FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2019-12
December 2019

Income Taxes (Topic 740)

Simplifying the Accounting for Income Taxes

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing this Update as part of its initiative to reduce complexity in accounting standards (the Simplification Initiative). The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. The specific areas of potential simplification in this Update were submitted by stakeholders as part of the Simplification Initiative.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect entities within the scope of Topic 740, Income Taxes.

What Are the Main Provisions?

The amendments in this Update simplify the accounting for income taxes by removing the following exceptions:

1. Exception to the incremental approach for intraperiod tax allocation when there is a loss from continuing operations and income or a gain from other items (for example, discontinued operations or other comprehensive income)
2. Exception to the requirement to recognize a deferred tax liability for equity method investments when a foreign subsidiary becomes an equity method investment
3. Exception to the ability not to recognize a deferred tax liability for a foreign subsidiary when a foreign equity method investment becomes a subsidiary
4. Exception to the general methodology for calculating income taxes in an interim period when a year-to-date loss exceeds the anticipated loss for the year.

The amendments in this Update also simplify the accounting for income taxes by doing the following:

1. Requiring that an entity recognize a franchise tax (or similar tax) that is partially based on income as an income-based tax and account for any incremental amount incurred as a non-income-based tax.

2. Requiring that an entity evaluate when a step up in the tax basis of goodwill should be considered part of the business combination in which the book goodwill was originally recognized and when it should be considered a separate transaction.
3. Specifying that an entity is not required to allocate the consolidated amount of current and deferred tax expense to a legal entity that is not subject to tax in its separate financial statements. However, an entity may elect to do so (on an entity-by-entity basis) for a legal entity that is both not subject to tax and disregarded by the taxing authority.
4. Requiring that an entity reflect the effect of an enacted change in tax laws or rates in the annual effective tax rate computation in the interim period that includes the enactment date.
5. Making minor Codification improvements for income taxes related to employee stock ownership plans and investments in qualified affordable housing projects accounted for using the equity method.

How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments in this Update simplify the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance.

When Will the Amendments Be Effective and What Are the Transition Requirements?

For public business entities, the amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Early adoption of the amendments is permitted, including adoption in any interim period for (1) public business entities for periods for which financial statements have not yet been issued and (2) all other entities for periods for which financial statements have not yet been made available for issuance. An entity that elects to early adopt the amendments in an interim period should reflect any adjustments as of the beginning of the annual period that includes that interim period. Additionally, an entity that elects early adoption must adopt all the amendments in the same period.

The amendments in this Update related to separate financial statements of legal entities that are not subject to tax should be applied on a retrospective basis for all periods presented. The amendments related to changes in ownership of foreign equity method investments or foreign subsidiaries should be applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. The amendments related to franchise taxes that are partially based on income should be applied on either a retrospective basis for all periods presented or a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. All other amendments should be applied on a prospective basis.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–23. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendment to Master Glossary

2. Supersede the Master Glossary term *Tax Consequences* from Subtopic 740-20 as follows:

~~**Tax Consequences**~~

~~The effects on income taxes—current or deferred—of an event.~~

Amendments to Subtopic 740-10

3. Amend paragraph 740-10-15-4, with a link to transition paragraph 740-10-65-8, as follows:

Income Taxes—Overall

Scope and Scope Exceptions

> Transactions

740-10-15-4 The guidance in this Topic does not apply to the following transactions and activities:

a. A franchise tax <u>(or similar tax)</u> to the extent it is based on capital <u>or a non-income-based amount</u> and there is no ~~additional~~<u>portion of the</u> tax based on income. ~~If there is an additional tax based on income, that excess is considered an income tax and is subject to the guidance in this Topic.~~<u>If a franchise tax (or similar tax) is partially based on income (for example, an entity pays the greater of an income-based tax and a non-income-based</u>

tax), deferred tax assets and liabilities shall be recognized and accounted for in accordance with this Topic. Deferred tax assets and liabilities shall be measured using the applicable statutory income tax rate. An entity shall not consider the effect of potentially paying a non-income-based tax in future years when evaluating the realizability of its deferred tax assets. The amount of current tax expense equal to the amount that is based on income shall be accounted for in accordance with this Topic, with any incremental amount incurred accounted for as a non-income-based tax. See Example 17 (paragraph 740-10-55-139) for an example of how to apply this guidance~~the determination of whether a franchise tax is an income tax~~.

b. A withholding tax for the benefit of the recipients of a dividend. A tax that is assessed on an entity based on dividends distributed is, in effect, a withholding tax for the benefit of recipients of the dividend and is not an income tax if both of the following conditions are met:
    1. The tax is payable by the entity if and only if a dividend is distributed to shareholders. The tax does not reduce future income taxes the entity would otherwise pay.
    2. Shareholders receiving the dividend are entitled to a tax credit at least equal to the tax paid by the entity and that credit is realizable either as a refund or as a reduction of taxes otherwise due, regardless of the tax status of the shareholders.

See the guidance in paragraphs 740-10-55-72 through 55-74 dealing with determining whether a payment made to a taxing authority based on dividends distributed is an income tax.

4. Amend paragraph 740-10-25-54, with a link to transition paragraph 740-10-65-8, as follows:

Recognition

> Transactions Directly between a Taxpayer and a Government

740-10-25-53 Transactions directly between a taxpayer and a government (in its capacity as a taxing authority) shall be recorded directly in income (in a manner similar to the way in which an entity accounts for changes in tax laws, rates, or other tax elections under this Subtopic). (See Example 26 [paragraph 740-10-55-202] for an illustration of a transaction directly with a governmental taxing authority.)

740-10-25-54 An entity shall determine whether a step up in the tax basis of goodwill relates to the business combination in which the book goodwill was originally recognized or whether it relates to a separate transaction. In situations in which the tax basis step up relates to the business combination in which the book goodwill was originally recognized~~that was previously not deductible~~, no deferred tax asset would be recorded for the increase in basis except to the extent that the newly deductible goodwill amount exceeds the remaining balance of book goodwill. In situations in which the tax basis step up relates to a separate transaction, a deferred tax asset would be recorded for the entire amount of the newly created tax goodwill in accordance with this Subtopic. Factors that may indicate that the step up in tax basis relates to a separate transaction include, but are not limited to, the following:

a. A significant lapse in time between the transactions has occurred.
b. The tax basis in the newly created goodwill is not the direct result of settlement of liabilities recorded in connection with the acquisition.
c. The step up in tax basis is based on a valuation of the goodwill or the business that was performed as of a date after the business combination.
d. The transaction resulting in the step up in tax basis requires more than a simple tax election.
e. The entity incurs a cash tax cost or sacrifices existing tax attributes to achieve the step up in tax basis.
f. The transaction resulting in the step up in tax basis was not contemplated at the time of the business combination.

5. Add paragraph 740-10-30-27A, with a link to transition paragraph 740-10-65-8, as follows:

Initial Measurement

> Allocation of Consolidated Tax Expense to Separate Financial Statements of Members

740-10-30-27 The consolidated amount of current and deferred tax expense for a group that files a consolidated tax return shall be allocated among the members of the group when those members issue separate financial statements. This Subtopic does not require a single allocation method. The method adopted, however, shall be systematic, rational, and consistent with the broad principles established by this Subtopic. A method that allocates current and deferred taxes to members of the group by applying this Topic to each member as if it were a separate taxpayer meets those criteria. In that situation, the sum of the amounts allocated to individual members of the group may not equal the consolidated amount. That may also be the result when there are intra-entity transactions between members of the group. The criteria are satisfied, nevertheless, after giving effect to the type of adjustments (including eliminations) normally present in preparing consolidated financial statements.

740-10-30-27A An entity is not required to allocate the consolidated amount of current and deferred tax expense to legal entities that are not subject to tax. However, an entity may elect to allocate the consolidated amount of current and deferred tax expense to legal entities that are both not subject to tax and disregarded by the taxing authority (for example, disregarded entities such as single-member limited liability companies). The election is not required for all members of a group that files a consolidated tax return; that is, the election may be made for individual members of the group that files a consolidated tax return. An entity shall not make the election to allocate the consolidated amount of current and deferred tax expense for legal entities that are partnerships or are other pass-through entities that are not wholly owned.

6. Add paragraph 740-10-50-17A, with a link to transition paragraph 740-10-65-8, as follows:

Disclosure

> Entities with Separately Issued Financial Statements That Are Members of a Consolidated Tax Return

740-10-50-17 An entity that is a member of a group that files a consolidated tax return shall disclose in its separately issued financial statements:

a. The aggregate amount of current and deferred tax expense for each statement of earnings presented and the amount of any tax-related balances due to or from affiliates as of the date of each statement of financial position presented
b. The principal provisions of the method by which the consolidated amount of current and deferred tax expense is allocated to members of the group and the nature and effect of any changes in that method (and in determining related balances to or from affiliates) during the years for which the above disclosures are presented.

740-10-50-17A An entity that is both not subject to tax and disregarded by the taxing authority that elects to include the allocated amount of current and deferred tax expense in its separately issued financial statements in accordance with paragraph 740-10-30-27A shall disclose that fact and provide the disclosures required by paragraph 740-10-50-17.

7. Amend paragraphs 740-10-55-26 and 740-10-55-139 through 55-144, with a link to transition paragraph 740-10-65-8, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Application of Accounting Requirements for Income Taxes to Specific Situations

> > > Measurement of Deferred Tax Liabilities and Assets

> > > > State and Local Income Taxes

740-10-55-26 Local (including franchise) taxes based on income are within the scope of this Topic. A tax, to the extent it is based on capital, is a ~~franchise~~non-income-based tax. As indicated in paragraph 740-10-15-4(a), if there is an ~~additional tax~~amount of a franchise tax based on income, that ~~excess~~amount is considered an income tax. Any additional amount incurred is considered a non-income-based tax. An~~A historical~~ example that illustrates this guidance is presented in Example 17 (see paragraph 740-10-55-139).

> Illustrations

> > Example 17: Determining Whether a Tax Is an Income Tax

740-10-55-139 The guidance in paragraph 740-10-55-26 addressing when a tax is an income tax is illustrated using the following ~~historical~~ example.

740-10-55-140 ~~In August 1991, a state amended its franchise tax statute to include a tax on income apportioned to the state based on the federal tax return. The new tax was effective January 1, 1992. The amount of~~A state's franchise tax on each corporation is~~was~~ set at the greater of 0.25 percent of the corporation's net taxable capital and 4.5 percent of the corporation's net taxable earned surplus. Net taxable earned surplus is~~was~~ a term defined by the tax statute for federal taxable income.

740-10-55-141 In this Example, the ~~total computed tax is an income tax only to the extent that the tax exceeds the capital-based tax in a given year~~amount of franchise tax equal to the tax on the corporation's net taxable earned surplus is an income tax.

740-10-55-142 ~~A deferred tax liability is~~Deferred tax assets and liabilities are required to be recognized under this Subtopic for the ~~amount by which the income-based tax payable on net reversing~~ temporary differences that exist as of the date of the statement of financial position using the tax rate to be applied to the corporation's net taxable earned surplus (4.5 percent)~~in each future year exceeds the capital-based tax computed for each future year based on the level of capital that exists as of the end of the year for which deferred taxes are being computed~~.

740-10-55-143 The portion of the ~~current tax liability based on income is required to be accrued with a charge to income~~total computed franchise tax that exceeds the amount equal to the tax on the corporation's net taxable earned surplus should not be presented as a component of income tax expense during ~~the~~any period in which the total computed franchise tax exceeds the amount equal to the tax on the corporation's net taxable earned surplus.~~income is earned. The portion of the deferred tax liability related to temporary differences is required to be recognized as of the date of the statement of financial position for temporary differences that exist as of the date of the statement of financial position.~~

740-10-55-144 ~~Because the state tax is an income tax only to the extent that the tax exceeds the capital-based tax in a given year, under the requirements of this Subtopic, deferred taxes are recognized for temporary differences that will reverse in future years for which annual taxable income is expected to exceed 5.5% (.25% of net taxable capital/4.5% of taxable income) of expected net taxable capital. In measuring deferred taxes, see paragraph 740-10-55-138 to determine whether a detailed analysis of the net reversals of temporary differences in each future year is warranted.~~ While the tax statutes of states or other jurisdictions differ, the accounting described in paragraphs 740-10-55-140 through 55-143~~above~~ would be appropriate if the tax structure of another state or jurisdiction was essentially the same as in this Example.

8. Add paragraph 740-10-65-8 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*

740-10-65-8 The following represents the transition and effective date information related to Accounting Standards Update No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes:*

a. The pending content that links to this paragraph shall be effective as follows:
   1. For **public business entities,** for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years.
   2. For all other entities, for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022.
b. Early adoption of the pending content that links to this paragraph is permitted for:
   1. Public business entities for periods for which financial statements have not yet been issued.
   2. All other entities for periods for which financial statements have not yet been made available for issuance.
c. An entity that elects early adoption of the pending content that links to this paragraph in an interim period shall reflect any adjustments as of the beginning of the annual period that includes that interim period. Additionally, an entity that elects early adoption shall adopt all the pending content that links to this paragraph in the same period.

d. An entity shall apply the pending content that links to this paragraph as follows:
   1. On a retrospective basis for all periods presented for the pending content that links to this paragraph related to the separate financial statements of legal entities that are both not subject to tax and disregarded by the taxing authority. Retrospective application is required only within the separate financial statements of those entities for which the election in the pending content that links to this paragraph is made.
   2. On a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption of the pending content that links to this paragraph related to changes in ownership of foreign equity method investments or foreign subsidiaries.
   3. On a retrospective basis for all periods presented or a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption of the pending content that links to this paragraph related to franchise taxes that are partially based on income.
   4. On a prospective basis for all other pending content that links to this paragraph.

e. An entity shall disclose the following in the first fiscal year after the entity's adoption date and in the interim periods within the first fiscal year:
   1. The nature of and reason for the change in accounting principle.
   2. The transition method.
   3. A qualitative description of the financial statement line items affected by the change.

Amendments to Subtopic 740-20

9. Amend paragraph 740-20-45-7, with a link to transition paragraph 740-10-65-8, as follows:

Income Taxes—Intraperiod Tax Allocation

Other Presentation Matters

> Allocation to Continuing Operations

740-20-45-7 The tax effect of pretax income or loss from continuing operations ~~generally~~ should be determined by a computation that does not consider the tax effects of items that are not included in continuing operations. ~~The exception to that incremental approach is that all items (for example, discontinued operations,~~

~~other comprehensive income, and so forth) be considered in determining the amount of tax benefit that results from a loss from continuing operations and that shall be allocated to continuing operations. That modification of the incremental approach is to be consistent with the approach in Subtopic 740-10 to consider the **tax consequences** of **taxable income** expected in future years in assessing the realizability of deferred tax assets. Application of this modification makes it appropriate to consider a gain on discontinued operations in the current year for purposes of allocating a tax benefit to a current-year loss from continuing operations.~~

10. Amend paragraphs 740-20-55-10 through 55-12 and their related heading and 740-20-55-14 and add paragraphs 740-20-55-12A through 55-12C and their related heading, with a link to transition paragraph 740-10-65-8, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 2: Allocations of Income Taxes to Continuing Operations and One Other Item

> > > Case A: Loss from Continuing Operations with a Gain on Discontinued Operations <u>(Tax Benefit Realizable)</u>

740-20-55-10 This Case illustrates allocation of income tax expense if there is only one item other than income from continuing operations. The assumptions are as follows:

a. The entity's pretax financial income and **taxable income** are the same.
b. The entity's ordinary loss from continuing operations is $500.
c. The entity also has a gain on discontinued operations of $900 that is a capital gain for tax purposes.
d. The tax rate is 40 percent on ordinary income and 30 percent on capital gains. **Income taxes currently payable** are $120 ($400 at 30 percent).
<u>e. The entity has determined that the deferred tax asset that would have resulted from the loss from continuing operations if the gain on discontinued operations had not occurred would be expected to be realized (that is, a **valuation allowance** would not have been needed).</u>

740-20-55-11 Income tax expense is allocated between the pretax loss from operations and the gain on discontinued operations as follows.

Total income tax expense		$ 120
Tax benefit allocated to the loss from operations	~~(150)~~	(200)
Incremental tax expense allocated to the gain on discontinued operations	~~$270~~	$ 320

740-20-55-12 The effect of the $500 loss from continuing operations was to offset an equal amount of capital gains that otherwise would be taxed at a 30 percent tax rate. However, the guidance in paragraph 740-20-45-7 requires that an entity determine the tax effects of pretax income from continuing operations by a computation that does not consider the tax effects of items that are not included in continuing operations. The entity has determined that, absent the capital gain from discontinued operations, a valuation allowance would not have been needed on the deferred tax asset resulting from the $500 loss from continuing operations. Thus, $200 ($500 at 40 percent)~~$150 ($500 at 30 percent)~~ of tax benefit is allocated to continuing operations. The ~~$270~~$320 incremental effect of the gain on discontinued operations is the difference between $120 of total tax expense and the ~~$150~~$200 tax benefit ~~from~~allocated to continuing operations.

> > > Case A1: Loss from Continuing Operations with a Gain on Discontinued Operations (Tax Benefit Not Realizable)

740-20-55-12A This Case illustrates allocation of income tax expense if there is only one item other than income from continuing operations. The assumptions are the same as in Case A except that the entity has determined that the deferred tax asset that would have resulted from the loss from continuing operations if the gain on discontinued operations had not occurred would not be expected to be realized (that is, a valuation allowance would have been needed).

740-20-55-12B Income tax expense is allocated between the pretax loss from operations and the gain on discontinued operations as follows.

Total income tax expense	$ 120
Tax benefit allocated to the loss from operations	-
Incremental tax expense allocated to the gain on discontinued operations	$ 120

740-20-55-12C The effect of the $500 loss from continuing operations was to offset an equal amount of capital gains that otherwise would be taxed at a 30 percent tax rate. However, the guidance in paragraph 740-20-45-7 requires that an entity determine the tax effects of pretax income from continuing operations by a computation that does not consider the tax effects of items that are not included in continuing operations. The entity has determined that, absent the capital gain from discontinued operations, a valuation allowance would have been needed on the deferred tax asset resulting from the $500 loss from continuing operations. Thus, zero tax benefit is allocated to continuing operations. The $120 incremental income tax expense related to the gain on discontinued operations is the difference between $120 of total tax expense and the zero tax benefit allocated to continuing operations.

> > > Case B: Income from Continuing Operations with a Loss from Discontinued Operations

740-20-55-13 This Case further illustrates the general requirement to determine the tax effects of pretax income from continuing operations by a computation that does not consider the tax effects of items that are not included in continuing operations.

740-20-55-14 To illustrate, assume that in the current year an entity has $1,000 of income from continuing operations and a $1,000 loss from discontinued operations. At the beginning of the year, the entity has a $2,000 net operating loss carryforward for which the deferred tax asset, net of its **{remove glossary link}valuation allowance{remove glossary link}**, is zero, and the entity did not reduce that valuation allowance during the year. No tax expense should be allocated to income from continuing operations because the $2,000 loss carryforward is sufficient to offset that income. Thus, no tax benefit is allocated to the loss from discontinued operations. ~~See paragraph 740-20-45-7 for the exception to the general requirement when an entity has a loss from continuing operations.~~

Amendments to Subtopic 740-30

11. Amend paragraph 740-30-25-15 and supersede paragraph 740-30-25-16, with a link to transition paragraph 740-10-65-8, as follows:

Income Taxes—Other Considerations or Special Areas

Recognition

> > Ownership Changes in Investments

740-30-25-15 An investment in common stock of a subsidiary may change so that it is no longer a subsidiary because the parent entity sells a portion of the investment, the subsidiary sells additional stock, or other transactions affect the investment. ~~If the remaining investment in common stock shall be accounted for by the equity method, the investor shall recognize income taxes on its share of~~

~~current earnings of the investee entity in accordance with the provisions of Subtopic 740-10.~~ If a parent entity did not recognize income taxes on its equity in undistributed earnings of a subsidiary for the reasons cited in paragraph 740-30-25-17 (and the entity in which the investment is held ceases to be a subsidiary), it shall accrue ~~as a~~in the current period ~~expense~~ income taxes on the temporary difference related to its remaining investment in common stock in accordance with the guidance in Subtopic 740-10.~~undistributed earnings in the period that it becomes apparent that any of those undistributed earnings (prior to the change in status) will be remitted. The change in the status of an investment would not by itself mean that remittance of these undistributed earnings shall be considered apparent. If a parent entity recognizes a deferred tax liability for the temporary difference arising from its equity in undistributed earnings of a subsidiary and subsequently reduces its investment in the subsidiary through a taxable sale or other transaction, the amount of the temporary difference and the related deferred tax liability will change.~~

740-30-25-16 Paragraph superseded by Accounting Standards Update No. 2019-12.~~An investment in common stock of an investee (other than a subsidiary or corporate joint venture) may change so that the investee becomes a subsidiary because the investor acquires additional common stock, the investee acquires or retires common stock, or other transactions affect the investment. A temporary difference for the investor's share of the undistributed earnings of the investee prior to the date it becomes a subsidiary shall continue to be treated as a temporary difference for which a deferred tax liability shall continue to be recognized to the extent that dividends from the subsidiary do not exceed the parent entity's share of the subsidiary's earnings subsequent to the date it became a subsidiary.~~

12. Amend paragraph 740-30-45-3, with a link to transition paragraph 740-10-65-8, as follows:

Other Presentation Matters

> Undistributed Earnings of Subsidiaries and Corporate Joint Ventures

740-30-45-3 If a parent entity did not recognize income taxes on its equity in undistributed earnings of a subsidiary for the reasons cited in paragraph 740-30-25-17 and the entity in which the investment is held ceases to be a subsidiary, paragraph 740-30-25-15 requires that it shall accrue ~~as a~~in the current period ~~expense~~ income taxes on the temporary difference related to its remaining investment in common stock in accordance with the guidance in Subtopic 740-10~~undistributed earnings in the period that it becomes apparent that any of those undistributed earnings prior to the change in status will be remitted~~.

Amendments to Subtopic 740-270

13. Amend paragraph 740-270-25-5, with a link to transition paragraph 740-10-65-8, as follows:

Income Taxes—Interim Reporting

Recognition

> General Recognition Approach

740-270-25-5 The effects of new tax legislation shall not be recognized prior to enactment. The tax effect of a change in tax laws or rates on taxes currently payable or refundable for the current year shall be ~~recorded after the effective dates prescribed in the statutes and~~ reflected in the computation of the annual effective tax rate beginning ~~no earlier than~~<u>in</u> the first interim period that includes the enactment date of the new legislation. The effect of a change in tax laws or rates on a **deferred tax liability** or asset shall not be apportioned among interim periods through an adjustment of the annual effective tax rate.

14. Amend paragraphs 740-270-30-11, 740-270-30-28, and 740-270-30-34, with a link to transition paragraph 740-10-65-8, as follows:

Initial Measurement

> Exclusion of Items from Estimated Annual Effective Tax Rate

> > Items Always Excluded from Estimated Annual Effective Tax Rate

740-270-30-11 The effects of changes in judgment about beginning-of-year valuation allowances and effects of changes in tax laws or rates <u>on deferred tax assets or liabilities and taxes payable or refundable for prior years (in the case of a retroactive change)</u> shall be excluded from the estimated annual effective tax rate calculation. ~~See paragraph 740-270-25-5 for requirements related to when the estimated annual effective tax rate shall be adjusted to reflect changes in tax laws and rates that affect current year taxes payable or refundable.~~

> Effect of Operating Losses

> > Year-to-Date Ordinary Loss; Anticipated Ordinary Loss for the Year

740-270-30-28 If an entity has an ordinary loss for the year to date at the end of an interim period and anticipates an ordinary loss for the fiscal year, the interim period tax benefit shall be computed in accordance with paragraph 740-270-30-5. The estimated tax benefit for the fiscal year, used to determine the estimated annual effective tax rate described in paragraphs 740-270-30-6 through 30-8, shall not exceed the tax benefit determined in accordance with paragraphs 740-270-30-30 through 30-33.~~ In addition to that limitation in the effective rate computation, if the year-to-date ordinary loss exceeds the anticipated ordinary loss for the fiscal year, the tax benefit recognized for the year to date shall not exceed the tax benefit determined, based on the year-to-date ordinary loss, in accordance with paragraphs 740-270-30-30 through 30-33.~~

> Determining Income Tax Benefit Limitations

740-270-30-34 See Example 2, Cases A1 and A2; B~~, C1~~; and C1 and C2 (paragraphs 740-270-55-15 through 55-17~~; 740-270-55-17;~~ and 740-270-55-19 through 55-20) for illustrations of computations involving operating losses, and Example 1, Cases B2 and B3 (see paragraphs 740-270-55-7 through 55-8)~~, and Example 2, Case A2 (see paragraph 740-270-55-16)~~ for illustrations of special year-to-date limitation computations.

15. Amend paragraphs 740-270-55-16, 740-270-55-44 through 55-45 and the related heading, and 740-270-55-49 and supersede paragraphs 740-270-55-50 through 55-51 and their related heading, with a link to transition paragraph 740-10-65-8, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 2: Accounting for Income Taxes Applicable to Ordinary Income (or Loss) at an Interim Date If an Ordinary Loss Is Anticipated for the Fiscal Year

> > > Case A: Realization of the Tax Benefit of the Loss Is More Likely Than Not

> > > > Case A2: Ordinary Income and Losses in Interim Periods

740-270-55-16 The entity has ordinary income and losses in interim periods and for the year to date. The full tax benefit of the anticipated ordinary loss and the anticipated tax credits will be realized by carryback. The full tax benefit of the maximum year-to-date ordinary loss can also be realized by carryback. Quarterly tax computations are as follows.

	Ordinary Income (Loss)			Tax (or Benefit)					
				~~Year-to-Date~~					
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	~~Computed~~ Year-to-Date	~~Limited to~~		Less Previously Provided		Reporting Period
First quarter	$ 20,000	$ 20,000	60%	$ 12,000			$ -		$ 12,000
Second quarter	(80,000)	(60,000)	60%	(36,000)			12,000		(48,000)
Third quarter	(80,000)	(140,000)	60%	(84,000)	~~$ (80,000) (a)~~		(36,000)	~~(44,000)~~	(48,000)
Fourth quarter	40,000	(100,000)	60%	(60,000)		~~(80,000)~~	(84,000)	~~20,000~~	24,000
Fiscal year	$ (100,000)								$ (60,000)

(a) Footnote superseded by Accounting Standards Update No. 2019-XX. ~~Because the year-to-date ordinary loss exceeds the anticipated ordinary loss for the fiscal year, the tax benefit recognized for the year-to-date is limited to the amount that would be recognized if the year-to-date ordinary loss were the anticipated ordinary loss for the fiscal year. The limitation is computed as follows:~~

~~Year-to-date ordinary loss times the statutory rate ($140,000 at 50%)~~	~~$ (70,000)~~
~~Estimated tax credits for the year~~	~~(10,000)~~
~~Year-to-date benefit limited to~~	~~$ (80,000)~~

> > Example 6: Effect of New Tax Legislation

740-270-55-44 The following ~~Cases illustrate~~Example illustrates the guidance in paragraphs 740-270-25-5 through 25-6 for accounting in interim periods for the effect of new tax legislation on income ~~taxes:~~taxes when legislation is effective in a future interim period.

a. Subparagraph superseded by Accounting Standards Update No. 2019-12.~~Legislation effective in a future interim period (Case A)~~
b. Subparagraph superseded by Accounting Standards Update No. 2019-12.~~Effective date of new legislation (Case B).~~

> > > ~~Case A:~~ Legislation Effective in a Future Interim Period

740-270-55-45 The assumed facts applicable to this ~~Case~~Example follow.

740-270-55-46 For the full fiscal year, an entity anticipates ordinary income of $100,000. All income is taxable in one jurisdiction at a 50 percent rate. Anticipated tax credits for the fiscal year total $10,000. No events that do not have tax consequences are anticipated.

740-270-55-47 Computation of the estimated annual effective tax rate applicable to ordinary income is as follows.

Tax at statutory rate ($100,000 at 50%)	$ 50,000
Less anticipated tax credits	(10,000)
Net tax to be provided	$ 40,000
Estimated annual effective tax rate ($40,000 ÷ $100,000)	40%

740-270-55-48 Further, assume that new legislation creating additional tax credits is enacted during the second quarter of the entity's fiscal year. The new legislation is effective on the first day of the third quarter. As a result of the estimated effect of the new legislation, the entity revises its estimate of its annual effective tax rate to the following.

Tax at statutory rate ($100,000 at 50%)	$50,000
Less anticipated tax credits	(12,000)
Net tax to be provided	$38,000
Estimated annual effective tax rate ($38,000 ÷ $100,000)	38%

740-270-55-49 The effect of the new legislation shall ~~not~~ be reflected ~~until it is effective or administratively effective~~in the computation of the annual effective tax rate beginning in the first interim period that includes the enactment date of the new legislation. Accordingly, quarterly tax computations are as follows.

	Ordinary Income					Tax				
Reporting Period	**Reporting Period**	**Year-to-Date**		**Estimated Annual Effective Tax Rate**		**Year-to-Date**		**Less Previously Provided**		**Reporting Period**
First quarter	$ 20,000	$ 20,000		40%		$ 8,000		$ -		$ 8,000
Second quarter	20,000	40,000	~~40%~~	38%	~~16,000~~	15,200		8,000	~~8,000~~	7,200
Third quarter	20,000	60,000		38%		22,800	~~16,000~~	15,200	~~6,800~~	7,600
Fourth quarter	40,000	100,000		38%		38,000		22,800		15,200
Fiscal year	$100,000									$ 38,000

~~**> > > Case B: Effective Date of New Legislation**~~

740-270-55-50 Paragraph superseded by Accounting Standards Update No. 2019-12.~~Legislation generally becomes effective on the date prescribed in the statutes. However, tax legislation may prescribe changes that become effective during an entity's fiscal year that are administratively implemented by applying a portion of the change to the full fiscal year. For example, if the statutory tax rate applicable to calendar-year corporations were increased from 48 to 52 percent, effective January 1, the increased statutory rate might be administratively applied to a corporation with a fiscal year ending at June 30 in the year of the change by applying a 50 percent rate to its **taxable income** for the fiscal year, rather than 48 percent for the first 6 months and 52 percent for the last 6 months. In that case the~~

~~legislation becomes effective for that entity at the beginning of the entity's fiscal year.~~

740-270-55-51 <u>Paragraph superseded by Accounting Standards Update No. 2019-12.</u>~~Applying this to specific legislation, an entity with a fiscal year other than a calendar year would account during interim periods for the reduction in the corporate tax rate resulting from the Revenue Act of 1978 through a revised annual effective tax rate calculation in the same way that the change will be applied to the entity's taxable income for the year. The revised annual effective tax rate would then be applied to pretax income for the year to date at the end of the current interim period.~~

Amendments to Subtopic 323-740

16. Amend paragraph 323-740-55-8, with a link to transition paragraph 740-10-65-8, as follows:

Investments—Equity Method and Joint Ventures—Income Taxes

Implementation Guidance and Illustrations

Qualified Affordable Housing Project Investments

> Illustrations

> > Example 1: Application of Accounting Guidance to a Limited Partnership Investment in a Qualified Affordable Housing Project

323-740-55-2 This Example illustrates the application of the cost, equity, and proportional amortization methods of accounting for a limited liability investment in a qualified affordable housing project.

323-740-55-3 The following are the terms for this Example.

Date of investment	January 1, 20X1
Purchase Price of Investment	$ 100,000

323-740-55-4 This Example has the following assumptions:

a. All cash flows (except initial investment) occur at the end of each year.

b. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).
c. The investor made a $100,000 investment for a 5 percent limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.
d. The partnership finances the project cost of $4,000,000 with 50 percent equity and 50 percent debt.
e. The annual tax credit allocation (equal to 4 percent of the project's original cost) will be received for a period of 10 years.
f. The investor's tax rate is 40 percent.
g. The project will operate with break-even pretax cash flows including debt service during the first 15 years of operations.
h. The project's taxable loss will be equal to depreciation expense. The cumulative book loss (and thus the cumulative depreciation expense) recognized by the investor is limited to the $100,000 investment.
i. Subparagraph superseded by Accounting Standards Update No. 2014-01.
j. It is assumed that all requirements are met to retain allocable tax credits so there will be no recapture of tax credits.
k. The investor expects that the estimated residual value of the investment will be zero.
l. All of the conditions described in paragraph 323-740-25-1 are met to qualify the investment for the use of the proportional amortization method.

323-740-55-8 A detailed analysis of the equity method follows.

Year	Net Investment (1)	Book Loss (2)	Tax Loss (Depreciation) (3)	Tax Credits (4)	Current Tax Benefit (5)	Deferred Tax Benefit (Expense) (6)	Impact on Net Income (7)
1	$ 92,727	$ 7,273	$ 7,273	$ 8,000	$ 10,909		$ 3,636
2	85,454	7,273	7,273	8,000	10,909		3,636
3	78,181	7,273	7,273	8,000	10,909		3,636
4	70,908	7,273	7,273	8,000	10,909		3,636
5	63,635	7,273	7,273	8,000	10,909		3,636
6 (a)	~~56,362~~ 32,000	~~7,273~~ 31,635	7,273	8,000	10,909	$ 9,746	~~3,636~~ (10,980)
7	~~49,089~~ 24,000	~~7,273~~ 8,000	7,273	8,000	10,909	291	~~3,636~~ 3,200
8	~~41,816~~ 16,000	~~7,273~~ 8,000	7,273	8,000	10,909	291	~~3,636~~ 3,200
9 ~~(a)~~	~~16,000~~ 8,000	~~25,816~~ 8,000	7,273	8,000	10,909	~~$ 7,418~~ 291	~~(7,489)~~ 3,200
10		~~16,000~~ 8,000	7,273	8,000	10,909	~~3,492~~ 291	~~(1,599)~~ 3,200
11			7,273		2,909	(2,909)	
12			7,273		2,909	(2,909)	
13			7,273		2,909	(2,909)	
14			5,451		2,183	(2,183)	
15			-		-	-	
Total		$ 100,000	$ 100,000	$ 80,000	$120,000	$ 0	$ 20,000

(1) End-of-year investment for a 5 percent limited liability interest in the project less the investor's share of losses.

(2) The investor's share of book losses recognized under the equity method. The cumulative losses recognized are limited to the investment of $100,000. (See also (a) below)

(3) Depreciation (on $200,000 tax basis of the underlying assets) using the straight-line method over 27.5 years up to the amount of the initial investment of $100,000.

(4) 4 percent tax credit on $200,000 tax basis of the underlying assets.

(5) (Column [3] x 40% tax rate) + column (4).

(6) The change in deferred taxes resulting from differences between the book and tax bases of the investment and tax losses in excess of the at-risk investment. In this Example, that amount can be determined as follows: (column [2] - column [3]) x 40% tax rate.

(7) Column (5) + column (6) - column (2).

(a) Projections of the total future ~~operating results~~tax benefits at the end of Year ~~9~~6 indicate that a net loss will be recognized over the remaining term of the investment indicating ~~a need to assess the investment for~~ an other-than-temporary impairment. For purposes of this Example, in Year 6,
impairment is measured as the excess of the carrying amount of the net investment over~~based on~~ the remaining tax credits allocable to the investor, although an alternative measure could include other tax benefits to be generated by the investment. The impairment loss recognized in this Example ~~($18,543)~~in Year 6 ($24,362) is derived as follows: Investment at the end of Year ~~8 ($41,816)~~5 ($63,635) less the loss recognized in Year ~~9~~6 ($7,273) before recognizing the impairment, the remaining tax credits allocable to the investor ~~($16,000)~~($32,000), and the estimated residual value ($0).

Amendments to Subtopic 718-740

17. Amend paragraph 718-740-45-7, with a link to transition paragraph 740-10-65-8, as follows:

Compensation—Stock Compensation—Income Taxes

Other Presentation Matters

> Employee Stock Ownership Plans

718-740-45-7 The tax benefit of tax-deductible dividends on allocated and unallocated **employee stock ownership plan** shares shall be recognized in ~~the income statement~~income taxes allocated to continuing operations.

Amendments to Status Sections

18. Amend paragraph 323-740-00-1, by adding the following item to the table, as follows:

323-740-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
323-740-55-8	Amended	2019-12	12/18/19

19. Amend paragraph 718-740-00-1, by adding the following item to the table, as follows:

718-740-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
718-740-45-7	Amended	2019-12	12/18/19

20. Amend paragraph 740-10-00-1, by adding the following items to the table, as follows:

740-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
740-10-15-4	Amended	2019-12	12/18/19
740-10-25-54	Amended	2019-12	12/18/19
740-10-30-27A	Added	2019-12	12/18/19
740-10-50-17A	Added	2019-12	12/18/19
740-10-55-26	Amended	2019-12	12/18/19
740-10-55-139 through 55-144	Amended	2019-12	12/18/19
740-10-65-8	Added	2019-12	12/18/19

21. Amend paragraph 740-20-00-1, by adding the following items to the table, as follows:

740-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Tax Consequences	Superseded	2019-12	12/18/19
740-20-45-7	Amended	2019-12	12/18/19
740-20-55-10 through 55-12	Amended	2019-12	12/18/19
740-20-55-12A through 55-12C	Added	2019-12	12/18/19
740-20-55-14	Amended	2019-12	12/18/19

22. Amend paragraph 740-30-00-1, by adding the following items to the table, as follows:

740-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
740-30-25-15	Amended	2019-12	12/18/19
740-30-25-16	Superseded	2019-12	12/18/19
740-30-45-3	Amended	2019-12	12/18/19

23. Amend paragraph 740-270-00-1, by adding the following items to the table, as follows:

740-270-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
740-270-25-5	Amended	2019-12	12/18/19
740-270-30-11	Amended	2019-12	12/18/19
740-270-30-28	Amended	2019-12	12/18/19
740-270-30-34	Amended	2019-12	12/18/19
740-270-55-16	Amended	2019-12	12/18/19
740-270-55-44	Amended	2019-12	12/18/19
740-270-55-45	Amended	2019-12	12/18/19
740-270-55-49	Amended	2019-12	12/18/19
740-270-55-50	Superseded	2019-12	12/18/19
740-270-55-51	Superseded	2019-12	12/18/19

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Susan M. Cosper
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. The Board is issuing the amendments in this Update as part of its Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. The specific areas of potential simplification were submitted by stakeholders as part of the Simplification Initiative.

BC3. The FASB issued proposed Accounting Standards Update, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, for public comment on May 14, 2019, with comments due on June 28, 2019. The Board received 24 comment letters on that proposed Update. Respondents were largely supportive of the Board's efforts to reduce complexity in accounting for income taxes. Those respondents commented that most of the proposed amendments would simplify the accounting for income taxes in a meaningful way without sacrificing the usefulness of information provided to users of financial statements. Most respondents agreed that the proposed amendments were operable and auditable and would not impose significant costs. The Board considered respondents' comments and concerns in reaching the conclusions in this Update, as discussed further in the remainder of this basis for conclusions.

BC4. The areas for simplification in this Update involve several aspects of the accounting for income taxes. First, the amendments in this Update simplify the accounting for income taxes by removing certain exceptions in Topic 740, including the exceptions to:

a. The incremental approach for intraperiod tax allocation when there is a loss from continuing operations and income or a gain from other items (for example, discontinued operations or other comprehensive income)
b. The requirement to recognize a deferred tax liability for equity method investments when a foreign subsidiary becomes an equity method investment

c. The ability not to recognize a deferred tax liability for a foreign subsidiary when a foreign equity method investment becomes a subsidiary
d. The general methodology for calculating income taxes in an interim period when a year-to-date loss exceeds the anticipated loss for the year.

BC5. The amendments in this Update also simplify the accounting for income taxes by:

a. Requiring that an entity recognize a franchise tax (or similar tax) that is partially based on income in accordance with Topic 740 and account for any incremental amount incurred as a non-income-based tax
b. Requiring that an entity evaluate when a step up in the tax basis of goodwill should be considered part of the business combination in which the book goodwill was originally recognized and when it should be considered a separate transaction
c. Specifying that an entity is not required to allocate the consolidated amount of current and deferred tax expense to a legal entity that is not subject to tax in its separate financial statements but that an entity may elect to do so (on an entity-by-entity basis) for a legal entity that is both not subject to tax and disregarded by the taxing authority
d. Requiring that an entity reflect the effect of an enacted change in tax laws or rates in the annual effective tax rate computation in the interim period that includes the enactment date
e. Making minor Codification improvements for income taxes related to employee stock ownership plans and investments in qualified affordable housing projects accounted for using the equity method.

Benefits and Costs

BC6. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board’s assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC7. The amendments in this Update will reduce cost and complexity by removing certain exceptions from and clarifying other areas of Topic 740. The amendments eliminate the need for an entity to analyze whether the exceptions for intraperiod tax allocation, ownership changes in investments, and year-to-date losses that exceed anticipated losses apply in a given period. The amendments also promote consistent application of and simplify GAAP for franchise taxes that are partially based on income, transactions that result in a step up in the tax basis of goodwill, separate financial statements of legal entities that are not subject to tax, and enacted changes in tax laws in interim periods by clarifying and amending guidance that already exists within GAAP. The amendments do not create new accounting requirements not previously included in Topic 740.

Basis for Conclusions

Franchise Taxes That Are Partially Based on Income

BC8. Franchise taxes in certain jurisdictions are calculated using the greater of two calculations—one based on income and one based on items other than income (for example, capital, capital expenditures, and gross revenue). Paragraph 740-10-15-4(a) currently states that Topic 740 does not apply to franchise taxes based on capital when there is no additional tax based on income. That paragraph further states that if there is a tax based on income that is in excess of the tax based on capital, then that excess is subject to the guidance in Topic 740. That guidance results in an entity separating the component of the tax based on items other than income from the component of the tax based on income when the income tax is greater than the tax on items other than income. Taxes based on items other than income generally should not be included in the income tax line on the financial statements.

BC9. Stakeholders indicated that the guidance for these types of franchise taxes increases the cost and complexity of applying Topic 740, particularly when the amount related to the non-income-based tax is not significant, and that the guidance does not result in increased usefulness to users of financial statements. In many cases, the tax amount based on amounts other than income (for example, capital) generally is only significant if that amount is greater than the income tax amount. That is because an entity is likely operating at a loss or near the break-even point in those situations. Stakeholders also indicated that this guidance introduces complexity in determining which rate to use when recording deferred taxes on temporary differences. For example, in cases in which the state tax is an income tax only to the extent that it exceeds the capital-based tax in a given year, deferred taxes would be recognized for temporary differences that reverse in future years for which annual taxable income is expected to exceed the capital tax.

BC10. The Board decided to amend paragraph 740-10-15-4(a) to require that if a franchise tax (or similar tax) is partially based on income (for example, the entity pays the greater of an income-based tax and a non-income-based tax), deferred tax assets and liabilities should be recognized and accounted for in accordance with Topic 740. The amount of current tax expense that is based on income should be accounted for in accordance with Topic 740, with any incremental amount incurred recorded as a non-income-based tax. The Board observed that this amendment simplifies Topic 740 and reduces the cost of applying the guidance in that Topic when the amounts for those types of franchise taxes are not significant because an entity would need to separate the tax on amounts other than income only if that amount is greater than the income tax amount.

BC11. Additionally, in response to a respondent's request, the Board included specific guidance in paragraph 740-10-15-4(a) that states that an entity would not need to consider the effect of potentially paying a non-income-based tax in future years when evaluating the realizability of its deferred tax assets. The Board noted that this clarification is consistent with the accounting for other incremental taxes (for example, the base erosion and anti-abuse tax).

BC12. The Board concluded that the amendment to franchise taxes that are partially based on income, at a minimum, maintains the decision-useful information provided to users and may increase that information. Additionally, applying the disclosure requirements in Topic 740 to these amounts will result in greater transparency of franchise tax amounts.

BC13. The Board considered feedback suggesting that it provide a scope exception for pass-through entities because bifurcation of the income and non-income-based components of franchise taxes would be an unnecessary burden in scenarios in which pass-through entities are subject to state franchise taxes for the right to do business in a state and those franchise taxes are not significant. The Board decided not to provide a scope exception for pass-through entities that are subject to state franchise taxes because it would contradict the entity's status as a taxable entity in the jurisdiction imposing the franchise tax. The Board also noted that this outcome is not a consequence of the amendments; rather, pass-through entities apply the current guidance when the franchise tax based on income is greater than the franchise tax based on amounts other than income. Lastly, the Board observed that adding an exception for pass-through entities would be contrary to the objectives of simplifying the accounting for income taxes and removing exceptions in Topic 740.

Transactions That Result in a Step Up in the Tax Basis of Goodwill

BC14. An entity may enter into a transaction with a government in its capacity as a taxing authority that results in an increase in the tax basis of assets of the entity. For example, tax laws in a foreign country may allow an entity to elect to step up the tax basis of certain fixed assets to fair value in exchange for a current payment to the government. This step up also could be acquired by sacrificing existing tax attributes (for example, a net operating loss carryforward or tax basis in another asset). In certain situations, the step up in the tax basis as a result of the transaction with the government results in a step up to the tax basis of goodwill.

BC15. If the step up in the tax basis of goodwill relates to the portion of goodwill from a prior business combination for which a deferred tax liability was not recognized, then current paragraph 740-10-25-54 prohibits the entity from recognizing a deferred tax asset for the increase in tax basis, except to the extent that the tax-deductible goodwill exceeds the remaining book balance of goodwill. Therefore, an entity would not record a deferred tax asset for the step up in basis of goodwill unless it would have recorded a deferred tax asset when the business combination had occurred.

BC16. Stakeholders indicated that the guidance in paragraph 740-10-25-54 that prohibits an entity from recognizing a deferred tax asset for the acquisition of a step up in the tax basis of goodwill may result in an outcome that does not represent the economics of the transaction. That is because an asset on the entity's statement of financial position (for example, cash or deferred tax assets for other tax attributes) would be sacrificed to obtain that benefit but the asset would be immediately expensed. For example, if an entity exchanges a net operating loss carryforward for the step up in tax basis of goodwill, it would reduce the balance of its deferred tax assets and recognize a corresponding expense. Those stakeholders indicated that, in this case, economically, the entity has exchanged one deferred tax asset (the net operating loss carryforward) for another deferred tax asset (the step up in tax basis of goodwill). Accordingly, the entire amount of the transaction should not be recognized in the income statement.

BC17. Those stakeholders noted that these transactions often are separate transactions even though they affect the goodwill recognized in the business combination. However, those stakeholders also acknowledged that in certain cases the step up in tax basis of goodwill relates to the business combination in which the book goodwill was originally recognized, in which case prohibiting the recognition of a deferred tax asset would be consistent with the guidance in Topic 805, Business Combinations. That is because the entity has actually exchanged one deferred tax asset (for example, a net operating loss carryforward) for a reduction in a deferred tax liability related to goodwill that was not recognized upon the acquisition of the business. Nonetheless, stakeholders indicated that it can be difficult to determine whether new tax-deductible goodwill relates to the business combination in which the goodwill was initially recognized in the financial statements because there often is a significant amount of time between the two transactions or because a realignment of the original book goodwill between reporting units may have occurred.

BC18. The Board decided that clarifying the guidance about whether a step up in the tax basis of goodwill relates to the business combination in which the book goodwill was originally recognized would reduce the cost of applying Topic 740 and indicate that a separate transaction may affect goodwill. Therefore, the Board decided to remove the prescriptive guidance in paragraph 740-10-25-54 and require that an entity determine whether the tax basis step-up transaction relates to the business combination in which the book goodwill was originally recognized (in which case a deferred tax asset would not be recognized unless the newly deductible goodwill exceeds the remaining balance of book goodwill) or to a separate transaction (in which case a deferred tax asset would be recognized) on the basis of certain indicators.

BC19. The Board acknowledged that judgment still would be needed to determine whether the transaction relates to the business combination in which the goodwill was originally recognized or whether it relates to a separate transaction. Therefore, the Board decided to provide indicators for making that determination. The Board noted that the indicators included in the amendment to paragraph 740-10-25-54 will distinguish transactions that were contemplated as part of the business combination from separate transactions that are entered into significantly after the business combination and that have economic consequences. The Board decided that the amendment better reflects the economic consequences of separate transactions because it results in the recognition of an asset instead of expense when the step up in tax basis results in a future tax benefit.

BC20. The Board considered feedback indicating that the types of transactions that result in a step up in the tax basis of goodwill are not limited to those directly between a taxpayer and a government. Feedback also indicated that, in practice, entities apply the current guidance (and would apply the amended guidance) in paragraph 740-10-25-54 to any transaction that results in a step up in the tax basis of goodwill. Therefore, those respondents recommended that the Board expand the scope of the proposed amendments to any transaction that results in a step up in the tax basis of goodwill by either removing or amending the heading above paragraph 740-10-25-54, "Transactions Directly between a Taxpayer and a Government." That heading was added in Accounting Standards Update No. 2018-09, *Codification Improvements,* and not as a result of the amendments in this Update. While the Board decided not to remove or amend that heading, it acknowledged that entities apply the guidance by analogy to any transaction that results in a step up in the tax basis of goodwill and that it did not intend to change that practice.

Separate Financial Statements of Legal Entities Not Subject to Tax

BC21. Topic 740 requires that the consolidated amount of current and deferred tax expense for a group that files a consolidated tax return be allocated among the members of the group when those members issue separate financial statements. Unlike a member of a group that files a consolidated tax return, a single-member limited liability company that is disregarded for tax purposes generally is not severally liable for the taxes of its taxable owner. Therefore, stakeholders indicated that some entities do not allocate the consolidated amount of current and deferred taxes to single-member limited liability companies that are disregarded entities in their separate financial statements, while other entities do.

BC22. The Board noted that allocating income taxes to single-member limited liability companies that are disregarded entities in separate financial statements adds to the cost and complexity of applying Topic 740. The Board noted that a single-member limited liability company is a separate legal entity that is not severally liable for the taxes of its owner, so the Board decided that the entity should not be required to include allocated income taxes in its separate financial statements. However, the Board also noted that some entities that are not subject to tax and are disregarded by the taxing authority (for example, certain rate-regulated entities or entities with cost-plus revenue arrangements) may want to include income taxes in their separate financial statements to reflect an allocation of the tax costs incurred by the consolidating parent entity. Therefore, the Board decided to clarify that an entity is not required to allocate amounts of consolidated current and deferred taxes to a legal entity that is not subject to tax (including a single-member limited liability company) in its separate financial statements, but an entity may elect to do so for a legal entity that is both not subject to tax and disregarded by the taxing authority.

BC23. The Board noted that this will clarify how all pass-through entities that are subsidiaries of taxable entities are treated under Topic 740. The Board noted that the separate financial statements of an entity that is not subject to tax that does not include allocated income taxes will provide financial statement users with information that is consistent with the economics of the entity because the income of a single-member limited liability company flows through to the owner of the entity (that is, the parent entity) for tax purposes and would not be taxed at the entity level. Additionally, a liability for income taxes for which the single-member limited liability company is not liable does not meet the conceptual definition of a liability.

BC24. The Board observed that paragraph 740-10-50-16 requires that an entity disclose that it is not subject to income taxes, which would provide financial statement users with information about the tax status of the entity. The Board also decided to require additional disclosures for an entity that is not subject to tax and that is disregarded by the taxing authority but elects to include the allocated amount of current and deferred tax expense in its separately issued financial statements by requiring that the entity disclose that election and provide the disclosures required by paragraph 740-10-50-17.

BC25. The Board considered feedback suggesting that it clarify whether the election to allocate amounts of consolidated current and deferred taxes to a legal entity that is not subject to tax and is disregarded by the taxing authority (including a single-member limited liability company) in its separate financial statements should be made on an entity-by-entity basis or whether it should apply to all entities in the consolidated tax return once the election is made. The Board decided that it is appropriate to make the election on an entity-by-entity basis because the existing guidance already acknowledges that the sum of the amounts allocated to individual members of the group may not equal the consolidated amount. Additionally, the Board noted that entities often would not be required to produce separate financial statements for each member of a consolidated tax return and that, therefore, it is not necessary for the election to be made for all entities to gain an understanding of consolidated income tax expense.

Intraperiod Tax Allocation

BC26. Intraperiod tax allocation is the process of allocating total tax expense or benefit to components of the income statement (such as continuing operations and discontinued operations) and directly to shareholders' equity and other comprehensive income. Total tax expense generally is allocated by first determining the amount of tax expense or benefit allocated to continuing operations and then proportionally allocating the remaining tax expense or benefit to items other than continuing operations. Generally, the tax effect of income from continuing operations should be determined without considering the tax effect of items that are not included in continuing operations.

BC27. Paragraph 740-20-45-7 provides an exception to this general approach by requiring that all components, including discontinued operations and items charged or credited directly to equity, be considered when determining the tax benefit from a loss from continuing operations. This exception applies only when there is a current-period loss from continuing operations. Application of this exception makes it appropriate to consider gain or income outside continuing operations (for example, one recognized in other comprehensive income) in the current year for purposes of allocating a tax benefit to a current-year loss from continuing operations. For example, an entity may consider the gain or income outside continuing operations to determine whether a valuation allowance needs to be recognized for purposes of allocating the tax benefit to continuing operations.

BC28. The Financial Accounting Foundation's *Post-Implementation Review Report on FASB Statement No. 109,* Accounting for Income Taxes, indicated that some preparers and auditors have difficulty applying certain aspects of the requirements in Topic 740 about intraperiod tax allocation. Stakeholders indicated that the exception to the incremental approach for intraperiod tax allocation (see paragraph 740-20-45-7) creates counterintuitive outcomes because it results in a benefit being allocated to continuing operations and an offsetting tax expense in another component, even when total tax expense is zero. Stakeholders also indicated that this exception is difficult to apply, is often overlooked, and does not provide any perceived benefit to users. Additionally, stakeholders observed that there is diversity in practice in how the guidance in paragraph 740-20-45-7 is interpreted. Some entities have interpreted the guidance to apply if there is a loss from continuing operations and any one category below continuing operations is in a gain position, whereas others have interpreted it to apply only when the sum of all categories below continuing operations is in an overall gain position. For those reasons, the Board decided that removing the exception to the incremental approach for intraperiod tax allocation will reduce the cost of applying Topic 740, while not significantly altering the information provided to users of financial statements.

BC29. While respondents broadly supported removing the exception to the incremental approach for intraperiod tax allocation, some respondents disagreed and noted that the removal might eliminate useful information and decrease comparability in certain circumstances. For example, the respondents asserted that removing the exception would result in a distorted presentation of tax benefits in circumstances in which an entity has a pretax gain outside of continuing operations that would serve as a source of taxable income to support the realization of losses that are part of continuing operations. The Board acknowledged that removing the exception could increase costs for entities in certain scenarios. However, for the reasons stated in paragraph BC28, the Board noted that, overall, the scenarios in which removing the exception would decrease the cost of applying Topic 740 are likely more common than those scenarios in which removing the exception would increase costs.

Ownership Changes in Investments

BC30. Topic 740 provides income tax guidance for situations in which an investment in common stock of a subsidiary changes so that it is no longer a subsidiary. If a parent entity did not recognize income taxes on its undistributed earnings because of the assertion that earnings were indefinitely reinvested or would be remitted in a tax-free liquidation, paragraph 740-30-25-15 requires that the outside basis difference be frozen (and that no deferred tax liability be recognized on the basis difference that exists as of that date) until the period when it becomes apparent that any of the undistributed earnings will be remitted. That guidance states that transitioning from a subsidiary to an equity method investment would not by itself mean that remittance of the undistributed earnings must be considered apparent. The entity recognizes deferred tax assets or liabilities and income tax expense (or benefit) on any basis differences that occur after the subsidiary becomes an equity method investment.

BC31. The Board noted that the current guidance that requires an entity to freeze the outside basis difference of a subsidiary that becomes an equity method investment represents an exception to the general principle for accounting for outside basis differences of equity method investments. The Board decided that this exception increases the cost and complexity of applying Topic 740 because the exception applies to only a portion of the outside basis difference of the equity method investment, so an entity is required to track the frozen amount and any subsequent changes to the outside basis separately. The Board also noted that the exception reduces the comparability of the accounting for income tax effects of equity method investments for financial statement users because the income tax effects of equity method investments are recognized only for certain equity method investments (or portions of certain equity method investments). Therefore, the Board decided to align the accounting for income tax effects of equity method investments by removing the exception in paragraph 740-30-25-15.

BC32. Topic 740 also provides income tax guidance for situations in which a foreign equity method investment becomes a subsidiary. Under current guidance in paragraph 740-30-25-16, the deferred tax liability previously recognized for a foreign equity method investment cannot be derecognized when the investment becomes a subsidiary—even if the entity asserts that earnings are indefinitely reinvested or will be remitted in a tax-free liquidation—unless dividends received from the subsidiary exceed earnings from the subsidiary after the date it became a subsidiary.

BC33. The Board noted that the current guidance that requires an entity to freeze the outside basis difference of a foreign equity method investment that becomes a subsidiary represents an exception to the general principle for accounting for outside basis differences of foreign subsidiaries. The Board decided that this exception increases the cost and complexity of applying Topic 740 because the exception applies to only a portion of the outside basis difference of the foreign subsidiary, so an entity is required to track the frozen amount and any subsequent changes to the outside basis separately. The Board also noted that the exception reduces the comparability across entities of the accounting for income tax effects of foreign subsidiaries for which the earnings are indefinitely reinvested because the income tax effects of a portion of a foreign subsidiary are recorded, while those of another portion are not. This lack of comparability reduces the usefulness of the information for financial statement users. Therefore, the Board decided to align the accounting for income tax effects of foreign subsidiaries by removing the exception in paragraph 740-30-25-16.

BC34. The Board considered feedback from a respondent who disagreed with removing the exception to the requirement to recognize a deferred tax liability for equity method investments when a foreign subsidiary becomes an equity method investment. The respondent explained that, in some circumstances, the investor still retains control or influence over whether or when the income tax consequences would occur and that removing the exception would force an entity to recognize a deferred tax liability even when the facts and circumstances support nonrecognition. The Board noted that the same facts and circumstances may exist when accounting for the outside basis differences for equity method investments that were not previously foreign subsidiaries. Given that the observation is not unique to differences created as a result of a change from consolidation to the equity method of accounting, the Board could see no basis to retain the exception and, therefore, affirmed its previous decision to remove the exception.

Enacted Changes in Tax Laws in Interim Periods

BC35. Topic 740 requires that an entity recognize the income tax effects of an enacted change in tax law on deferred tax assets or liabilities on the date of enactment. However, under the interim-period income tax model, the tax effect of a change in tax law on taxes payable or refundable for the current year should be recorded after the effective date of the tax law. Because of the use of the term *effective date*, a tax law enacted at the beginning of the year with an effective date in the middle of the year would result in an entity recognizing the effect of the enacted tax law in the period of enactment for deferred tax assets and liabilities, but the enacted tax law would not affect the annual effective tax rate (used in the interim-period income tax model) until the period that includes the effective date of the tax law.

BC36. Stakeholders indicated that applying the guidance on the effect of an enacted change in tax law is difficult in practice because of how income taxes in interim financial statements are calculated. The interim reporting guidance in Subtopic 740-270 does not require that an entity separately recognize current tax expense and deferred tax expense in interim periods. An entity generally estimates the annual effective tax rate on the basis of an annual forecast of its income and an estimation of expected permanent differences. The entity then applies the annual effective tax rate to the year-to-date income and makes a reasonable allocation of the expense to current taxes payable and deferred taxes. An entity generally does not estimate temporary differences for the purpose of income tax accounting in an interim period.

BC37. Stakeholders noted that the requirement to wait until the effective date to recognize the effects of the enacted change in tax law on current taxes payable requires that the entity make a more precise estimate of the allocation between current taxes and deferred taxes because the entity is required to wait until the effective date to recognize the effects of the enacted change in tax law on current taxes payable while recognizing the effects of the change on deferred taxes on the enactment date.

BC38. The Board observed that this results in increased costs for preparers. Therefore, the Board decided to amend paragraph 740-270-25-5 to require that the effects of an enacted change in tax law be reflected in the computation of the annual effective tax rate in the first interim period that includes the enactment date to both reduce the costs of applying the guidance and simplifying it. The Board also noted that this change would align the guidance for changes in tax law in interim periods with the general principle that the effects of enacted changes in tax laws should be recorded on the enactment date.

BC39. The Board acknowledged that recognizing the effects of the enacted change in tax law on current taxes payable on the enactment date could result in recognizing a portion of the effect of a change in tax law in periods before the tax law takes effect. However, that phenomenon also occurs under current guidance because an entity must estimate deferred tax assets and liabilities (that are remeasured at the enactment date) that are expected to reverse in the current year and include that estimate when determining the annual effective tax rate. This is a general consequence of the interim-period income tax model. The Board also noted that financial statement users should benefit from an entity recognizing the effects of the enacted change in tax law on current taxes payable on the enactment date because it will provide more timely information that could be used in users' financial statement analyses.

Year-to-Date Loss Limitation in Interim Period Tax Accounting

BC40. Under the interim-period income tax model in Subtopic 740-270, an entity is required to make its best estimate of the annual effective tax rate for the full fiscal year at the end of each interim period and use that rate to calculate income taxes on a year-to-date basis. Subtopic 740-270 includes general guidance for calculating income tax expense or benefit when there is a loss for the year-to-date period and anticipated income for the full year and vice versa. That guidance specifies that an entity should apply the annual effective tax rate to the year-to-date income or loss as long as the tax benefits for any losses are expected to be realized during the year or would be recognizable as a deferred tax asset at the end of the year (that is, a valuation allowance would not be necessary).

BC41. Paragraph 740-270-30-28 provides specific guidance for circumstances in which an entity incurs a loss on a year-to-date basis that exceeds the anticipated ordinary loss for the year, which is an exception to the general guidance in Subtopic 740-270. If an entity has an ordinary loss for the year-to-date period at the end of an interim period that exceeds the anticipated ordinary loss for the year, the income tax benefit recognized for the year-to-date period is limited to the income tax benefit determined on the basis of the year-to-date ordinary loss.

BC42. The Board decided that removing the exception to the general principle in Subtopic 740-270 would reduce the costs and complexity of applying Topic 740 in interim periods. The Board observed that the exception is easily overlooked by preparers and is, thus, prone to errors. Removing the exception would remove that propensity for error. Additionally, the Board decided that eliminating the exception should not significantly change the information provided to users of financial statements because removing the exception is consistent with the general principle in Subtopic 740-270 and results in more neutral recognition of tax benefits compared with tax expense. The Board acknowledged that removing the exception may result in recognizing tax benefits in a given period that exceed the tax benefits that would be received on the basis of the year-to-date loss, but the Board decided that the benefit of limiting the tax benefits would not outweigh the costs of the limitation.

Codification Improvements

BC43. The Board decided to make two minor improvements to the Codification. Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*, amended paragraph 718-740-45-7 to state that "the tax benefit of tax-deductible dividends on allocated and unallocated employee stock ownership plan shares shall be recognized in *the income statement*" (emphasis added).

BC44. Before Update 2016-09 was issued, paragraph 718-740-45-7 stated that the tax benefit of tax-deductible dividends for allocated shares should be recognized in income taxes allocated to continuing operations. Other references to the tax effects of tax-deductible dividends throughout the Codification (for example, paragraphs 740-20-45-8(d) and 740-20-55-2(d)) still indicate that the tax benefit of tax-deductible dividends should be recognized in income taxes allocated to continuing operations. Therefore, the Board decided to change the phrase *the income statement* in paragraph 718-740-45-7 to *income taxes allocated to continuing operations* to specify where the tax benefit of tax-deductible dividends should be presented in the income statement.

BC45. The Board proposed to supersede paragraph 323-740-55-8 to remove an error in the calculation of when an impairment should be recognized under the equity method of accounting. The Board noted that Subtopic 323-740, Investments—Equity Method and Joint Ventures—Income Taxes, is focused on the application of the proportional amortization method and not the general equity method. Section 323-740-55 includes an example that illustrates the application of the proportional amortization method to an investment in qualified affordable housing projects, so the Board decided that the example in paragraph 323-740-55-8 is not needed.

BC46. Some respondents raised concerns about superseding the example in paragraph 323-740-55-8, noting that entities apply that guidance as a basis to measure an identified impairment on an undiscounted basis. Therefore, those respondents noted that removing the example would result in the elimination of guidance that is used in the accounting for subsequent measurement of qualified affordable housing property investments under the equity method. On the basis of respondents' feedback, the Board reversed its decision to supersede the example in paragraph 323-740-55-8 and instead decided to correct the error in the calculation of when an impairment should occur under the equity method.

Effective Date

BC47. The Board decided that for public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. The effective date for public business entities is consistent with comments from respondents who noted that the amendments would not take a significant amount of time to implement. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. The effective date for all other entities is responsive to input from most respondents that other than public business entities should be provided additional time to adopt the amendments.

BC48. The Board considered whether to apply its philosophy from Accounting Standards Update No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*, in determining the effective dates for the amendments in this Update. The philosophy in Update 2019-10 extends and simplifies how effective dates are staggered between larger public companies and all other entities for major Updates. The Board concluded that it would not apply that philosophy in determining the effective dates for the amendments in this Update for several reasons:

a. The philosophy was exposed for public comment and had not yet been finalized when the Board completed its redeliberations on this project.
b. The amendments in this Update are not expected to be a major change for entities.
c. The *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* already provides guidance on determining the effective dates for nonpublic business entities.

BC49. Early adoption of the amendments in this Update is permitted, including adoption in an interim period (a) for public business entities for periods for which financial statements have not yet been issued and (b) for all other entities for periods for which financial statements have not yet been made available for issuance. If an entity adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes the interim period. An entity that elects early adoption must adopt all the amendments in the same period.

Transition

BC50. The Board decided that different transition approaches should apply to each income tax simplification because each has a different effect on the financial statements. Respondents generally agreed with the transition methods in the proposed Update on Topic 740 except for the proposed transition method for the amendments on franchise taxes that are partially based on income; those respondents' concerns are discussed in paragraph BC53.

Retrospective Transition

BC51. The Board decided to require a retrospective transition approach for the income tax simplification that would clarify that a legal entity that is not subject to tax is not required to be allocated amounts of consolidated current and deferred taxes in its separate financial statements. The Board concluded that it could be misleading to present no deferred taxes or income tax expense in the period of adoption and then present current and deferred tax expense (and deferred tax assets or liabilities, if allocated) in prior periods. The Board noted that retrospective transition for this simplification would result in increased comparability and would not be costly in situations in which the entity previously allocated income taxes to an entity that is not subject to tax because the entity only would need to remove deferred taxes and income tax expense in the comparative periods from the separate financial statements of the entity not subject to tax. The Board acknowledged that retrospective transition would result in increased costs if an entity decides to allocate income taxes upon adoption to an entity that is not subject to tax and that is a disregarded entity. However, on the basis of stakeholder feedback, the Board noted that allocating income taxes upon adoption to these types of entities is expected to be uncommon. The Board clarified that retrospective transition applies only to the separate financial statements of those entities that elected to allocate current and deferred taxes.

Modified Retrospective Transition

BC52. The Board decided to require a modified retrospective transition approach for the income tax simplifications related to changes in ownership of investments. Those simplifications result in an entity recognizing a deferred tax liability for a foreign subsidiary that became an equity method investment and removing a deferred tax liability for a foreign equity method investment that became a subsidiary. The Board decided that a retrospective transition approach would result in adjusting deferred tax amounts (and potentially income tax expense) related to these investments in each period, which could be costly and complex. The Board noted that a modified retrospective transition (that is, recognizing or removing a deferred tax liability at the beginning of the fiscal year of adoption with a cumulative-effect adjustment to retained earnings) not only reduces the comparability of income tax amounts in comparative periods but also reduces the cost and complexity of transition. The Board decided that the transition disclosures required should provide investors with information about the change and the reason for the change, which would provide disclosure about the lack of comparability. The Board decided that a prospective transition would not be appropriate for these simplifications because they affect deferred taxes that are recognized on the statement of financial position.

Retrospective Transition or Modified Retrospective Transition

BC53. The Board originally proposed to require a retrospective transition approach for the income tax simplification for franchise taxes that are partially based on income because that approach would improve comparability without requiring an entity to incur significant costs. The Board decided that prospective transition would not be appropriate because changes in the deferred tax assets and liabilities under a prospective transition would be recognized in expense during the period of adoption. Respondents expressed concerns about requiring retrospective transition and noted that it would require entities to recognize or remeasure deferred tax assets and liabilities and to assess or reassess the need for a valuation allowance in each prior period presented. Those respondents suggested that the Board either (a) require modified retrospective transition or (b) allow either retrospective transition or modified retrospective transition. On the basis of feedback received from respondents, the Board decided to allow an entity to apply the amendments on either a retrospective basis or a modified retrospective basis. The Board concluded that providing an option for transition methods (rather than requiring modified retrospective transition) addresses respondents' concerns while not precluding an entity from applying the amendments on a retrospective basis.

Prospective Transition

BC54. The Board decided to require a prospective transition approach for the other income tax simplifications. Specifically, the Board decided to require prospective transition for the exception to the incremental approach for intraperiod tax allocation to reduce the cost of transition without significantly affecting the comparability of information. This income tax simplification does not affect the amount of deferred taxes or total income tax expense. Therefore, the Board noted that retrospective transition would not affect the statement of financial position but that it would provide comparative information for income tax expense in years in which there is a loss from continuing operations and a gain or income from other components. However, the Board noted that restating comparative periods under retrospective transition would be costly because it would require that an entity recalculate the income tax expense from continuing operations. Additionally, the Board noted that this simplification would apply only when there is a loss from continuing operations and a gain or income from other components, which might not occur in comparative periods. Therefore, investors often see income tax expense presented under these circumstances in some periods and not in others.

BC55. The Board also decided to require a prospective transition approach for the two simplifications that relate to interim reporting (interim-period accounting for enacted changes in tax law and year-to-date loss limitation in interim-period tax accounting) to reduce the cost of transition without significantly affecting the comparability of information. The Board noted that interim reporting does not affect the amount of deferred taxes or income tax expense at the end of a year, so these simplifications should not affect the amount of deferred taxes recognized at the beginning of the period of adoption. Therefore, the Board noted that retrospective transition will not affect the statement of financial position but that it will provide comparative information for income tax expense in interim periods. However, the Board noted that calculating income tax expense in interim periods is complex and relies upon estimates of anticipated income for the full year. Restating comparative periods under retrospective transition would be costly and complex and would raise questions about whether the estimate of anticipated income for the full year as of the interim date should be updated. Additionally, the Board noted that each of these simplifications applies only in limited circumstances and those circumstances might not occur in comparative periods, so investors often see income tax expense presented under those circumstances in some periods and not in others.

BC56. Additionally, the Board decided to require a prospective transition approach for the income tax simplification for the step up in tax basis of goodwill. The Board noted that this type of transaction often is a one-time transaction for entities; therefore, requiring a prospective transition approach should not affect comparability. The Board also decided to require a prospective transition approach for the Codification improvements because they are minor clarifications and likely should not need transition guidance.

Transition Disclosures

BC57. The Board decided to require that an entity disclose the nature of and reason for the change in accounting principle, the transition method, and a qualitative description of the financial statement line items affected by the change. The Board decided that it would not be cost beneficial to require quantitative disclosures that would effectively require an entity to maintain two sets of accounting records solely to meet disclosure requirements that would not be required when preparing the entity's basic financial statements.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification®* in this Accounting Standards Update require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those improvements, which will be incorporated into the proposed 2020 Taxonomy, are available through Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.