



SHORT TERM INTERNATIONAL CONVERGENCE: INCOME TAXES

Financial Accounting Standards Advisory Council
September 2004

Background and Objective of the Project

Phase two of the short-term convergence project includes accounting for income taxes. IAS 12, *Income Taxes*, is the prevailing international guidance on income taxes and is based on principles similar to those of FASB Statement No. 109, *Accounting for Income Taxes*. However, there are certain differences in the application of those similar principles that result in noncomparability between entities applying Statement 109 and those applying IAS 12. The objective in undertaking this project is to work with the IASB to reduce or eliminate that noncomparability by reconsidering the narrow set of provisions that give rise to it.

Discussion at the September Council Meeting

At the September Council meeting, the Board would like to discuss with FASAC the decisions made to date. The Board would like to solicit input from Council members on significant operationality and cost-benefit issues.

Issues Deliberated to Date by the Board

The income tax project has been discussed at five Board meetings where the Board deliberated the following topics:

Project scope

As discussed in the March 2004 FASAC meeting, the Board affirmed the scope of the income tax project as the inventory of differences between Statement 109 and IAS 12.

Note: These materials are provided to facilitate understanding of the issues to be addressed at the September 23, 2004 FASAC meeting. These materials are presented for discussion purposes only; they are not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

Asset Acquisitions

At the April 2004 joint meeting, the FASB and the IASB reached agreement on the recognition of deferred taxes in an asset acquisition (other than a business combination) when there is a difference between the tax and GAAP bases of the acquired asset.

The Boards tentatively decided that the acquired asset should be recognized at fair value (assuming full deductibility for tax purposes). A deferred tax asset or liability would be recognized in the amount of difference between the fair value of the asset and its tax basis multiplied by the tax rate. Any difference between the consideration paid and the sum of the fair value of the asset and the recognized deferred tax amount would be recognized as a purchase discount allowance and presented on the balance sheet as offset of the related deferred tax asset or liability.

APB Opinion 23 and Steamship Enterprise Exceptions

At its July 27 meeting, the Board requested that the FASB staff perform limited additional research on the cost-benefit and practical considerations associated with recording deferred taxes on unremitted earnings of foreign subsidiaries. The Board will not consider any changes to the remaining Opinion 23 and steamship enterprise exceptions as part of this project.

Current Activities

The FASB staff is working on two issues that will be discussed in September and October 2004. Those issues are intraperiod tax allocation and the foreign unremitted earnings exception.

Intraperiod Tax Allocation and "Backwards Tracing"

The FASB staff is currently working with the IASB staff to define the scope of the differences between IAS 12 and Statement 109 and determine the impact of this issue on the Boards' deliberations in the short-term convergence project.

Foreign Unremitted Earnings

Members of the FASB and IASB Boards and their staffs are in the process of conducting educational field visits to understand the practical and cost-benefit considerations. Additionally, the staff discussed the matter with a number of preparers (both tax and financial reporting) from U.S.-based multinational enterprises, auditors, and users of financial statements. Based on the results of this work, the staff anticipates presenting their findings at a Board meeting in early October. The staff intends for the Boards to deliberate the matter at the joint FASB-IASB Board meeting in October.

The staff met informally with preparers from three large multinational enterprises to understand their views on the conceptual, cost-benefit, and practical considerations of providing deferred taxes on unremitted earnings. Additionally, members of the FASB and IASB Boards and staff conducted educational field visits with preparers from two other large multinational enterprises to discuss similar considerations.

The staff also:

- Discussed the complexities of computing foreign tax credits on repatriated earnings and tax planning considerations associated with repatriation with two international tax partners from large accounting firms.
- Consulted User Advisory Council members that are part of the project's resource group to determine the value that users would place on the information resulting from elimination of the foreign unremitted earnings exception.

As a result of the activities described above, the staff gained an understanding of the complexities of computing deferred tax liabilities on unremitted foreign earnings. Many factors contribute to the costs and complexity, including:

1. The nature of the U.S. worldwide taxing regime (sourcing and expense allocations, baskets, alternative minimum tax calculations).
2. The potential legal restrictions on the amount, timing, and manner of foreign remittances.
3. The computation of the amount of foreign tax credits that would reduce the federal tax liability and the interaction and ordering requirements among those credits and other tax credits.

4. The significant tax planning that occurs prior to repatriation of foreign earnings (computing a deferred tax liability on the earnings that are indefinitely reinvested would necessitate the development of a number of assumptions that may not be rooted in economic reality).
5. The quality and availability of existing tax data for earnings that are indefinitely reinvested, such as the historical and current tax earnings and profits of each foreign subsidiary.
6. Scarce tax expertise and resources necessary to perform the calculation.

Project Time Table

The Board plans to complete its deliberations of the issues in this project in the fourth quarter of 2004 and issue an Exposure Draft in the first quarter of 2005.

Remaining issues that will be deliberated include:

1. Whether to amend Statement 109's prohibition on recognition of a deferred tax asset when an enterprise transfers assets between different tax jurisdiction and is required to make a tax payment to one of the jurisdictions.
2. Statement 109 and IAS 12 have different guidance for recognition and measurement of deferred tax assets and liabilities.
3. Statement 109 prohibits recognition of deferred taxes for differences related to assets and liabilities that, under Statement 52, are remeasured from the local currency into the functional currency using historical exchange rates.
4. As a result of different disclosure requirements, and tentative decisions, the impact on disclosure requirements will need to be considered.

Questions for FASAC Members

The Board would appreciate FASAC members' comments and observations on the following matters:

1. Are there other costs or complexities that negatively impact the cost-benefit equations that the Boards and staff should consider?
2. Are you aware of conceptual or cost-benefit arguments that would support the elimination of the exception?