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No. 2013-11
July 2013

Income Taxes (Topic 740)

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Topic 740, Income Taxes, does not include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, 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 or tax credit carryforward for that year and the net operating loss or tax credit carryforward has not been utilized. Other entities present unrecognized tax benefits as a reduction of a deferred tax asset for a net operating loss or tax credit carryforward in certain circumstances. The objective of the amendments in this Update is to eliminate that diversity in practice.

Who Is Affected by the Amendments in This Update?

This Update applies to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date.

What Are the Main Provisions?

An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements 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 a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. For example, an entity should not evaluate whether the deferred tax asset expires before the statute of limitations on the tax position or whether the deferred tax asset may be used prior to the unrecognized tax benefit being settled.

The amendments in this Update do not require new recurring disclosures.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Current U.S. GAAP does not include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this Update are an improvement to current U.S. GAAP because they are expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist.

When Will the Amendments Be Effective?

The amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. For nonpublic entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2014. Early adoption is permitted.

The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS does not include explicit guidance on the presentation of unrecognized tax benefits.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–6. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 740-10

2. Add paragraphs 740-10-45-10A through 45-10B and amend paragraphs 740-10-45-11 through 45-13, with a link to transition paragraph 740-10-65-3, as follows:

Income Taxes—Overall

Other Presentation Matters

> Statement of Financial Position Classification of Income Tax Accounts

> > Tax Accounts, Other Than Deferred

> > > Unrecognized Tax Benefits

<u>**740-10-45-10A** Except as indicated in paragraphs 740-10-45-10B and 740-10-45-12, an **unrecognized tax benefit**, or a portion of an unrecognized tax benefit, shall be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward.</u>

<u>**740-10-45-10B** To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit shall be presented in the financial statements as a liability and shall not be combined with deferred tax assets. The assessment of whether a deferred tax asset is</u>

available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and shall be made presuming disallowance of the tax position at the reporting date.

740-10-45-11 An entity that presents a classified statement of financial position shall classify an unrecognized tax benefit that is presented as a liability in accordance with paragraphs 740-10-45-10A through 45-10B ~~associated with an~~ ~~**unrecognized tax benefit**~~ as a current liability ~~(or the amount of a net operating loss carryforward or amount refundable is reduced)~~ to the extent the entity anticipates payment (or receipt) of cash within one year or the operating cycle, if longer. ~~The liability for unrecognized tax benefits (or reduction in amounts refundable) shall not be combined with deferred tax liabilities or assets.~~

740-10-45-12 ~~A~~An unrecognized tax benefit presented as a liability ~~recognized for an unrecognized tax benefit~~ shall not be classified as a deferred tax liability unless it arises from a **taxable temporary difference**. Paragraph 740-10-25-17 explains how the recognition and measurement of a **tax position** may affect the calculation of a temporary difference.

> > > Offsetting

740-10-45-13 The offset of cash or other assets against the tax liability or other amounts owing to governmental bodies is not acceptable except as noted in ~~paragraph~~paragraphs 210-20-45-6 and 740-10-45-10A through 45-10B.

Amendments to Subtopic 210-20

3. Amend paragraphs 210-20-15-3 and 210-20-60-3, with a link to transition paragraph 740-10-65-3, as follows:

Balance Sheet—Offsetting

Scope and Scope Exceptions

> Other Considerations

210-20-15-3 The general principle of a **right of setoff** involves only two parties, and exceptions to that general principle shall be limited to practices specifically permitted by the Subtopics listed in this paragraph. Various accounting Subtopics specify accounting treatments in circumstances that result in offsetting or in a presentation in a statement of financial position that is similar to the effect of offsetting. The guidance in this Subtopic does not modify the accounting treatment in the particular circumstances prescribed by any of the following Subtopics:

a. Paragraphs 840-30-35-32 through 35-52 (leveraged leases)
b. Subtopic 715-30 (accounting for pension plan assets and liabilities)

c. Subtopic 715-60 (accounting for plan assets and liabilities)
d. Subtopic ~~740-30~~740-10 (net tax asset or liability amounts reported)
dd. Paragraphs 815-10-45-1 through 45-7 (derivative instruments with the right to reclaim cash collateral or the obligation to return cash collateral)
e. Subtopics 940-320 (trade date accounting for trading portfolio positions) and 910-405 (advances received on construction contracts)
f. Paragraph 942-305-45-1 (reciprocal balances with other banks).

Relationships

> Income Taxes

210-20-60-3 For guidance on amounts reported for net tax assets or liabilities, see Subtopic 740-10~~740-30~~.

4. Add paragraph 740-10-65-3 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*

740-10-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2013-11, *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists:*

a. The pending content that links to this paragraph shall be effective as follows:
   1. For fiscal years, and interim periods within those years, beginning after December 15, 2013.
   2. For **{add glossary link to 5th definition}nonpublic entities{add glossary link to 5th definition}**, for fiscal years, and interim periods within those years, beginning after December 15, 2014.
b. Earlier adoption of the pending content that links to this paragraph is permitted.
c. An entity shall apply the pending content that links to this paragraph prospectively to unrecognized tax benefits that exist at the effective date.
d. An entity may elect to apply the pending content that links to this paragraph retrospectively.
e. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

5. Amend paragraph 740-10-00-1, by adding the following items to the table, as follows:

740-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
740-10-45-10A	Added	2013-11	07/18/2013
740-10-45-10B	Added	2013-11	07/18/2013
740-10-45-11 through 45-13	Amended	2013-11	07/18/2013
740-10-65-3	Added	2013-11	07/18/2013

6. Amend paragraph 210-20-00-1, by adding the following items to the table, as follows:

210-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
210-20-15-3	Amended	2013-11	07/18/2013
210-20-60-3	Amended	2013-11	07/18/2013

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Leslie F. Seidman, *Chairman*
Daryl E. Buck
Russell G. Golden
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Topic 740 does not include explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. 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 or tax credit carryforward for that year and the net operating loss or tax credit 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 in certain circumstances.

General Considerations

BC3. The Task Force considered three approaches for the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. Two of the approaches, which are described in paragraph BC2, are the accounting policies followed by most entities. The third approach was to allow an entity to make an accounting policy election to apply one of the other two approaches to all unrecognized tax benefits. The Task Force rejected the third approach, however, because it would not resolve the diversity in practice in the presentation of unrecognized tax benefits.

BC4. The Task Force decided an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements 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 a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. For example, an entity should not evaluate whether the deferred tax asset expires before the statute of limitations on the tax position or whether the deferred tax asset would be used prior to the unrecognized tax benefit being settled. However, an entity would need to consider limitations as of the reporting date on the use of deferred tax assets (for example, limitations on the use of a net operating loss due to an alternative minimum taxation system). The presentation approach in this Update affects presentation and disclosure of current and deferred income taxes.

BC5. Some Task Force members selected the presentation approach in this Update because, in their view, an entity's tax provision should be prepared as if the uncertain tax position was not claimed on the entity's tax return. If an uncertain tax position was settled with the taxing authority on the basis recognized and measured in the financial statements, then the resolution of the position effectively amounts to additional taxable income or income tax. If under the tax law for the applicable jurisdiction the net operating loss carryforward, a similar tax loss, or a tax credit carryforward would be applied to the additional liability that would arise in the event that the uncertain tax position is not sustained and the settlement related to the uncertain tax position will not result in a payment of taxes, but instead would reduce the net operating loss carryforward, a similar tax loss, or the tax credit carryforward, then the deferred tax asset presented in the statement of financial position would be reduced for the unrecognized tax benefit accordingly.

BC6. Some Task Force members concluded that the presentation approach in this Update is consistent with the offsetting guidance in Subtopic 210-20, Balance Sheet—Offsetting. Those Task Force members observed that in some jurisdictions, an unrecognized tax benefit, a net operating loss carryforward, a similar tax loss, and a tax credit carryforward may satisfy the conditions of paragraph 210-20-45-1 because the unrecognized tax benefits would be offset under the provisions of the tax law.

BC7. The Board issued a proposed Accounting Standards Update on February 21, 2013, with a comment period that ended on April 22, 2013, and received 10 comment letters on the proposed Update. Eight of the 10 respondents agreed with the proposed presentation approach for unrecognized tax benefits. Some of those respondents supported the presentation approach because they stated that it is consistent with how the liability would be settled if the tax position were disallowed by the taxing authority.

BC8. The Task Force considered the feedback from the two respondents who did not support the presentation approach in this Update. Those respondents supported the other approaches that the Task Force previously considered but ultimately rejected in its initial deliberations. The respondents stated the cost and complexity of the presentation approach was higher than the cost and complexity of the other approaches. In addition, they stated the incremental cost and complexity were not warranted because the approach in this Update does not provide better information to users of financial statements. After considering that feedback, a majority of the Task Force concluded that the incremental benefits of the Update justify the incremental cost and complexity of the presentation approach in this Update. In addition, the Task Force concluded that the presentation approach in this Update provides more decision-useful information to users of financial statements than the other approaches considered because it reflects how the liability would be settled if the tax position were disallowed by the taxing authority at the reporting date and will reduce diversity in practice.

BC9. The Task Force decided that no new recurring disclosures should be required as a result of the amendments in this Update because the amendments do not affect the recognition or measurement of uncertain tax positions under Topic 740 and because the currently required tabular reconciliation of the gross amount of unrecognized tax benefits will provide public entity users with relevant information about the unrecognized tax benefits offset against net operating loss carryforwards, similar tax losses, or tax credit carryforwards. The existing disclosure requirements in Topic 740 would be unchanged by the amendments in this Update. All of the comment letters that addressed recurring disclosures agreed that no new recurring disclosures should be required.

Transition and Early Adoption

BC10. The Task Force reached a consensus that the amendments in this Update should be applied prospectively to all unrecognized tax benefits that exist at the effective date for public entities for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013, and for nonpublic entities for the fiscal years (and interim reporting periods within those years) beginning after December 15, 2014. The Task Force concluded that the costs of requiring a full retrospective application outweigh the benefits of providing the information to users of financial statements.

BC11. The Task Force decided to permit early adoption of the amendments to eliminate existing diversity in practice as soon as is practicable.

BC12. The Task Force decided that an entity may adopt the amendments on a retrospective basis. The Task Force did not want to preclude an entity from retrospective adoption if the entity thought the information was useful to the users of its financial statements.

BC13. The Task Force decided that nonpublic entities should have additional time to implement the Update because of their learning cycle and because the Task Force is aware that nonpublic entities previously informed the FASB about their particular challenges with implementing the guidance in accounting for unrecognized tax benefits.

Benefits and Costs

BC14. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC15. The Task Force anticipates that the benefits to users of financial statements would justify the costs incurred by entities to apply the amendments in this Update. The accounting policy of some entities is similar to the approach in this Update. The accounting policy of other entities is different from the approach in this Update, but because the amendments will be applied prospectively, the Task Force anticipates that those entities would have the information necessary to apply the amendments, since they need the information to recognize and measure uncertain tax positions, meet the existing disclosure requirements for unrecognized tax benefits, and prepare a tax return. The benefits of the amendments in this Update would be elimination of diversity in practice and increased comparability of financial statements among entities. In addition, the presentation approach in this Update is consistent with how an unrecognized tax benefit would be settled if the tax position were disallowed by a taxing authority at the reporting date.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). Those changes, which will be incorporated into the proposed 2014 UGT, are available for public comment at www.fasb.org, and finalized as part of the annual release process starting in September 2013.