

MINUTES



To: Board Members

From: Short-Term Convergence—Income Tax Team (Gagon, Ext. 322)

Subject: Minutes of the October 20, 2004 Joint Board Meeting **Date:** October 27, 2004

cc: Bielstein, Smith, Petrone, Leisenring, FASB Project Team, IASB Project Team, Mahoney, Thompson, Vincent, Sutay, Gabriele, Swift, Polley, FASB Intranet (e-mail), Project Team Resource Group Members

Topic: Foreign Unremitted Earnings Exceptions

Basis for Discussion: Board Memorandums 6 and 7 dated October 7 and October 15, 2004

Length of Discussion: 9:00 a.m. to 10:50 a.m.(EST)

Attendance:

Board members present:	FASB: Herz, Trott, Schipper, Batavick, Crooch, Seidman, and Schieneman IASB: Tweedie, Jones, Barth, Bruns, Cope, Enstrom, Garnett, Gelard, Leisenring, McGregor, O'Malley, Smith, Whittington, and Yamada
Board members absent:	None
Staff in charge of topic:	Thomas, Posta, and Bugg (IASB)
Other staff at Board table:	FASB: Bielstein, Cassel, and Gagon IASB: Stevenson, Upton, and Fleming
Outside participants:	Lubozynski and Cohen (Both PwC)

Summary of Decisions Reached:

The FASB and IASB (the Boards) discussed the complexities surrounding the calculation of a deferred tax liability for permanently reinvested unremitted earnings of foreign subsidiaries and joint ventures. Because of the practical complexities in calculating the amount of deferred taxes for such items, the Boards decided to retain the exceptions in IAS 12, *Income Taxes*, and FASB Statement No. 109, *Accounting for Income Taxes*, for the recognition of deferred tax liabilities for certain investments in foreign subsidiaries (or foreign corporate joint ventures). Additionally, in order to achieve convergence, the IASB decided to amend the language in IAS 12 so that it is similar to that in Statement 109 and APB Opinion No. 23, *Accounting for Income Taxes—Special Areas*, with respect to unremitted foreign earnings. The Boards also requested that the staff evaluate whether improvements could be made to the disclosure requirements surrounding unremitted earnings of foreign subsidiaries and joint ventures.

Objective of Meeting:

The objective of the meeting was to determine whether to retain the exceptions related to temporary differences for foreign subsidiaries and joint ventures in Statement 109 and IAS 12 (referred to as the foreign earnings exceptions). The objective of the meeting was met.

Matters Discussed and Decisions Reached:

Ms. Posta provided opening remarks discussing previous FASB and IASB consideration of the matter and introduced Dennis Lubozynski and Brett Cohen. Messrs. Lubozynski and Cohen are partners in the national office at PricewaterhouseCoopers LLP and subject-matter experts in income taxes and accounting for income taxes. Mr. Lubozynski provided a summary level explanation of some of the income tax intricacies associated with calculating deferred taxes for unremitted earnings of foreign subsidiaries and joint ventures and entertained Board members' questions about the material covered.

Following the educational portion of the meeting, Ms. Bugg introduced the three alternatives identified by the staff. Those alternatives were:

Alternative A: (*Retain exceptions*) Retain the Statement 109 and IAS 12 exceptions for the recognition of deferred tax liabilities on the excess for financial reporting over the tax basis of an investment in a foreign subsidiary (or foreign corporate joint venture). Additionally, in order to achieve convergence, amend the language in IAS 12 so that it is similar to that in Statement 109 and Opinion 23 on unremitted foreign earnings.

Alternative B: (*Practicability exception*) Modify the exception on providing deferred tax liabilities on foreign unremitted earnings to only apply to those companies that (1) have unremitted earnings in foreign subsidiaries not intended to be repatriated in the foreseeable future AND (2) are consolidated into a parent company that is in a tax jurisdiction with the complexities of the United States, Australia, and the United Kingdom.

Alternative C: (*Partial recognition*) Retain an exception for the incremental tax paid by the parent company upon repatriation to its home country, but require recognition of a deferred tax liability for the foreign withholding taxes that would be paid on expatriation of dividends out of the subsidiary's foreign jurisdiction.

Ms. Bugg indicated that the staffs believe that the cost and practicality research performed to date, along with prior research, supports retaining the exceptions in Statement 109 and IAS 12 (collectively referred to as the Income Tax Statements) until a project that is a broad reconsideration of accounting for income taxes is added to the Boards' agendas. Therefore, Ms. Bugg stated that the staffs recommend Alternative A for purposes of the short-term convergence project.

Ms. Bugg added that the staffs also considered information about the potential impact on the staffs' analysis and recommendation of recent pending U.S. tax legislation. In light of the information ascertained on the proposed Act, the staffs continue to support their recommendation for Alternative A.

Ms. Schipper stated that although she normally is unsupportive of exceptions within standards and believes that this exception for foreign subsidiaries could be

a tool for earnings management, she supports the staffs' recommendation. She stated that, in this case, the staffs' research sufficiently shows that eliminating this exception is not worth the effort that would be required. She believes that the underlying problem with this issue is the measurement attributes currently required by the Income Tax Statements.

Mr. McGregor expressed concern about allowing a blanket exception to the Income Tax Statements that would encompass all essentially permanent investments in foreign subsidiaries in all foreign jurisdictions. He suggested modifying Alternative B such that companies would be required to recognize a deferred tax liability for temporary differences related to foreign investments, unless that calculation would result in undue cost and effort. He acknowledged that there is a liability for these temporary differences, and that recognizing zero is unrepresentative. Under a modified Alternative B, at least some entities would be required to recognize deferred tax liabilities for foreign subsidiaries or joint ventures.

Mr. Gelard responded by stating that there are various complexities in tax systems outside the United States. He stated that the problem with Alternative B is determining whether a system is too complex, which he believes is impossible or impractical.

Mr. Leisenring stated that he disagrees with Ms. Schipper's view that the underlying problem is the required measurement attributes. Rather, the complexities exist when using either a fair value measurement or when calculating a liability under the Income Tax Statements. He stated that he also supports Alternative A. He also indicated that (1) he does not support Alternative B because those that operated in complex tax jurisdictions would be "rewarded" for their complexity by not having to recognize a deferred tax liability in their financial statements and (2) he does not support Alternative C because, while the amount could be determined, it is not representationally faithful.

Mr. Trott stated that he believes the Boards should be concerned with comparability and that the Boards should focus their attention on the issue of

comparability and earnings management. He said that this would coincide with Ms. Schipper's thoughts on earnings management and believes that the focus should be on "foreseeable future" and management intent for repatriating earnings and changes in intent.

Mr. Whittington also agreed with the staffs' recommendation. He stated that this project is a short-term convergence project and should be focused on differences between the two Statements. In this case, Statement 109 and IAS 12 are not significantly different and, therefore, the exceptions should be retained in both standards for purposes of a short-term convergence project.

Mr. Schieneman stated that he agrees with the staff recommendation. He stated that he disagrees with concerns about earnings management because changes in expected repatriation would be transparent in the effective tax rate. He indicated that he supports retaining the exceptions for a different reason than other Board members and the staffs. He views the taxes of foreign income as amounts that may never be paid and believes that their recognition as a liability would be a complication for analysts.

Ms. Barth indicated that she agrees with the staffs' recommendation for the same reasons as other Board members. However, she believes the Boards need to look at the disclosure requirements when they address disclosures within the project. The current disclosures do not seem to be effective and other disclosure requirements might be more useful. Ms. Barth suggested that the Boards consider improving these disclosures as part of the scope of this short-term convergence project. Ms. O'Malley agreed with Ms. Barth's comments about the need for clear disclosures in this area, which are not buried in rate reconciliations.

Mr. Garnett indicated that he does not support Alternative B because preparers would hire tax professionals to justify their conclusions that the tax systems that they operate in are too complex to calculate deferred tax liabilities for financial reporting. He stated that Alternative A seems to be the best alternative. Additionally, under IAS 12, it appears that the foreign earnings exception is not

made solely for complexity, but also on the basis of management's *control* of the timing of the dividend distribution. Therefore, converging IAS 12 language to Statement 109's language for the foreign earnings exception, adds to the understandability of IAS 12. Specifically, convergence would eliminate the notion that *control* of the timing of payment precludes the recognition of a liability.

Mr. Thomas responded to the issue of increased disclosure by stating that the staff had initially considered enhanced disclosures and had devoted significant time talking to users, subject matter experts, and preparers about enhanced disclosures. Through their discussions, the staff became concerned that the additional disclosures would either be forward looking, which is not consistent with GAAP disclosures, or boilerplate, which would not be effective. Further, many of the issues the disclosures were trying to address were audit and enforcement issues that are inherent in an intent-based standard. Ms. Seidman agreed with Mr. Thomas' remarks and reported that User Advisory Council members are more interested in qualitative information about the unremitted earnings. After discussion among Board members, Mr. Thomas stated that disclosure requirements will be addressed at a later meeting, and the staff would readdress this topic at that time.

Mr. Batavick noted that he also supports the staffs' recommendation but disagreed with addressing whether the disclosure requirements for unremitted earnings could be improved as part of this project. He indicated that this is a short-term convergence project, and that the Boards should focus on issuing an Exposure Draft in a relatively timely manner. Additionally, entities should already be disclosing information concerning unremitted earnings in their financial statements.

Mr. Herz called for a vote on the staffs' recommendation. Both Boards unanimously supported the staffs' recommendation (Alternative A). Mr. Herz also asked that the staffs consider the disclosure issues concerning unremitted earnings as part of the other disclosure issues associated with this short-term convergence project.

Follow-up Items:

None.

General Announcements:

None.