence 285.1]]

25-10 [For example, if an entity decides to sell a subsidiary that meets the requirements of paragraph 205-20-45-1 for measurement and display as a discontinued operation and the parent entity's tax basis in the stock of the subsidiary (outside tax basis) exceeds the financial reporting amount of the investment in the subsidiary, the decision to sell the subsidiary makes it apparent that the **deductible temporary difference** will reverse in the foreseeable future. Assuming in this example that it is more likely than not that the deferred tax asset will be realized, [EITF 93-17, paragraph ISSUE, sequence 7]] [the tax **benefit** for the excess of outside tax basis over financial reporting basis shall be recognized when it is apparent that the temporary difference will reverse in the foreseeable future. The same criterion shall apply for the recognition of a deferred tax liability related to an excess of financial reporting basis over outside tax basis of an investment in a subsidiary that was previously not recognized under the provisions of paragraph 740-30-25-18. [EITF 93-17, paragraph DISCUSSION, sequence 10.1]]

25-11 [The need for a **valuation allowance** for the deferred tax asset referred to in paragraph 740-30-25-9 and other related deferred tax assets, such as a deferred tax asset for foreign tax credit **carryforwards**, shall be assessed. [FAS 109, paragraph 34, sequence 285.2.1.1]]

25-12 [Paragraph 740-10-30-18 identifies four sources of taxable income to be considered in determining the need for and amount of a valuation allowance for those and other deferred tax assets. One source is future reversals of temporary differences. [FAS 109, paragraph 34, sequence 285.2.1.2]]

25-13 [Future distributions of future earnings of a subsidiary or corporate joint venture, however, shall not be considered except to the extent that a deferred tax liability has been recognized for existing undistributed earnings or earnings have been remitted in the past. [FAS 109, paragraph 34, sequence 285.2.2.2]]

25-14 [A tax benefit shall not be recognized, however, for tax deductions or favorable tax rates attributable to future dividends of undistributed earnings for which a deferred tax liability has not been recognized under the requirements of paragraph 740-30-25-18. [FAS 109, paragraph 145, sequence 500.1]]

> > Ownership Changes in Investments

25-15 [An investment in common stock of a subsidiary may change so that it is no longer a subsidiary because the parent entity sells a portion of the investment, the subsidiary sells additional stock, or other transactions affect the investment. If the remaining investment in common stock shall be accounted for by the equity method, the investor shall recognize income taxes on its share of current earnings of the investee entity in accordance with the provisions of Subtopic 740-10. [APB 23, paragraph 13, sequence 55.1.2.1]] [If a parent entity did not recognize income taxes on its equity in undistributed earnings of a subsidiary for the reasons cited in paragraph 740-30-25-17 [APB 23, paragraph 13, sequence 55.1.2.2]] [(and the entity in which the investment is held ceases to be a subsidiary), it shall accrue as a current period expense income taxes on undistributed earnings in the period that it becomes apparent [APB 23, paragraph 13, sequence 55.2.1]] [that any of those undistributed earnings (prior to the change in status) will be remitted. The accrual of those income taxes shall not be accounted for as an extraordinary item.

[APB 23, paragraph 13, sequence 55.2.2.1.1]] [The change in the status of an investment would not by itself mean that remittance of these undistributed earnings shall be considered apparent. [APB 23, paragraph 13, sequence 56]] [If a parent entity recognizes a deferred tax liability for the temporary difference arising from its equity in undistributed earnings of a subsidiary and subsequently reduces its investment in the subsidiary through a taxable sale or other transaction, the amount of the temporary difference and the related deferred tax liability will change. [APB 23, paragraph 13, sequence 55.2.2.1.2.1]]

25-16 [An investment in common stock of an investee (other than a subsidiary or corporate joint venture) may change so that the investee becomes a subsidiary because [APB 23, paragraph 13, sequence 55.2.2.1.2.2]] [the investor acquires additional common stock, [APB 23, paragraph 13, sequence 55.2.2.2.1]] [the investee acquires or retires common stock, [APB 23, paragraph 13, sequence 55.2.2.2.2.1]] [or other transactions affect the investment. A temporary difference for the investor's share of the undistributed earnings of the investee prior to the date it becomes a subsidiary shall continue to be treated as a temporary difference for which a deferred tax liability shall continue to be recognized to the extent that dividends from the subsidiary do not exceed the parent entity's share of the subsidiary's earnings subsequent to the date it became a subsidiary. [APB 23, paragraph 13, sequence 55.2.2.2.2.2]]

> > Exceptions to Comprehensive Recognition of Deferred Income Taxes

25-17 [The presumption in paragraph 740-30-25-3 that all undistributed earnings will be transferred to the parent entity may be overcome, and no income taxes shall be accrued by the parent entity, for entities and periods identified in the following paragraph if sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation. A parent entity shall have evidence of specific plans for reinvestment of undistributed earnings of a subsidiary which demonstrate that remittance of the earnings will be postponed indefinitely. [APB 23, paragraph 12, sequence 54.2.1.1]] These criteria required to overcome the presumption are sometimes referred to as the indefinite reversal criteria. [Experience of the entities and definite future programs of operations and remittances are examples of the types of evidence required to substantiate the parent entity's representation of indefinite postponement of remittances from a subsidiary. [APB 23, paragraph 12, sequence 54.2.1.2]] [The indefinite reversal criteria shall not be applied to the inside basis differences of foreign subsidiaries. [EITF 93-16, paragraph DISCUSSION, sequence 9]]

25-18 [As indicated in paragraph 740-10-25-3, a deferred tax liability shall not be recognized for either of the following types of temporary differences unless it becomes apparent that those temporary differences will reverse in the foreseeable future: [FAS 109, paragraph 31, sequence 269]]

a. [An excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary or a foreign corporate joint venture that is essentially permanent in duration [FAS 109, paragraph 31, sequence 270]]

b. [Undistributed earnings of a domestic subsidiary or a domestic corporate joint venture that is essentially permanent in duration that arose in fiscal years beginning on or before December 15, 1992. [FAS 109, paragraph 31, sequence 271]] [A last-in, first-out (LIFO) pattern determines whether reversals pertain to differences that arose in fiscal years beginning on or before December 15, 1992. [FAS 109, paragraph 31, sequence 272]]

25-19 [If circumstances change and it becomes apparent that some or all of the undistributed earnings of a subsidiary will be remitted in the foreseeable future but income taxes have not been recognized by the parent entity, it shall accrue as an expense of the current period income taxes attributable to that remittance; income tax expense for such undistributed earnings shall not be accounted for as an extraordinary item. If it becomes apparent that some or all of the undistributed earnings of a subsidiary on which income taxes have been accrued will not be remitted in the foreseeable future, the parent entity shall adjust income tax expense of the current period; such adjustment of income tax expense shall not be accounted for as an extraordinary item. [APB 23, paragraph 12, sequence 54.2.2]]

740-30-45 Other Presentation Matters

General

> Undistributed Earnings of Subsidiaries and Corporate Joint Ventures

45-1 This guidance addresses presentation in the income statement of specific types of adjustments to **income taxes**. The specific types of adjustments addressed result from either the recognition or derecognition of deferred income taxes related to exceptions to comprehensive recognition of deferred income taxes arising from investments in subsidiaries and corporate joint ventures.

45-2 Paragraph 740-30-25-18 identifies situations where deferred tax liabilities are not recorded for specific temporary differences. [Paragraph 740-30-25-19 provides that if circumstances change and it becomes apparent that some or all of the undistributed earnings of a **subsidiary** will be remitted in the foreseeable future but income taxes have not been recognized by the parent entity, it shall accrue as an expense of the current period income taxes attributable to that remittance; income tax expense for such undistributed earnings shall not be accounted for as an extraordinary item. If it becomes apparent that some or all of the undistributed earnings of a subsidiary on which income taxes have been accrued will not be remitted in the foreseeable future, the parent entity shall adjust income tax expense of the current period; such adjustment of income tax expense shall not be accounted for as an extraordinary item. [APB 23, paragraph 12, sequence 54.2.2]]

45-3 [If a parent entity did not recognize income taxes on its equity in undistributed earnings of a subsidiary for the reasons cited in paragraph 740-30-25-17 [APB 23, paragraph 13, sequence 55.1.2.2]] [and the entity in which the investment is held ceases to be a subsidiary, paragraph 740-30-25-15 requires that it shall accrue as a current period expense income taxes on undistributed earnings in the period that it becomes apparent [APB 23, paragraph 13, sequence 55.2.1]] [that any of those undistributed earnings prior to the change in status will be remitted; the accrual of those income taxes shall not be accounted for as an extraordinary item. [APB 23, paragraph 13, sequence 55.2.2.1.1]]

740-30-50 Disclosure

General

> Undistributed Earnings of Subsidiaries and Corporate Joint Ventures

50-1 This guidance establishes disclosure requirements applicable to unrecognized deferred tax liabilities related to investments in subsidiaries and corporate joint ventures.

50-2 [All of the following information shall be disclosed whenever a **deferred tax liability** is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures: [FAS 109, paragraph 44, sequence 319]]

a. [A description of the types of temporary differences for which a deferred tax liability has not been recognized and the types of events that would cause those temporary differences to become taxable [FAS 109, paragraph 44, sequence 320]]

b. [The cumulative amount of each type of **temporary difference** [FAS 109, paragraph 44, sequence 321]]

c. [The amount of the unrecognized deferred tax liability for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable. [FAS 109, paragraph 44, sequence 322]] [While paragraph 740-30-25-14 prohibits recognition of a tax **benefit** for tax deductions or favorable tax rates attributable to future dividends of undistributed earnings for which a deferred tax liability has not been recognized, [FAS 109, paragraph 145, sequence 500.1]] [favorable tax treatment would be reflected in measuring that unrecognized deferred tax liability for disclosure purposes. [FAS 109, paragraph 145, sequence 500.2]]

d. [The amount of the deferred tax liability for temporary differences other than those in (c) (that is, undistributed domestic earnings) that is not recognized in accordance with the provisions of paragraph 740-30-25-18. [FAS 109, paragraph 44, sequence 323]]

ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

May 29, 2009

740 Income Taxes
270 Interim Reporting

740-270-05 Overview and Background

General

05-1 This Subtopic addresses the accounting and disclosure for **income taxes** in interim periods. The accounting requirements established in this Subtopic build upon the general requirements for accounting for income taxes established in Subtopic 740-10 as well as the intraperiod tax allocation process established in Subtopic 740-20.

05-2 Subtopic 740-10 addresses the computation of total tax expense for an entity. Subtopic 740-20 addresses the process of allocating total **income tax expense (or benefit)** for a period to different components of comprehensive income and shareholders' equity.

05-3 Because an interim period is a subset of a longer period, typically a year, incremental requirements for recognition and measurement are established by this Subtopic.

05-4 [This Subtopic describes: [FIN 18, paragraph 2, sequence 21.1]]

a. [The general computation of interim period income taxes (see paragraphs 740-270-30-1 through 30-9) [FIN 18, paragraph 2, sequence 21.2.1]]

b. [The application of the general computation to specific situations (see paragraphs 740-270-30-22 through 30-28) [FIN 18, paragraph 2, sequence 21.2.2.1]]

c. [The interim period income taxes requirements applicable to significant unusual or infrequently occurring items, discontinued operations, and extraordinary items (see Section 740-270-45) [FIN 18, paragraph 2, sequence 21.2.2.2.1]]

d. [Special computations applicable to operations taxable in multiple jurisdictions (see paragraph 740-270-30-36) [FIN 18, paragraph 2, sequence 21.2.2.2.2.1]]

e. [Guidelines for reflecting the effects of new tax legislation in interim period income tax provisions (see paragraphs 740-270-25-5 through 25-6) [FIN 18, paragraph 2, sequence 21.2.2.2.2.2.1]]

f. [Disclosure requirements (see paragraph 740-270-50-1). [FIN 18, paragraph 2, sequence 21.2.2.2.2.2.2.1.1]]

This Subtopic also provides Examples and illustrations in Section 740-270-55.

740-270-15 Scope and Scope Exceptions

General

ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

> Overall Guidance

15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Subtopic 740-10-15.

740-270-20 Glossary

Asset Group

[An asset group is the unit of accounting for a long-lived asset or assets to be held and used, which represents the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. [FAS 144, paragraph 4, sequence 104.1.2.2.1]]

Benefit

See Tax (or Benefit).

Carryforwards

[Deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year; a tax credit carryforward is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried forward and the length of the carryforward period. The terms carryforward, operating loss carryforward, and tax credit carryforward refer to the amounts of those items, if any, reported in the tax return for the current year. [FAS 109, paragraph 289, sequence 1044]]

Component of an Entity

[A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment, a reporting unit, a subsidiary, or an asset group. [FAS 144, paragraph 41, sequence 185]]

Deferred Tax Asset

[The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. [FAS 109, paragraph 289, sequence 1050]]

Deferred Tax Expense (or Benefit)

[The change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets acquired in a purchase business combination during the year, it is the change since the combination date. Income tax expense (or benefit) for the year is allocated among continuing operations, discontinued operations, extraordinary items, and items charged or credited directly to shareholders' equity. [FAS 109, paragraph 289, sequence 1054]]

Deferred Tax Liability

[The deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law. [FAS 109, paragraph 289, sequence 1056]]

Extraordinary Items

[Extraordinary items are events and transactions that are distinguished by their unusual nature and by the infrequency of their occurrence. Thus, both of the following criteria should be met to classify an event or transaction as an extraordinary item: [APB 30, paragraph 20, sequence 63]]

a. [Unusual nature. The underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates (see paragraph 225-20-60-3). [APB 30, paragraph 20,

sequence 64]]

b. [Infrequency of occurrence. The underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates (see paragraph 225-20-60-3). [APB 30, paragraph 20, sequence 65]]

Income Tax Expense (or Benefit)

[The sum of current tax expense (or benefit) and deferred tax expense (or benefit). [FAS 109, paragraph 289, sequence 1066]]

Income Taxes

[Domestic and foreign federal (national), state, and local (including franchise) taxes based on income. [FAS 109, paragraph 289, sequence 1062]]

Operating Segment

[A component of a public entity. See Section 280-10-50 for additional guidance on the definition of an operating segment. [FAS 131, paragraph 10, sequence 49]]

Ordinary Income (or Loss)

[Ordinary income (or loss) refers to income (or loss) from continuing operations before income taxes (or benefits) excluding significant unusual or infrequently occurring items. Extraordinary items, discontinued operations, and cumulative effects of changes in accounting principles are also excluded from this term. [FIN 18, paragraph 5, sequence 25.1]] [The term is not used in the income tax context of ordinary income vs. capital gain. [FIN 18, paragraph 5, sequence 25.2]] The meaning of unusual or infrequently occurring items is consistent with their use in the definition of the term extraordinary item.

Reporting Unit

[The level of reporting at which goodwill is tested for impairment. A reporting unit is an operating segment or one level below an operating segment (also known as a component). [FAS 142, paragraph F1, sequence 649.2]]

Tax (or Benefit)

[Tax (or benefit) is the total income tax expense (or benefit), including the provision (or benefit) for income taxes both currently payable and deferred. [FIN 18, paragraph 5, sequence 27]]

Tax Consequences

[The effects on income taxes—current or deferred—of an event. [FAS 109, paragraph 289, sequence 1076]]

Tax Position

[A position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited to: [FIN 48, paragraph 4, sequence 22]]

a. [A decision not to file a tax return [FIN 48, paragraph 4, sequence 23]]

b. [An allocation or a shift of income between jurisdictions [FIN 48, paragraph 4, sequence 24]]

c. [The characterization of income or a decision to exclude reporting taxable income in a tax return [FIN 48, paragraph 4, sequence 25]]

d. [A decision to classify a transaction, entity, or other position in a tax return as tax exempt. [FIN 48, paragraph 4, sequence 26]]

Taxable Income

[The excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority. [FAS 109, paragraph 289, sequence 1072]]

Unrecognized Tax Benefit

[The difference between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to Subtopic 740-10. [FIN 48, paragraph 17, sequence 47.1.2.1]]

Valuation Allowance

[The portion of a deferred tax asset for which it is more likely than not that a tax benefit will not be realized. [FAS 109, paragraph 289, sequence 1082]]

740-270-25 Recognition

General

> General Recognition Approach

25-1 This guidance addresses the issue of how and when **income tax expense (or benefit)** is recognized in interim periods and distinguishes between elements that are recognized through the use of an estimated annual effective tax rate applied to measures of year-to-date operating results, referred to as **ordinary income (or loss)**, and specific events that are discretely recognized as they occur.

25-2 [The **tax (or benefit)** related to ordinary income (or loss) shall be computed at an estimated annual effective tax rate and the tax (or benefit) related to all other items shall be individually computed and recognized when the items occur. [FIN 18, paragraph 6, sequence 28.2.1]]

25-3 [If an entity is unable to estimate a part of its ordinary income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported. [FIN 18, paragraph 8, sequence 37.2]]

25-4 [The tax benefit of an operating loss carryforward from prior years shall be included in the effective tax rate computation if the tax benefit is expected to be realized as a result of ordinary income in the current year. Otherwise, the tax benefit shall be recognized in the manner described in paragraph 740-270-45-4 in each interim period to the extent that income in the period and for the year to date is available to offset the operating loss carryforward or, in the case of a change in judgment about realizability of the related **deferred tax asset** in future years, the effect shall be recognized in the interim period in which the change occurs. [FIN 18, paragraph 20, sequence 63.2.2]]

25-5 [The effects of new tax legislation shall not be recognized prior to enactment. The tax effect of a change in tax laws or rates on taxes currently payable or refundable for the current year shall be recorded after the effective dates prescribed in the statutes and reflected in the computation of the annual effective tax rate beginning no earlier than the first interim period that includes the enactment date of the new legislation. [APB 28, paragraph 20, sequence 59.2.2.2.2.2.2.1]] [The effect of a change in tax laws or rates on a **deferred tax liability** or asset shall not be apportioned among interim periods through an adjustment of the annual effective tax rate. [APB 28, paragraph 20, sequence 59.2.2.2.2.2.2.2.1]]

25-6 [The tax effect of a change in tax laws or rates on taxes payable or refundable for a prior year shall be recognized as of the enactment date of the change as tax expense (benefit) for the current year. [APB 28, paragraph 20, sequence 59.2.2.2.2.2.2.2.2]] See Example 6 (paragraph 740-270-55-44) for illustrations of accounting for changes caused by new tax legislation.

25-7 [The effect of a change in the beginning-of-the-year balance of a **valuation allowance** as a result of a change in judgment about the realizability of the related deferred tax asset in future years shall not be apportioned among interim periods through an adjustment of the effective tax rate but shall be recognized in the interim period in which the change occurs. [APB 28, paragraph 20, sequence 59.2.2.2.2.2.1]]

> Recognition of the Tax Benefit of a Loss in Interim Periods

25-8 This guidance establishes requirements for considering whether the amount of income tax benefit recognized in an interim period shall be limited due to interim period losses.

25-9 [The tax effects of losses that arise in the early portion of a fiscal year shall be recognized only when the tax benefits are expected to be either: [APB 28, paragraph 20, sequence 59.1]]

a. [Realized during the year [APB 28, paragraph 20, sequence 59.1.2]]

b. [Recognizable as a deferred tax asset at the end of the year in accordance with the provisions of Subtopic 740-10. [APB 28, paragraph 20, sequence 59.1.3]]

25-10 [An established seasonal pattern of loss in early interim periods offset by income in later interim periods shall constitute evidence that realization is more likely than not, unless other evidence indicates the established seasonal pattern will not prevail. [APB 28, paragraph 20, sequence 59.2.1]]

25-11 [The tax effects of losses incurred in early interim periods may be recognized in a later interim period of a fiscal year if their realization, although initially uncertain, later becomes more likely than not. [APB 28, paragraph 20, sequence 59.2.2.1]] [When the tax effects of losses that arise in the early portions of a fiscal year are not recognized in that interim period, no tax provision shall be made for income that arises in later interim periods until the tax effects of the previous interim losses are utilized. [APB 28, paragraph 20, sequence 59.2.2.2.1]]

25-12 [If an entity has a significant unusual, infrequently occurring, or extraordinary loss or a loss from discontinued operations, the tax benefit of that loss shall be recognized when the tax benefit of the loss is expected to be either: [FIN 18, paragraph 18, sequence 59.1.1.2]]

a. [Realized during the year [FIN 18, paragraph 18, sequence 59.1.2.1]]

b. [Recognizable as a deferred tax asset at the end of the year in accordance with the provisions of Subtopic 740-10. [FIN 18, paragraph 18, sequence 59.1.2.2.1]]

[Realization would appear to be more likely than not if future **taxable income** from (ordinary) income during the current year is expected based on an established seasonal pattern of loss in early interim periods offset by income in later interim periods. [FIN 18, paragraph 18, sequence 59.1.2.2.2]]

25-13 See Example 3, Cases A and B (paragraphs 740-270-55-26 through 55-28) for example computations involving unusual, infrequently occurring, or extraordinary losses.

25-14 [If recognition of a deferred tax asset at the end of the fiscal year for all or a portion of the tax benefit of the loss depends on taxable income from the reversal of existing taxable temporary differences, see paragraphs 740-270-30-32 through 30-33 for guidance. If all or a part of the tax benefit is not realized and future realization is not more likely than not in the interim period of occurrence but becomes more likely than not in a subsequent interim period of the same fiscal year, the previously **unrecognized tax benefit** shall be reported that subsequent interim period in the same manner that it would have been reported if realization had been more likely than not in the interim period of occurrence, that is, as a tax benefit relating to continuing operations, discontinued operations, or an extraordinary item. [FIN 18, paragraph 18, sequence 59.2]] See Subtopic 740-20 for the requirements to allocate total income tax expense (or benefit).

740-270-30 Initial Measurement

General

> General Methodology and Use of Estimated Annual Effective Tax Rate

30-1 This guidance establishes the methodology, including the use of an estimated annual effective tax rate, to determine **income tax expense (or benefit)** in interim financial information.

30-2 [In reporting interim financial information, income tax provisions shall be determined under the general requirements for accounting for **income taxes** set forth in Subtopic 740-10. [APB 28, paragraph 19, sequence 57.1]]

30-3 Income tax expense (or benefit) for an interim period is based on income taxes computed for ordinary income or loss and income taxes computed for items or events that are not part of ordinary income or loss.

30-4 [Paragraph 740-270-25-2 requires that the **tax (or benefit)** related to **ordinary income (or loss)** be computed at an estimated annual effective tax rate and the tax (or benefit) related to all other items be individually computed and recognized when the items occur. [FIN 18, paragraph 6, sequence 28.2.1]]

30-5 [The estimated annual effective tax rate, described in paragraphs 740-270-30-6 through 30-8, shall be applied to the year-to-date ordinary income (or loss) at the end of each interim period to compute the year-to-date tax (or benefit) applicable to ordinary income (or loss). [FIN 18, paragraph 9, sequence 40.1.2]]

30-6 [At the end of each interim period the entity shall make its best estimate of the effective tax rate expected to be applicable for the full fiscal year. [APB 28, paragraph 19, sequence 57.2.1.1]] [In some cases, the estimated annual effective tax rate will be the statutory rate modified as may be appropriate in particular circumstances. In other cases, the rate will be the entity's estimate of the tax (or benefit) that will be provided for the fiscal year, stated as a percentage of its estimated ordinary income (or loss) for the fiscal year (see paragraphs 740-270-30-30 through 30-34 if an ordinary loss is anticipated for the fiscal year). [FIN 18, paragraph 8, sequence 31.2.2.2.2.2]]

30-7 [The tax effect of a **valuation allowance** expected to be necessary for a **deferred tax asset** at the end of the year for originating deductible temporary differences and **carryforwards** during the year shall be included in the effective tax rate. [APB 28, paragraph 20, sequence 59.2.2.2.2.1]]

30-8 [The estimated effective tax rate shall also reflect anticipated investment tax credits, foreign tax rates, percentage depletion, capital gains rates, and other available tax planning alternatives. However, in arriving at this estimated effective tax rate, no effect shall be included for the tax related to significant unusual or extraordinary items that will be separately reported or reported net of their related tax effect in reports for the interim period or for the fiscal year. [APB 28, paragraph 19, sequence 57.2.2]] [The rate so determined shall be used in providing for income taxes on a current year-to-date basis. [APB 28, paragraph 19, sequence 57.2.1.2]]

30-9 Examples 1 through 2 (see paragraphs 740-270-55-2 through 55-23) contain illustrations of the computation of estimated annual effective tax rates beginning in paragraphs 740-270-55-3; 740-270-55-12; and 740-270-55-19 through 55-20.

> Exclusion of Items from Estimated Annual Effective Tax Rate

30-10 This guidance identifies items that are always excluded from the determination of the estimated annual effective tax rate. This guidance also specifies the alternatives for including or excluding certain investment tax credits in the estimated annual effective tax rate.

> > Items Always Excluded from Estimated Annual Effective Tax Rate

30-11 [The effects of changes in judgment about beginning-of-year valuation allowances and effects of changes in tax laws or rates shall be excluded from the estimated annual effective tax rate calculation. [FIN 18, paragraph 16, sequence 52.1.2.2.1.2]] See paragraph 740-270-25-5 for requirements related to when the estimated annual effective tax rate shall be adjusted to reflect changes in tax laws and rates that affect current year taxes payable or refundable.

30-12 [Taxes related to significant unusual or extraordinary items that will be separately reported or reported net of their related tax effect also shall be excluded [FIN 18, paragraph 16, sequence 52.1.2.1]] [from the estimated annual effective tax rate calculation. [FIN 18, paragraph 16, sequence 52.1.2.2.1.1]] [This description of significant unusual or extraordinary items includes unusual items, infrequently occurring items, discontinued operations, and extraordinary items. [FIN 18, paragraph 16, sequence 54]]

30-13 [As these items are excluded from the estimated annual effective tax rate, Section 740-270-25 requires that the related tax effect be recognized in the interim period in which they occur. [FIN 18, paragraph 16, sequence 52.1.2.2.2.2]] See Example 3 (paragraph 740-270-55-24) for illustrations of accounting for these items in the interim period which they occur.

> > Certain Tax Credits

30-14 [Certain investment tax credits may be excluded from the estimated annual effective tax rate. If an entity includes allowable investment tax credits as part of its provision for income taxes over the productive life of acquired property and not entirely in the year the property is placed in service, amortization of deferred investment tax credits need not be taken into account in estimating the annual effective tax rate; however, if the investment tax credits are taken into account in the estimated annual effective tax rate, the amount taken into account shall be the amount of amortization that is anticipated to be included in income in the current year (see paragraphs 740-10-25-46 and 740-10-45-28). [FIN 18, paragraph 8, sequence 34.1]]

30-15 [Further, paragraphs 840-30-30-14 and 840-30-35-34 through 35-35 require that investment tax credits related to leases that are accounted for as leveraged leases shall be deferred and accounted for as return on the net investment in the leveraged leases in the years in which the net investment is positive and explains that the use of the term *years* is not intended to preclude application of the accounting described to shorter periods. If an entity accounts for investment tax credits related to leveraged leases in accordance with those paragraphs for interim periods, those investment tax credits shall not be taken into account in estimating the annual effective tax rate. [FIN 18, paragraph 8, sequence 34.2]]

> Ability to Make Estimates

30-16 This guidance addresses the consequences of an entity's inability to reliably estimate some or all of the information which is ordinarily required to determine the annual effective tax rate in interim financial information.

30-17 [Paragraph 740-270-25-3 requires that if an entity is unable to estimate a part of its ordinary income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated be reported in the interim period in which the item is reported. [FIN 18, paragraph 8, sequence 37.2]]

30-18 [Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on evaluations of possible future events and transactions and may be subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year to date may be the best estimate of the annual effective tax rate. [FIN 18, paragraph 8, sequence 37.1]]

30-19 [The effect of translating foreign currency financial statements may make it difficult to estimate an annual effective foreign currency tax rate in dollars. For example, in some cases depreciation is translated at historical exchange rates, whereas many transactions included in income are translated at current period average exchange rates. If depreciation is large in relation to earnings, a change in the estimated ordinary income that does not change the effective foreign currency tax rate can change the effective tax rate in the dollar financial statements. This result can occur with no change in exchange rates during the current year if there have been exchange rate changes in past years. If the entity is unable to estimate its annual effective tax rate in dollars or is otherwise unable to make a reliable estimate of its ordinary income (or loss) or of the related tax (or benefit) for the fiscal year in a jurisdiction, the tax (or benefit) applicable to ordinary income (or loss) in that jurisdiction shall be recognized in the interim period in which the ordinary income (or loss) is reported. [FIN 18, paragraph 85, sequence 234]]

> Effect of Operating Losses

30-20 This guidance addresses changes to the general methodology to determine income tax expense (or benefit) in interim financial information as set forth in paragraph 740-270-30-5 when an entity has experienced or expects to experience operating losses.

30-21 An entity may have experienced year-to-date ordinary income (or loss) at the end of any interim period. These year-to-date actual results of either ordinary income (or loss) may differ from the results expected by the entity for either ordinary income (or loss) for the full fiscal year. This guidance identifies the required methodology for recording interim period income taxes for each of the four possible relationships of year-to-date ordinary income (or loss) and expected full fiscal year ordinary income (or loss). [See Examples 1 through 2 (paragraphs 740-270-55-2 through 55-23) for example computations in these different situations. This guidance also establishes income tax benefit limitations when ordinary losses exist. [FIN 18, paragraph 2, sequence 21.2.2.2.2.2.2.2]]

> > Year-to-Date Ordinary Income; Anticipated Ordinary Income for the Year

30-22 [If an entity has ordinary income for the year to date at the end of an interim period and anticipates ordinary income for the fiscal year, the interim period tax shall be computed in accordance with paragraph 740-270-30-5. [FIN 18, paragraph 10, sequence 42.2]]

30-23 See Example 1, Cases A and B1 (paragraphs 740-270-55-4 through 55-6) for illustrations of the application of these requirements.

> > Year-to-Date Ordinary Loss; Anticipated Ordinary Income for the Year

30-24 [If an entity has an ordinary loss for the year to date at the end of an interim period and anticipates ordinary income for the fiscal year, the interim period tax benefit shall be computed in accordance with paragraph 740-270-30-5, except that the year-to-date tax benefit recognized shall be limited to the amount determined in accordance with paragraphs 740-270-30-30 through 30-33. [FIN 18, paragraph 11, sequence 43.2]]

30-25 See Example 1, Cases B2 and B3 (paragraphs 740-270-55-7 through 55-8) for illustrations of the application of these requirements.

> > Year-to-Date Ordinary Income; Anticipated Ordinary Loss for the Year

30-26 [If an entity has ordinary income for the year to date at the end of an interim period and anticipates an ordinary loss for the fiscal year, the interim period tax shall be computed in accordance with paragraph 740-270-30-5. The estimated tax benefit for the fiscal year, used to determine the estimated annual effective tax rate described in paragraphs 740-270-30-6 through 30-8, shall not exceed the tax benefit determined in accordance with paragraphs 740-270-30-30 through 30-33 . [FIN 18, paragraph 12, sequence 44.2]]

30-27 See Example 2, Cases A2 and C2 (paragraphs 740-270-55-16 and 740-270-55-20) for illustrations of the application of these requirements.

> > Year-to-Date Ordinary Loss; Anticipated Ordinary Loss for the Year

30-28 [If an entity has an ordinary loss for the year to date at the end of an interim period and anticipates an ordinary loss for the fiscal year, the interim period tax benefit shall be computed in accordance with paragraph 740-270-30-5. The estimated tax benefit for the fiscal year, used to determine the estimated annual effective tax rate described in paragraphs 740-270-30-6 through 30-8, shall not exceed the tax benefit determined in accordance with paragraphs 740-270-30-30 through 30-33. In addition to that limitation in the effective rate computation, if the year-to-date ordinary loss exceeds the anticipated ordinary loss for the fiscal year, the tax benefit recognized for the year to date shall not exceed the tax benefit determined, based on the year-to-date ordinary loss, in accordance with paragraphs 740-270-30-30 through 30-33. [FIN 18, paragraph 13, sequence 45.2]]

30-29 See Example 2, Cases A1; B; and C1 (paragraphs 740-270-55-15; 740-270-55-17; and 740-270-55-19) for illustrations of the application of these requirements.

> Determining Income Tax Benefit Limitations

30-30 [Paragraph 740-270-25-9 provides that a tax benefit shall be recognized for a loss that arises early in a fiscal year if the tax benefits are expected to be either of the following: [FIN 18, paragraph 14, sequence 46.1.2]]

a. [Realized during the year [FIN 18, paragraph 14, sequence 46.2.1]]

b. [Recognizable as a deferred tax asset at the end of the year in accordance with the requirements established in Subtopic 740-10. Paragraph 740-10-30-5(e) requires that a valuation allowance be recognized if it is more likely than not that the tax benefit of some portion or all of a deferred tax asset will not be realized. [FIN 18, paragraph 14, sequence 46.2.2.1]]

30-31 [The limitations described in the preceding paragraph shall be applied in determining the estimated tax benefit of an ordinary loss for the fiscal year, used to determine the estimated annual effective tax rate and the year-to-date tax benefit of a loss. [FIN 18, paragraph 14, sequence 46.2.2.2]]

30-32 [The reversal of existing taxable temporary differences may be a source of evidence in determining whether a tax benefit requires limitation. [FIN 18, paragraph 15, sequence 49.1.1]] [A **deferred tax liability** related to existing taxable temporary differences is a source of evidence for recognition of a tax benefit when all of the following conditions exist: [FIN 18, paragraph 15, sequence 49.1.2]]

a. [An entity anticipates an ordinary loss for the fiscal year or has a year-to-date ordinary loss in excess of the anticipated ordinary loss for the fiscal year. [FIN 18, paragraph 15, sequence 49.2.1]]

b. [The tax benefit of that loss is not expected to be realized during the year. [FIN 18, paragraph 15, sequence 49.2.2.1]]

c. [Recognition of a deferred tax asset for that loss at the end of the fiscal year is expected to depend on **taxable income** from the reversal of existing taxable temporary differences (that is, a higher deferred tax asset valuation allowance would be necessary absent the existing taxable temporary differences). [FIN 18, paragraph 15, sequence 49.2.2.2.1]]

The requirement to consider the reversal of existing taxable temporary differences is illustrated in Example 2, Case D (see paragraph 740-270-55-21).

30-33 [If the tax benefit relates to an estimated ordinary loss for the fiscal year, it shall be considered in determining the estimated annual effective tax rate described in paragraphs 740-270-30-6 through 30-8. If the tax benefit relates to a year-to-date ordinary loss, it shall be considered in computing the maximum tax benefit that shall be recognized for the year to date. [FIN 18, paragraph 15, sequence 49.2.2.2.2]]

30-34 See Example 2, Cases A1; B, C1; and C2 (paragraphs 740-270-55-15 ; 740-270-55-17; and 740-270-55-19 through 55-20) for illustrations of computations involving operating losses, and Example 1, Cases B2 and B3 (see paragraphs 740-270-55-7 through 55-8), and Example 2, Case A2 (see paragraph 740-270-55-16) for illustrations of special year-to-date limitation computations.

> Multiple Tax Jurisdictions

30-35 This guidance addresses possible changes to the general interim period income tax expense methodology when an entity is subject to tax in multiple jurisdictions.

30-36 [If an entity that is subject to tax in multiple jurisdictions pays taxes based on identified income in one or more individual jurisdictions, interim period tax (or benefit) related to consolidated ordinary income (or loss) for the year to date shall be computed in accordance with the requirements of this Subtopic using one overall estimated annual effective tax rate with the following exceptions: [FIN 18, paragraph 22, sequence 67]]

a. [If in a separate jurisdiction an entity anticipates an ordinary loss for the fiscal year or has an ordinary loss for the year to date for which, in accordance with paragraphs 740-270-30-30 through 30-33, no tax benefit can be recognized, the entity shall exclude ordinary income (or loss) in that jurisdiction and the related tax (or benefit) from the overall computations of the estimated annual effective tax rate and interim period tax (or benefit). A separate estimated annual effective tax rate shall be computed for that jurisdiction and applied to ordinary income (or loss) in that jurisdiction in accordance with the methodology otherwise required by this Subtopic. [FIN 18, paragraph 22, sequence 68]]

b. [If an entity is unable to estimate an annual effective tax rate in a foreign jurisdiction in dollars or is otherwise unable to make a reliable estimate of its ordinary income (or loss) or of the related tax (or benefit) for the fiscal year in a jurisdiction, the entity shall exclude ordinary income (or loss) in that jurisdiction and the related tax (or benefit) from the overall computations of the estimated annual effective tax rate and interim period tax (or benefit). [FIN 18, paragraph 22, sequence 69.1]] [The tax (or benefit) related to ordinary income (or loss) in that jurisdiction [FIN 18, paragraph 22, sequence 69.2.1]] [shall be recognized in the interim period in which the ordinary income (or loss) is reported. [FIN 18, paragraph 22, sequence 69.2.2]] [The tax (or benefit) related to ordinary income (or loss) in a jurisdiction may not be limited to tax (or benefit) in that jurisdiction. It might also include tax (or benefit) in another jurisdiction that results from providing taxes on unremitted earnings, foreign tax credits, and so forth. [FIN 18, paragraph 22, sequence 70]]

See Example 5, Cases A; B; and C (paragraphs 740-270-55-39 through 55-43) for illustrations of accounting for income taxes applicable to ordinary income if an entity is subject to tax in multiple jurisdictions.

> Accounting for Income Taxes Applicable to the Cumulative Effect of a Change in Accounting Principle

30-37 Topic 250 establishes the accounting requirements related to recording the effect of a change in accounting principle. The guidance in this Subtopic addresses issues related to the measurement of the tax effect in interim periods associated with those changes.

30-38 [The tax (or benefit) applicable to the cumulative effect of the change on retained earnings at the beginning of the fiscal year shall be computed the same as for the annual financial statements. [FIN 18, paragraph 63, sequence 185]]

30-39 [When an entity makes an accounting change in other than the first interim period of the entity's fiscal year, paragraph 250-10-45-14 , requires that financial information for the prechange interim periods of the fiscal year shall be reported by retrospectively applying the newly adopted accounting principle to those prechange interim periods. The tax (or benefit) applicable to those prechange interim periods shall be recomputed. The revised tax (or benefit) shall reflect the year-to-date amounts and annual estimates originally used for the prechange interim periods, modified only for the effect of the change in accounting principle on those year-to-date and estimated annual amounts. [FIN 18, paragraph 64, sequence 186]]

740-270-35 Subsequent Measurement

General

35-1 This guidance addresses the accounting for interim period **income tax expense (or benefit)** in periods subsequent to an entity's first interim period within a fiscal year. See Section 740-270-30 for a description of and requirements related to the determination of the estimated annual effective tax rate.

35-2 [The estimated annual effective tax rate is described in paragraphs 740-270-30-6 through 30-8. As indicated in paragraph 740-270-30-18 , estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on evaluations of possible future events and transactions and may be subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year to date may be the best estimate of the annual effective tax rate. [FIN 18, paragraph 8, sequence 37.1]]

35-3 [As indicated in paragraph 740-270-30-6, at the end of each successive interim period the entity shall make its best estimate of the effective tax rate expected to be applicable for the full fiscal year. [APB 28, paragraph 19, sequence 57.2.1.1]] [As indicated in paragraph 740-270-30-8, the rate so determined shall be used in providing for **income taxes** on a current year-to-date basis. [APB 28, paragraph 19, sequence 57.2.1.2]] [The rate shall be revised, if necessary, as of the end of each successive interim period during the fiscal year to the entity's best current estimate of its annual effective tax rate. [FIN 18, paragraph 8, sequence 31.2.2.2.2.1]]

35-4 [As indicated in paragraph 740-270-30-5, the estimated annual effective tax rate shall be applied to the year-to-date **ordinary income (or loss)** at the end of each interim period to compute the year-to-date **tax (or benefit)** applicable to ordinary income (or loss). [FIN 18, paragraph 9, sequence 40.1.2]] [The interim period tax (or benefit) related to ordinary income (or loss) shall be the difference between the amount so computed and the amounts reported for previous interim periods of the fiscal year. [FIN 18, paragraph 9, sequence 40.2]]

35-5 [One result of the year-to-date computation is that, if the tax benefit of an ordinary loss that occurs in the early portions of the fiscal year is not recognized because it is more likely than not that the tax benefit will not be realized, tax is not provided for subsequent ordinary income until the **unrecognized tax benefit** of the earlier ordinary loss is offset (see paragraphs 740-270-25-9 through 25-11). [FIN 18, paragraph 9, sequence 41]] [As indicated in paragraph 740-270-30-31, the limitations described in paragraph 740-270-25-9 shall be applied in determining the estimated tax benefit of an ordinary loss for the fiscal year, used to determine the estimated annual effective tax rate, and the year-to-date tax benefit of a loss. [FIN 18, paragraph 14, sequence 46.2.2.2]] [As indicated in paragraph 740-270-30-33, if the tax benefit relates to an estimated ordinary loss for the fiscal year, it shall be considered in determining the estimated annual effective tax rate described in paragraphs 740-270-30-6 through 30-8. If the tax benefit relates to a year-to-date ordinary loss, it shall be considered in computing the maximum tax benefit that shall be recognized for the year to date. [FIN 18, paragraph 15, sequence 49.2.2.2.2]]

35-6 [A change in judgment that results in subsequent recognition, derecognition, or change in measurement of a **tax position** taken in a prior interim period within the same fiscal year is an integral part of an annual period and, consequently, shall be reflected as such under the requirements of this Subtopic. [FIN 48, paragraph 14, sequence 44]] This requirement differs from the requirement in paragraph 740-10-25-15 applicable to a change in judgment that results in subsequent recognition, derecognition, or a change in measurement of a tax position taken in a prior annual period, which requires that the change (including any related interest and penalties) be recognized as a discrete item in the period in which the change occurs.

35-7 See Example 1, Case C (paragraph 740-270-55-9) for an illustration of how changes in estimates impact quarterly income tax computations.

740-270-45 Other Presentation Matters

General

45-1 Subtopic 740-20 establishes requirements to allocate total **income tax expense (or benefit)** of an entity for a period to different components of comprehensive income and shareholders' equity. That process is referred to as intraperiod tax allocation. This Section addresses that required allocation of income tax expense (or benefit) in interim periods.

45-2 [Section 740-20-45 describes the method of applying tax allocation within a period. The tax allocation computation shall be made using the estimated fiscal year ordinary income together with [FIN 18, paragraph 16, sequence 52.2]] [unusual items, infrequently occurring items, discontinued operations, and extraordinary items for the year-to-date period. [FIN 18, paragraph 16, sequence 54]]

45-3 [Extraordinary items and discontinued operations that will be presented net of related tax effects in the financial statements for the fiscal year shall be presented net of related tax effects in interim financial statements. Unusual or infrequently occurring items that will be separately disclosed in the financial statements for the fiscal year shall be separately disclosed as a component of pretax income from continuing operations, and the **tax (or benefit)** related to such items shall be included in the tax (or benefit) related to continuing operations. See paragraphs 740-270-25-12 through 25-14 for interim period recognition guidance when an entity has a significant unusual, infrequently occurring, or extraordinary loss or a loss from discontinued operations. See paragraphs 740-270-45-7 through 45-8 for the application of interim period allocation requirements to recognized income tax expense (or benefit) and discontinued operations. [FIN 18, paragraph 17, sequence 58.2]] See Example 7 (paragraph 740-270-55-52) for an illustration of the income statement display of these items.

45-4 [Paragraph 740-20-45-3 requires that the manner of reporting the tax benefit of an operating loss carryforward recognized in a subsequent year generally is determined by the source of the income in that year and not by the source of the operating loss carryforward or the source of expected future income that will result in realization of a **deferred tax asset** for the operating loss carryforward. The tax benefit is allocated first to reduce tax expense from continuing operations to zero with any excess allocated to the other source(s) of income that provides the means of realization, for example, extraordinary items, discontinued operations, and so forth. [FIN 18, paragraph 20, sequence 63.1]] [That requirement also pertains to reporting the tax benefit of an operating loss carryforward in interim periods. [FIN 18, paragraph 20, sequence 63.2.1]]

45-5 Paragraph 740-270-25-11 establishes the requirement that when the tax effects of losses that arise in the early portions of a fiscal year are not recognized in that interim period, no tax provision shall be made for income that arises in later interim periods until the tax effects of the previous interim losses are utilized. [The tax benefits of interim losses accounted for in this manner would not be reported as extraordinary items in the results of operations of the interim period. [APB 28, paragraph 20, sequence 60]]

> Specific Requirements Applicable to Discontinued Operations

45-6 This guidance addresses specific requirements for the intraperiod allocation of **income taxes** in interim periods when there are discontinued operations.

45-7 [When an entity reports discontinued operations, the computations described in paragraphs 740-270-25-12 through 25-14, 740-270-30-11 through 30-13, and 740-270-45-2 through 45-3 shall be the basis for the tax (or benefit) related to the income (or loss) from operations of the discontinued component before the date on which the criteria in paragraph 360-10-45-9 are met. [FIN 18, paragraph 19, sequence 61.1]] [The term *discontinued component* refers to the disposal of a **component of an entity**. [FIN 18, paragraph 19, sequence 62]]

45-8 [Income (or loss) from operations of the discontinued component, prior to the interim period in which the date on which the criteria in paragraph 360-10-45-9 are met occurs, will have been included in **ordinary income (or loss)** of prior periods and thus will have been included in the estimated annual effective tax rate and tax (or benefit) calculations described in Sections 740-270-30 and 740-270-35 applicable to ordinary income. The total tax (or benefit) provided in the prior interim periods shall not be recomputed but shall be divided into two components, applicable to the remaining ordinary income (or loss) and to the income (or loss) from operations of the discontinued component as follows. A revised estimated annual effective tax rate and resulting tax (or benefit) shall be computed, in accordance with Sections 740-270-30 and 740-270-35 applicable to ordinary income, for the remaining ordinary income (or loss), based on the estimates applicable to such operations used in the original calculations for each prior interim period. The tax (or benefit) related to the operations of the discontinued component shall be the total of: [FIN 18, paragraph 19, sequence 61.2.1]]

a. [The difference between the tax (or benefit) originally computed for ordinary income (or loss) and the recomputed amount for the remaining ordinary income (or loss) [FIN 18, paragraph 19, sequence 61.2.2.1]]

b. [The tax computed in accordance with paragraphs 740-270-25-12 through 25-14; 740-270-30-11 through 30-13; and 740-270-45-2 through 45-3 for any unusual or infrequently occurring items of the discontinued component. [FIN 18, paragraph 19, sequence 61.2.2.2]]

See Example 4 (paragraph 740-270-55-29) for an illustration of accounting for income taxes applicable to income or (loss) from discontinued operations at an interim date.

740-270-50 Disclosure

General

> Variations in Customary Income Tax Expense Relationships

50-1 [Application of the requirements for accounting for **income taxes** in interim periods may result in a significant variation in the customary relationship between income tax expense and pretax accounting income. The reasons for significant variations in the customary relationship between income tax expense and pretax accounting income shall be disclosed in the interim period financial statements if they are not otherwise apparent from the financial statements or from the nature of the entity's business. [FIN 18, paragraph 25, sequence 75]]

740-270-55 Implementation Guidance and Illustrations

General

55-1 [This Section, which is an integral part of the requirements of this Subtopic, provides Examples of applying the required accounting for interim period **income taxes** to some specific situations. In general, the Examples illustrate matters unique to accounting for income taxes at interim dates. The Examples do not include consideration of the nature of tax credits and events that do not have **tax consequences** or illustrate all possible combinations of circumstances. [FIN 18, paragraph 41, sequence 116]]

> Illustrations

> > Example 1: Accounting for Income Taxes Applicable to Ordinary Income (or Loss) at an Interim Date if Ordinary Income Is Anticipated for the Fiscal Year

55-2 The following Cases illustrate the guidance in Sections 740-270-30 and 740-270-35 for accounting for income taxes applicable to **ordinary income (or loss)** at an interim date if ordinary income is anticipated for the fiscal year:

a. Ordinary income in all interim periods (Case A)

b. Ordinary income and losses in interim periods (Case B)

c. Changes in estimates (Case C).

55-3 [Cases A and B share all of the following assumptions: [FIN 18, paragraph 43, sequence 119]]

a. [For the full fiscal year, an entity anticipates ordinary income of $100,000. All income is taxable in one jurisdiction at a 50 percent rate. [FIN 18, paragraph 43, sequence 120]] [Anticipated tax credits for the fiscal year total $10,000. No events that do not have tax consequences are anticipated. No changes in estimated ordinary income, tax rates, or tax credits occur during the year. [FIN 18, paragraph 43, sequence 121]]

b. [Computation of the estimated annual effective tax rate applicable to ordinary income is as follows. [FIN 18, paragraph 43, sequence 122]]

Tax at statutory rate ($100,000 at 50%)	$ 50,000
Less anticipated tax credits	(10,000)
Net tax to be provided	$ 40,000
Estimated annual effective tax rate ($40,000 ÷ $100,000)	40%

[FIN 18, paragraph 43, sequence 123]

c. [Tax credits are generally subject to limitations, usually based on the amount of tax payable before the credits. In computing the estimated annual effective tax rate, anticipated tax credits are limited to the amounts that are expected to be realized or are expected to be recognizable at the end of the current year in accordance with the provisions of Subtopic 740-10. If an entity is unable to estimate the amount of its tax credits for the year, see paragraphs 740-270-30-17 through 30-18. [FIN 18, paragraph 43, sequence 124]]

> > > Case A: Ordinary Income in All Interim Periods

55-4 [The entity has ordinary income in all interim periods. Quarterly tax computations are as follows. [FIN 18, paragraph 44, sequence 125]]

	Ordinary Income			Tax		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ 20,000	$20,000	40%	$ 8,000	$ -	$ 8,000
Second quarter	20,000	40,000	40%	16,000	8,000	8,000
Third quarter	20,000	60,000	40%	24,000	16,000	8,000
Fourth quarter	40,000	100,000	40%	40,000	24,000	16,000
Fiscal year	$ 100,000					$ 40,000

[FIN 18, paragraph 44, sequence 126]

> > > Case B: Ordinary Income and Losses in Interim Periods

55-5 The following Cases illustrate ordinary income and losses in interim periods:

a. Year-to-date ordinary income (Case B1)

b. Year-to-date ordinary losses, realization more likely than not (Case B2)

c. Year-to-date ordinary losses, realization not more likely than not (Case B3).

> > > > Case B1: Year-to-Date Ordinary Income

55-6 [The entity has ordinary income and losses in interim periods; there is not an ordinary loss for the fiscal year to date at the end of any interim period. Quarterly tax computations are as follows. [FIN 18, paragraph 45, sequence 127]]

	Ordinary Income (Loss)			Tax (or Benefit)		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ 40,000	$ 40,000	40%	$16,000	$ -	$ 16,000
Second quarter	40,000	80,000	40%	32,000	16,000	16,000
Third quarter	(20,000)	60,000	40%	24,000	32,000	(8,000)
Fourth quarter	40,000	100,000	40%	40,000	24,000	16,000
Fiscal year	$ 100,000					$ 40,000

[FIN 18, paragraph 45, sequence 128]

> > > > Case B2: Year-to-Date Ordinary Losses, Realization More Likely than Not

55-7 [The entity has ordinary income and losses in interim periods, and there is an ordinary loss for the year to date at the end of an interim period. Established seasonal patterns provide evidence that realization in the current year of the tax **benefit** of the year-to-date loss and of anticipated tax credits is more likely than not. Quarterly tax computations are as follows. [FIN 18, paragraph 46, sequence 129]]

	Ordinary Income (Loss)			Tax (or Benefit)		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ (20,000)	$ (20,000)	40%	$(8,000)	$ -	$ (8,000)
Second quarter	10,000	(10,000)	40%	(4,000)	(8,000)	4,000
Third quarter	15,000	5,000	40%	2,000	(4,000)	6,000
Fourth quarter	95,000	100,000	40%	40,000	2,000	38,000
Fiscal year	$ 100,000					$ 40,000

[FIN 18, paragraph 46, sequence 130]

> > > > Case B3: Year-to-Date Ordinary Losses, Realization Not More Likely than Not

55-8 [The entity has ordinary income and losses in interim periods, and there is a year-to-date ordinary loss during the year. There is no established seasonal pattern and it is more likely than not that the tax benefit of the year-to-date loss and the anticipated tax credits will not be realized in the current or future years. Quarterly tax computations are as follows. [FIN 18, paragraph 47, sequence 131]]

	Ordinary Income (Loss)				Tax		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate		Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ (20,000)	$ (20,000)	—	(a)	$ -	$ -	$ -
Second quarter	10,000	(10,000)	—	(a)	-	-	-
Third quarter	15,000	5,000	40%		2,000	-	2,000
Fourth quarter	95,000	100,000	40%		40,000	2,000	38,000
Fiscal year	$100,000						$ 40,000

(a) No benefit is recognized because the tax benefit of the year-to-date loss is not expected to be realized during the current year or recognizable as a deferred tax asset at the end of the current year in accordance with the provisions of Subtopic 740-10.

[FIN 18, paragraph 47, sequence 132]

> > > Case C: Changes in Estimates

55-9 [During the fiscal year, all of an entity's operations are taxable in one jurisdiction at a 50 percent rate. No events that do not have tax consequences are anticipated. Estimates of ordinary income for the year and of anticipated credits at the end of each interim period are as shown below. Changes in the estimated annual effective tax rate result from changes in the ratio of anticipated tax credits to tax computed at the statutory rate. Changes consist of an unanticipated strike that reduced income in the second quarter, an increase in the capital budget resulting in an increase in anticipated investment tax credit in the third quarter, and better than anticipated sales and income in the fourth quarter. The entity has ordinary income in all interim periods. Computations of the estimated annual effective tax rate based on the estimate made at the end of each quarter are as follows. [FIN 18, paragraph 48, sequence 135]]

	Estimated, end of First Quarter	Estimated, end of Second Quarter	Estimated, end of Third Quarter	Actual Fiscal Year
Estimated ordinary income for the fiscal year	$ 100,000	$ 80,000	$ 80,000	$ 100,000
Tax at 50% statutory rate	$ 50,000	$ 40,000	$ 40,000	$ 50,000
Less anticipated credits	(5,000)	(5,000)	(10,000)	(10,000)
Net tax to be provided	$ 45,000	$ 35,000	$ 30,000	$ 40,000
Estimated annual effective tax rate	45%	43.75%	37.5%	40%

[FIN 18, paragraph 48, sequence 136]

55-10 [Quarterly tax computations are as follows. [FIN 18, paragraph 48, sequence 137]]

Reporting Period	Ordinary Income: Reporting Period	Ordinary Income: Year-to-Date	Estimated Annual Effective Tax Rate	Tax: Year-to-Date	Tax: Less Previously Provided	Tax: Reporting Period
First quarter	$ 25,000	$25,000	45%	$11,250	$ -	$ 11,250
Second quarter	5,000	30,000	43.75%	13,125	11,250	1,875
Third quarter	25,000	55,000	37.5%	20,625	13,125	7,500
Fourth quarter	45,000	100,000	40%	40,000	20,625	19,375
Fiscal year	$100,000					$ 40,000

[FIN 18, paragraph 48, sequence 138]

> > Example 2: Accounting for Income Taxes Applicable to Ordinary Income (or Loss) at an Interim Date if an Ordinary Loss Is Anticipated for the Fiscal Year

55-11 The following Cases illustrate the guidance in Section 740-270-30 for accounting for income taxes applicable to ordinary income (or loss) at an interim date if an ordinary loss is anticipated for the fiscal year:

a. Realization of the tax benefit of the loss is more likely than not (Case A)

b. Realization of the tax benefit of the loss is not more likely than not (Case B)

c. Partial realization of the tax benefit of the loss is more likely than not (Case C)

d. Reversal of net deferred tax credits (Case D).

55-12 [Cases A, B, and C share the following assumptions. [FIN 18, paragraph 49, sequence 139]]

a. [For the full fiscal year, an entity anticipates an ordinary loss of $100,000. The entity operates entirely in one jurisdiction where the tax rate is 50 percent. Anticipated tax credits for the fiscal year total $10,000. No events that do not have tax consequences are anticipated. [FIN 18, paragraph 49, sequence 140]]

b. [If there is a recognizable tax benefit for the loss and the tax credits pursuant to the requirements of Subtopic 740-10, computation of the estimated annual effective tax rate applicable to the ordinary loss would be as follows. [FIN 18, paragraph 49, sequence 141]]

Tax benefit at statutory rate ($100,000 at 50%)	$(50,000)
Tax credits	(10,000)
Net tax benefit	$(60,000)
Estimated annual effective tax rate ($60,000 ÷ $100,000)	60%

[FIN 18, paragraph 49, sequence 142]

55-13 [Cases A, B, and C state varying assumptions with respect to assurance of realization of the components of the net tax benefit. When the realization of a component of the benefit is not expected to be realized during the current year or recognizable as a **deferred tax asset** at the end of the current year in accordance with the provisions of Subtopic 740-10, that component is not included in the computation of the estimated annual effective tax rate. [FIN 18, paragraph 49, sequence 143]]

> > > Case A: Realization of the Tax Benefit of the Loss Is More Likely than Not

55-14 The following Cases illustrate when realization of the tax benefit of the loss is more likely than not:

a. Ordinary losses in all interim periods (Case A1)

b. Ordinary income and losses in interim periods (Case A2).

> > > > Case A1: Ordinary Losses in All Interim Periods

55-15 [The entity has ordinary losses in all interim periods. The full tax benefit of the anticipated ordinary loss and the anticipated tax credits will be realized by carryback. Quarterly tax computations are as follows. [FIN 18, paragraph 50, sequence 144]]

	Ordinary Loss			Tax Benefit		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ (20,000)	$(20,000)	60%	$(12,000)	$ -	$ (12,000)
Second quarter	(20,000)	(40,000)	60%	(24,000)	(12,000)	(12,000)
Third quarter	(20,000)	(60,000)	60%	(36,000)	(24,000)	(12,000)
Fourth quarter	(40,000)	(100,000)	60%	(60,000)	(36,000)	(24,000)
Fiscal year	$(100,000)					$ (60,000)

[FIN 18, paragraph 50, sequence 145]

> > > > Case A2: Ordinary Income and Losses in Interim Periods

55-16 [The entity has ordinary income and losses in interim periods and for the year to date. The full tax benefit of the anticipated ordinary loss and the anticipated tax credits will be realized by carryback. The full tax benefit of the maximum year-to-date ordinary loss can also be realized by carryback. Quarterly tax computations are as follows. [FIN 18, paragraph 51, sequence 146]]

	Ordinary Income (Loss)			Tax (or Benefit) Year-to-Date			
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Computed	Limited to	Less Previously Provided	Reporting Period
First quarter	$ 20,000	$ 20,000	60%	$ 12,000		$ -	$ 12,000
Second quarter	(80,000)	(60,000)	60%	(36,000)		12,000	(48,000)
Third quarter	(80,000)	(140,000)	60%	(84,000)	$ (80,000) (a)	(36,000)	(44,000)
Fourth quarter	40,000	(100,000)	60%	(60,000)		(80,000)	20,000
Fiscal year	$(100,000)						$ (60,000)

(a) Because the year-to-date ordinary loss exceeds the anticipated ordinary loss for the fiscal year, the tax benefit recognized for the year-to-date is limited to the amount that would be recognized if the year-to-date ordinary loss were the anticipated ordinary loss for the fiscal year. The limitation is computed as follows:

Year-to-date ordinary loss times the statutory rate ($140,000 at 50%)	$ (70,000)
Estimated tax credits for the year	(10,000)
Year-to-date benefit limited to	$ (80,000)

[FIN 18, paragraph 51, sequence 147]

> > > Case B: Realization of the Tax Benefit of the Loss Is Not More Likely than Not

55-17 [In Cases A1 and A2, if neither the tax benefit of the anticipated loss for the fiscal year nor anticipated tax credits were recognizable pursuant to Subtopic 740-10, the estimated annual effective tax rate for the year would be zero and no **tax (or benefit)** would be recognized in any quarter. That conclusion is not affected by changes in the mix of income and loss in interim periods during a fiscal year. However, see paragraph 740-270-30-18. [FIN 18, paragraph 52, sequence 152]]

> > > Case C: Partial Realization of the Tax Benefit of the Loss Is More Likely than Not

55-18 The following Cases illustrate when partial realization of the tax benefit of the loss is more likely than not:

a. Ordinary losses in all interim periods (Case C1)

b. Ordinary income and losses in interim periods (Case C2).

> > > > Case C1: Ordinary Losses in All Interim Periods

55-19 [The entity has an ordinary loss in all interim periods. It is more likely than not that the tax benefit of the loss in excess of $40,000 of prior income available to be offset by carryback ($20,000 of tax at the 50 percent statutory rate) will not be realized. Therefore the estimated annual effective tax rate is 20 percent ($20,000 benefit more likely than not to be realized divided by $100,000 estimated fiscal year ordinary loss). Quarterly tax computations are as follows. [FIN 18, paragraph 53, sequence 153]]

	Ordinary Loss			Tax Benefit		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ (20,000)	$(20,000)	20%	$(4,000)	$ -	$ (4,000)
Second quarter	(20,000)	(40,000)	20%	(8,000)	(4,000)	(4,000)
Third quarter	(20,000)	(60,000)	20%	(12,000)	(8,000)	(4,000)
Fourth quarter	(40,000)	(100,000)	20%	(20,000)	(12,000)	(8,000)
Fiscal year	$(100,000)					$ (20,000)

[FIN 18, paragraph 53, sequence 154]

> > > > Case C2: Ordinary Income and Losses in Interim Periods

55-20 [The entity has ordinary income and losses in interim periods and for the year to date. It is more likely than not that the tax benefit of the anticipated ordinary loss in excess of $40,000 of prior income available to be offset by carryback ($20,000 of tax at the 50 percent statutory rate) will not be realized. Therefore the estimated annual effective tax rate is 20 percent ($20,000 benefit more likely than not to be realized divided by $100,000 estimated fiscal year ordinary loss), and the benefit that can be recognized for the year to date is limited to $20,000 (the benefit that is more likely than not to be realized). Quarterly tax computations are as follows. [FIN 18, paragraph 54, sequence 154.1]]

	Ordinary Income (Loss)			Tax (or benefit)			
				Year-to-Date			
Reporting Period	Ordinary Income (Loss)	Year-to-Date	Estimated Annual Effective Tax Rate	Computed	Limited to	Less Previously Provided	Reporting Period
First quarter	$ 20,000	$ 20,000	20%	$ 4,000		$ -	$ 4,000
Second quarter	(80,000)	(60,000)	20%	(12,000)		4,000	(16,000)
Third quarter	(80,000)	(140,000)	20%	(28,000)	$ (20,000)	(12,000)	(8,000)
Fourth quarter	40,000	(100,000)	20%	(20,000)		(20,000)	-
Fiscal year	$(100,000)						$ (20,000)

[FIN 18, paragraph 54, sequence 155]

> > > Case D: Reversal of Net Deferred Tax Credits

ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

55-21 [The entity anticipates a fiscal year ordinary loss. The loss cannot be carried back, and future profits exclusive of reversing temporary differences are unlikely. Net deferred tax liabilities arising from existing net taxable temporary differences are present. A portion of the existing net taxable temporary differences relating to those liabilities will reverse within the loss carryforward period. Computation of the estimated annual effective tax rate to be used (see paragraphs 740-270-30-32 through 30-33) is as follows. [FIN 18, paragraph 55, sequence 156]]

Estimated fiscal year ordinary loss		$(100,000)
The tax benefit to be recognized is the lesser of:		
Tax effect of the loss carryforward ($100,000 at 50% statutory rate)	$50,000	
Amount of the net deferred tax liabilities that would otherwise have been settled during the carry-forward period	$24,000	
Estimated annual effective tax rate ($24,000 ÷ $100,000)		24%

[FIN 18, paragraph 55, sequence 157]

55-22 [Quarterly tax computations are as follows. [FIN 18, paragraph 55, sequence 158]]

	Ordinary Loss			Tax Benefit		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ (20,000)	$(20,000)	24%	$(4,800)	$ -	$ (4,800)
Second quarter	(20,000)	(40,000)	24%	(9,600)	(4,800)	(4,800)
Third quarter	(20,000)	(60,000)	24%	(14,400)	(9,600)	(4,800)
Fourth quarter	(40,000)	(100,000)	24%	(24,000)	(14,400)	(9,600)
Fiscal year	$(100,000)					$ (24,000)

[FIN 18, paragraph 55, sequence 159]

55-23 [Note that changes in the timing of the loss by quarter would not change this computation. [FIN 18, paragraph 55, sequence 160]]

> > Example 3: Accounting for Income Taxes Applicable to Unusual, Infrequently Occurring, or Extraordinary Items

55-24 The following Cases illustrate accounting for income taxes applicable to unusual, infrequently occurring, or extraordinary items when ordinary income is expected for the fiscal year:

a. Realization of the tax benefit is more likely than not at date of occurrence (Case A)

b. Realization of the tax benefit not more likely than not at date of occurrence (Case B).

55-25 [Cases A and B illustrate the computation of the tax (or benefit) applicable to unusual, infrequently occurring, or extraordinary items when ordinary income is anticipated for the fiscal year. These Cases are based on the assumptions and computations presented in paragraph 740-270-55-3 and Example 1, Cases A and B (see paragraphs 740-270-55-4 through 55-8), plus additional information supplied in Cases A and B of this Example. The computation of the tax (or benefit) applicable to the ordinary income is not affected by the occurrence of an unusual, infrequently occurring, or extraordinary item; therefore, each Case refers to one or more of the illustrations of that computation in Example 1, Cases A and B (see paragraphs 740-270-55-4 through 55-8), and does not reproduce the computation and the assumptions. The income statement display for tax (or benefit) applicable to unusual, infrequently occurring, or extraordinary items is illustrated in Example 7 (see paragraph 740-270-55-52). [FIN 18, paragraph 56, sequence 161]]

> > > Case A: Realization of the Tax Benefit Is More Likely than Not at Date of Occurrence

55-26 [As explained in paragraph 740-270-55-25, this Case is based on the computations of tax applicable to ordinary income that are illustrated in Example 1, Case A (see paragraph 740-270-55-4). In addition, the entity experiences a tax-deductible unusual, infrequently occurring, or extraordinary loss of $50,000 (tax benefit $25,000) in the second quarter. Because the loss can be carried back, it is more likely than not that the tax benefit will be realized at the time of occurrence. Quarterly tax provisions are as follows. [FIN 18, paragraph 57, sequence 162]]

			Tax (or Benefit) Applicable to	
Reporting Period	Ordinary Income	Unusual, Infrequently Occurring, or Extraordinary Loss	Ordinary Income	Unusual, Infrequently Occurring, or Extraordinary Loss
First quarter	$ 20,000		$ 8,000	
Second quarter	20,000	$ (50,000)	8,000	$ (25,000)
Third quarter	20,000		8,000	
Fourth quarter	40,000		16,000	
Fiscal year	$100,000	$ (50,000)	$ 40,000	$ (25,000)

[FIN 18, paragraph 57, sequence 163]

55-27 [Note that changes in assumptions would not change the timing of the recognition of the tax benefit applicable to the unusual, infrequently occurring, or extraordinary item as long as realization is more likely than not. [FIN 18, paragraph 57, sequence 164]]

>>> Case B: Realization of the Tax Benefit Not More Likely than Not at Date of Occurrence

55-28 [As explained in paragraph 740-270-55-25, this Case is based on the computations of tax applicable to ordinary income that are illustrated in Example 1, Cases A and B1 (see paragraphs 740-270-55-4 through 55-6). In addition, the entity experiences a tax-deductible unusual, infrequently occurring, or extraordinary loss of $50,000 (potential benefit $25,000) in the second quarter. The loss cannot be carried back, and available evidence indicates that a **valuation allowance** is needed for all of the deferred tax asset. As a result, the tax benefit of the unusual, infrequently occurring, or extraordinary loss is recognized only to the extent of offsetting ordinary income for the year to date. Quarterly tax provisions under two different assumptions for the occurrence of ordinary income are as follows. [FIN 18, paragraph 58, sequence 165]]

			Tax (or Benefit) Applicable to				
			Ordinary Income (Loss)		Unusual, Infrequently Occurring, or Extraordinary Loss		
Assumptions and Reporting Period	Ordinary Income (Loss)	Unusual, Infrequently Occurring, or Extraordinary Loss	Reporting Period	Year-to-Date	Year-to-Date	Less Previously Provided	Reporting Period
Income in all quarters:							
First quarter	$ 20,000		$ 8,000	$ 8,000			
Second quarter	20,000	$ (50,000)	8,000	16,000	$(16,000)	$ -	$ (16,000)
Third quarter	20,000		8,000	24,000	(24,000)	(16,000)	(8,000)
Fourth quarter	40,000		16,000	40,000	(25,000)	(24,000)	(1,000)
Fiscal year	$ 100,000	$ (50,000)	$ 40,000				$ (25,000)
Income and loss quarters:							
First quarter	$ 40,000		$ 16,000	$16,000			
Second quarter	40,000	$ (50,000)	16,000	32,000	$(25,000)	$ -	$ (25,000)
Third quarter	(20,000)		(8,000)	24,000	(24,000)	(25,000)	1,000
Fourth quarter	40,000		16,000	40,000	(25,000)	(24,000)	(1,000)
Fiscal year	$ 100,000	$ (50,000)	$ 40,000				$ (25,000)

[FIN 18, paragraph 58, sequence 166]

>> Example 4: Accounting for Income Taxes Applicable to Income (or Loss) from Discontinued Operations at an Interim Date

55-29 [This Example illustrates the guidance in paragraph 740-270-45-7. An entity anticipates ordinary income for the year of $100,000 and tax credits of $10,000. The entity has ordinary income in all interim periods. The estimated annual effective tax rate is 40 percent, computed as follows. [FIN 18, paragraph 62, sequence 168]]

Estimated pretax income	$ 100,000
Tax at 50% statutory rate	$ 50,000
Less anticipated credits	(10,000)
Net tax to be provided	$ 40,000
Estimated annual effective tax rate	40%

[FIN 18, paragraph 62, sequence 169]

55-30 [Quarterly tax computations for the first two quarters are as follows. [FIN 18, paragraph 62, sequence 170]]

	Ordinary Income			Tax		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ 20,000	$20,000	40%	$ 8,000	$ -	$ 8,000
Second quarter	25,000	45,000	40%	18,000	8,000	10,000

[FIN 18, paragraph 62, sequence 171]

55-31 [In the third quarter a decision is made to discontinue the operations of Division X, a segment of the business that has recently operated at a loss (before income taxes). The pretax income (and losses) of the continuing operations of the entity and of Division X through the third quarter and the estimated fourth quarter results are as follows. [FIN 18, paragraph 62, sequence 172]]

		Division X	
Reporting Period	Revised Ordinary Income from Continuing Operations	Loss from Operations	Provision for Loss on Disposal
First quarter	$ 25,000	$ (5,000)	
Second quarter	35,000	(10,000)	
Third quarter	50,000	(10,000)	$ (55,000)
Fourth quarter	50,000 (a)	-	-
Fiscal year	$ 160,000	$ (25,000)	$ (55,000)

(a) Estimated.

[FIN 18, paragraph 62, sequence 173]

55-32 [No changes have occurred in continuing operations that would affect the estimated annual effective tax rate. Anticipated annual tax credits of $10,000 included $2,000 of credits related to the operations of Division X. The revised estimated annual effective tax rate applicable to ordinary income from continuing operations is 45 percent, computed as follows. [FIN 18, paragraph 62, sequence 175]]

Estimated ordinary income from continuing operations	$160,000
Tax at 50% statutory rate	80,000
Less anticipated tax credits applicable to continuing operations	(8,000)
Net tax to be provided	$ 72,000
Estimated annual effective tax rate	45%

[FIN 18, paragraph 62, sequence 176]

55-33 [Quarterly computations of tax applicable to ordinary income from continuing operations are as follows. [FIN 18, paragraph 62, sequence 177]]

	Ordinary Income			Tax		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period
First quarter	$ 25,000	$25,000	45%	$11,250	$ -	$ 11,250
Second quarter	35,000	60,000	45%	27,000	11,250	15,750
Third quarter	50,000	110,000	45%	49,500	27,000	22,500
Fourth quarter	50,000	160,000	45%	72,000	49,500	22,500
Fiscal year	$160,000					$ 72,000

[FIN 18, paragraph 62, sequence 178]

55-34 [Tax benefit applicable to Division X for the first two quarters is computed as follows. [FIN 18, paragraph 62, sequence 179]]

	Tax Applicable to Ordinary Income		
Reporting Period	Previously Reported (A)	Recomputed (Above) (B)	Tax Benefit Applicable to Division X (A-B)
First quarter	$ 8,000	$ 11,250	$ (3,250)
Second quarter	10,000	15,750	(5,750)
			$ (9,000)

[FIN 18, paragraph 62, sequence 180]

55-35 [The third quarter tax benefits applicable to both the loss from operations and the provision for loss on disposal of Division X are computed based on estimated annual income with and without the effects of the Division X losses. Current year tax credits related to the operations of Division X have not been recognized. It is assumed that the tax benefit of those credits will not be realized because of the discontinuance of Division X operations. Any reduction in tax benefits resulting from recapture of previously recognized tax credits resulting from discontinuance or current year tax credits applicable to the discontinued operations would be reflected in the tax benefit recognized for the loss on disposal or loss from operations as appropriate. If, because of capital gains and losses, and so forth, the individually computed tax effects of the items do not equal the aggregate tax effects of the items, the aggregate tax effects are allocated to the individual items in the same manner that they will be allocated in the annual financial statements. The computations are as follows. [FIN 18, paragraph 62, sequence 181]]

	Loss from Operations Division X	Provision for Loss on Disposal
Estimated annual income from continuing operations	$ 160,000	$ 160,000
Loss from Division X operations	(25,000)	
Provision for loss on disposal of Division X		(55,000)
Total	$ 135,000	$ 105,000
Tax at 50% statutory rate	$ 67,500	$ 52,500
Anticipated credits from continuing operations	(8,000)	(8,000)
Tax credits of Division X and recapture of previously recognized tax credits resulting from discontinuance	-	-
Taxes on income after effect of Division X losses	59,500	44,500
Taxes on income before effect of Division X losses—see computation above	72,000	72,000
Tax benefit applicable to the losses of Division X	(12,500)	(27,500)
Amounts previously recognized—see computation above	(9,000)	-
Tax benefit recognized in third quarter	$ (3,500)	$ (27,500)

[FIN 18, paragraph 62, sequence 182]

55-36 [The resulting revised quarterly tax provisions are summarized as follows. [FIN 18, paragraph 62, sequence 183]]

ICC Docket No. 12-0321
Staff Initial Brief
Appendix C

	Pretax Income (Loss)			Tax (or Benefit) Applicable to		
Reporting Period	Continuing Operations	Operations of Division X	Provisions for Loss on Disposal	Continuing Operations	Operations of Division X	Provisions for Loss on Disposal
First quarter	$ 25,000	$ (5,000)		$ 11,250	$ (3,250)	
Second quarter	35,000	(10,000)		15,750	(5,750)	
Third quarter	50,000	(10,000)	$ (55,000)	22,500	(3,500)	$ (27,500)
Fourth quarter	50,000			22,500		
Fiscal year	$ 160,000	$ (25,000)	$ (55,000)	$ 72,000	$ (12,500)	$ (27,500)

[FIN 18, paragraph 62, sequence 184]

> > Example 5: Accounting for Income Taxes Applicable to Ordinary Income if an Entity Is Subject to Tax in Multiple Jurisdictions

55-37 The following Cases illustrate the guidance in paragraph 740-270-30-36 for accounting for income taxes applicable to ordinary income if an entity is subject to tax in multiple jurisdictions:

a. Ordinary income in all jurisdictions (Case A)

b. Ordinary loss in a jurisdiction; realization of the tax benefit not more likely than not (Case B)

c. Ordinary income or tax cannot be estimated in one jurisdiction (Case C).

55-38 [Cases A, B, and C assume that an entity operates through separate corporate entities in two countries. Applicable tax rates are 50 percent in the United States and 20 percent in Country A. The entity has no unusual or extraordinary items during the fiscal year and anticipates no tax credits or events that do not have tax consequences. (The effect of foreign tax credits and the necessity of providing tax on undistributed earnings are ignored because of the wide range of tax planning alternatives available.) For the full fiscal year the entity anticipates ordinary income of $60,000 in the United States and $40,000 in Country A. The entity is able to make a reliable estimate of its Country A ordinary income and tax for the fiscal year in dollars. Computation of the overall estimated annual effective tax rate in Cases B and C is based on additional assumptions stated in those Cases. [FIN 18, paragraph 65, sequence 187]]

> > > Case A: Ordinary Income in All Jurisdictions

55-39 Computation of the overall estimated annual effective tax rate is as follows.

Anticipated ordinary income for the fiscal year:	
In the United States	$ 60,000
In Country A	40,000
Total	$100,000
Anticipated tax for the fiscal year:	
In the United States ($60,000 at 50% statutory rate)	$ 30,000
In Country A ($40,000 at 20% statutory rate)	8,000
Total	$ 38,000
Overall estimated annual effective tax rate ($38,000 ÷ $100,000)	38%

[FIN 18, paragraph 65, sequence 188]

55-40 [Quarterly tax computations are as follows. [FIN 18, paragraph 65, sequence 189]]

	Ordinary Income				Tax			
Reporting Period	United States	Country A	Total	Year-to-Date	Overall Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Reported	Reporting Period
First quarter	$ 5,000	$ 15,000	$ 20,000	$20,000	38%	$ 7,600	$ -	$ 7,600
Second quarter	10,000	10,000	20,000	40,000	38%	15,200	7,600	7,600
Third quarter	10,000	10,000	20,000	60,000	38%	22,800	15,200	7,600
Fourth quarter	35,000	5,000	40,000	100,000	38%	38,000	22,800	15,200
Fiscal year	$60,000	$ 40,000	$100,000					$ 38,000

[FIN 18, paragraph 65, sequence 190]

> > > Case B: Ordinary Loss in a Jurisdiction; Realization of the Tax Benefit Not More Likely than Not

55-41 [In this Case, the entity operates through a separate corporate entity in Country B. Applicable tax rates in Country B are 40 percent. Operations in Country B have resulted in losses in recent years and an ordinary loss is anticipated for the current fiscal year in Country B. It is expected that the tax benefit of those losses will not be recognizable as a deferred tax asset at the end of the current year pursuant to Subtopic 740-10; accordingly, no tax benefit is recognized for losses in Country B, and interim period tax (or benefit) is separately computed for the ordinary loss in Country B and for the overall ordinary income in the United States and Country A. The tax applicable to the overall ordinary income in the United States and Country A is computed as in Case A of this Example. Quarterly tax provisions are as follows. [FIN 18, paragraph 66, sequence 191]]

	Ordinary Income (or Loss)					Tax (or Benefit)		
Reporting Period	United States	Country A	Combined Excluding Country B	Country B	Total	Combined Excluding Country B	Country B	Total
First quarter	$ 5,000	$ 15,000	$ 20,000	$ (5,000)	$15,000	$ 7,600	$ -	$ 7,600
Second quarter	10,000	10,000	20,000	(25,000)	(5,000)	7,600	-	7,600
Third quarter	10,000	10,000	20,000	(5,000)	15,000	7,600	-	7,600
Fourth quarter	35,000	5,000	40,000	(5,000)	35,000	15,200	-	15,200
Fiscal year	$60,000	$ 40,000	$ 100,000	$ (40,000)	$60,000	$ 38,000	$ -	$38,000

[FIN 18, paragraph 66, sequence 192]

> > > Case C: Ordinary Income or Tax Cannot Be Estimated in One Jurisdiction

55-42 [In this Case, the entity operates through a separate corporate entity in Country C. Applicable tax rates in Country C are 40 percent in foreign currency. Depreciation in that country is large and exchange rates have changed in prior years. The entity is unable to make a reasonable estimate of its ordinary income for the year in Country C and thus is unable to reasonably estimate its annual effective tax rate in Country C in dollars. Accordingly, tax (or benefit) in Country C is separately computed as ordinary income (or loss) occurs in Country C. The tax applicable to the overall ordinary income in the United States and Country A is computed as in Case A of this Example. Quarterly computations of tax applicable to Country C are as follows. [FIN 18, paragraph 67, sequence 193]]

	Foreign Currency (FC) Amounts		Translated Amounts in Dollars	
Reporting Period	Ordinary Income in Reporting Period	Tax (at 40% rate)	Ordinary Income in Reporting Period	Tax
First quarter	FC 10,000	FC 4,000	$ 12,500	$ 3,000
Second quarter	5,000	2,000	8,750	1,500
Third quarter	30,000	12,000	27,500	9,000
Fourth quarter	15,000	6,000	16,250	4,500
Fiscal year	FC 60,000	FC 24,000	$ 65,000	$18,000

[FIN 18, paragraph 67, sequence 194]

55-43 [Quarterly tax provisions are as follows. [FIN 18, paragraph 67, sequence 195]]

	Ordinary Income					Tax		
Reporting Period	United States	Country A	Combined Excluding Country C	Country C	Total	Combined Excluding Country C	Country C	Total
First quarter	$ 5,000	$ 15,000	$ 20,000	$ 12,500	$ 32,500	$ 7,600	$ 3,000	$10,600
Second quarter	10,000	10,000	20,000	8,750	28,750	7,600	1,500	9,100
Third quarter	10,000	10,000	20,000	27,500	47,500	7,600	9,000	16,600
Fourth quarter	35,000	5,000	40,000	16,250	56,250	15,200	4,500	19,700
Fiscal year	$60,000	$ 40,000	$ 100,000	$ 65,000	$ 165,000	$ 38,000	$ 18,000	$56,000

[FIN 18, paragraph 67, sequence 196]

> > Example 6: Effect of New Tax Legislation

55-44 The following Cases illustrate the guidance in paragraphs 740-270-25-5 through 25-6 for accounting in interim periods for the effect of new tax legislation on income taxes:

a. Legislation effective in a future interim period (Case A)

b. Effective date of new legislation (Case B).

> > > Case A: Legislation Effective in a Future Interim Period

55-45 [The assumed facts applicable to this Case follow. [FIN 18, paragraph 68, sequence 197]]

55-46 [For the full fiscal year, an entity anticipates ordinary income of $100,000. All income is taxable in one jurisdiction at a 50 percent rate. Anticipated tax credits for the fiscal year total $10,000. No events that do not have tax consequences are anticipated. [FIN 18, paragraph 68, sequence 198]]

55-47 [Computation of the estimated annual effective tax rate applicable to ordinary income is as follows. [FIN 18, paragraph 68, sequence 199]]

Tax at statutory rate ($100,000 at 50%)	$50,000
Less anticipated tax credits	(10,000)
Net tax to be provided	$40,000
Estimated annual effective tax rate ($40,000 ÷ $100,000)	40%

[FIN 18, paragraph 68, sequence 200]

55-48 [Further, assume that new legislation creating additional tax credits is enacted during the second quarter of the entity's fiscal year. The new legislation is effective on the first day of the third quarter. As a result of the estimated effect of the new legislation, the entity revises its estimate of its annual effective tax rate to the following. [FIN 18, paragraph 69, sequence 201]]

Tax at statutory rate ($100,000 at 50%)	$ 50,000
Less anticipated tax credits	(12,000)
Net tax to be provided	$ 38,000
Estimated annual effective tax rate ($38,000 ÷ $100,000)	38%

[FIN 18, paragraph 69, sequence 202]

55-49 [The effect of the new legislation shall not be reflected until it is effective or administratively effective. Accordingly, quarterly tax computations are as follows. [FIN 18, paragraph 69, sequence 203]]

	Ordinary Income			Tax		
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Peviously Provided	Reporting Period
First quarter	$ 20,000	$20,000	40%	$ 8,000	$ -	$ 8,000
Second quarter	20,000	40,000	40%	16,000	8,000	8,000
Third quarter	20,000	60,000	38%	22,800	16,000	6,800
Fourth quarter	40,000	100,000	38%	38,000	22,800	15,200
Fiscal year	$100,000					$ 38,000

[FIN 18, paragraph 69, sequence 204]

> > > Case B: Effective Date of New Legislation

55-50 [Legislation generally becomes effective on the date prescribed in the statutes. However, tax legislation may prescribe changes that become effective during an entity's fiscal year that are administratively implemented by applying a portion of the change to the full fiscal year. For example, if the statutory tax rate applicable to calendar-year corporations were increased from 48 to 52 percent, effective January 1, the increased statutory rate might be administratively applied to a corporation with a fiscal year ending at June 30 in the year of the change by applying a 50 percent rate to its **taxable income** for the fiscal year, rather than 48 percent for the first 6 months and 52 percent for the last 6 months. In that case the legislation becomes effective for that entity at the beginning of the entity's fiscal year. [FIN 18, paragraph 24, sequence 74]]

55-51 [Applying this to specific legislation, an entity with a fiscal year other than a calendar year would account during interim periods for the reduction in the corporate tax rate resulting from the Revenue Act of 1978 [FTB 79-09, paragraph 1, sequence 9]] [through a revised annual effective tax rate calculation in the same way that the change will be applied to the entity's taxable income for the year. The revised annual effective tax rate would then be applied to pretax income for the year to date at the end of the current interim period. [FTB 79-09, paragraph 3, sequence 11]]

> > Example 7: Illustration of Income Taxes in Income Statement Display

55-52 [The following illustrates the location in an income statement display of the various tax amounts computed under this Subtopic. [FIN 18, paragraph 71, sequence 206]]

Net sales [a]		$XXXX
Other income [a]		XXX
		XXXX
Costs and expenses:		
Cost of sales [a]	$XXXX	
Selling, general, and administrative expenses [a]	XXXX	
Interest expense [a]	XXX	
Other deductions [a]	XX	
Unusual items	XXX	
Infrequently occurring items	XXX	XXXX
Income (loss) from continuing operations before income taxes and other items listed below		XXXX
Provision for income taxes (benefit) [b]		XXXX
Income (loss) from continuing operations before other items listed below		XXXX
Discontinued operations:		
Income (loss) from operations of discontinued Component X (less applicable income taxes of $XXXX)	XXXX	
		XXXX
Income (loss) before extraordinary items		XXXX
Extraordinary items (less applicable income taxes of $XXXX)		XXXX
Net income (loss)		$XXXX

(a) Components of ordinary income (loss).
(b) Consists of the total of income taxes (or benefit) applicable to ordinary income, unusual items, and infrequently occurring items.

[FIN 18, paragraph 71, sequence 207]