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Ms. Hillary H. Salo
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File Reference No. 2023-ED100
Financial Accounting Standards Board
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Proposed Accounting Standards Update, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures* (File Reference No. 2023-ED100)

Dear Ms. Salo:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update (ASU or Update), *Income Taxes (Topic740): Improvements to Income Tax Disclosures*, issued by the Financial Accounting Standards Board (FASB or Board).

We generally support the Board's proposal to improve income tax disclosures. We note that the Board has received feedback from investors who requested more transparency about income tax information, and we commend the Board for focusing on disclosures regarding the income tax rate reconciliation and income taxes paid in response to those requests.

We support the FASB's proposal to incorporate income tax disclosures required by the Securities and Exchange Commission (SEC) into US GAAP. We encourage the FASB staff to work with the SEC staff to eliminate potential redundancies between the income tax disclosure requirements and Regulation S-X 4-08(h) once the guidance is finalized.

We support the proposal to remove the disclosures required by paragraphs 740-10-50-15(d), related to unrecognized tax benefits, and 740-30-50-2(b), regarding the cumulative amount of each type of unrecognized temporary difference. We also support the proposal to replace the term *public entity* in Accounting Standards Codification (ASC or Codification) 740 with the term *public business entity* (PBE) as defined in the Master Glossary of the Codification.

Our responses to the questions posed in the proposal are set out in Appendix A of this letter. In Appendix B, we provide recommendations to clarify parts of the proposed guidance.

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We would be pleased to discuss our comments with the FASB or its staff at your convenience.

Very truly yours,

Ernst & Young LLP

Appendix A — Responses to questions raised in the Proposed Accounting Standards Update, *Income Taxes (Topic740): Improvements to Income Tax Disclosures*

Question 1: The amendments in this proposed Update would require that public business entities disclose specific categories in the rate reconciliation, with further disaggregation of certain reconciling items (by nature and/or jurisdiction) that are equal to or greater than 5 percent of the amount computed by multiplying the income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate.

a. Should any of the proposed specific categories be eliminated or any categories added? Please explain why or why not.

b. Should incremental guidance be provided on how to categorize certain income tax effects in the proposed specific categories? If so, please describe the specific income tax effect and explain how it should be categorized and why.

c. Do you agree with the proposed 5 percent threshold? Please explain why or why not.

We believe the proposed categories are understandable and that entities can apply judgment to categorize items not specifically described. However, we believe that the Board should consider providing additional clarity related to the following items.

Proposed 5% threshold

We believe that a 5% threshold is appropriate because it would be consistent with the threshold SEC registrants already apply for disclosures required by Regulation S-X, Rule 4-08(h). However, we recommend that the final guidance require that the threshold apply to all of the categories listed in 740-10-50-12A(a) and all of the items for which further disaggregation is required by 740-10-50-12A(b), not just the items listed in 740-10-50-12A(b) subparagraphs 1 through 3.

Without this change, we are concerned that diversity in practice may arise in how practitioners apply general principles of materiality to disclose the categories. Our recommendation would also remove any potential ambiguity around the use of the term "reconciling item" when applying the threshold, since the term is commonly used to refer to items defined as categories in the proposed amendments.

If the Board decides not to revise the amendments to apply the 5% threshold at the category level, we recommend that it clarify in paragraph BC15 of the Background Information and Basis for Conclusions of the final ASU that the guidance in paragraph 105-10-05-6 applies to all categories in the rate reconciliation, not just to the reconciling items specified in 740-10-50-12A(b).

We also recommend that the Board make the following clarifications to proposed paragraph 740-10-50-12A(b):

> 740-10-50-12A(b) Separate disclosure shall be required for any reconciling item **included in the categories** listed below in which the effect of the reconciling item is equal to or greater than 5 percent of the amount computed by multiplying the income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate of the jurisdiction of domicile. When disaggregating the following reconciling items by nature, an entity should consider the reconciling item's ~~**fundamental or essential**~~ characteristics, such as the **tax law or transaction** ~~**event**~~ that caused the reconciling item and the activity with which the reconciling item is associated.

Foreign tax credits

We observe that the illustration in proposed paragraph 740-10-55-231 includes foreign tax credits granted by the country of domicile in the tax credits category. Since the proposed ASU does not specify where foreign tax credits should be categorized in the rate reconciliation, it is not clear whether the Board believes that this is the only acceptable category for foreign tax credits or whether other alternatives would be acceptable. If the Board believes that this is the only appropriate category for foreign tax credits, we recommend that it amend paragraph 740-10-50-12A(a)(5) to state, "[t]ax credits, including foreign tax credits." If the Board believes it would be acceptable to present foreign tax credits in other categories, we recommend that it clarify that entities should determine the appropriate classification of foreign tax credits based on their assessment of what would be most useful to users of their financial statements.

Changes in unrecognized tax benefits

The proposed guidance in paragraph 740-10-50-12A(c) indicates that the category *Changes in unrecognized tax benefits* relates to income taxes imposed by the jurisdiction of domicile. However, when an entity has recorded an uncertainty related to a tax position, it also reflects any ancillary effects the uncertain tax position has on taxes paid or accrued in other jurisdictions. It is unclear whether the FASB's intent is to have companies reflect the ancillary effects from the uncertainty from tax positions taken in the country of domicile in the *Changes in unrecognized tax benefits* category or reflect them in the *Foreign tax effects* or the *State and local income tax* categories. We recommend the Board consider clarifying where companies should present the ancillary effects for changes in unrecognized tax benefits in the rate reconciliation. Without clarity, we are concerned that diversity in practice may result on where this information is presented in the rate reconciliation.

Alternative minimum taxes

We believe that the rate reconciliation disclosure requirements should remain principles-based, and therefore, we do not believe that the Board should provide prescriptive guidance about specific tax legislation (e.g., the Inflation Reduction Act that created the new US corporate alternative minimum tax, laws other countries enact to implement the Organisation for Economic Co-operation and Development's Global Anti-Base Erosion (GloBE) model rules).

However, we believe that it would be helpful for the FASB to add a discussion to the Basis for Conclusions that says an entity should determine the classification of alternative minimum taxes based upon the terms and operation of a jurisdiction's alternative minimum tax regime. For example, in certain circumstances, an alternative minimum tax could be presented in a separate category, or in the categories of foreign tax effects or the effect of cross-border tax laws, depending upon the nature of the tax.

Question 2: The proposed amendments would require that public business entities provide a qualitative description of the state and local jurisdictions that contribute to the majority of the effect of the state and local income tax category. A qualitative description of state and local jurisdictions was selected over a quantitative disclosure because state and local tax provisions are often calculated for multiple jurisdictions using a single apportioned tax rate. Do you agree with the proposed qualitative disclosure as opposed to providing a quantitative disaggregation? Please explain why or why not.

We believe that the Board's basis for the proposed qualitative disclosures is clear, namely that many companies use blended apportionment rates for determining state and local tax expense (benefit). The proposed qualitative disclosure would provide users with additional information about state and local jurisdictions that have a significant impact on the rate reconciliation without requiring entities to incur the cost of providing additional disclosures about the effect on the rate reconciliation from individual state and local jurisdictions.

Question 3: The proposed amendments would require that public business entities provide an explanation, if not otherwise evident, of individual reconciling items in the rate reconciliation, such as the nature, effect, and significant year-over-year changes of the reconciling items. Do you agree with the proposed disclosure? Please explain why or why not.

We believe that the Board's basis for the proposed disclosures is clear.

Question 6: Are the proposed amendments to the rate reconciliation disclosure clear and operable? Please explain why or why not.

Refer to our response to question 1 above for suggested changes.

Question 7: The Board decided not to provide incremental guidance for the rate reconciliation disclosure for situations in which an entity operates at or around break even or an entity is domiciled in a jurisdiction with no or minimal statutory tax rate but has significant business activities in other jurisdictions with higher statutory tax rates. Do you agree with that decision? Please explain why or why not, and if not, what incremental guidance (including the relevant disclosures) would you recommend?

In practice today, public companies that operate at or around break even apply judgment when complying with the income tax disclosure requirements in Regulation S-X, Rule 4-08(h). We agree with the Board's decision not to provide incremental guidance.

Question 8: The proposed amendments would require that public business entities provide quantitative disclosure of the rate reconciliation on an annual basis and a qualitative description of any reconciling items that result in significant changes in the estimated annual effective tax rate from the effective tax rate of the prior annual reporting period on an interim basis. Do you agree with that proposed frequency? Please explain why or why not.

We believe the proposed frequency is a reasonable alternative. ASC 740-270-25-2 requires that tax expense (benefit) related to ordinary income (or loss) be computed using an estimated annual effective tax rate. Additionally, in most cases, ASC 740-270-30-36 requires an entity subject to income tax in multiple jurisdictions to use an overall worldwide consolidated estimated annual effective tax rate to determine the interim tax (benefit) for the year-to-date period. A requirement to provide detailed rate reconciliation information for interim periods would potentially be inconsistent with the use of an estimated annual effective rate.

Question 9: The proposed amendments would require that all entities disclose the amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign taxes, on an annual and interim basis, with further disaggregation on an annual basis by individual jurisdictions in which income taxes paid (net of refunds received) is equal to or greater than 5 percent of total income taxes paid (net of refunds received). Do you agree with the proposed 5 percent threshold? Please explain why or why not. Do you agree that income taxes paid should be disclosed as the amount net of refunds received, rather than as the gross amount? Please explain why or why not.

We believe that the proposed threshold is reasonable. We agree that the amount disclosed should be net of refunds as we understand this is consistent with how companies record payments and refunds made to the taxing jurisdiction.

Question 13: The proposed amendments would require that all entities disclose (a) income taxes paid disaggregated by federal (national), state, and foreign taxes on an interim and annual basis and (b) income taxes paid disaggregated by jurisdiction on an annual basis. Do you agree with that proposed frequency? Please explain why or why not.

We agree that the proposed frequency is appropriate. However, differences between the timing of tax payments and refunds in various jurisdictions (and which fiscal year payments and refunds relate to) may reduce the usefulness of the proposed disclosures.

Question 15: Are those proposed amendments for entities other than public business entities clear and operable? Please explain why or why not.

We believe that the proposed amendments for entities other than public business entities are clear and operable.

Question 17: In evaluating the effective date, how much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Should early adoption be permitted? Please explain your response.

We defer to preparers about how much time would be needed to implement the proposed amendments. However, we believe the FASB should consider giving entities that are PBEs but aren't considered public entities under ASC 740 today more time to implement any final guidance (e.g., in line with the timeline for other than public business entities).

We are concerned that the FASB's proposal to use the term PBE may make implementation more complex and challenging for these entities because they would have to provide many more disclosures than they do today. These entities include:

- Entities whose financial statements are included in a registrant's SEC filing because they are significant acquirees under Rule 3-05 of Regulation S-X
- Equity method investees under Rule 3-09 of Regulation S-X
- Equity method investees whose summarized financial information is included in a registrant's SEC filing under Rule 4-08(g) of Regulation S-X
- Certain financial institutions that are required by the Exchange Act to file financial statements with the Federal Deposit Insurance Corporation, the Federal Reserve or the Office of the Comptroller of the Currency but not the SEC
- Certain insurance companies that file financial statements with state insurance regulators but not the SEC

We defer to investors and preparers with respect to questions directed at those stakeholders (i.e., questions 4, 5, 6, 10, 11, 12, 14 and 16).

Appendix B — Other comments

We understand the Board's basis to remove the disclosure required by paragraph 740-30-50-2(b). We recommend that the Board also consider removing the disclosure required by paragraph 740-30-50-2(c) for reasons similar to those noted in BC36. That is, after the enactment of the Tax Cuts and Jobs Act, disclosure of the amount of deferred tax liabilities of foreign subsidiaries not recognized is less relevant since the law generally allows entities to repatriate earnings from foreign subsidiaries without incurring US federal income taxes. Therefore, the Board should consider not only removing the requirement to disclose the amount of temporary difference for which a deferred tax liability is not recognized but also the amount of the deferred tax liability as required in 740-30-50-2(c).

We also suggest removing the requirement in 740-30-50-2(d) to disclose amounts of deferred tax liabilities for temporary differences for undistributed domestic earnings (i.e., deferred tax liabilities that don't relate to those described in 740-30-50-2(c)).

This requirement relates to disclosure of deferred tax liabilities not recorded that would result from temporary differences of domestic subsidiaries or domestic corporate joint ventures that arose in fiscal years beginning on or before 15 December 1992 in accordance with 740-10-25-3(a)(2). Limiting the disclosure requirement to the qualitative language in 740-30-50-2(a), relative to all temporary differences for which a deferred tax liability has not been recognized due to one of the exceptions, would provide a meaningful indication of possible future tax consequences.

In addition, we recommend that the following wording changes (in bold and underscored) to clarify the proposed guidance:

740-10-50-11A The objective of these disclosure requirements is for an entity, particularly an entity operating in multiple jurisdictions, to disclose sufficient information to enable users of financial statements to understand the nature and magnitude of factors contributing to the difference between **its** effective tax rate and the statutory tax rate **in its country of domicile**.

740-10-50-12 A public business entity shall disclose a reconciliation, in accordance with paragraphs 740-10-50-12A through 50-12C, between the amount of reported income tax expense (or benefit) from continuing operations and the amount computed by multiplying the income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate of the jurisdiction of domicile. If a public business entity, as the parent entity, is not domiciled in the United States, the **applicable statutory** federal (national) income tax rate in that entity's jurisdiction of domicile shall be used in making the computation.

We also recommend the following change to clarify ASC 740-10-50-12A(c). Because the rate reconciliation presents the difference between the reported income tax expense/benefit in a foreign jurisdiction and an amount that would result from using the reporting entity's statutory tax rate, the proposed language may not be clear. Further, the words "income taxes imposed by" the jurisdiction could be interpreted to mean the amount of the current tax payable for the period rather than the GAAP income tax expense/benefit amount reported in the financial statements. Since the "remaining categories listed" include a category for valuation allowances, we also suggest revising the proposed language to include that category as it is not imposed by a jurisdiction.

740-10-50-12A(c) For the purpose of categorizing reconciling items, the state and local income tax category reflects income tax~~es imposed~~ **expense (benefit)** at the state or local level within the jurisdiction (country) of domicile **(net of federal (national) income tax effect),** the foreign tax effects category reflects **the rate differential from** income tax~~es imposed~~ **expense (benefit) of the** ~~by~~ foreign jurisdictions, and the remaining categories listed in (a) reflect **the rate differential from the effect of** federal (national) income tax~~es imposed~~ **expense (benefits) provided** by the jurisdiction (country) of domicile **and the effect of changes in a valuation allowance related to deferred tax assets for temporary differences in the jurisdiction of domicile**.