

MINUTES



Financial Accounting
Standards Board

To: Board Members

From: Short-Term Convergence—Income
Tax Team (Kispert, Ext. 310 and
Duke, Ext. 297)

Subject: Minutes of the March 23, 2005
Board Meeting

Date: March 30, 2005

cc: Bielstein, Smith, Petrone, Leisenring, Project Team (Cassel,
J. Johnson, McGeachin, Posta, Thomas), Golden, McBride, Geary,
Mahoney, Thompson, Vincent, Sutay, Gabriele, Swift, Polley, FASB
Intranet (e-mail), Getz

Topic: The tax rate to be used in measuring deferred
tax assets and liabilities (specifically, the use of
tax rates for distributed or undistributed
earnings and the use of enacted tax rates
versus substantively enacted tax rates)

Basis for Discussion: Board Memorandums 11 and 12 dated
March 2 and 10, 2005, respectively

Length of Discussion: 9:10 a.m. to 10:10 a.m. (EST)

Attendance:

Board members present: FASB: Herz, Schipper, Batavick, Crooch,
Seidman, Young, and Trott (by phone)
IASB: Leisenring

Board members absent: None

Staff in charge of topic: Posta

Other staff at Board table: Thomas, McGeachin (by phone), Bielstein,
Cassel, Duke, and Kispert

Outside participants: None

Summary of Decisions Reached:

The Board considered certain differences between the provisions of FASB Statement No. 109, *Accounting for Income Taxes*, and IAS 12, *Income Taxes*, related to the tax rate to be used in measuring deferred tax assets and liabilities.

1. If income is taxed at different rates depending on whether that income is distributed to shareholders, the Board decided that:
 - a. Deferred tax assets or liabilities should be measured based on the undistributed rate.
 - b. To the extent that there is an obligation to distribute a portion of that income, any deferred tax assets or liabilities related to that portion should be remeasured using the distributed rate.
2. 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 that:
 - 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.

The Board requested that the IASB consider whether similar wording could be added to IAS 12. That is, that operations (including subsidiaries) within U.S. taxing jurisdictions that apply IAS should reflect changes in the U.S. tax laws or tax rates when they are enacted.

Objective of Meeting:

The objective of the meeting was for the Board to consider differences between the provisions of Statement 109 and IAS 12 related to the tax rate to be used in measuring deferred tax assets and liabilities (specifically, the use of tax rates for distributed or undistributed earnings and the use of enacted tax rates versus substantively enacted

tax rates). The staff will also report the related project decisions reached by the IASB at its March 2005 meeting. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

Section 1: Use of Tax Rates for Distributed or Undistributed Earnings

1. Ms. Posta stated that the first topic is the use of tax rates for distributed and undistributed earnings and that the purpose of Board Memorandum 11 was to report the decisions reached and rationale of the FASB and IASB (collectively, the Boards). She stated that an example was provided in the memo to help illustrate the differences in conclusions. Those differences seem to be based on either differences in the Boards' conceptual definitions about what assets and liabilities are, or differences in how the Boards are applying those definitions, for example, in Example 1 in the handout, whether the refund from the taxing authority meets the definition of an asset.
2. Ms. Posta added that at the March 2005 IASB meeting, IASB Board members favored joint discussion of this issue at the forthcoming April 2005 joint FASB-IASB meeting (the April meeting). While the issue may seem of limited importance to some, IASB members noted that it is fundamental in terms of recognition and measurement of assets and liabilities. IASB members suggested that those discussions include: (a) analysis of why the amount refundable (or incremental amount due) upon a dividend distribution meets (or does not meet) the definition of an asset or liability and (b) the possibility of finding a common solution by additional disclosures (reconciliations) and alternative presentations (for example, using the distributed rate but disclosing the impact or amount of taxes that would be paid upon a distribution of retained earnings).
3. Ms. Posta asked the Board whether they support reconsidering their previous conclusion and adopting the approach of the IASB for purposes of the forthcoming Exposure Draft and whether they prefer to jointly discuss this issue at the April meeting.
4. Ms. Schipper stated that she did not favor discussing the issue at the April meeting because she believes that the issue raised is how to define the obligating event.

Defining the obligating event should be considered by the Boards as part of their conceptual framework project, not within a short-term convergence project. Ms. Schipper was doubtful that the Boards would learn anything incremental by exposing the two views and noted that both views are defensible. She asserted that the FASB's January 2005 decision is conceptually superior; however, for purposes of short-term convergence, she was willing to accept the use of the undistributed rate. Ms. Schipper added that this issue should be considered when the conceptual framework project addresses how to define the obligating event.

5. Ms. Seidman agreed with Ms. Schipper's conclusions and stated that she also would be willing to support the use of the undistributed rate for purposes of the Exposure Draft. She agreed that the Boards should expose one view and assess the implications through the comment letters received, rather than exposing two, competing views. She also indicated that she does not see the need for discussion of this issue at the April meeting.
6. Mr. Young stated that he prefers the distributed rate because it gives investors a better picture of the return of capital. He also stated that he is flexible about which rate should be used because disclosures could provide the necessary information with either rate. He stated that he would be open to discussing the issue at the April meeting.
7. Mr. Batavick stated that at the previous meeting, he supported the undistributed rate and continues to do so because he believes the undistributed rate provides more useful information to the investors.
8. Mr. Trott stated that he agrees with Ms. Schipper's and Ms. Seidman's conclusions and that he does not object to requiring the use of the undistributed rate in the Exposure Draft. Mr. Trott added that he does not support discussing the issue at the joint meeting in the context of the short-term convergence project but supports the issue being considered within the conceptual framework project.
9. Mr. Crooch agreed with Mr. Trott, Ms. Schipper, and Ms. Seidman.
10. Mr. Herz asked whether any Board member objected to (a) requiring the use of the undistributed rate (until there is an obligation to distribute a portion of the earnings to

the shareholders) and (b) not discussing the issue at the April meeting in the context of this short-term convergence project. No Board members objected.

Section 2: Enacted Versus Substantively Enacted Tax Rates

11. Ms. Posta stated that the Boards reached different conclusions on the use of the enacted tax rates versus substantively enacted tax rates. She stated that the purpose of Board Memorandum 12 was to consider the decisions reached by the IASB about what constitutes “substantively enacted rates.” She stated that the first issue is about the terminology and recognition threshold and that the second issue is whether to include additional application guidance.
12. Ms. Posta stated that in terms of the terminology, while both Boards appear to be describing the same point in the process upon which changes in tax laws or rates should be included in the measurement of current and deferred taxes, they are using different terms. The FASB is using the term *enacted* to describe the point at which every action, other than perfunctory actions, has occurred that is required for a measure to become law. The IASB is using the terms *enacted* and *substantively enacted* for accounting purposes to describe when the process of enactment is complete, which they describe as when the remaining steps will not change the outcome.
13. Ms. Posta also stated that within the IASB’s definition of substantively enacted there is a subtle, yet important distinction in the use of *will not change* [the outcome] versus *cannot change* [the outcome]. The term *will not change* [the outcome] means that the likelihood of the future remaining steps changing the outcome is very small, but still possible. Whereas the term *cannot change* [the outcome] means that the likelihood of the future steps changing the outcome is zero. Ms. Posta observed that this subtle distinction has some significant consequences in the application.
14. Ms. Posta stated that the staff identified two alternatives in the memo:

Alternative A: Adopt the IASB’s approach for non-U.S. jurisdictions for purposes of applying Statement 109. Therefore, the process of enactment would be considered complete for accounting purposes when the remaining steps will not change the outcome of the tax law or rate change.

This approach would allow entities to recognize the effect of a change prior to the actual enactment if the remaining steps were extremely unlikely. For the United States, the president's signature would always be required (or a comparable measure for states within the United States).

Ms. Posta noted that some view the IASB's principle and the required U.S. approach in Alternative A as inconsistent because there may be a point before the president's (or executive's) signature that would constitute enactment for accounting purposes.

Alternative B: This alternative is the same as Alternative A except that the term *cannot change* [the outcome] would be used in the definition, rather than *will not change* [the outcome].

Ms. Posta noted that IASB members object to the use of the *cannot* language because that point would be when the legislation is officially enacted; whereas, they believe that an earlier point in the process is appropriate.

15. Ms. Posta stated that the staff believes that there are advantages and merit to both alternatives. From a theoretical perspective, some staff members prefer that the point of enactment for purposes of accounting be the point at which the remaining steps cannot change the outcome (Alternative B). However, from a practical and convergence perspective, the staff acknowledges the desire to eliminate reconciling items, particularly those that could be created in non-U.S. jurisdictions that are following U.S. GAAP and report on an interim basis. Therefore, with the IASB's proposed changes to the definition of substantively enacted, as well as the additional application guidance, the staff recommended that the FASB adopt the IASB's terminology and definition of substantively enacted for non-U.S. jurisdictions for purposes of applying Statement 109 (Alternative A).
16. Mr. Herz asked whether it is clear under the IASB's approach that presidential signature is required for U.S. subsidiaries. Ms. Posta responded that she believes it is clear in the table (included as an attachment to these minutes) that the IASB is proposing to include in the guidance.
17. Mr. Trott noted that the table is inconsistently applied across the countries and disagrees with the way the IASB applied its *will not change* [the outcome] threshold

to various countries. He stated that he would prefer to use the terminology of *cannot change* [the outcome]. He suggested that this issue be excluded from the scope of this convergence project because it appears that the IASB and FASB are at an impasse.

18. Mr. Leisenring noted that for U.S. purposes, the *will not change* threshold was meant to be the president's signature. He clarified that members of the individual countries determined the point of substantive enactment (as defined by the IASB) that is included within the table.
19. Mr. Trott compared the assessment of Canada and the United States and noted that the conclusions reached for those countries are inconsistent with each other. He added that it is inappropriate to have a probability assertion included in determining whether a change in tax rates or laws has been substantively enacted.
20. Mr. Batavick agreed with Mr. Trott's view and observed that the application of the probability-based criterion could be problematic. He also stated that he would be willing to accept the use of the term *substantively enacted* if the threshold were defined as the remaining steps *cannot change* [the outcome]. However, if it appears that the Boards cannot converge on this issue, he prefers maintaining the use of the enacted rates and laws terminology within the guidance in Statement 109.
21. Ms. Schipper stated that the *will not change* phrase is based on a probabilistic assessment of someone else's behavior. In the case of Canada, that probabilistic assessment is based on the view that a party will not vote against its own bill because of severe consequences, which deter that activity. Nevertheless, it is possible for a party to vote against its own bill. If that reasoning were applied to a situation in the United States in which the president has been an outspoken proponent of a bill and has announced publicly that he intends to sign that bill, there would be a remote chance that the president would change his mind. However, using the IASB's table, that change in the tax rate or law would not be considered substantively enacted until the president signs the bill. Therefore, the application of *will not change* is internally inconsistent. Ms. Schipper agreed with Messrs. Trott and Batavick that the Boards are at an impasse. In the interest of convergence, Ms. Schipper stated that she would accept the table of rules that tells people what

will not change means. However, she stated that it is not her first preference to adopt the IASB's decision.

22. Mr. Leisenring stated that he agrees the table is inconsistent across jurisdictions, but the idea of *cannot change* is impalatable to some members of the IASB. He stated that the United Kingdom recently passed its Provisional Collection of Taxes Act, but that the Act will not meet the *cannot change* threshold for quite some time. However, taxpayers will begin to pay taxes at the rate outlined in the Act now. He added that he believes that the accounting should reflect that checks are being written for taxes at the new rate.
23. Mr. Crooch stated that he accepts that the experts in those countries are correct in assessing the point in the process at which substantive enactment occurs. He stated that in the interest of convergence, he would adopt the IASB's approach and place the table within Statement 109 as an example of what substantive enactment means in certain countries.
24. Ms. Schipper noted that the table will not be a set of examples; rather, it will be a table of unambiguous rules for the jurisdictions that are included in the table.
25. Ms. Seidman stated that she believes the conclusion reached for the United States in U.S. GAAP is correct. That is, that the president's signature is required before a law is deemed enacted for purposes of accounting. She stated that she would be willing to support the terminology of enacted or substantially enacted as indicated in the following table of rules.
26. Mr. Young stated that he prefers Alternative A, but he prefers not to include the table. In addition to being convergent, he indicated that Alternative A is more representationally faithful. He added that he does not believe that including a table of rules would be appropriate because the processes are dynamic.
27. Mr. Leisenring noted that using the term *cannot change* will more likely ensure that there is consistency across companies for recording a change in tax rate or law in the same period. However, that alternative would result in a change in tax rate or law not being reflected in the period that people begin to pay taxes at the new rate.

28. Mr. Herz stated that he could accept Alternative A, as long as U.S. practice is not changed. He also noted that maintaining the table would be difficult.
29. Mr. Cassel clarified that defining the point of enactment does not mean that there cannot be successive legislation.
30. Mr. Leisenring noted that if the Boards reach divergent conclusions on this issue, it could imply that various jurisdictions would begin to record tax rate or law changes in different periods than other jurisdictions. However, there is greater concern that for a given jurisdiction, such as for the United States, a change in tax rate or law would be accounted for at a different point in time under U.S. GAAP than under IAS.
31. Ms. Schipper asked whether the IASB proposed expanding the tabular presentation of rules for all jurisdictions that apply IFRS and IAS. Mr. Leisenring answered that he is not sure whether the table will be expanded or whether countries that are not included in the table will be required to analogize from the table to what is appropriate treatment in their jurisdictions.
32. Mr. Trott noted that his objection to the staff's recommendation relates to how the IASB explains its objective and then requires the use of a table that is inconsistent with that description. Ms. Schipper agreed that it would be difficult for jurisdictions to determine which country to analogize to because of the inconsistent application of the objective.
33. Ms. Seidman suggested that a footnote be included in Statement 109 that states (a) in the United States, the enactment date is the date when the president signs a bill and (b) in other jurisdictions, the point of enactment occurs when the remaining steps are perfunctory or ceremonial. Mr. Leisenring noted that if the FASB decides to do as Ms. Seidman suggested, it is likely that the IASB would not include the table in its guidance. Mr. Trott suggested that the IASB's guidance include a statement that the effect of tax rate changes be reflected as set forth in the table and should not use the terminology of *will not change* because it is not applied consistently to the table.

34. Mr. Thomas stated that, absent the table of rules, there will likely be inconsistent application of substantively enacted. However, this issue does not deal with a fundamental recognition or measurement difference but a timing difference.
35. Ms. Bielstein noted that one objective is to improve the operationality of the substantively enacted guidance in IAS 12. The use of *will not change* does not seem to improve the operationality.
36. Ms. Schipper suggested that an alternative is that Statement 109 not be changed, and the IASB add a footnote to its guidance that states that in the United States, substantive enactment occurs when the president signs. Mr. Herz noted that Ms. Schipper's suggestion will eliminate reconciling items for U.S. companies following U.S. GAAP and international standards but that there will continue to be reconciling items for the reporting of non-U.S. jurisdictions.
37. Ms. Seidman suggested that in order to achieve convergence, Ms Schipper's suggestion be combined with a similar statement in U.S. GAAP. That is, U.S. GAAP would require the use of the current Statement 109 approach for the United States, but for jurisdictions outside of the U.S., the IASB's approach would be used. Mr. Leisenring clarified that for non-U.S. jurisdictions that would mean that tax rate and law changes would be accounted for when those changes are substantively enacted (as defined and applied under IAS).
38. Mr. Herz asked whether the Board agreed with (a) the combined suggestion (paragraphs 36 and 37), which includes requesting that the IASB consider similar wording in its guidance and (b) not including additional application guidance for jurisdictions outside the U.S. No Board members objected.

Follow-up Items:

None.

General Announcements:

None.

Attachment: Application Guidance for the Point of Substantive Enactment**(IASB February 2005 Decision)**

Country	Enactment for Accounting Purposes
United Kingdom	Substantive enactment occurs when the House of Commons passes a resolution under the Provisional Collection of Taxes Act.
Canada	Substantive enactment occurs as set out in EIC 111, i.e., if there is a majority government, when detailed draft legislation has been tabled for first reading in Parliament. If there is a minority government, proposed amendments to the Income Tax Act would not normally be considered to be substantively enacted until the proposals have passed third reading in the House of Commons.
Australia	Substantive enactment occurs as set out in UIG 39, i.e., when the Bill has been tabled in the Parliament and there is majority support for the passage of the Bill through both Houses of Parliament.
France	Substantive enactment occurs upon signature by the executive.
Germany	Substantive enactment occurs when the Bundestag and Bundesrat pass the legislation.
Japan	Substantive enactment occurs when the Diet passes the legislation.
United States	Substantive enactment occurs upon the signing of legislation by the President or upon a successful override vote by both houses of Congress.
South Africa	Substantive enactment occurs when the National Assembly passes the Money Bill.