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THOUGHT LEADERSHIP FROM THE BDO NATIONAL TAX ASC 740 SPECIALTY SERVICES

BDO KNOWS:

ASC 740

SUBJECT

FASB MAKES TENTATIVE DECISIONS WITH RESPECT TO DISCLOSURE OF INCOME TAXES RELATED TO FOREIGN EARNINGS

SUMMARY

The FASB ("Board") made tentative decisions at its February 11, 2015 meeting on income tax disclosure requirements in ASC 740 related to foreign earnings. These decisions are made pursuant to the FASB's on-going Disclosure Framework Project ("disclosure project"). The tax and accounting treatments of foreign earnings continue to be a topic of interest and controversy to tax policy makers in Washington, investors and other stakeholders, the SEC, and the PCAOB. The Board is considering the topic from a footnote disclosure perspective and discussed at its February 11 meeting potential income tax disclosure changes specific to foreign earnings. These tentative decisions aim to improve transparency and provide relevant information regarding the income tax effects from foreign earnings in the tax footnote.

The Board's tentative disclosure decisions with respect to foreign earnings include:

- Income before taxes separated between domestic and foreign earnings - foreign earnings would be further disaggregated for any country that is significant to total earnings.
- Domestic tax expense recognized in the current period on foreign earnings.
- Undistributed foreign earnings for which the indefinite reinvestment assertion is no longer made and an explanation of why the assertion has changed. Separate disclosure is necessary for any country that is significant to the disclosed amount.
- A disaggregation of the current requirement to disclosure the cumulative amount of the temporary difference related to indefinitely reinvested foreign earnings for any country which represents at least 10 percent of the total cumulative temporary difference required to be disclosed.

The Board decided **not** to require the disclosure of:

- Disaggregation of deferred tax liabilities for undistributed foreign earnings by country.
- An estimate of the unrecognized deferred tax liability based on simplified assumptions.
- Any change in management's plans for undistributed foreign earnings based on past or current conditions.

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The FASB and its staff continue to review the current disclosures requirements, the tentative decisions, and input from stakeholders. The FASB could decide to change or revise these tentative decisions. An exposure draft is not expected until the FASB has considered disclosure changes for two additional income tax topics: uncertain tax benefits and miscellaneous income tax items.

DETAILS:

Disclosure Framework Project:

This FASB project seeks to improve the effectiveness of disclosures in notes to financial statements by requiring disclosure of information that is most important or relevant to an entity's financial statement users. The FASB's disclosure framework is intended to promote consistent decisions by the FASB about disclosure requirements and to serve as a "guide" to disclosure decisions undertaken by reporting entities. The FASB also wants to provide flexibility and discretion in applying disclosures requirements.

The FASB is currently evaluating disclosure requirements on four accounting topics:

- Fair Value Measurement (ASC 820-10-50)
- Defined Benefit Plans (ASC 715-20-50)
- Income Taxes (ASC 740-10-50)
- Inventory (ASC 330-10-50)

The tentative decisions made on February 11 reflect certain concepts from the proposed FASB Concepts Statements, *Conceptual Framework for Financial Reporting – Chapter 8: Notes to Financial Statements*. For example, one proposed concept focuses on entity-specific factors that impact cash flows for a particular financial statement line item, such as income taxes. The FASB staff concluded that the jurisdictions in which the reporting entity operates provide relevant information about expected cash flows for income taxes. To give the preparer flexibility in applying this proposed disclosure without incurring significant cost, the tentative decisions focus on "significant" jurisdictions. However, "significant" is not defined for disclosing pretax income by jurisdiction because of perceived application issues when there is consolidated income (or loss) but country-specific loss or income.

The tentative decisions also reflect users' input that the disclosure of accumulated foreign earnings by "significant" jurisdictions would be more relevant than providing a single amount for all jurisdictions. Users presumably would be able to determine the foreign tax credits that would be applied, analyze the advantages or disadvantages of remitting from a particular country, and understand certain exposures related to earnings accumulated in a "significant" country.

Undistributed Foreign Earnings – Current GAAP and Recent Issues

The growing globalization of businesses has meant that a greater share of income is generated outside a reporting entity's home country and in jurisdictions with no tax or low-tax rates. For US reporting entities alone it is estimated by various studies that as much as $2 trillion of accumulated foreign income is held outside the US, mostly in jurisdictions with low tax rates. The high technology and pharmaceutical industries in particular have very significant accumulated foreign earnings which have not been subject to US tax.

Current US GAAP (ASC 740) generally requires the recognition of a deferred income tax liability at the parent entity's home country tax rate for the excess of financial reporting basis over tax basis in the stock of a foreign subsidiary (i.e., outside basis difference).The outside-basis difference generally consists of unremitted earnings (including translation effects) and could also include purchase accounting book-tax differences.

An exception to recognition of a deferred tax liability exists if the parent entity has the intent and ability to assert that undistributed foreign earnings are indefinitely or "permanently" reinvested outside the parent's jurisdiction (for US reporting entities, the foreign earnings would have to be invested outside the US).[1] The parent entity's ability to avoid incurring the home-country tax on accumulated foreign earnings is implicit in the indefinite reinvestment assertion. ASC 740 currently requires the reporting entity to disclose in the footnotes of the financial statements the amount of the undistributed foreign earnings and an estimate of the tax liability that would be incurred upon repatriation of the foreign earnings (i.e., an estimate of the deferred tax liability that is currently not recognized because of the indefinite reinvestment assertion), or a statement that such estimation is not practicable to determine.

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[1] ASC 740-10-25-17 (formerly APB 23).

SEC reviews of this accounting has also been on a rise as evident by the increasing amount of comment letters related to indefinite reinvestment assertions and related disclosures. The SEC has been concerned with the level of transparency around the unrecorded tax liability, management's intention and ability to defer the US tax on accumulated foreign earnings, and the potential implications to a reporting entity's liquidity resources.

More recently, the PCAOB has also indicated that it will closely inspect audit work related to the assertion given the growing amount of accumulated foreign earnings outside the US. The FASB has also considered revising the accounting for accumulated foreign earnings, but ultimately decided to keep the current exception to comprehensive recognition of income tax on foreign earnings.

On the tax legislation front, policy makers in Washington are trying to develop a solution that would be supported by all branches of the US government as well as US-based multinational businesses. These efforts have generated various proposals, yet without a resolution on a final proposal.

BDO INSIGHTS

BDO supports the FASB's efforts to improve the effectiveness of financial statement disclosures through development of a disclosure framework to ensure consistency and provide flexibility.

These tentative decisions focus less on future-looking events and repatriation scenarios that might not occur, and more on the disclosure of relevant information that is already available in the reporting entity's accounting system without adding undo cost to disclose. Therefore, we see these as improvements to the current requirements. This would also "codify" a disclosure of domestic vs. foreign pretax income which is already required by the SEC.

However, there are questions that should be answered: (1) What information is gained by requiring quantification and disclosure of the US tax expense recognized for current period foreign earnings? (2) Would it make sense to clarify the term "significant" to prevent potential confusion and inconsistent application? (3) Would stakeholders also benefit from knowing the foreign income tax rate(s) in "significant" jurisdictions?

BDO will continue to monitor this project and provide input to the FASB.