EITF ABSTRACTS

Issue No. 91-8

Title: Application of FASB Statement No. 96 to a State Tax Based on the Greater of a Franchise Tax or an Income Tax

Dates Discussed: September 12, 1991; November 21, 1991

References: FASB Statement No. 96, *Accounting for Income Taxes*
FASB Statement No. 109, *Accounting for Income Taxes*
APB Opinion No. 11, *Accounting for Income Taxes*
AICPA Accounting Interpretation 24, *Franchise Taxes Based on Income,* of APB Opinion No. 11

ISSUE

In August 1991 the state of Texas amended its franchise tax statute to include a tax on income apportioned to Texas based on the federal tax return. The new tax is effective January 1, 1992. Local (including franchise) taxes based on income are within the scope of Statement 96 and Opinion 11.

The amount of franchise tax on each corporation is the greater of (1) 0.25 percent of the corporation's net taxable capital and (2) 4.5 percent of the corporation's net taxable earned surplus. Net taxable earned surplus is a term defined by the tax statute for federal taxable income.

The issues are to what extent the new Texas tax is based on income and how the amount of deferred Texas taxes should be computed under Statement 96.

EITF DISCUSSION

The Task Force reached a consensus that the total computed Texas tax is an income tax only to the extent that the tax exceeds the capital-based tax in a given year. For companies that have adopted Statement 96, temporary differences should be scheduled. [Note: See STATUS section.] A deferred tax liability should be recognized 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. Paragraph 20 of Statement 96 requires that a deferred tax liability or asset be adjusted for the effect of a change in tax law in the period of enactment. Thus, a corporation subject to Texas tax laws that has adopted Statement 96 would have to adjust its deferred taxes in the first reporting period that includes August 1991 to reflect the change in the corporate tax. The portion of the current tax liability based on income should 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 should be recognized as of the balance sheet date for temporary differences that exist as of the balance sheet date.

While the discussion focused primarily on the recently amended franchise tax statute of Texas, and no other state tax was specifically discussed, the implication was that the accounting described above would be appropriate if the tax structure of another state was essentially the same as that of Texas.

Certain Task Force members noted that the consensus is consistent with Interpretation 24, which was issued in 1972 and addressed a similar issue. The Interpretation states that the tax, to the extent it is based on capital, is a franchise tax. If there is an additional tax based on income, that excess is considered an income tax.

STATUS

In February 1992, the FASB issued Statement 109, which supersedes Statement 96.

Two basic principles of Statement 109 are to recognize a current tax liability or asset for the estimated taxes payable or refundable on tax returns for the current year and a deferred tax liability or asset for the estimated future tax effects attributable to temporary differences and carryforwards. A deferred tax liability or asset is measured 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.

Under the consensus for Issue 91-8, the Texas tax is an income tax only to the extent that the tax exceeds the capital-based tax in a given year. Accordingly, under Statement 109 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. In applying the consensus, reference should be made to paragraph 236 of Statement 109 in determining whether a detailed analysis of the net reversals of temporary differences in each future year is warranted.

Statement 109 is consistent with Statement 96 in requiring that deferred tax assets and liabilities be adjusted for the effect of changes in tax laws and rates. The effect is included in income from continuing operations for the period that includes the enactment date.

No further EITF discussion is planned.