FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout

Disclosure Framework—Disclosure Review, Income Taxes

March 23, 2016

PURPOSE OF THIS MEETING

1. At the October 21, 2015 Board meeting, the Board directed the staff to perform additional outreach with users, preparers, and others to review the tentative Board decisions reached to date on disclosures related to income taxes.

2. This meeting will cover the issues identified during that outreach, including the costs and complexities and the perceived benefits of those disclosures as well as possible changes to the Board's tentative decisions. The meeting also will cover transition for all of the proposed changes to the income tax disclosures.

BACKGROUND INFORMATION

3. The objective and primary focus of the disclosure framework project is to improve the effectiveness of disclosures in the notes to financial statements by clearly communicating the information that is most important and relevant to users of each entity's financial statements.

4. The focus of this part of the disclosure framework project is both to test the ability of the 2014 proposed FASB Concepts Statement, *Conceptual Framework for Financial Reporting—Chapter 8: Notes to the Financial Statements*, to identify relevant and suitable disclosures and to improve existing disclosures in Topic 740, Income Taxes.

ISSUE GROUP 1

Issue 1: Change in Tax Law (Issue 1 of Board Memo 95)

5. At the October 21, 2015 meeting, the Board tentatively decided that entities should be required to qualitatively disclose that a change in tax law that is probable to have an effect on the reporting entity in a future period has been enacted.

Basis for Tentative Board Decision

6. The tentative Board decision in paragraph 5 above was identified using Question L6 of the 2014 proposed Concepts Statement, which states:

> Are the prospects for cash flows related to the line item affected by changes in entity-specific factors or sector-specific factors, particularly those that can be expected to change frequently or significantly, and would a user not be expected to be aware of the factors or their potential effects?

7. The Board tentatively decided to require this disclosure because it would be helpful to assess changes in tax laws that would have an effect on prospects for cash flows. Also, the Board determined that such disclosure would not be costly because preparers said that they already make similar disclosures in either the notes to financial statements or in the Management Discussion and Analysis section of Form 10-K.

Question for the Board
1. Should entities qualitatively disclose that a change in tax law that is probable to have an effect on the reporting entity in a future period has been enacted?

Issue 2: Deferred Tax Line Items (Issue 2 of Board Memo 95)

8. At the October 21, 2015 meeting, the Board tentatively decided that entities should be required to disclose the line item(s) on the balance sheet in which the amount of deferred taxes are presented, if they are not presented as a separate line item on the balance sheet.

Basis for Tentative Board Decision

9. The tentative Board decision in paragraph 8 above was identified using Question L16 of the proposed Concepts Statement, which states:

> Does a line item have a direct relationship to another line item(s) in another statement that is not otherwise apparent?

10. The staff has identified instances in which deferred taxes have been presented on multiple lines on the balance sheet and noted that users generally struggle with understanding the effect of taxes on the financial statements. Therefore, the Board tentatively decided to require this disclosure.

Question for the Board
2. Should entities disclose the line item(s) on the balance sheet in which the amount of deferred taxes are presented?

Issue 3: Domestic Tax Expense on Foreign Sourced Earnings (Issue 4 of Board Memo 95)

11. At the February 11, 2015 meeting, the Board tentatively decided that entities should be required to disclose domestic tax expense on foreign sourced earnings.

Basis for Tentative Board Decision

12. The tentative Board decision in paragraph 11 above was identified using Question L4 of the proposed Concepts Statement, which states:

> Does the line item include components of different natures that could affect prospects for net cash flows differently?

13. The Board decided to require this disclosure on the basis of the feedback of the November 2013 Post-Implementation Review Report of FASB Statement No. 109, *Accounting for Income Taxes*, and other research that indicated that users want more information about income taxes and the effect of foreign operations on those income taxes.

Question for the Board
3. Should entities disclose domestic tax expense on foreign sourced earnings?

Issue 4: Assertion about Undistributed Foreign Earnings (Issue 5 of Board Memo 95)

14. At the February 11, 2015 meeting, the Board tentatively decided that entities should be required to disclose the amount of and explanation for a change in assertion about the temporary difference for the cumulative amount of investments associated with undistributed foreign earnings that are no longer asserted to be essentially permanent in duration with separate disclosures made for any country that is significant to the disclosed amount. That tentative decision did not include a disclosure in which an entity changes its assertion that previous investments associated with undistributed foreign earnings are asserted to be essentially permanent in duration.

Basis for Tentative Board Decision

15. The tentative Board decision in paragraph 14 above was identified using Question O2 of the proposed Concepts Statement, which states:

> Are there other events or circumstances that are not represented by an asset or a liability and a gain or loss (or income or expense) in an entity's financial statements but for which there is uncertainty in the decision about whether it should be recognized (that would include items other than the contingencies discussed in Questions O1(a) and O1(b))?

16. The Board decided to tentatively require this disclosure because users requested more information on indefinitely reinvested foreign earnings.

Question for the Board
4. Should entities disclose the amount of and explanation for a change in assertion about the temporary difference for the cumulative amount of investments associated with undistributed foreign earnings that are (a) asserted to be essentially permanent in duration *and/or* (b) no longer asserted to be essentially permanent in duration?

ISSUE GROUP 2

Issue 5: Disaggregation about the Temporary Difference on the Investments Associated with Undistributed Foreign Earnings (Issue 6 of Board Memo 95)

17. Paragraph 740-30-50-2(c) requires disclosure of the temporary difference for the cumulative amount of investments associated with undistributed foreign earnings that are essentially permanent in duration and the "amount of the unrecognized deferred tax liability for temporary differences… if determination of that liability is practicable or a statement that determination is not practicable…"

18. At the February 11, 2015 meeting, the Board tentatively decided that entities should be required to provide a disaggregation of the temporary difference for the cumulative amount of investments associated with undistributed foreign earnings that are essentially permanent in duration if any country represents at least 10 percent of the disclosed amount.

19. At the request of the Board, the staff held a workshop with preparers, users, and a practitioner in December 2015 and performed additional outreach to ascertain whether the tentative Board decisions would provide users with beneficial and useful information that would not be too costly or complex for a preparer to provide.

20. As a result of concerns that had been raised about the benefits of this disclosure, the staff is revisiting this decision and has analyzed whether disclosure of the aggregate of cash, cash equivalents, marketable securities, and loans (liquid assets) associated with the temporary difference for the cumulative amount of investments associated with undistributed foreign earnings that are essentially permanent in duration would be more beneficial.

Basis for Tentative Board Decision

21. The tentative Board decision in paragraph 18 above was identified using Question L4 of the proposed Concepts Statement (see paragraph 12 above for Question L4).

22. The Board decided to require this disclosure because:

(a) Stakeholders noted that there is no liability recognized for U.S. taxes on these undistributed foreign earnings.

(b) The disaggregation of those undistributed foreign earnings by country would help users assess amounts of future cash flows about future remittances of those earnings.

23. This disclosure was intended to be responsive to the November 2013 Post-Implementation Review Report on Statement 109 in which users requested insight into foreign tax exposures of reporting entities. Users are especially focused on this issue because taxes on temporary differences for the cumulative amount of investments associated with undistributed foreign earnings that are essentially permanent in duration are not recognized or measured. Also, of the Fortune 500 companies that disclosed information about undistributed foreign earnings, only 11 percent provided an amount of the estimated tax on those undistributed foreign earnings. The remaining 89 percent did not disclose the liability associated with these earnings because those companies say it is not practicable to do so.

Questions for the Board

5(a). Should an entity disaggregate the temporary difference for the cumulative amount of investments associated with undistributed foreign earnings that are essentially permanent in duration if any country represents at least 10 percent of the disclosed amount (retaining the Board's tentative decision)?

5(b). Should a reporting entity be required to disclose the aggregate of cash, cash equivalents, marketable securities, and loans related to the temporary difference for the cumulative amount of investments associated with undistributed foreign earnings that are essentially permanent in duration?

ISSUE GROUP 3

Issue 6: Income Tax Expense (Issue 3 of Board Memo 95)

24. U.S. Securities and Exchange Commission (SEC) Regulation S-X 210-4.08(h), *General Notes to Financial Statements: Income Tax Expense*, requires disclosure of income tax expense applicable to:

    (a) U.S. Federal income taxes

    (b) Foreign income taxes

    (c) Other income taxes.

25. Current generally accepted accounting principles (GAAP) do not require disaggregation of income tax expense at the level required by SEC Regulation S-X 210-4.08(h).

26. The following alternatives were developed using the indicated questions in paragraph 6 and 12 above from the proposed Concepts Statement:

    (a) *Alternative A*—Disaggregate income tax expense (benefit) (income tax expense) between domestic and foreign.

    (b) *Alternative B*—Disaggregate income tax expense between domestic and foreign with a further disaggregation of foreign income tax expense for any country that is significant to total income tax expense.

Question for the Board
6. Should entities be required to disclose Alternative A or Alternative B?

Issue 7: Disaggregation of Pretax Income and Income Taxes Paid (Issue 7 of Board Memo 95)

27. Disclosure of both domestic and foreign income (loss) before income tax expense (pretax income) is a required disclosure per SEC Regulation S-X 210-4.08(h). At the February 11, 2015 meeting, the Board tentatively decided to require entities to disaggregate pretax income between domestic and foreign and to further disaggregate foreign pretax income for any country that is significant to total pretax

income. At the October 21, 2015 meeting, the Board discussed disaggregation of income taxes paid by foreign country but decided that the disclosure of pretax income by significant country coupled with the other tentative Board decisions on undistributed foreign earnings would give a user sufficient information to analyze tax exposures to foreign countries.

28. As a result of concerns about costs, complexity, and benefits of the disaggregation of pretax income, the staff is revisiting the Board's tentative decision to disaggregate foreign pretax income by significant country. Also, the staff has explored whether disaggregation of income taxes paid by country would be beneficial and less costly. This alternative disclosure would expand the Board's tentative decision to disaggregate income taxes paid between domestic and foreign.

29. A limitation to disclosing income tax paid versus pretax income is that it is possible an entity can pay little tax to a particular country in a particular reporting period because of timing differences or low rates, even though there is a significant amount of income generated by that country in the period. Income taxes paid for that country may be judged to be immaterial and, therefore, no disclosure would be made for that country. Therefore, the staff identified two alternatives to deal with this limitation:

    (a) *Alternative A*—Require disaggregation of income taxes paid when that country has significant pretax income.

    (b) *Alternative B*—Provide a qualitative disclosure explaining the circumstances in which the income tax paid is low relative to pretax income generated in that country.

Basis for Tentative Board Decision

30. The tentative Board decision in paragraph 27 above was identified using Question L6 of the proposed Concepts Statement (see paragraph 6 above for Question L6).

31. The November 2013 Post-Implementation Review Report on Statement 109, research and articles from various sources, and feedback from users on this project

and other projects indicate that disclosure about foreign earnings and the tax effect of those earnings would be useful. Users say that that additional information would provide them with a better understanding of the sustainability of an entity's tax rate and quality of the entity's earnings. Therefore, the Board decided to require the disclosure.

Questions for the Board
7(a). Should an entity disaggregate foreign pretax income for any country that is significant to total pretax income (retaining the Board's tentative decision)? 7(b). Should an entity (1) disaggregate income taxes paid by country and (2) provide a qualitative disclosure explaining the circumstances in which the income tax paid is low relative to the pretax income generated in that country?

ISSUE GROUP 4

Issue 8: Disaggregation of Income Taxes Paid by Time Period (Issue 8 of Board Memo 95)

32. At the October 21, 2015 Board meeting, the staff recommended the disaggregation of income taxes paid by current tax year, prior tax year, *subsequent tax year*, other income tax years (including audit settlements over multiple years, interest, and penalties), and refunds received or applied (income taxes paid by time period). The Board voted against this recommendation because it was unsure about the benefit of this information and thought that other disclosures provided enough information for users' assessments.

33. The staff thinks that the Board should reconsider this recommendation in light of the more recent outreach performed, which indicates that this information may be more beneficial than previously thought.

Question for the Board
8. Should an entity disaggregate income taxes paid by current tax year, prior tax year, *subsequent tax year*, other tax years (including audit settlements over multiple years, interest, and penalties), and refunds received or applied?

ISSUE GROUP 5

Issue 9: Private Company Considerations (Issue 9 of Board Memo 95)

34. The Board requested that the staff review whether disclosures for public entities should be applicable to private companies. The staff performed outreach, and private company stakeholders raised issues with the following disclosures:

    (a) The rate reconciliation as currently required in GAAP for public entities

    (b) An explanation of the nature and amounts of the valuation allowance recorded and/or released during the reporting period

    (c) The amounts and expiration dates of carryforwards recorded on the tax return basis, the amounts and expiration dates of carryforwards that will give rise to a deferred tax asset (tax effected), and the total amount of the unrecognized tax benefit that offsets the tax-effected carryforwards.

35. The staff also solicited feedback on disclosures about investments associated with undistributed foreign earnings and other disclosures discussed in this memo for private companies. Those disclosures are as follows:

    (a) Qualitative disclosure that a change in tax law that is probable to have an effect on the reporting entity in a future period has been enacted

    (b) Disclosure of the amount of and explanation for a change in assertion about investments associated with undistributed foreign earnings that are asserted to be essentially permanent in duration *and* are no longer asserted to be essentially permanent in duration

    (c) Disclosure of the aggregate of cash, cash equivalents, marketable securities, and loans related to the temporary difference for the cumulative amount of investments associated with undistributed foreign earnings that are essentially permanent in duration

    (d) Disaggregation of pretax income between domestic and foreign

(e) Disaggregation of income taxes paid by country and a qualitative disclosure explaining the circumstances in which the income tax paid is low relative to the pretax income generated in that country

(f) Disaggregation of income taxes paid by time period.

Questions for the Board
9(a). Should private companies disclose the income tax disclosures discussed in paragraph 34 of this handout? 9(b). Should private companies be required to make any of the other disclosures in paragraph 35 of this handout?

ISSUE GROUP 6

Issue 10: Transition (Issue 10 of Board Memo 95)

36. The staff identified two transition alternatives for all income tax disclosures:

(a) *Alternative A*—Require retrospective transition for all income tax disclosures.

(b) *Alternative B*—Require prospective transition for all income tax disclosures.

Question for the Board
10. Should income tax disclosures be applied using a retrospective transition method or a prospective transition method?