In depth

National Office

FASB issues guidance on income tax disclosures

US2023-12
December 14, 2023

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At a glance

On December 14, the FASB issued a final standard on improvements to income tax disclosures. The standard requires disaggregated information about a reporting entity's effective tax rate reconciliation as well as information on income taxes paid. The standard is intended to benefit investors by providing more detailed income tax disclosures that would be useful in making capital allocation decisions.

ASU 2023-09, *Improvements to Income Tax Disclosures,* applies to all entities subject to income taxes. For public business entities (PBEs), the new requirements will be effective for annual periods beginning after December 15, 2024. For entities other than public business entities (non-PBEs), the requirements will be effective for annual periods beginning after December 15, 2025. The guidance will be applied on a prospective basis with the option to apply the standard retrospectively. Early adoption is permitted.

Background

The FASB's technical agenda has included a project to improve income tax disclosures since 2015. The FASB performed research and outreach, receiving feedback from investors that the existing income tax disclosure requirements, which have remained largely unchanged for more than 15 years, do not provide sufficient detail to assess global tax risk. Specifically, investors have asked for more disaggregated income tax information, particularly jurisdictional information. Although the project has had several exposure drafts and an evolution in scope over the years, disaggregation has remained a focal point. In the Basis for Conclusions, the FASB noted its view that the ASU improves the transparency of income tax disclosures by requiring (1) consistent categories and greater disaggregation of information in the rate reconciliation and (2) income taxes paid disaggregated by jurisdiction.

Key provisions of the new guidance

The new guidance focuses on two specific disclosure areas: the rate reconciliation and income taxes paid. The rate reconciliation disclosure requirements differ for PBEs as compared to non-PBEs. The income taxes paid disclosures are the same for all entities.

Rate reconciliation disclosures for public business entities

Prior to adoption of the ASU, ASC 740 requires public entities, as defined, to provide a tabular rate reconciliation that reconciles (1) income tax expense attributable to continuing operations to (2) the statutory federal income tax rate applied to pre-tax income from continuing operations. The reconciliation is required to include the nature and estimated amount of each "significant reconciling item." Public entities can present the tabular reconciliation using either dollar amounts or percentages. Although ASC 740 does not define "significant" with regard to the rate reconciliation, SEC regulation S-X 4-08(h)(2) requires disclosure of individual reconciling items that are more than 5% of the amount computed by multiplying pre-tax income by the statutory tax rate (e.g., for a US-based entity subject to the 21% statutory tax rate, any item that increases or decreases the tax rate by 1.05% or more).

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The ASU replaced the term "public entity" with "public business entity*,*" as defined in the Master Glossary. The ASU requires public business entities, on an annual basis, to provide:

- a tabular rate reconciliation (using both percentages *and* reporting currency amounts) of (1) the reported income tax expense (or benefit) from continuing operations, to (2) the product of the income (or loss) from continuing operations before income taxes and the applicable statutory federal (national) income tax rate of the jurisdiction (country) of domicile using specific categories, and
- separate disclosure for any reconciling items within certain categories that are equal to or greater than a specified quantitative threshold.

The quantitative threshold for the designated categories requiring further disaggregation is 5%. That is, if the absolute value of the effect of the reconciling item is equal to or greater than the absolute value of 5% of the product of the income or loss from continuing operations before income tax and the applicable statutory federal income tax rate, the reconciling item must be separately disclosed. The FASB chose the 5% threshold to be consistent with the existing SEC requirement in Regulation S-X 4-08(h)(2).

When a PBE as the parent entity is not domiciled in the US, consistent with SEC requirements, the ASU indicates that the federal (national) income tax rate in that entity's country of domicile should normally be used in the reconciliation. Further, any reporting entity that does not use the US federal rate should disclose the rate used and the basis for using that rate.

See Appendix 1 for an illustrative example from the ASU of the rate reconciliation for a PBE.

Specific categories

The ASU requires the use of eight specific categories within the tabular rate reconciliation that are prescribed in ASC 740-10-50-12A(a). Per paragraph BC18 in the Basis for Conclusions, the FASB believes that the standardization of the categories within the rate reconciliation will provide disclosure consistency and comparability that will help users of financial statements better understand the factors that affect an entity's tax rate and assess whether an entity's tax rate is sustainable.

Excerpt from ASC 740-10-50-12A
For each annual reporting period, a public business entity shall disclose a tabular reconciliation, using both percentages and reporting currency amounts, according to the following requirements: a. The following specific categories shall be disclosed: 1. State and local income tax, net of federal (national) income tax effect 2. Foreign tax effects 3. Effect of changes in tax laws or rates enacted in the current period 4. Effect of cross-border tax laws 5. Tax credits 6. Changes in valuation allowances 7. Nontaxable or nondeductible items 8. Changes in unrecognized tax benefits.

The ASU is written with the expectation that the starting point for the reconciliation is the federal statutory rate in the reporting entity's jurisdiction (country) of domicile. As a result, all of the categories (except the changes in unrecognized tax benefits category, as discussed below) are considered through that lens.

- The state and local income tax category should include income taxes imposed by state and local jurisdictions in the jurisdiction (country) of domicile.
- The foreign tax effects category should include all income taxes imposed by jurisdictions outside of the country of domicile.
- Categories 3 through 7 should only include federal (national) income tax impacts imposed by the jurisdiction (country) of domicile. For example, the cross-border tax effects category only includes cross-border taxes that are imposed by the jurisdiction (country) of domicile. Similarly, the valuation allowance category only reflects the change in valuation allowance related to federal (national) taxes in the jurisdiction (country) of domicile. Any change in valuation allowance in a foreign jurisdiction would be included in the foreign tax effects category and would be separately disclosed as a reconciling item if the impact meets the quantitative threshold.

The changes in unrecognized tax benefits category may include reconciling items for all jurisdictions on an aggregate basis.

Some reconciling items are interrelated or interdependent and have an offsetting effect on each other. The ASU, however, requires gross presentation of all reconciling items unless specific guidance permits net presentation.

If a reconciling item does not fall into any specific category, the entity is required to disclose the reconciling item separately as an “other adjustment” in the tabular reconciliation if it meets the 5% threshold.

State and local income tax, net of federal (national) income tax effect

The state and local income tax category reflects income taxes imposed at the state or local level within the jurisdiction (country) of domicile. A qualitative description of the states and local jurisdictions that make up the majority (greater than 50%) of the effect of the state and local income tax category is also required. For the purpose of identifying the states and local jurisdictions that make up the majority of the effect, a PBE should begin with the state or local jurisdiction that has the largest effect and, in descending order, add states or local jurisdictions with the next largest effect until the aggregated effect is greater than 50%.

Foreign tax effects

The foreign tax effects category reflects income taxes imposed by foreign jurisdictions. Within the foreign tax effects category, reconciling items are required to be disaggregated by both jurisdiction (country) and by nature (including statutory rate differentials) if either or both is over the 5% threshold.

A foreign jurisdiction that meets the 5% threshold should be separately disclosed as a reconciling item. In addition, if any individual reconciling item within a foreign jurisdiction meets the 5% threshold, that reconciling item should be separately disclosed by nature and jurisdiction regardless of whether the jurisdiction exceeds the threshold in total. For example, the Basis for Conclusions indicates that a statutory tax rate difference between a foreign jurisdiction (country) and the jurisdiction (country) of domicile that meets the 5% threshold should be separately disclosed as a reconciling item within the foreign jurisdiction.

Effect of changes in tax laws or rates enacted in the current period

This category reflects the cumulative tax effects of a change in enacted tax laws or rates on current or deferred tax assets and liabilities at the date of enactment.

The tax effects included in this category are intended to be consistent with existing guidance in ASC 740 related to the effects of changes in tax laws or rates and the requirement for those effects, both current and deferred, to be included in the tax provision attributable to continuing operations in the period that includes the enactment date.

Effect of cross-border tax laws

The effect of cross-border tax laws category reflects the effect of incremental income taxes imposed by the jurisdiction (country) of domicile on income earned in foreign jurisdictions. The FASB concluded that the tax effect of both the cross-border tax and any related tax credit provided by the jurisdiction (country) of domicile on the same income during the same reporting period may be presented on a net basis in the effect of cross-border tax laws category. They clarified that this effectively means that if there is a credit in the same jurisdiction, which is an inherent part of the calculation of a cross-border tax law, the credit could be netted with the cross-border tax law effect. The example used by the FASB is global low-taxed intangible income (GILTI) and its related foreign tax credits (GILTI FTCs). Reconciling items within the effect of cross-border tax laws category should be separately disclosed if over the 5% threshold.

Tax credits

The tax credits category should reflect the effect of tax credits provided by the jurisdiction. Reconciling items within the tax credits category should be separately disclosed if over the 5% threshold.

The FASB had initially included foreign tax credits as a rate reconciling item within the example provided in the Exposure Draft; however, it ultimately opted to remove "foreign tax credits" from the tax credit category in the final ASU considering their conclusions regarding netting of foreign tax credits with the related tax in certain cases (e.g., GILTI and GILTI FTCs).

Changes in valuation allowances

The changes in valuation allowance category reflects the income tax effect of valuation allowances initially recognized or subsequently adjusted in the reporting period. For example, a US-domiciled reporting entity that establishes a full valuation allowance on its federal deferred tax assets would present the initial impact to record the valuation allowance on both its beginning-of-year deferred tax assets and deferred tax assets generated in the current year in aggregate within the changes in valuation allowance category.

Nontaxable or nondeductible items

This category reflects the tax effect of nontaxable or nondeductible items in the jurisdiction. Reconciling items within the nontaxable or nondeductible items category should be separately disclosed if over the 5% threshold.

Reporting entities may need to apply judgment when determining what reconciling items may be included in this category. For example, excess tax benefits related to share-based payments are arguably neither "nontaxable" nor "nondeductible." However, despite feedback received in comment letters, the FASB did not provide specific guidance on the disclosure of the rate-reconciling impact related to excess tax benefits on share-based payment awards. The FASB, however, indicated in the Basis for Conclusions that it does not believe that excess benefits and shortfalls must be viewed as separate reconciling items, and therefore it affirmed that the impact of share-based payment awards could be viewed as a single reconciling item within the nontaxable or nondeductible items category.

Changes in unrecognized tax benefits

The changes in unrecognized tax benefits category is unique in two ways.

First, it only includes the tax effect of changes in judgment related to tax positions taken in *prior* annual reporting periods. Uncertain tax benefits related to *current* year tax positions will be shown net with the reconciling item that relates to the uncertain tax position. For example, if a reporting entity generates federal research and development (R&D) credits in the current period, the rate reconciling item related to the R&D credit benefit should be presented in the tax credits category net of any associated unrecognized tax benefit (assuming the R&D credit net of uncertain tax benefit meets or exceeds the 5% threshold).

Second, the ASU permits reporting entities to aggregate changes in unrecognized tax benefits for all jurisdictions within the changes in unrecognized tax benefits category.

Qualitative disclosure

A PBE is required to provide an explanation, if not otherwise evident, of the individual reconciling items disclosed, such as the nature, effect, and underlying causes of the reconciling items and the judgment used in categorizing the reconciling items.

The FASB acknowledged in the Basis for Conclusions that the specific categories may not cover all income tax effects and that judgment may be needed when determining how to categorize certain income tax effects that do not clearly fall into a single category or when certain income tax effects have characteristics of multiple categories. When judgment has been applied, an entity should consider whether an accompanying explanation is needed. For example, a reporting entity may disclose the categories impacted by the tax effects of a significant transaction in the current period.

Rate reconciliation disclosures for entities other than public business entities

Prior to adoption of the ASU, ASC 740-10-50-13 requires nonpublic entities to disclose the nature of significant reconciling items but does not require a numerical reconciliation. In the ASU, the FASB replaced the term “nonpublic entities” with “entities other than public business entities.” In addition, the ASU requires non-PBEs to qualitatively disclose the nature and effect of the specific categories of reconciling items and individual jurisdictions that result in a significant difference between the statutory tax rate and the effective tax rate. Consistent with existing guidance, a numerical reconciliation is not required.

Income taxes paid disclosures

Prior to adoption of the ASU, ASC 230-10-50-2 requires reporting entities to disclose the total amount of income taxes paid during the period.

For each annual period presented, the ASU requires all reporting entities to disclose the year-to-date amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign. It also requires additional disaggregated information on income taxes paid (net of refunds received) to an individual jurisdiction equal to or greater than 5% of total income taxes paid (net of refunds received). An entity may identify a country, state, or local territory as an individual jurisdiction.

The amount of income taxes paid required to be disclosed is the net amount paid or net refund received in the period, computed as total income taxes paid net of cash refunds received. When determining the jurisdictions for separate disclosure in accordance with ASC 740-10-50-23, an entity should apply the 5% quantitative threshold by comparing (1) the absolute value of the net payment or net refund *in each jurisdiction* with (2) the absolute value of total income taxes paid (net of refunds received).

Although the ASU requires disaggregation by jurisdiction for each annual period presented, it does not require disclosure of comparative information by jurisdiction for all years presented. For example, if an individual jurisdiction is over 5% for the current annual period but did not meet the quantitative threshold in the prior annual period, the income taxes paid for that jurisdiction in the prior annual period do not need to be disclosed currently. The same principle would apply for individual jurisdictions that met the quantitative threshold in the prior annual period but are under the threshold in the current annual period—only the amount related to the prior annual period needs to be presented.

Neither ASC 740 nor ASC 230 define what types of payments/refunds constitute “income taxes paid” for the supplemental disclosure requirement. We believe that this disclosure should generally include any cash payments for income taxes made directly to or received directly from the taxing authority. However, given the lack of explicit guidance, if payments

other than those made or received directly from the taxing authority for income taxes are included in the supplemental disclosure, reporting entities should consider a qualitative explanation of the amounts that are included.

The ASU does not prescribe a specific location for the income taxes paid disclosures. Given the potential for the disclosure of income taxes paid disaggregated by jurisdiction to be voluminous, we would expect that reporting entities may elect to include all of the supplemental disclosures of income taxes paid within the income tax footnote with the other income tax disclosures required under ASC 740.

Materiality

ASC 105-10-05-06 states that the provisions of the Codification need not be applied to immaterial items. Though this is longstanding guidance, the FASB received feedback from numerous stakeholders to clarify whether and how materiality should be considered under the new required disclosures. During a Board meeting, the FASB was clear that it does not intend to codify materiality guidance within any specific Topic as the materiality guidance provided by Topic 105 is applicable to all guidance in the Codification, including disclosures.

The Basis for Conclusions of this ASU explicitly indicates that an entity need not separately disclose (1) the required specific categories or reconciling items if they are immaterial, even if the quantitative threshold is met, or (2) income taxes paid for any jurisdiction (whether federal, state, or foreign groupings or individual jurisdictions are over 5%) if the amount is not material.

Amendments to other disclosures

The ASU requires that all reporting entities disclose the following information:

- Income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign, and

- Income tax expense (or benefit) from continuing operations disaggregated by federal (national), state, and foreign.

These requirements were codified in ASC 740 to align with existing SEC guidance in Regulation S-X 4-08(h).

The ASU removes the following existing disclosure requirements:

- The nature and estimate of the range of reasonably possible increases or decreases in the unrecognized tax benefits balance in the next 12 months, or to make a statement that an estimate of the range cannot be made (previously in ASC 740-10-50-15(d))

    - Removal of this disclosure was based on feedback on the earlier exposure drafts that the amount is difficult to reliably predict and therefore may not provide meaningful information to investors.

    - Reporting entities should continue to monitor whether disclosures are required under ASC 275, *Risks and Uncertainties*.

- The cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to undistributed earnings of subsidiaries and corporate joint ventures (previously in ASC 740-30-50-2(b))

    - Removal of this disclosure was based on feedback on the earlier exposure drafts that the disclosure is costly to prepare and significantly less relevant after considering the effects of the Tax Cuts and Jobs Act.

- Reporting entities should continue to disclose:
    - a description of the types of temporary differences for which deferred tax liabilities have not been recognized and the types of events that would cause those temporary differences to become taxable under ASC 740-30-50-2(a), and
    - the amount of the unrecognized deferred tax liabilities for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of those liabilities is practicable, or a statement that determination is not practicable under ASC 740-30-50-2(c).

Effective date and transition

For PBEs, ASU 2023-09 is effective for annual periods beginning after December 15, 2024. For non-PBEs, the ASU is effective for annual periods beginning after December 15, 2025. The guidance should be applied on a prospective basis with the option to apply the standard retrospectively. Early adoption is permitted.

Given the magnitude of changes to the tabular reconciliation as compared to the existing requirements, PBEs will need to consider how they will adopt the standard. Whether it is applied prospectively or retrospectively, the adoption of the ASU will necessitate consideration of the reporting entity's processes, systems, and controls around disclosures. The foreign tax effects category in particular expands significantly on existing disclosure for most reporting entities. PBEs may want to consider leveraging their 2023 data to develop their processes and controls. Additionally, as reporting entities consider the lack of comparability in the footnote if adopted prospectively, starting early will allow entities flexibility on their transition method.

To have a deeper discussion, contact:

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Appendix 1 - Illustrative example from the ASU

Rate reconciliation example

The following example in ASC 740-10-55-231 illustrates the rate reconciliation disclosure under the new standard.

EXAMPLE 1

Public business entity

The following illustrates the specific categories and the reconciling items disclosed by a public business entity in its tabular rate reconciliation in accordance with the final standard. The entity is domiciled in the United States and presents comparative financial statements. For the disclosure of foreign tax effects in accordance with the requirements, it is assumed that the 5 percent threshold, computed by multiplying the income (or loss) from continuing operations before income taxes by the applicable statutory federal (national) income tax rate of the United States, is met:

- For Ireland, both at the jurisdiction level and for certain individual reconciling items of the same nature within Ireland
- For the United Kingdom, for certain individual reconciling items of the same nature within the United Kingdom, but not at the jurisdiction level
- For Switzerland and Mexico, at the jurisdiction level, but not for any individual reconciling items of the same nature within each jurisdiction.

	Year Ended December 31, 20X2		Year Ended December 31, 20X1		Year Ended December 31, 20X0	
	Amount	Percent	Amount	Percent	Amount	Percent
U.S. Federal Statutory Tax Rate	$ AA	aa %	$ BB	bb %	$ CC	cc %
State and Local Income Taxes, Net of Federal Income Tax Effect [a]	AA	aa	BB	bb	CC	cc
Foreign Tax Effects						
United Kingdom						
Statutory tax rate difference between United Kingdom and United States	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Share-based payment awards	AA	aa	BB	bb	CC	cc
Research and development tax credits	(AA)	(aa)	(BB)	(bb)	CC	cc
Other	(AA)	(aa)	BB	bb	(CC)	(cc)
Ireland						
Statutory tax rate difference between Ireland and United States	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Changes in valuation allowances	(AA)	(aa)	(BB)	(bb)	CC	cc
Enacted changes in tax laws or rates	-	-	BB	bb	-	-
Other	AA	aa	(BB)	(bb)	(CC)	(cc)
Switzerland	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Mexico	AA	aa	BB	bb	CC	cc
Other foreign jurisdictions	(AA)	(aa)	(BB)	(bb)	CC	cc
Effect of Changes in Tax Laws or Rates Enacted in the Current Period	-	-	-	-	(CC)	(cc)
Effect of Cross-Border Tax Laws						
Global intangible low-taxed income	AA	aa	BB	bb	CC	cc
Foreign-derived intangible income	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Base erosion and anti-abuse tax	AA	aa	BB	bb	CC	cc
Other	AA	aa	-	-	-	-
Tax Credits						
Research and development tax credits	-	-	(BB)	(bb)	(CC)	(cc)
Energy-related tax credits	(AA)	(aa)	-	-	-	-
Other	-	-	(BB)	(bb)	-	-
Changes in Valuation Allowances	AA	aa	(BB)	(bb)	(CC)	(cc)
Nontaxable or Nondeductible Items						
Share-based payment awards	AA	aa	BB	bb	CC	cc
Goodwill impairment	AA	aa	BB	bb	-	-
Other	AA	aa	(BB)	(bb)	CC	cc
Changes in Unrecognized Tax Benefits	(AA)	(aa)	BB	bb	(CC)	(cc)
Other Adjustments	AA	aa	(BB)	(bb)	(CC)	(cc)
Effective Tax Rate	$ AA	aa %	$ BB	bb %	$ CC	cc %

[a] State taxes in California and New York made up the majority (greater than 50 percent) of the tax effect in this category.