FASB Emerging Issues Task Force

Issue No. 13-C

Title: Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit Carryforward Exists

Document: Issue Summary No. 1, Supplement No. 1[*]

Date prepared: May 28, 2013

FASB Staff: Walsh (ext. 354) / Irwin (ext. 468)

EITF Liaison: Mark Bielstein

Date previously discussed: January 17, 2013

Previously distributed EITF materials: Issue Summary No. 1, dated January 3, 2013

Background

1. Topic 740, Income Taxes, does not include explicit guidance on the presentation in the statement of financial position of an unrecognized tax benefit when a net operating loss carryforward or a tax credit carryforward exists. There is diversity in practice in the presentation of unrecognized tax benefits in those instances. Some entities present unrecognized tax benefits as a liability unless the unrecognized tax benefit is directly associated with a tax position taken in a tax year that results in, or that resulted in, the recognition of a net operating loss carryforward for that year and the net operating loss carryforward has not been utilized. Other entities present unrecognized tax benefits as a reduction of a deferred tax asset for a net operating loss carryforward or tax credit carryforward.

[*] **The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

2. In reaching its consensus for exposure, the Task Force concluded that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the statement of financial position as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward or tax credit carryforward at the reporting date is not available under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, the unrecognized tax benefit would be presented in the statement of financial position as a liability.

3. At its January 31, 2013 meeting, the Board ratified the consensus-for-exposure reached by the Task Force in this Issue and approved the issuance of a proposed Update for a 60-day public comment period. The proposed Update was posted to the FASB website on February 21, 2013, with a comment period that ended on April 22, 2013. Ten comment letters were received on the proposed Update and have been distributed to Task Force members.

4. At the June 11, 2013 EITF meeting, the Task Force will have the opportunity to consider the comment letters as it redeliberates the consensus-for-exposure. The Task Force will then be asked whether it would like to affirm its consensus-for-exposure on this Issue as a final consensus.

Summary of Comment Letters Received and FASB Staff Analysis and Recommendation

5. Ten comment letters were received on the proposed Update. Respondents included:

Preparers (CL#1, CL#3, CL#4, CL#5, CL#7, CL#9, CL#10)	7
Professional accounting associations (CL#6, CL#8)	2
Industry associations (CL#2)	1
Total	**10**

6. Respondents were asked to comment on the following questions in the proposed Update:

> **Question 1:** Do you agree with the proposed approach for the presentation in the statement of financial position of unrecognized tax benefits when net operating loss carryforwards or tax credit carryforwards exist? If not, what approach do you prefer and why?
>
> **Question 2:** Do you agree that no new recurring disclosures about the presentation of unrecognized tax benefits should be required? If not, what disclosures would be appropriate?
>
> **Question 3:** Do you agree that the proposed Update should be adopted retrospectively? If not, why not?
>
> **Question 4:** For preparers, how much time is necessary to implement the proposed Update? Should the effective date for public and nonpublic entities be the same? If not, why not?

7. The FASB staff's analysis of the significant comments received from respondents follows.

8. In Question 1, respondents were asked whether they agreed with the approach in the proposed Update for presentation in the statement of financial position of unrecognized tax benefits when net operating loss carryforwards or tax credit carryforwards exist. Eight respondents (CL#2, CL#3, CL#4, CL#5, CL#6, CL#8, CL#9, CL#10) agreed with the approach in the proposed Update. One respondent (CL#2) stated that the guidance would "result in a more faithful representation of a company's financial situation as it will no longer reflect a liability that would not result in an incremental outflow of cash."

9. Two respondents (CL#1, CL#7) disagreed with the approach in the proposed Update. One of the respondents (CL#1) who disagreed with the approach stated that entities should be permitted to make an accounting policy election to present unrecognized tax benefits either (a) in the same manner as in the proposed Update or (b) as a liability. That respondent stated that "in some cases, the cost of tracking utilization of net operating losses against unrecognized tax benefits by year, by jurisdiction and by entity, may exceed any potential benefit of the proposed presentation to financial statement users." The approach suggested by the respondent was considered by the Task Force at its January 17, 2013 meeting. The Task Force did not select the

approach because it would not eliminate diversity in practice, which was one of the primary reasons the Issue was added to the EITF agenda.

10. The other respondent (CL#7) who disagreed with the approach in the proposed Update stated that entities should be required to present unrecognized tax benefits as a liability. The respondent stated that liability presentation "is more meaningful to investors than offsetting those liabilities with net operating loss or tax credit carryforwards." The approach suggested by that respondent was considered by the Task Force at the January 17, 2013 meeting. The Task Force did not select the approach because it was inconsistent with the manner in which the liability may actually be settled as of the reporting period.

11. The FASB staff noted that several respondents provided the Task Force with useful suggestions for clarifying the requirements in the proposed Update. The FASB staff will consider all of those editorial suggestions when drafting the final Update. The following are the primary amendments to the Codification for this Issue with changes marked from the exposure draft.

> **740-10-45-10A** An unrecognized tax benefit, or a portion of an unrecognized tax benefit, shall be presented in the ~~statement of~~ financial statements ~~position~~ as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or tax credit carryforward that exists at the reporting date is either not available under the tax law of the applicable jurisdiction or would not be used to settle any additional income taxes that would result from the disallowance of a tax position, the unrecognized tax benefit shall be presented in the ~~statement of~~ financial statements ~~position~~ as a liability.

Issue 1: Does the Task Force wish to affirm its consensus-for-exposure for the presentation in the statement of financial position of unrecognized tax benefits when net operating loss carryforwards or tax credit carryforwards exist?

Recurring Disclosures

12. In Question 2 of the proposed Update, respondents were asked whether they agreed that no new recurring disclosures about the presentation of unrecognized tax benefits should be required. All of the respondents who answered the question (CL#2, CL#4, CL#5, CL#6, CL#9, CL#10) agreed that no new recurring disclosures should be required.

Issue 2: Does the Task Force wish to affirm that the guidance in the proposed Update would not require any new recurring disclosures?

Transition

13. In Question 3, respondents were asked whether they agreed with a retrospective transition approach with early adoption permitted. Of the eight respondents who answered this question, four respondents (CL#4, CL#6, CL#8, CL#10) agreed that the transition approach should be retrospective and four respondents (CL#1, CL#2, CL#5, CL#9) disagreed and stated that the transition approach should be prospective. One of the respondents (CL#5) who did not support retrospective application stated that they would be supportive of an option to apply the guidance retrospectively rather than a mandatory retrospective application. It appears to the FASB staff that some of the respondents who agreed with a retrospective transition approach may think the presentation approach in the proposed Update is consistent with their current practice.

14. The respondents who disagreed with the transition approach in the proposed Update stated that the costs of a retrospective approach would outweigh the benefits to users of financial statements. They cited concerns about the costs of compiling the necessary data for each reporting period, which may be five years for SEC registrants, and each jurisdiction for entities that operate in many jurisdictions with different tax laws. One respondent also observed that the transition approach for FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, was a prospective approach even though it had a significant impact on some entities' financial statements.

15. To better understand respondents' concerns about a retrospective transition approach, the FASB staff discussed those concerns with two of the respondents (CL#1, CL#2). Both of those

respondents thought there would be costs and complexity to evaluate the liability presentation for each prior period and jurisdiction. They observed that they would need to assess, for each tax jurisdiction and each reporting period, the unrecognized tax benefit position, the net operating loss (or other tax loss) position, and whether there would be any limitations on offsetting under the tax law for the particular year (for example, the entity may be required to pay alternative minimum tax or other taxes that limit the use of a net operating loss). The costs may include internal staff (accounting, tax, and legal) and potentially external consultants. They also observed that their auditors would need to perform procedures on the adjustment to prior periods. While they supported the Task Force addressing the diversity in practice by adding clear guidance to the Codification, they did not think the issue was important to users of financial statements because the amount of the liability is rarely material.[1] Consequently, they did not think the costs of a retrospective transition approach were a good use of resources.

16. As addressed below, some respondents observed that the effective date should be influenced by the transition approach. They asserted that a retrospective transition approach would require a later effective date. Therefore, the FASB staff believes that the Task Force should weigh the benefits of a retrospective transition approach against the benefits of reducing diversity in practice sooner.

17. After considering the feedback from respondents, the FASB staff recommends that the Task Force select a prospective transition approach. The guidance would apply to all unrecognized tax benefits that exist at the effective date (that is, not only to unrecognized tax benefits arising after the effective date). The FASB staff does not recommend a retrospective transition approach. There would be costs and complexity for preparers, particularly preparers who have many tax jurisdictions, and there does not appear to be a significant benefit to users of financial statements because the Issue involves presentation for an item that is rarely material.

Issue 3: Does the Task Force wish to (a) affirm that the guidance in the proposed Update should be applied retrospectively with early adoption permitted or (b) select a prospective

[1] Based on the FASB staff's analysis using an XBRL tool in December 2012, unrecognized tax benefits as a percentage of total assets and total liabilities on average were 1 percent and 2 percent, respectively, for approximately 500 large SEC registrants per their most recent annual filings.

approach? In addition, does the Task Force wish to affirm the transition disclosures in the proposed Update, which would require entities to apply the disclosure requirements in paragraphs 250-10-50-1 through 50-3 for an accounting change?

Effective Date

18. In Question 4, respondents were asked how much time would be needed to implement the proposed amendments and whether the effective date for public and nonpublic entities should be the same. Of the five respondents who answered the question, three respondents (CL#4, CL#8, CL#10) stated that the proposed amendments would not require a significant amount of time to implement. Two respondents (CL#2, CL#9) stated that more time would be required if the Task Force selects a retrospective transition approach.

19. Two respondents (CL#8, CL#10) stated that no additional time would be needed for nonpublic entities to implement the proposed guidance. However, the FASB staff observes that one of those respondents (CL#8) appears to believe that the proposed Update is consistent with current practice and the other respondent (CL#10) is an SEC registrant. The FASB staff also observes that nonpublic entities had significant difficulties adopting Interpretation 48. Although the guidance in the proposed Update is expected to be significantly less costly and less complex to implement than Interpretation 48, the Task Force may wish to consider the previous difficulties experienced by nonpublic entities in this area. Finally, the FASB staff observes that the guidance may be issued after the normal education cycle for nonpublic stakeholders if the final guidance is issued in July 2013 and is effective for fiscal year 2014.

20. After considering the feedback from respondents, the FASB staff recommends that the Task Force select either one of the following effective dates based on the transition approach, if affirmed, above:

a. Annual periods beginning after December 15, 2013, and interim periods within those annual periods, if the transition approach is **prospective**.
b. Annual periods beginning after December 15, 2014, and interim periods within those annual periods, if the transition approach is **retrospective**.

21. After considering feedback from respondents on this and other projects, the FASB staff recommends that the Task Force select either one of the following effective dates for nonpublic entities based on the effective date for public entities:

a. Annual periods beginning after December 15, 2014, and interim periods within those annual periods, if the effective date for public entities is annual periods beginning after December 15, 2013
b. Annual periods beginning after December 15, 2015, and interim periods within those annual periods, if the effective date for public entities is annual periods beginning after December 15, 2014.

Issue 4: What effective date does the Task Force wish to affirm for public and nonpublic entities?