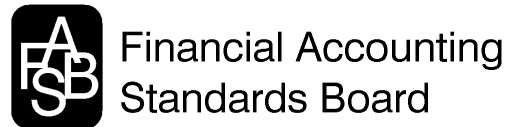


MINUTES



To: Board Members

From: Convergence—Income Tax Team
(Choi, Ext. 446)

Subject: Minutes of the December 5, 2007 Board Meeting: Sweep Issues—Income Taxes **Date:** January 14, 2008

cc: Bielstein, Golden, MacDonald, Lott, Posta, Convergence Income Tax Project Team (Cassel, Malcolm, Paul, Choi), Allen, C. Smith, Gabriele, Sutay, Klimek, Chookaszian, Glotzer, Tully, FASB Intranet, GASB: Bean, IASB: Leisenring, McGeachin, Upton

Topic: Sweep Issues—Income Taxes

Basis for Discussion: Board Memorandum 19 dated November 14, 2007

Length of Discussion: 9:00 a.m. to 9:47 a.m. (EST)

Attendance:

Board members present: FASB: Herz, Smith, Linsmeier, Batavick, Crooch, Seidman, and Young
IASB: Leisenring

Board members absent: None

Staff in charge of topic: Paul, Malcolm

Other staff at Board table: Bielstein, Choi, Cassel, Smith

Outside participants: None

Summary of Decisions Reached:

The Board discussed remaining issues in its short-term convergence project on income taxes that it is conducting jointly with the IASB. The Board made the following decisions

1. FASB Statement No. 109, *Accounting for Income Taxes*, would be amended to include a definition of the term *tax basis*. The IASB plans to consider including a consistent definition of tax basis in IAS 12, *Income Taxes*.
2. The existing Statement 109 guidance about the realizability of deferred tax assets would be retained. The Board acknowledged the IASB's tentative decision to amend IAS 12 to converge to Statement 109's valuation allowance approach, but to describe that approach differently. The Board directed the staff to include in the basis for conclusions of the Exposure Draft the Boards' conclusion that the financial reporting results of the two standards should be the same even though the guidance is phrased differently.
3. Paragraph 28 of Statement 109 would be amended to explicitly include current tax consequences of a change in an entity's tax status. This amendment would result in guidance consistent with SIC Interpretation 25, *Income Taxes—Changes in the Tax Status of an Entity or its Shareholders*. The Board directed the staff to note in the basis for conclusions its belief that the proposed amendment would not change the application of Statement 109.
4. Statement 109 would be amended to require the use of the tax rate applicable to distributed earnings if the entity intends to distribute income to owners and it has the ability to do so; in all other cases use of the rate applicable to undistributed earnings would be required. The Board had previously decided to require use of the undistributed rate in all cases (unless an obligation to distribute exists). The Board decided to change that decision to address a variety of application issues it raised.
5. An entity would be required adopt the standard through a cumulative catch-up of retained earnings as of the beginning of the year in which the final Statement is adopted, except as it relates to the decision affecting the allocation of the purchase price in asset acquisitions with tax basis differences. The guidance for that decision would apply prospectively to transactions entered into after the effective date.
6. An entity would be required to adopt the proposed Statement in the first fiscal year beginning after December 15, 2009. Early adoption would be prohibited.

The Board also directed the staff to begin drafting an Exposure Draft with a 120-day comment period. The Board expects that proposed Statement will be ready for publication early in the second quarter of 2008.

Objective of Meeting:

The purpose of this meeting is to finalize remaining topics to be considered by the Board prior to drafting an exposure document. Those topics are:

- Issue 1: Definition of tax basis
- Issue 2: Realizability of deferred tax assets
- Issue 3: Change in tax status
- Issue 4: Distributed versus undistributed rate
- Issue 5: Transition, exposure period, and effective date.

Matters Discussed and Decisions Reached:

Issue 1: Definition of Tax Basis

1. The IASB tentatively decided to amend the definition of tax base as follows:

Tax base is a measurement attribute. It is the measurement under existing tax law applicable to a present asset, liability, or equity instrument recognised for tax purposes as a result of one or more past events. That asset, liability, or equity instrument may or may not be recognised for financial reporting.

The Board [IASB] decided to establish that the tax base of an asset is determined by the amount deductible by the entity if it sold or otherwise disposed of the asset for its carrying amount at the balance sheet date. [Emphasis added.]

2. The IASB staff intended to change the definition of tax basis in IAS 12 to align with the practice of determining tax basis under Statement 109. The italicized portion of the definition in paragraph 2 above requires an assumption that is not explicit in Statement 109. Accordingly, the staff recommends not including that portion in the definition.
3. Mr. Paul posed the following question to the Board: Does the Board wish to amend Statement 109 to include the definition of tax basis as recommended by the staff?
 - a. *View A—No, the Board does not wish to explicitly define tax basis.*
 - b. *View B—Yes, the Board wishes to amend Statement 109 to include the definition of tax basis as recommended by the staff.*
 - c. *View C—Yes, the Board wishes to amend Statement 109 and would like the staff to develop other alternatives.*
4. **Issue 1—Staff Recommendation:** The staff recommended adopting the first paragraph of the converged definition of tax basis. However, the staff recommends

excluding the second paragraph of the IASB's definition (the italicized portion of the definition in paragraph 2) as it seems to require an assumption that is not explicit in Statement 109. Therefore, if the Board agrees with the staff recommendation, the IASB staff plans to recommend (during the drafting of the Exposure Draft of the proposed amendments to IAS 12) that the IASB reconsider whether the italicized portion of the definition is necessary.

5. **Issue 1—Board Vote:** The Board voted unanimously in favor of the staff recommendation
6. **Issue 1—Board Comments:** All Board members agreed with the staff. Mr. Young noted that the second paragraph of the definition seemed very asset-focused and should be modified to include language addressing liabilities and equity as in the first paragraph. Ms. Bielstein agreed that, at a minimum, the IASB should consider rewording the second paragraph as it is too narrow as written.
7. Mr. Batavick questioned when the IASB was going to reassess its tentative definition. Mr. Paul noted that the IASB staff stated that it would reassess the definition when addressing any "sweep issues" during the drafting of the Exposure Draft. Ms. Bielstein recommended that for all sweep issues identified during drafting that may lead to potential differences between the two standards, members of each Board and both staffs could meet to work through differences rather than bringing issues back to the two Boards separately.

Issue 2: Realizability of Deferred Tax Assets

8. IAS 12 requires that deferred tax assets (DTA) be recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. In other words, the DTA is not recognized unless it is probable that the asset would be realized. Statement 109 currently requires that any DTA be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the DTA will not be realized. The valuation allowance should be sufficient to reduce the DTA to the amount that is more likely than not to be realized.

9. The IASB tentatively agreed to amend IAS 12 to converge with the Statement 109 valuation allowance approach to account for deferred tax assets. The IASB tentatively decided to incorporate language on the realization of deferred tax assets in the proposed amendments to IAS 12 that is generally consistent with Statement 109. The IASB asked the FASB if it would like to make conforming changes to Statement 109 using the same language that is in the proposed amendments to IAS 12. The intention is for the guidance to remain unchanged in Statement 109, but to conform with the language used in the revisions to IAS 12.
10. The staff posed the following question to the Board: Does the Board wish to change the wording regarding realizability of deferred tax assets contained in Statement 109?
 - a. *View A—Statement 109 should be amended to conform to the language proposed for IAS 12.*
 - b. *View B—The Board should retain the terminology currently contained in Statement 109.*
11. **Issue 2—Staff Recommendation:** The staff recommends View B. The staff is concerned that changing the words in Statement 109 will change how the guidance is interpreted despite the Boards' intention that the changes would not change the application of Statement 109.
12. **Issue 2—Board Vote:** The Board voted unanimously in favor of the staff recommendation.
13. **Issue 2—Board Comments:** All Board members agreed with the staff's analysis. Ms. Seidman suggested noting in the basis of conclusions that the Board considered adopting converged guidance but concluded that it would not because there is no practical effect due to the difference in wording. Mr. Batavick emphasized that it is more important that the Boards achieve convergence of the principles in the two standards rather than using the same wording.

Issue 3: Change in Tax Status

14. SIC 25 interprets IAS 12 and addresses a change in the tax status of an entity or its shareholders that may have consequences for an entity by increasing or decreasing its tax liabilities or assets. SIC 25 requires current and deferred tax consequences of a change in tax status to be included in profit or loss for the period, unless those consequences relate to transactions and events that result in a direct credit or charge to the recognized amount of equity. Statement 109 (paragraph 28) includes guidance on how to treat the deferred tax effects of a change in an entity's tax status from taxable to non-taxable and vice versa. The guidance requires that "the effect of recognizing or eliminating the deferred tax liability or asset shall be included in income from continuing operations." The IASB decided that the tax consequences addressed by SIC 25 would not be narrowed to address only deferred tax consequences, but would continue to cover both current and deferred tax consequences. The IASB asked the FASB to explicitly state that the scope of Statement 109 addresses both current and deferred tax consequences of any change in tax status of an entity that affects the tax assets and liabilities of that entity, and thus converges with IAS 12 and SIC 25.
15. The staff posed the following question to the Board: Does the Board wish to amend paragraph 28 of Statement 109 to explicitly include current tax consequences?
- a. *View A—Paragraph 28 of Statement 109 should be amended to explicitly include current tax consequences of a change in tax status.*
 - b. *View B—The Board should not amend paragraph 28 of Statement 109.*
16. **Issue 3—Staff Recommendation:** The staff recommends View A. It believes that paragraph 28 of Statement 109 already implies that the current consequences of a change in tax status would be reflected in income from continuing operations and an amendment to clarify this requirement to ensure convergence is advisable.
17. **Issue 3—Board Vote:** The Board voted unanimously in favor of the staff recommendation.
18. **Issue 3—Board Comments:** All Board members agreed with the staff's analysis. Ms. Seidman noted that she was concerned there may be other areas of Statement 109 that could be similarly amended with the insertion of the word "current" without

changing application of the guidance. She noted that she was not in favor of making all of those changes, although she did not object to the staff recommendation on this issue.

Issue 4: Distributed versus Undistributed

19. In some tax jurisdictions, corporate income is taxed at different rates depending on whether that income is distributed to shareholders. An entity's tax rate for income that is distributed to shareholders (the distributed rate) may be higher or lower than the undistributed rate.
20. In addition to dual-rate jurisdictions, some jurisdictions allow for a deduction for dividends from otherwise taxable income for certain types of entities. Examples of organizations that receive a deduction for dividends include Real Estate Investment Trusts (REIT), Registered Investment Companies (RIC), and Cooperatives (Co-op). Generally, these organizations must meet certain requirements to receive the dividend deduction; most commonly, they must distribute a significant portion of taxable income (90 percent for REIT or RIC).
21. IAS 12 requires deferred tax assets and liabilities to be measured using the tax rate applicable to undistributed profits unless a liability to distribute those earnings has been recognized. Statement 109 is silent on distributed and undistributed rate issues.
22. At the October 2005 joint Board meeting, the Boards decided to require the tax rate applicable to undistributed profits. However, if there was an obligation to distribute a portion of those profits, any deferred taxes on that portion would be measured at the distributed rate. Certain FASB members continued to express a view that the tax rate applicable to distributed profits was the appropriate rate to use. However, the FASB decided to converge with the IASB's decision.
23. The Boards directed the staff to consider the impact of this decision on organizations that receive a dividends paid deduction (for example, REITs, RICs, and Co-ops) that render them essentially tax-exempt upon adequate distribution of dividends. The staff considered five alternatives when examining this issue:
 - a. *Alternative A: No special treatment for REITs, RICs, and co-ops*
 - b. *Alternative B: Define in-substance tax-exempt entity*
 - c. *Alternative C: Point-in-time analysis*

- d. *Alternative D: Distribution outside the entity to be included as a tax planning strategy in determining whether or not the recovery of an asset or settlement of a liability has taxable consequences*
 - e. *Alternative E: Require the rate that an entity expects will apply to measure current or deferred tax assets or liabilities.*
24. The IASB reconsidered and has tentatively concluded on Alternative E.
25. The staff posed the following question to the Board: Does the Board wish to change its previous decision and require the use of the rate that the entity expects will apply (Alternative E)?
26. **Issue 4—Staff Recommendation:** The staff recommended Alternative E to require the use of the tax rate applicable to distributed earnings if the entity intends to distribute income to owners and it has the ability to do so; in all other cases, use of the rate applicable to undistributed earnings would be required. The Board had previously decided to require use of the undistributed rate in all cases (unless an obligation to distribute exists). The Board decided to change that decision to address a variety of application issues it raised.
27. Alternative E has a number of advantages over the others listed in paragraph 23.:
- a. It contains a principle that is already contained in both Statement 109 and IAS 12. Alternative E expands on the expectation approach to rates contained in both Statement 109 and IAS 12 and would not require any sort of exception to that approach.
 - b. It uses terms that are familiar and principles based rather than establishing bright-lines and introducing thresholds that need to be established and clarified. The notion of foreseeable future is a concept that is contained in Statement 109 and IAS 12 in the discussion on recognizing a deferred tax liability for earnings of a foreign subsidiary (paragraph 31 of Statement 109 and paragraph 39 of IAS 12).
 - c. It should result in an entity applying a rate that better reflects the economics of its tax situation rather than requiring a rate to apply in all circumstances.
28. There may be some challenges with alternative E as it will require judgment to determine what rate to apply in a dual-rate tax jurisdiction. Additionally, some may argue, particularly those who support the undistributed rate, that this alternative would result in recording the tax benefit for an obligation that the entity has not

incurred. The staff acknowledges that conceptually this recommendation would allow for the tax affects of a distribution to be recorded before the liability for the distribution is recorded; but as articulated above, anticipating intended actions of the entity is a concept already contemplated and included in Statement 109 and IAS 12.

29. **Issue 4—Board Vote:** The Board voted in favor of the staff’s recommendation.

30. **Issue 4—Board Comments:** Mr. Young argued that he did not believe that applying a tax rate based on management intent was the best alternative because it would lead to a lack of comparability between different entities and which rate was being used would not be transparent to users. He noted that he believes applying the distributed rate is preferable because it provides the most economically relevant information to capital providers and simplifies issues facting REITs and RICs. Mr. Young noted that his view was not the majority view and that he would not object to the staff’s recommendation.

31. Mr. Paul noted that members of both Boards throughout the years have supported a variety of alternatives. Mr. Leisenring noted that he was not in favor of the either the staff recommendation or applying the distributed rate. He contended that an entity should not be permitted to use the distributed rate without having the obligation to pay dividends. That is, an entity must declare dividends and have the liability on its balance sheet before it can realize the tax benefit associated with those distributions.

32. Mr. Herz stated he prefers applying the undistributed rate and crafting an exception for REITs and RICs. However, he does not object to the staff recommendation even though it allows for the application of the distributed rate for a broader set of entities.

Issue 5: Transition, Exposure Period, Effective Date, and Early Adoption

Issue 5A: Transition

33. After evaluating potential transition guidance for each decision, the staff identified two decisions in which retrospective adoption may not be practicable. Those issues are:

- a. Assets acquired with tax basis difference outside of a business combination
- b. Changes in tax laws or rates.

Assets Acquired with Tax Basis Differences Outside of a Business Combination (“98-11”)

34. The decision reached by the Board for assets acquired with tax basis differences outside of a business combination (the “98-11 decision”) requires that an asset be measured at fair value at the date it is acquired. A corresponding deferred tax asset or liability is recognized as the 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 is recognized as a purchase discount allowance on the deferred tax.
35. Current guidance contained in EITF Issue No. 98-11, “Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations,” requires that an entity apply the simultaneous equations method, but does not require an entity to determine the fair value of the asset acquired. Therefore, it is possible that an entity would not know what the fair value of the asset was on the day it was acquired.
36. To apply this decision retroactively, therefore, an entity would need to determine the fair value of any assets acquired and then reallocate the consideration as of the acquisition date based on the revised guidance. Any asset whose amortization period impacted any of the years presented or that remained on the balance sheet as of the earliest date of adoption would need to be evaluated.
37. Although it may be possible for an entity to apply this guidance retroactively, the costs of doing so appear to outweigh the benefits. Two reasons retroactive adoption would be difficult are (a) the potential number of years that the decision may impact and (b) the cost of determining fair value for acquisitions after the transaction has closed (in some cases, significantly later). The staff believes that a modified retrospective adoption will pose similar challenges. As it impacts specific, non-recurring transactions, the staff believes that prospective adoption for asset acquisitions could be applied without requiring all decisions to be adopted prospectively.

Changes in Tax Laws or Rates

38. In determining the point at which deferred tax assets and liabilities should be adjusted for the effect of a change in tax laws or rates, the Board decided:
- a. For operations within U.S. taxing jurisdictions, to retain the Statement 109 guidance that requires that the effect of the change in tax laws or rates be recognized in the period of enactment.
 - b. For operations other than U.S. taxing jurisdictions, to amend Statement 109 to require the use of an approach that is consistent with International Accounting Standards (IAS). The IAS approach requires that deferred tax assets and liabilities be measured based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.
39. The staff believes that it should be possible to determine when tax rates applicable to individual subsidiaries within different tax jurisdictions were substantially enacted and utilize this information to retrospectively adopt this decision. However, the cost of obtaining the information required to make these determinations and performing the resulting calculation may be excessive when compared to the benefit received by users of retroactive adoption. A modified retrospective adoption of one year would appear to reduce the cost (as it only requires the entity to examine and potentially change two period ends) and complexity of adoption, as would a cumulative catch-up as of the date of adoption.
40. The staff does not believe that decisions that the Board had tentatively reached for the other issues (definition of tax basis, realizability of deferred tax assets, and change in tax status) will have a significant impact, if any, on practice.
41. Given the nature of the project and the fact that the Boards' changed different areas of IAS 12 and Statement 109, converged transition methodology isn't necessary to achieve convergence on a going-forward basis for new transactions.
42. The staff obtained some limited input regarding transition from members of the Investors Technical Advisory Committee (ITAC). This input suggested that users have a relatively narrow focus when evaluating income taxes, primarily focusing on material disclosed tax contingencies, material reconciling differences between statutory, cash, and effect tax rates, unusually low effective tax rates, and material deferred tax balances at entities that have incurred material negative results from operations. Those members expressed an opinion that the proposed changes to

Statement 109 included in this project would not have a material impact on their evaluation of any of the focus areas mentioned and that they did not have a strong preference for retrospective adoption of the proposed Statement. Therefore, the staff does not believe that users will realize a significant benefit from a full retrospective adoption when compared to other possible transition methods.

43. For many entities, calculation of the tax provision is a manual process and represents one of the entity's most complex reporting areas, as evidenced by the ratio of material weaknesses reported under Sarbanes-Oxley, Section 404, which were attributed to income tax accounting. Requiring companies to adjust the tax provision for multiple periods for multiple changes to Statement 109, therefore, will likely be more costly when compared to adoption of other standards.
44. The staff posed the following questions to the Board: Should restatement of prior years' financial statements be required for any of the proposed changes? If not, should the required method of transition for the proposed Exposure Draft on income taxes be a cumulative catch-up except for the Issue 98-11 decision, which would be applied prospectively?
45. **Issue 5A—Staff Recommendation:** The staff recommends that the proposed Statement be applied with a cumulative catch-up of retained earnings as of the beginning of the year for which the final Statement is initially applied. The staff also recommends that prospective treatment be applied for acquisitions of assets (the 98-11 decision) due to the discrete nature of the transactions impacted. Generally, the staff believes the Board should provide one transition method for the entire standard and does not believe that the Board should provide transition methods that vary based on the particular issue. However, the staff does not believe making an exception for the 98-11 decision will create an undue amount of complexity for adoption.
46. **Issue 5A—Board Vote:** The Board voted in favor of the staff recommendation.
47. **Issue 5A—Board Comments:** Mr. Young noted that of all the decisions reached by the Board in this project, retrospective adoption for the decision concerning intercompany transfers would provide the most benefit to users. Ms. Smith agreed, noting the view of a few members of ITAC who believe this decision was the only issue that users may consider relevant when considering retrospective adoption. Mr.

48. Mr. Linsmeier argued that he did not believe enough effort was being made to provide users with time series information. Out of the five decisions evaluated for retrospective adoption, he believes that only the “98-11” decision is costly and problematic. Rather than accommodating the transition of that decision by moving all of the other decisions to a “cumulative catch-up adjustment” transition, he believes retrospective adoption should be applied. Ms. Bielstein commented that the staff specifically discussed the benefits of retrospective application with several ITAC members. Those users clearly stated that they did not see significant benefits with retrospective application in this case. Mr. Herz suggested that those responses were perhaps an indication of the lack of attention users provide for income tax issues. Mr. Paul clarified that based on this feedback, the staff believes the costs to preparers of retrospective application would outweigh the benefits to users.
49. Mr. Young commented that income tax accounting has always lacked transparency and that users have always relied heavily on management’s analysis. However, he noted that despite a lack of knowledge and interest beforehand, users responded positively to the issuance of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. Therefore, he argued that more benefits could be realized from retrospective adoption than users are currently contemplating.
50. Ms. Malcolm noted that the IASB’s transition would be most consistent with a cumulative catch-up adjustment. However, since different changes had to be made to

IAS 12 to converge with Statement 109, the IASB's transition provisions will be slightly different.

51. Finally, Mr. Linsmeier encouraged the Board to prescribe retrospective adoption in the proposed Exposure Draft based on the broader objective and let respondents indicate in their comment letters why it is not feasible.
52. Mr. Batavick, Mr. Crooch, Ms. Seidman, Mr. Smith, and Mr. Herz are in favor of transition disclosures, but against providing different transition provisions for each decision as it would add complexity. Therefore, they are in favor of the staff recommendation.

Issue 5B: Exposure Period

53. The staff posed the following question to the Board: How long should the forthcoming proposed Statement on income taxes be exposed?
54. **Issue 5B—Staff Recommendation:** The IASB has implemented a policy in which its documents will be exposed for a period of 120 days. For purposes of convergence, the staff recommended a 120-day comment period for the proposed Exposure Draft.
55. **Issue 5B—Board Vote:** The Board unanimously voted in favor of the staff recommendation.
56. **Issue 5B—Board Comments:** None.

Issue 5C: Effective Date

57. Because the proposed Exposure Draft is part of a convergence project, the staff believes that the Boards should select a converged effective date for their respective proposed Exposure Drafts. The IASB currently anticipates that an Exposure Draft will be issued in early 2008 and a final Statement in 2009. Therefore, the staff recommends that the final Statement be effective for fiscal years beginning on or after December 15, 2009. The staff posed the following question to the Board: Does the Board agree with the staff's recommendation for the effective date?
58. **Issue 5C—Staff Recommendation:** The staff recommends that the final Statement be effective for fiscal years beginning on or after December 15, 2009.

59. **Issue 5C—Board Vote:** The Board unanimously voted in favor of the staff recommendation.

60. **Issue 5C—Board Comments:** None.

Issue 5D: Early Adoption

61. The staff posed the following question to the Board: Should the Board encourage early application of the proposed Exposure Draft?

- a. *Alternative A: Permit/encourage early adoption provided that the final Statement is adopted at the beginning of a fiscal year.*
- b. *Alternative B: Do not permit early adoption.*

62. **Issue 5D—Staff Recommendation:** The staff recommends Alternative B.

63. **Issue 5D—Board Vote:** The Board voted unanimously in favor of the staff recommendation.

64. **Issue 5D—Board Comments:** None.

Follow-up Items:

66. Ms. Bielstein stated that the staff's intention is to ballot the Exposure Draft by March 31, 2008.

General Announcements:

None.