

MINUTES



Financial Accounting
Standards Board

To: Board Members

From: Short-Term Convergence—Income Tax Team (Kispert, Ext. 310)

Subject: Minutes of the April 21, 2005 Joint Board Meeting (Short-Term Convergence—Income Taxes) **Date:** May 4, 2005

cc: Bielstein, Smith, Petrone, Leisenring, IASB (McGeachin, Upton, Buchanan) Project Team (Cassel, J. Johnson, Posta, Thomas), Golden, McBride, Geary, Mahoney, Thompson, Vincent, Sutay, Gabriele, Swift, Polley, FASB Intranet (e-mail), Getz

Topic: Intraperiod Allocation

Basis for Discussion: IASB Agenda Paper 3 (FASB memorandum 13), Agenda Paper 3A, Agenda Paper 3B, Agenda Paper 3C, Agenda Paper 3D and Appendix A, Agenda Paper 3E, Agenda Paper 3F, Agenda Paper 3G, and Agenda Paper 3H dated April 7, 2005

Length of Discussion: 11:00am to 11:45am (BST)

Attendance:

Board members present: FASB: Herz, Schipper, Batavick, Crooch, Seidman, Young, and Trott
IASB: Tweedie, Jones, Barth, Bruns, Cope, Engström, Garnett, Gélard, Leisenring, McGregor, O'Malley, Smith, Whittington, and Yamada

Board members absent: None

Staff in charge of topic: Thomas and McGeachin

Other staff at Board table: Bielstein and Upton

Outside participants: None

Summary of Decisions Reached:

At the joint meeting, the IASB and the FASB decided:

1. Not to amend the intraperiod tax allocation requirements in paragraphs 35–38 and 273–276 of FASB Statement No. 109, *Accounting for Income Taxes*, in this project.
2. To amend IAS 12, *Income Taxes*, to adopt the intraperiod tax allocation requirements of Statement 109. The requirement to allocate income taxes to items previously credited or charged to equity contained in paragraphs 57, 58, and 61–65 of IAS 12 would be amended and replaced with guidance similar to that in paragraphs 35–38 and 273–276 of Statement 109.
3. To add intraperiod tax allocation to the scope of the second phase of the project on financial performance reporting by business enterprises.

Objective of Meeting:

The objective of the meeting was for the Boards to discuss whether and, if so, how to eliminate certain differences between their existing standards of accounting for income taxes relating to intraperiod tax allocation, specifically the reporting of the effects in tax rates (or law), tax status, and valuation allowances.

Matters Discussed and Decisions Reached:

1. Mr. Thomas began the meeting by stating that paragraphs 57 and 58 of IAS 12 require that current and deferred taxes be accounted for consistent with the underlying transactions for all equity items. Statement 109 generally requires tracing for capital items, but paragraphs 26–28 require recognition of tax rate or law, tax status, and valuation allowance changes in income from continuing operations.
2. Mr. Thomas stated that from 1993 to 1997, the FASB received and considered numerous requests to add a project to its agenda to amend paragraphs 26–28 of Statement 109 to require tracing for all equity items, including components of other comprehensive income (OCI). The FASB never added a project to its agenda,

though an approach was exposed to a limited number of constituents who had been vocal advocates of amending Statement 109. The issue arises again today due to convergence.

3. Mr. Thomas noted that Statement 109 has detailed guidance on intraperiod tax allocation, while IAS 12's guidance is principles based. That is, IAS 12 requires intraperiod allocation but does not have detailed guidance.
4. Mr. Thomas stated that the alternatives are as follows:
 - a. Option A: Do not converge on intraperiod allocation at this time. The FASB and IASB Boards could separately deliberate intraperiod allocation if either Board believes improvements in their standard is advisable.
 - b. Option B: Converge the intraperiod allocation principles in IAS 12 with the detailed intraperiod allocation requirements in Statement 109. This would effectively result in retaining the intraperiod allocation guidance in Statement 109, amended to require allocation to the components of income, OCI or capital of changes in (1) tax rates, (2) tax laws, (3) tax status of an entity, and (4) valuation allowances. Mr. Thomas stated that the staff recommended option B.
5. Ms. McGeachin added that this is an allocation issue. Also, most of the requirements in Statement 109 do not conflict with those in IAS 12, either because the requirements are the same or because IAS 12 is silent. However, the requirements for changes in tax effects do differ. IAS 12 requires those changes to be recorded in equity, whereas Statement 109 requires those changes to be recorded in continuing operations. Ms. McGeachin noted that both Boards have expressed interest in exploring combining the requirements in Statement 109 and IAS 12 but have expressed concern about whether that is operational.
6. Mr. Trott stated that one of the questions is whether there is valuable information within the income statement allocation to continuing operations, to discontinued operations, and to items of OCI. Should income tax expense be reflected in one line item on the single statement of earnings and comprehensive income, and not attempt to allocate it to all components of comprehensive income and capital that are

reported net of tax? Mr. Trott stated that he views the allocation on the income statement as an exercise of trying to do something one cannot do. Income taxes are cumulative; that is, total income tax expense is the result of all tax attributes generated or utilized in the current year and carried forward from previous years or to future years. One cannot specifically attribute a number for an individual income impact to a specific transaction from something that is computed on a cumulative basis. He suggested that the Boards approach this issue more broadly, such as deciding whether they even want to have intraperiod allocation in the single statement of earnings and comprehensive income.

7. Ms. O'Malley stated that Mr. Trott raised some interesting points; however, she does not believe that there can be a single tax line so long as there is net income and comprehensive income. Perhaps there could be two tax lines. Also, the Boards should consider what information users want as to tax effects, especially if the rate is significantly different from the normal overall effective tax rate. Ms. O'Malley noted that she believes integrating this project and the reporting financial performance project would be beneficial.
8. Mr. Cope stated that he agrees with Ms. O'Malley. The value of the tax rate reconciliation depends on the transparency with which it is prepared. Also, if we base tax on continuing operations, it is important to consider the effects on net income.
9. Mr. Upton noted that the question is once the income tax is allocated to components of OCI, how do we get it out of OCI when the amounts are reclassified into continuing operations? We might simplify the allocation exercise, but we would not escape the tracking.
10. Mr. Engström stated that he favors one line of taxes, with changes going to profit and loss; however, for this decision he prefers the "American model."
11. Ms. Barth stated that she agrees with Mr. Engström and Mr. Trott in that this is trying to allocate a number that cannot be allocated. She prefers one line for income taxes, but does take the point that there may have to be two lines until net income and OCI is sorted out in Segment B of the reporting financial performance project.

12. Mr. Leisenring stated that he does not believe one tax line in OCI will simplify anything if there is more than one item in OCI because of the issue of getting the tax allocation out of OCI. If the tax is displayed in one line, people will question what it is composed of. Mr. Leisenring also stated that a contentious point in all of the hedging discussions is when does this reverse to net income. He stated that the principle for tax reversals ought to be the same as for a cash flow hedge. That is, you ought to know exactly when the allocation will come out of OCI.
13. Mr. Jones stated that he believes that net income is being preserved for the benefit of preparers, not users. If net income is preserved but tax is ignored, he thinks that the Boards will get a significant reaction from preparers.
14. Mr. Bruns stated that the key question for him is, what is the information content? He believes that the tax people will trace regardless; however, users cannot do it.
15. Mr. Cope stated that the joint international group on performance reporting said that a fair amount of attention is paid to net income because it is an important starting point for analysis. However, net income is not the metric on which the valuation is done. If an attempt is not made to distinguish between the taxes applied to items within net income, that starting point is going to be very different.
16. Mr. Young stated that he agrees with Mr. Cope. If there is a discontinued operation that has a disproportionate impact on the tax rate, that is important information for the user. Users are very dependent on information prepared by management in this area.
17. Mr. Smith asked whether this is a tracking or methodology issue. For example, if one is only taking out of OCI the income tax allocated to items that are recycled, then one could track it and it would only be a matter of methodology
18. Mr. Thomas stated that if one is using a specific identification method with respect to changes in OCI, it is not controversial whether one can track those items. It is only difficult to track items when the portfolio method is used, and then one must allocate to a net number.
19. Mr. Leisenring noted that an allocation method can always be developed. However, you have to decide what the anchor is; that is, where do you start the allocation?

Users want to know that the taxes for continuing operations is predictable; that predictability will not be there if the “plug” goes to continuing operations.

20. Mr. Whittington agreed that the allocation is imprecise. Therefore, he stated he would prefer a single tax line and to not do any intraperiod allocation. However, he is not sure a single number will suffice if net income is used.
21. Mr. Engström stated that all of the details should not be brought into specific figures. The use of disclosures (notes) is important.
22. Ms. Schipper stated that the first question is whether it is conceptually appropriate to do an allocation. She stated that she would answer “no.” She noted that even if you believe that it is conceptually appropriate, you need to ask whether the allocation is worth the trouble. There is standard-setting time and effort needed to write the detailed rules, there is preparer time and effort needed to execute those rules, and there is user time and effort needed to sort through the resulting numbers. Thus, Ms. Schipper stated she believes it is not worth the cumulative trouble.
23. Ms. Schipper suggested a new alternative: Do not change Statement 109, and suggest to the IASB that they consider whether paragraphs 57–65 of IAS 12 may be altered to clarify that tracing back changes in tax rates, laws, status of an entity, and the IAS equivalent of valuation allowances would not be required. Also, the IASB Board should be asked whether any of the implementation guidance in Statement 109 would be a useful addition to IAS 12.
24. Ms. Barth stated that she supports Ms. Schipper’s recommendation for the IASB to converge with the FASB.
25. Mr. Herz stated that he also supports that recommendation.
26. Mr. McGregor asked whether Ms. Schipper’s recommendation would be a pragmatic approach until this issue can be addressed in Segment B of the reporting financial performance project. Ms. Schipper agreed with that statement.
27. Mr. Tweedie asked whether anyone objected to trying to converge with the FASB. No one objected. Mr. Tweedie then asked for further views supporting Ms. Schipper’s recommendation.

28. Mr. Thomas noted that the argument that can be made for Ms. Schipper's recommendation is that Statement 109 has been used by a significant number of companies for over 10 years. Further, the FASB has received many technical inquiries on this topic. Therefore, there is a body of literature with interpretations for the IASB to take guidance from.
29. Mr. Upton stated that the basis for conclusions for Ms. Schipper's alternative is a pragmatic one.
30. Ms. Schipper stated that the basis for conclusions is also conceptual. The staff's argument for Option A is compelling because these remeasurements are changes in assets and liabilities that occur in the current period and, therefore, those effects of remeasurements belong in income from continuing operations. However, even if one does not accept that conceptual argument, a pragmatic argument can be made that an arbitrary allocation based on rules is not worth the trouble. Both of these arguments support her recommendation. However, Ms. Schipper noted that this issue may be revisited when display in a performance statement is discussed in the reporting financial performance project.
31. Ms. O'Malley stated she agrees with Ms. Schipper on the pragmatic reasons. This option allows the Boards to reach convergence quickly. Messrs. Whittington and McGregor agreed with Ms. O'Malley.
32. Mr. Thomas clarified that the decision the Board was voting on was the detailed intraperiod tax allocation guidance on Statement 109 that was included in Agenda Paper 3B, to the extent it is applicable to IFRS.
33. The Boards concurred that this was the point they were voting on.
34. Mr. Tweedie took a vote in favor of the IASB adopting the intraperiod allocation guidance in Statement 109.
35. The FASB voted not to amend the detailed intraperiod tax allocation requirements of Statement 109 at this time and to add intraperiod tax allocation to the scope of the reporting financial performance project.

36. The IASB voted to adopt the detailed intraperiod tax allocation guidance of Statement 109 into IAS 12 and to add intraperiod tax allocation to the scope of the reporting financial performance project.

Follow-up Items:

None.

General Announcements:

None.