

EITF ABSTRACTS

Issue No. 93-16

Title: Application of FASB Statement No. 109 to Basis Differences within Foreign Subsidiaries That Meet the Indefinite Reversal Criterion of APB Opinion No. 23

Date Discussed: November 18, 1993

References: FASB Statement No. 109, *Accounting for Income Taxes*
APB Opinion No. 23, *Accounting for Income Taxes—Special Areas*

ISSUE

Enterprises can have temporary differences within their foreign subsidiaries (referred to as "inside basis differences") that meet the indefinite reversal criterion of Opinion 23, as amended by Statement 109. Opinion 23, as amended, relates specifically to differences between the tax basis and the financial reporting basis of an investment in a foreign subsidiary (referred to as an "outside basis difference").

This Issue relates to inside basis differences of an Italian subsidiary of a U.S. parent where the local currency is the functional currency. In Italy, fixed assets are occasionally restated for tax purposes to compensate for the effects of inflation. The amount that offsets the increase in the tax basis of fixed assets is described as a credit to "revaluation surplus," which some view as a component of equity for tax purposes. That amount becomes taxable in certain situations, such as in the event of a liquidation of the Italian subsidiary or if the earnings associated with the revaluation surplus are distributed. For purposes of this Issue, it is assumed that no mechanisms are available under the tax law to avoid eventual treatment of the revaluation surplus as taxable income.

The issue is whether the indefinite reversal criterion of Opinion 23, as amended, applies only to temporary differences related to outside basis differences or whether it should be applied to the revaluation surplus related to inside basis differences of foreign subsidiaries in the consolidated financial statements of the parent and its foreign subsidiaries.

EITF DISCUSSION

The Task Force reached a consensus that the indefinite reversal criterion of Opinion 23, as amended, should not be applied to inside basis differences of foreign subsidiaries and that a deferred tax liability should be provided on the amount of the revaluation surplus.

In reaching this consensus, Task Force members noted that paragraph 15 of Statement 109 acknowledges that some temporary differences are deferred taxable income and have balances only on the income tax balance sheet. Therefore, these differences cannot be identified with a particular asset or liability for financial reporting purposes. Because the inside basis difference related to the revaluation surplus results in taxable amounts in future years based on the provisions of the Italian tax law, it qualifies as a temporary difference under Statement 109 even though it may be characterized as a component of equity for tax purposes. Task Force members further noted that Statement 109 clearly limits the indefinite reversal criterion in Opinion 23, as amended, to the temporary differences described in paragraph 31 of Statement 109 and should not be applied to analogous types of temporary differences.

The Task Force also reached a consensus that entities that did not previously record a deferred tax liability for such inside basis differences must do so for all differences that arise in fiscal years beginning after December 15, 1992. Thus, if inside basis differences exist for revaluations that arose in fiscal years beginning before December 16, 1992 and no deferred tax liability was

recognized upon adoption of Statement 109, no deferred tax liability for those differences is required by this consensus. However, for those situations, the Task Force noted that entities should make the disclosures required by paragraph 44 of Statement 109.

STATUS

No further EITF discussion is planned.