

# Defining Issues<sup>®</sup>

KPMG LLP (US)



## Alert

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## Accounting for Income Taxes

The FASB decided, during a joint meeting with the IASB, to retain Statement 109's exception to recognizing deferred taxes on investments in foreign subsidiaries.<sup>1</sup> The decision will alleviate widespread concern that the exception would be eliminated, which would have significantly increased deferred tax liabilities and the complexity of deferred tax calculations.

The IASB at the same meeting tentatively decided to amend IAS 12's provisions on unremitted foreign earnings to make them similar to the requirements in Statement 109 and Opinion 23.<sup>2</sup> The staffs of the two Boards will develop recommendations to reduce differences between U.S. and international disclosure requirements pertaining to the unremitted foreign earnings exception.

The exception to recognizing deferred taxes on investments in foreign subsidiaries limits the amounts of deferred tax liabilities and deferred income-tax expense that must be recognized. More specifically, companies do not recognize a deferred tax liability on the excess of the financial-statement carrying amount over the tax basis of an investment in a foreign subsidiary or foreign corporate joint venture that is essentially permanent. However, the deferred tax liability is recognized when it becomes apparent that the differences will reverse in the foreseeable future. Opinion 23 contains additional guidance on applying the indefinite reversal criterion.

### Tax Uncertainties

The FASB continues to work on its project to issue a proposed Interpretation of Statement 109 on accounting for uncertain tax positions. The proposal will address situations in which the taxing authority's position might differ from the position an entity takes on its tax return. A draft of the Interpretation is expected to be exposed for public comment in the fourth quarter of 2004.

<sup>1</sup> FASB Statement No. 109, Accounting for Income Taxes, February 1992.

<sup>2</sup> IASB, International Accounting Standard No. 12, Income Taxes; APB Opinion 23, Accounting for Income Taxes – Special Areas, April 1972.



### **New Tax Law**

Corporate accounting for income taxes will be affected by the American Jobs Creation Act of 2004, signed into law today by President Bush. The new law allows domestic entities to repatriate foreign earnings at a reduced rate, subject to certain limitations. The law's incentive to repatriate foreign earnings will affect evaluations of whether some or all of those earnings qualify for Statement 109's exception from recognizing deferred tax liabilities. Companies with foreign operations will need to evaluate how the change in the tax law affects whether some or all of their foreign earnings will be indefinitely reinvested in the foreign tax jurisdiction.

Other provisions of the new tax law could also affect financial-statement tax expense. For example, the law repeals an export tax benefit for U.S.-based manufacturing activities and grants a special deduction that, depending on the circumstances, could reduce the effective tax rate. We understand that the FASB plans to issue a Staff Position to address whether the tax effect of the special deduction should be recognized only as amounts are deducted on the tax return or treated as a change in tax rates with adjustments to deferred tax assets and liabilities.

The descriptive and summary statements in this presentation are not intended to substitute for the text of what the FASB or IASB might ultimately adopt as accounting requirements or for the text of the American Jobs Creation Act of 2004. Reporting entities complying with any FASB or IASB requirements and with tax legislation should apply the texts of the adopted final requirements and law, consider their particular circumstances, and consult their accounting and legal advisors.

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