Financial Reporting Insights

ASU 2023-09 EXPANDED INCOME TAX DISCLOSURE REQUIREMENTS

June 2025

Overview

On December 14, 2023, the Financial Accounting Standards Board (FASB or Board) issued Accounting Standards Update (ASU) 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures* (ASU 2023-09). The amendments in this ASU address investor requests for more transparency about income tax information through improvements to income tax disclosures primarily related to an entity's effective tax rate reconciliation and income taxes paid information. However, ASU 2023-09 does not amend the recognition or measurement requirements of Accounting Standards Codification (ASC or Codification) Topic 740 (ASC 740).

For public business entities, the amendments in ASU 2023-09 are effective for annual periods beginning after December 15, 2024 (i.e., 2025 for public business entities with calendar year ends). For entities other than public business entities, the amendments are effective one year later.

This publication provides a comprehensive discussion of ASU 2023-09, including implementation and interpretive guidance to assist with the adoption of the new disclosure requirements.

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1. BACKGROUND AND SCOPE

In December 2023, the Financial Accounting Standards Board (FASB) issued ASU 2023-09 to address investor requests for more transparency about income tax information through improvements to income tax disclosures primarily related to the rate reconciliation and income taxes paid information.

The FASB believes that the disclosures required by ASU 2023-09 will provide investors with information on a timely basis, which will allow them to better:

- Assess how an entity's operations and related tax risks and tax planning and operational opportunities affect its tax rate and prospects for future cash flow
- Understand an entity's exposure to potential changes in jurisdictional tax legislation and the ensuing risks and opportunities
- Assess income tax information that affects cash flow forecasts and capital allocation decisions
- Identify potential opportunities to increase future cash flows

The amendments in ASU 2023-09 apply to all entities that are subject to ASC 740. However, the tabular quantitative effective tax rate reconciliation is only required for public business entities (PBEs). ASU 2023-09 uses the term "public business entity" rather than "public entity," which was previously used in ASC 740. The change is intended to improve the consistency in the Codification without creating a significant change in practice. However, entities should carefully evaluate the definition of these terms in the ASC Master Glossary to determine which ASC 740 disclosures apply to their circumstances. For example, certain community banks that may not have previously been considered public entities could be considered PBEs.

The ASC Master Glossary defines a PBE as a business entity meeting any one of the criteria listed below. Neither a not-for-profit entity nor an employee benefit plan is a business entity.

a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).
b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
d. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.
e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including notes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

NOTE: Unless otherwise noted, references to specific ASC sections in the remainder of this publication refer to the sections as amended by ASU 2023-09.

2. RATE RECONCILIATION BETWEEN INCOME TAX EXPENSE (BENEFIT) AND STATUTORY EXPECTATIONS

The income tax expense or benefit reported by an entity often differs, sometimes significantly, from the income tax amounts determined in reference to the entity's statutory tax rate. The objective of the enhanced effective tax rate reconciliation disclosure requirements introduced by ASU 2023-09 is to enable financial statement users to understand the nature and magnitude of the factors contributing to the difference between the entity's effective tax rate and their statutory tax rate. PBEs are required to provide quantitative annual disclosures while other entities are required to qualitatively disclose this information.

The remainder of this section discusses the effective tax rate reconciliation requirements for PBEs while Section 3 addresses the requirements for entities other than PBEs.

2.1 Overview of effective tax rate reconciliation requirements for PBEs

ASC 740-10-50-12 requires a PBE to disclose an annual reconciliation between the amount of reported income tax expense (or benefit) from continuing operations and the amount computed by multiplying the income (or loss) from continuing operations before income taxes[1] by the applicable statutory federal (national) income tax rate of the jurisdiction (country) of domicile. When the rate used by a PBE is other than the U.S. federal corporate income tax rate, the PBE is required to disclose the rate used and the basis for using that rate. See Section 2.2.1 for further considerations related to non-U.S. domiciled entities.

For each annual reporting period, ASC 740-10-50-12A(a) requires that a PBE disclose a tabular effective tax rate reconciliation using both reporting currency amounts and percentages, disaggregated by the following eight specific categories:

1. State and local income tax, net of federal (national) income tax effect
2. Foreign tax effects
3. Effect of cross-border tax laws
4. Effect of changes in tax laws or rates enacted in the current period
5. Nontaxable or nondeductible items
6. Tax credits
7. Changes in valuation allowances
8. Changes in unrecognized tax benefits

ASC 740-10-50-12A(c) specifies that categories 3 through 7 above consist solely of federal income taxes assessed by an entity's country of domicile. Category 1 reflects all taxes assessed by states and localities within the entity's country of domicile, while category 2 reflects income taxes assessed by jurisdictions outside the entity's country of domicile. Category 8 is the sole category where aggregated disclosure across all jurisdictions is permitted.

[1] Although not defined in ASC 740, in practice, the term "income (or loss) from continuing operations before income taxes" is understood to include all pretax income and expenses items, except those related to discontinued operations (see ASC 205-20), other comprehensive income (see ASC 220-10), or the cumulative effect of a change in accounting principle through retrospective application of the new accounting principle to all prior periods (see ASC 250-10).

ASU 2023-09 – Basis for Conclusions, Paragraph BC25 (partial excerpt)

The Board considered whether it was necessary to define the specific categories included in paragraph 740-10-50-12A(a). In the proposed Update, the Board decided that defining the specific categories would not be necessary because the categories are understandable, currently used in practice and intended to be general to accommodate future changes to the tax environment.

If it is not otherwise evident, a PBE is required to provide an explanation of individual reconciling items required by ASC 740-10-50-12A(a), such as the nature, effect and underlying causes of the reconciling items and the judgment used in categorizing such reconciling items.

ASC 740-10-50-12A(b) requires further disaggregation of certain reconciling items (as summarized in the table below), based on a quantitative threshold equal to 5% or more of the amount determined by multiplying income (or loss) from continuing operations before income taxes by the applicable federal statutory tax rate ("the 5% threshold"). Entities reconciling to the U.S. federal statutory tax rate of 21% would generally need to disclose items affecting the effective tax rate by 1.05% (21% x 5%) or more. The 5% threshold aligns with the effective tax rate reconciliation disclosure threshold in US SEC Regulation S-X, Title 17 CFR § 210.4-08(h)(2).

Effective Tax Rate Reconciliation Category	Further Required Disaggregated Information
State and local income tax, net of federal (national) income tax effect	Qualitative information only (see Section 2.3.1)
Foreign tax effects	Quantitative, by nature [Note 1] and jurisdiction
Effect of cross-border tax laws	Quantitative, by nature
Enactment of new tax laws	None
Nontaxable or nondeductible items	Quantitative, by nature
Tax credits	Quantitative, by nature
Changes in valuation allowances	None
Changes in unrecognized tax benefits	None
Other adjustments [Note 2]	Quantitative, by nature

Note 1: When disaggregating reconciling items by nature, ASC 740-10-50-12A(b) explains that entities should consider the reconciling item's fundamental or essential characteristics, such as the event that caused the reconciling item and the activity that is associated with the reconciling item. For example, reconciling items within the "Tax credits" category may be disaggregated by type of credit, such as research and development or energy tax credits.

Note 2: The "Other adjustments" category is used for reconciling items that do not fit within the eight categories specified in ASC 740-10-50-12A(a). See Section 2.10 for further information.

All reconciling items are required to be presented on a gross basis within the annual effective tax rate reconciliation, except for the following items specified in ASC 740-10-50-12A(c):

- Taxes on cross border income imposed by the entity's country of domicile may be presented net of the related tax credits within the "Effect of cross-border tax laws" category if the taxes and credits relate to the same income during the same reporting period (e.g., Global Intangible Low-Taxed Income [GILTI] net of foreign tax credits).

- An unrecognized tax benefit recognized in the current annual period for a tax position taken or expected to be taken in the same reporting period may be presented on a net basis in the category where the tax position is presented. For example, current year research and development credits may be presented net with the current year unrecognized U.S. federal tax benefit in the "Tax credits" category.
- Reconciling items presented in the "Changes in unrecognized tax benefits category" may be presented on a combined basis for all jurisdictions.

RSM COMMENTARY: Materiality Considerations

Entities should view the disclosure requirements in ASC 740-10-50-12A through 50-12C through the lens of materiality. ASC 105-10-05-6 states that "the provisions of the Codification need not be applied to immaterial items." As a result, the amendments on the disclosure of reconciling items by specific categories with further disaggregation of reconciling items within those categories based on the application of a quantitative threshold do not apply to immaterial items. In other words, an entity does not need to separately disclose the specific categories or reconciling items if they are immaterial, even if the quantitative threshold specified in ASC 740-10-50-12A(b) is met (paragraph BC22 in ASU 2023-09). See Section 4.2 for further discussion.

Further guidance with respect to each individual category within the effective tax rate reconciliation is discussed below.

2.2 Income taxes calculated at the federal (national) statutory rate

The starting point of the effective tax rate reconciliation is the entity's consolidated income tax expense (or benefit) calculated by multiplying consolidated income from continuing operations before income taxes by the federal statutory tax rate of the entity's country of domicile.

Although not defined in ASC 740, an entity's country of domicile is generally understood as the entity's principal place of business (i.e., where the entity conducts its primary business activities).

Example 2-1: Income taxes calculated at the federal statutory rate

Entity A is a U.S. domiciled corporation that conducts business in both the United States and internationally. For the year ended December 31, 20X6, Entity A has consolidated pretax income from continuing operations of $10,500,000, of which $7,500,000 is U.S.-sourced income, with the remainder being sourced from its foreign operations. Based on the U.S. federal statutory tax rate of 21% as of December 31, 20X6, the beginning amount reported in Entity A's effective tax reconciliation in accordance with ASC 740-10-50-12 is $2,205,000, calculated as:

$10,500,000 (consolidated pretax income from continuing operations) x 21% (the federal statutory rate of the country in which the entity is domiciled) = $2,205,000

RSM COMMENTARY: Domestic versus foreign sourced income

In the example above, Entity A used total consolidated pretax income from continuing operations to calculate the starting point of its effective tax rate reconciliation rather than utilizing only the pretax income sourced from its U.S. operations. This is necessary to appropriately reflect the impact of the foreign sourced income as a reconciling item between the entity's income taxes calculated at the federal statutory tax rate of the country in which it is domiciled (i.e., the U.S. tax rate of 21%) and its actual effective tax rate.

2.2.1 Considerations for entities not domiciled in the United States

ASC 740-10-50-12 indicates that an entity that is not domiciled in the U.S. would normally use the federal statutory income tax rate of its country of domicile in preparing its effective tax rate reconciliation. However, when the rate used is other than the U.S. federal corporate tax rate, the entity must disclose both the statutory rate used and the basis for using that rate.

Although ASC 740 permits non-U.S.-domiciled entities to use a rate other than the federal statutory rate of its jurisdiction of domicile, it does not provide guidance on how to determine or when to use an alternative rate as the starting point of the effective tax rate reconciliation. Paragraph BC38 of ASU 2023-09 indicates that an entity would be expected to apply judgment in determining the appropriateness of using a different statutory income tax rate if the entity is domiciled in a jurisdiction with an income tax rate significantly lower than the U.S. statutory income tax rate.

2.3 State and local income taxes, net of federal income tax effect

ASC 740-10-50-12A(c) states that the state and local income tax category reflects income taxes imposed at the state or local level within the entity's jurisdiction (country) of domicile. As a result, for a U.S.-domiciled entity, this category includes state, city, county and any other local income taxes within the U.S.

The "State and local income taxes, net of federal income tax effect" category includes all current and deferred income taxes related to the state and other local jurisdictions and, where applicable, reconciling items within this category are presented net of the related federal statutory income tax benefit resulting from the deductibility of the state and local income taxes for federal purposes. Accordingly, this effective tax rate category includes tax credits, non-taxable and non-deductible items, changes in deferred tax asset valuation allowances, and changes in tax laws and rates related to these state and local jurisdictions. However, this reconciliation category excludes income taxes related to state and local jurisdictions outside of the entity's country of domicile; such state and local income taxes would be included within the "Foreign tax effects" category described in Section 2.4.

RSM COMMENTARY: State and local income taxes, net of federal income tax effect

Presenting the impact of state and local income taxes on an entity's effective tax rate reconciliation in accordance with the new disclosure requirements may result in a change in practice for some entities. Prior to the adoption of ASU 2023-09, many entities included the effects of state and local taxes and, as applicable, foreign taxes, together with the related federal income tax effects within specific rate reconciliation line items that were disaggregated by nature. For example, the changes in the deferred tax assets valuation allowance reconciling line item would include changes related to federal, state and foreign taxes. Pursuant to ASC 740-10-50-12A(c) all changes related to state and local taxes within the entity's jurisdiction of domicile are required to be aggregated and reflected on a single line item within the effective tax rate reconciliation. For example, changes in the state deferred tax assets valuation allowance are required to be included within the "State and local taxes, net of federal income tax effect" reconciling line item.

Example 2-2: State and local income taxes, net of federal income tax effect

[Continued from Example 2-1.]

Within the U.S., Entity A conducts business in four states (New York, Illinois, New Jersey and Indiana). For the year ended December 31, 20X6, state and local income tax expense totaled $531,646, which is deductible for U.S. federal tax purposes.

The amount reported in the year-end effective tax rate reconciliation disclosure within the "State and local income taxes, net of federal income tax effect" category is $420,000, which is calculated as:

(State and local income taxes) x (100% – federal statutory tax rate percentage)

or

$531,646 x (100% - 21% [the U.S. federal statutory tax rate]) = $420,000

2.3.1 Required supplementary qualitative disclosures about certain components of the state and local income tax category

Pursuant to ASC 740-10-50-12B, a PBE is required to provide a qualitative description of the state and local jurisdictions that make up the majority of the effect of the state and local income tax category. To identify those state and local jurisdictions, a PBE should start with the state or local jurisdiction that has the largest effect and then add jurisdictions in descending order of their effect until the cumulative effect of those jurisdictions is greater than 50 percent of the "State and local income taxes, net of federal income tax effect" category.

Example 2-3: Determining the state and local jurisdictions that make up the majority of the state and local tax category

[Continued from Example 2-2.]

Entity A calculates the total income tax expense for each state (and the localities within those states in which it operates) and then lists those amounts in order from the highest to the lowest to identify the jurisdictions that, individually or in the aggregate, represent more than 50% of the entity's total state and local tax expense.

Year Ended December 31, 20X6			
	Income Tax Expense (Net of Federal Benefit)	Percent of Total S&L Taxes	Cumulative Percent of Total S&L Taxes
New York	$152,470	36.3%	36.3%
Illinois	116,130	27.8%	64.0%
New Jersey	81,370	N/A	N/A
Indiana	70,030	N/A	N/A
Total state and local taxes	$420,000		

The table above shows that the combined income tax expense related to New York and Illinois represents over 50% of the effect of Entity A's state and local tax category. As a result, New York and Illinois are required to be identified in a note to the effective tax rate reconciliation as the jurisdictions representing the majority of the state and local income tax category in accordance with ASC 740-10-50-12B.

RSM COMMENTARY: Alternate method to determine which jurisdictions represent the majority of the state and local income tax category

As noted in paragraph BC40 of ASU 2023-09, an entity may use the data supporting the composite (or blended) state tax rate used to compute the state tax provision for financial reporting purposes to identify which state and local jurisdictions represent the majority of the effect of the state and local income tax rate category on its effective tax rate reconciliation.

2.4 Foreign tax effects

The "Foreign tax effects" category on the effective tax rate reconciliation captures the effect of income taxes levied on income by a jurisdiction outside the entity's jurisdiction (country) of domicile. It includes the income tax effects of federal, state (or similar type tax jurisdictions, such as provinces in Canada) and all other local taxing jurisdictions that are outside the entity's country of domicile. The foreign tax effects category excludes cross-border taxes imposed by the entity's country of domicile on income earned in foreign jurisdictions. It also excludes any reconciling items related to changes in unrecognized tax benefits, which are aggregated with federal, state and local taxes and separately disclosed as a single line item titled "Unrecognized tax benefits."

In accordance with ASC 740-10-50-12A(b)(2), reconciling items within the foreign tax effects category must be disaggregated by both country and nature. If a foreign jurisdiction meets or exceeds the 5% threshold, it should be disclosed separately as a reconciling item. Additionally, any reconciling item within any foreign jurisdiction should be separately disclosed by nature if its gross amount (positive or negative) meets or exceeds the 5% threshold, regardless of whether the jurisdiction itself meets or exceeds the 5% threshold.

Example 39, Case A from ASC 740-10-55-231 (reproduced in Section 7.1.1) further illustrates the disclosure of foreign tax effects in accordance with ASC 740-10-50-12A(b)(2).

A common reconciling item within the foreign tax effects category is the difference between the federal statutory rate of the entity's country of domicile and the federal statutory rate in the foreign jurisdiction. The formula used to calculate this differential is:

Foreign pretax income (loss) from continuing operations x (Foreign jurisdiction federal statutory tax rate – Country of domicile federal statutory tax rate)

While this is a common reconciling item, the current U.S. federal rate of 21% is comparable with that of many foreign jurisdictions. As a result, the federal statutory tax rate differential may not meet the 5% threshold that would require separate disclosure within the effective tax rate reconciliation.

Other reconciling items that may need to be disaggregated by nature within the "Foreign tax effects" category include, but are not limited to, state and local income taxes, nontaxable or nondeductible items, changes in valuation allowances, and tax credits.

Example 2-4: Disaggregation within the foreign income tax category

[Continued from Example 2-3.]

Entity A's international operations include business activities conducted through its wholly-owned subsidiaries in Macau, the United Kingdom and China. The statutory income tax rates were 12%, 25% and 25%, respectively.

Macau meets the 5% threshold for separate disclosure under the "Foreign tax effects" category in accordance with ASC 740-10-50-12A(b)(2) based on pretax income from continuing operations of $1,850,000. Components of Macau's income tax expense that also meet or exceed the 5% threshold for separate disclosure include the reduction in the deferred tax assets valuation allowance of $125,000 and the statutory tax rate difference between Macau and the U.S. of ($166,500), which was calculated as:

Foreign pretax income from continuing operations of $1,850,000 x (Foreign jurisdiction federal statutory tax rate of 12% – Country of domicile federal statutory tax rate of 21%) = ($166,500).

In accordance with ASC 740-10-50-12A(b), the 5% threshold used to identify reconciling items requiring separate disclosure is $110,250, which was calculated as:

Consolidated pretax income from continuing operations of $10,500,000 x (U.S. federal income tax rate of 21% x 5%) = $110,250.

There are no other foreign tax items either at the country level or individual reconciling items of the same nature within each jurisdiction level that meets or exceeds the 5% threshold.

Based on the above facts, Entity A would present the following details (among other information) within the "Foreign tax effects" category of its effective tax rate reconciliation in accordance with ASC 740-10-50-12A:

	Year Ended December 31, 20X6
Foreign tax effects	
Macau:	
Statutory tax rate difference	($166,500)
Change in valuation allowance	(125,000)
Other foreign jurisdictions Note 1	52,000

Note 1: Foreign pretax income from continuing operations for the United Kingdom and China totaled $1.3 million. The rate differential was calculated as:

Foreign pretax income from continuing operations of $1,300,000 x (Foreign jurisdiction federal statutory tax rate of 25% – Jurisdiction of domicile federal statutory tax rate of 21%) = $52,000

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

The "Effect of changes in tax laws or rates enacted in the current period" category in the effective tax rate reconciliation includes the cumulative tax effects of a change in enacted tax laws or rates on current or deferred tax assets and liabilities at the date of enactment. The date of enactment is defined as the date that the legislation becomes law, rather than the date or period that the law became effective. Entities should not recognize the impact of rate changes prior to the date of enactment, regardless of the likelihood of such changes occurring.

Importantly, the amounts reported in this reconciling line item are limited to those resulting from changes in the federal tax laws or rates of the entity's country of domicile. In other words, this effective tax rate reconciliation category does not include the tax effects of new tax laws enacted by state, local or foreign jurisdictions, which would be included in either the "State and local income tax, net of federal (national) income tax effect" or the "Foreign tax effects" category.

Example 2-5: Changes in enacted tax laws or rates

[Continued from Example 2-4.]

On November 15, 20X6, the United States enacted legislation that will lower the corporate tax rate to 15% from the current rate of 21%. The new tax rate becomes effective on January 1, 20X7.

Because the newly enacted tax rate is effective on January 1, 20X7, Entity A will use the 21% federal income tax rate to calculate its current taxes payable (refundable) for the year; however, deferred taxes at December 31, 20X6, will be measured using the new 15% tax rate because that is the federal income tax rate that will be effective in the period when the deferred taxes are expected to be realized or settled.

Assuming net taxable temporary differences of $2,500,000 as of December 31, 20X6, the impact of the rate change on Entity A's taxes, which is separately presented in the effective tax rate reconciliation in accordance with ASC 740-10-50-12A(a)(3), is $150,000 based on the following calculation:

	Year Ended December 31, 20X6
Impact on rate reconciliation of change in enacted federal tax rates:	
Deferred tax liability at current federal rate ($2,500,000 x 21%)	(525,000)
Deferred tax liability at the enacted federal tax rate ($2,500,000 x 15%)	(375,000)
Effect of changes in tax laws or rates enacted in the current period	($150,000)

2.6 Effect of cross-border tax laws

The "Effect of cross-border tax laws" category of the effective tax rate reconciliation includes the effect of incremental income taxes imposed by the jurisdiction of domicile on an entity's income earned in foreign jurisdictions. For a U.S.-domiciled entity, examples include the tax effects related to GILTI, base erosion and anti-abuse tax, and foreign-derived intangible income.

ASC 740-10-50-12A(c)(3) permits an entity to present cross-border taxes net of related tax credits provided by the same jurisdiction of domicile, provided such taxes and credits relate to the same income during the same reporting period.

Reconciling items within this category are required to be disaggregated by nature and separately disclosed if they meet or exceed the 5% threshold in accordance with ASC 740-10-50-12A(b).

Example 2-6: Effect of cross border tax laws

[Continued from Example 2-5.]

Entity A has a wholly-owned subsidiary, Sub X, located in Macau, which develops and holds patents for cutting-edge software solutions. Sub X is classified as a Controlled Foreign Corporation under U.S. tax law. Entity A is subject to GILTI tax because Sub X operates in a low-tax foreign jurisdiction.

For the year ended December 31, 20X6, Sub X has net income from continuing operations exceeding the return on tangible assets of $1,780,000. Based on a GILTI tax rate of 12.5%, Entity A's GILTI tax expense is $222,500. Related tax credits are $187,500 based on a percentage of foreign taxes paid by Sub X. Entity A is not subject to any other cross-border taxes.

Based on the above assumed facts, the impact of cross-border tax laws separately reported on Entity A's effective tax rate reconciliation for the year ended December 31, 20X6, is $35,000, or $222,500 (GILTI taxes) - $187,500 (eligible tax credits), as permissible pursuant to ASC 740-10-50-12A(c)(3).

2.7 Tax credits

The "Tax credits" category of the effective tax rate reconciliation includes the effect of all tax credits related to the federal income taxes imposed by the entity's country of domicile. Common U.S. federal income tax credits include investment tax credits, production tax credits, research and experimentation credits, work opportunity credits, and foreign tax credits. These credits are generally nonrefundable and nontransferable and therefore accounted for under ASC 740.[2] State, local and foreign jurisdictions offer similar types of credits; however, those tax credits are reported within the respective "State and local taxes" or "Foreign tax effects" category of the effective tax rate reconciliation, rather than the "Tax credits" category.

Except for certain tax credits related to cross-border taxes (see Section 2.6), ASC 740-10-50-12A(b) requires eligible tax credits to be presented on a gross basis within the effective tax rate reconciliation. In addition, reconciling items within the "Tax credits" category are required to be disaggregated by nature and separately disclosed if they meet or exceed the 5% threshold in accordance with ASC 740-10-50-12A(b) (3).

RSM COMMENTARY: Reporting the impact of tax credits within the effective tax rate reconciliation

It is important to understand the difference between tax credits and other reconciling items within the effective tax rate reconciliation. Tax credits directly reduce the income tax amounts (e.g., a tax credit of $100 directly reduces income tax expense by $100) while other reconciling items generally reduce or increase the income subject to taxation, which indirectly reduces or increases the income taxes after applying the applicable income tax rate. Therefore, tax credits are not tax effected within the effective tax rate reconciliation, while other reconciling items generally are tax effected.

2.8 Changes in valuation allowances

The "Changes in valuation allowances" category within the effective tax rate reconciliation includes changes to federal deferred tax asset valuation allowances that are initially recognized or subsequently adjusted during the year. Only changes in deferred tax asset valuation allowances related to federal taxes in the entity's country of domicile are captured in this reconciliation category and no further disaggregation of amounts is required (i.e., this category is not subject to the 5% threshold analysis). Changes in state and local or foreign deferred tax asset valuation allowances are reported within the "State and local taxes" or "Foreign tax effects" category, as applicable.

RSM COMMENTARY: Impact on legacy practices for reporting valuation allowances

Prior to the adoption of ASU 2023-09, many PBEs aggregated the change in domestic federal, state and local, and all foreign jurisdiction deferred tax asset valuation allowances within the same line item of the effective tax rate reconciliation. This usually reconciled to the similarly titled amount reflected in the deferred tax assets and liabilities disclosure required by ASC 740-10-50-2 or the valuation allowance roll forward because these disclosures were presented on a worldwide consolidated basis. The adoption of ASU 2023-09 will result in a change in the presentation of changes in valuation allowance within the rate reconciliation because ASC 740-10-50-12A requires:

- Income taxes, including changes in valuation allowances, imposed at the state or local level within the country of domicile to be presented in the "State and local income tax, net of federal income tax effect" category
- Income taxes, including changes in valuation allowances, imposed by foreign jurisdictions to be presented in the "Foreign tax effects" category
- The remaining categories listed in ASC 740-10-50-12A(a) to reflect federal income taxes imposed by the country of domicile

[2] Only tax credits subject to ASC 740 are reflected in an entity's effective tax rate reconciliation prepared in accordance with U.S. GAAP.

Example 2-7: Changes in valuation allowances

[Continued from Example 2-6.]

At December 31, 20X5, Entity A reported a valuation allowance of $700,000 related to U.S. federal net operating losses generated in its first year of operation. However, after considering the pretax income reported since its initial year of operations and all other available evidence, Entity A now concludes that it is more likely than not that the full amount of its U.S. federal deferred tax assets will be realized. As a result, Entity A reverses the full valuation allowance of $700,000 as of December 31, 20X6, and reflects that change as a negative amount within the “Changes in valuation allowances” category of its effective tax rate reconciliation.

2.9 Nontaxable or nondeductible items

Based on how the terms nontaxable and nondeductible are used in ASC 740, we believe the types of reconciling items included under the “Nontaxable or nondeductible items” category of the effective tax rate reconciliation include:

- Income that is permanently excluded from taxable income (i.e., not subject to tax, such as interest from municipal bonds)
- Expenses that cannot be deducted for tax purposes, such as fines and penalties and certain meals and entertainment expenses
- Items with no tax effect due to scope exceptions (e.g., the exception related to the second component of goodwill where book goodwill exceeds tax deductible goodwill as discussed in ASC 805-740-25-9)

Reconciling items within the nontaxable or nondeductible category are required to be further disaggregated by nature and separately disclosed if they meet or exceed the 5% threshold in accordance with ASC 740-10-50-12A(b)(3).

Example 2-8: Nontaxable or nondeductible items

[Continued from Example 2-7.]

Entity A reviewed its list of nontaxable and nondeductible items and identified two permanent book versus tax differences that may require separate presentation within its effective tax rate reconciliation in accordance with ASC 740-10-50-12A(a)(7) for the year ended December 31, 20X6:

- Nontaxable interest income of ($1,000,000), with a tax effect of ($210,000)
- Nondeductible meals and entertainment expenses of $700,000, with a tax effect of $147,000

Although the combined (net) tax-effected value of items identified ($63,000) is below the threshold for disaggregation ($110,250 [see calculation in Example 2-4]), the gross amount of each reconciling item exceeds the 5% threshold and therefore must be separately presented (among other information) on the effective tax rate reconciliation as illustrated below:

	Year Ended December 31, 20X6
Nontaxable or nondeductible items	
Tax exempt interest income	($210,000)
Meals and entertainment	147,000

2.10 Changes in unrecognized tax benefits

The "Changes in unrecognized tax benefits" category includes reconciling items that result from changes in judgment related to tax positions taken in prior annual reporting periods (e.g., subsequent recognition, derecognition and change in measurement of unrecognized tax benefits), which may be disclosed on an aggregated basis for all jurisdictions. Further disaggregation of reconciling items within this category is not required.

Unrecognized tax benefits (UTB) arising in the current year may also be disclosed within the "Changes in unrecognized tax benefits" category on an aggregated basis for all jurisdictions. Alternatively, entities may choose to present current year UTB and the related tax position on a net basis within the category where the tax position is presented. For example, a current year unrecognized U.S. federal tax benefit related to certain nondeductible expenses may be netted against the related item within the nontaxable and nondeductible expenses category. However, when the current year's UTB is presented net of the item giving rise to the UTB within a category other than the "Changes in unrecognized tax benefits" category, the current year UTB should not be aggregated for all jurisdictions.

3. RATE RECONCILIATION REQUIREMENTS FOR ENTITIES OTHER THAN PBES

Entities other than PBEs are not required to provide the numerical tabular reconciliation of the effective tax rate discussed in Section 2 above, which is consistent with legacy disclosure requirements. Instead, ASC 740-10-50-13 requires that entities other than PBEs qualitatively disclose the nature and effect of specific categories of reconciling items (as outlined in Section 2.1) and individual jurisdictions that result in a significant difference between the statutory tax rate and the effective tax rate. Accordingly, if state or foreign income taxes significantly impact an entity's effective tax rate, the jurisdictions that contribute to the increase or decrease in the rate should be disclosed.

See Section 7.2 for an example of a qualitative rate reconciliation for an entity other than a PBE.

4. OTHER RATE RECONCILIATION CONSIDERATIONS

4.1 Other judgments required when preparing the effective tax rate reconciliation

When the FASB issued ASU 2023-09, it recognized that the effective tax rate reconciliation categories specified in ASC 740-10-50-12A(a) may not encompass all income tax effects. Therefore, judgment may be required to categorize certain income tax effects that do not clearly fit into a single category. Additionally, judgment may be needed when categorizing income tax effects with characteristics of multiple categories or when assessing reconciling items for further disaggregation as per ASC 740-10-50-12A(b). In cases where judgment is applied, an entity should consider whether financial statement users are able to understand the nature and magnitude of the factors contributing to the difference between the entity's effective tax rate and their statutory tax rate (see disclosure objectives discussed in Section 2). An entity should also consider if an accompanying explanation is necessary. For instance, an entity might include the tax effects of share-based payment awards (e.g., nondeductible expenses, shortfalls and windfalls) in the "Nontaxable or nondeductible items" category, even if windfalls alone might not exclusively relate to this category. In this scenario, the entity should provide an explanation detailing the types of tax effects included in the "Nontaxable or nondeductible items" category in accordance with ASC 740-10-50-12C.

Judgment may be required to determine the appropriate category for a reconciling item. If an entity determines that the reconciling item does not fall into any specified category, it must disclose the reconciling item separately within the "Other adjustments" catchall category of the effective tax rate reconciliation if it meets or exceeds the 5% threshold, in accordance with ASC 740-10-50-12A(b)(3).

4.2 Materiality considerations

When the FASB exposed for comment the disclosure requirements that were later codified through ASU 2023-09, several stakeholders requested clarification from the FASB regarding whether and how materiality should be considered when evaluating if reconciling items meeting the quantitative threshold must be disclosed. The FASB noted that the guidance in ASC 105-10-05-6, which states that the provisions of the Codification need not be applied to immaterial items, applies to the amendments in this update, as it does to all Codification guidance. Therefore, the amendments on the disclosure of reconciling items by specific categories with further disaggregation based on a quantitative threshold do not apply to immaterial items. In other words, an entity is not required to separately disclose the specified categories or reconciling items if they are immaterial, even if the quantitative threshold is met.

When assessing the concept of materiality and determining the level of detail to be disclosed in accordance with ASC 740-10-50-12A through 50-13 to keep the overall financial statements from being misstated or misleading, entities should focus on the total mix of information from the perspective of a reasonable investor. To be consistent with the concept of materiality, this assessment should be objective and should take into consideration all relevant facts and circumstances, including both quantitative and qualitative factors. Entities that file financial statements with the SEC should note that the SEC staff has repeatedly commented that a materiality analysis is not a mechanical exercise, nor should it be based solely on a quantitative analysis.

4.3 Gross versus net presentation

ASC 740 generally requires presenting impacts to the effective tax rate reconciliation on a gross basis to allow investors to see the full extent of tax expenses and credits, providing a clearer picture of the entity's tax situation. This means that each tax effect should be disclosed separately without netting them against related tax benefits.

However, net presentation is permitted in specific cases where certain conditions are met. For instance, net presentation is allowed when cross-border tax laws and related foreign tax credits are involved, particularly when a credit is an inherent part of the tax calculation. An example of this is the GILTI tax regime, where the foreign tax credits directly reduce the GILTI tax liability. Therefore, the net effect of GILTI and its related foreign tax credits can be presented together within the "Cross-border tax credits" category.

Another exception to the gross presentation requirement is for unrecognized tax benefits with related tax positions taken or expected to be taken in the same reporting period. This means if an entity has a current year uncertain tax position that results in an unrecognized tax benefit, and this position is related to a specific tax position, the net amount can be presented in the category where the tax position is recorded in the rate reconciliation. For example, if an entity anticipates that a tax authority will challenge a deduction, the entity can present the net effect of the deduction and the related tax reserve.

In summary, while the FASB decided to generally require gross presentation for transparency, it recognized that in certain limited cases, net presentation may provide a more accurate reflection of the entity's tax position, particularly where cross-border tax laws and related foreign tax credits are inherently linked, or for unrecognized tax benefits tied to specific tax positions.

4.4 Withholding taxes

Withholding taxes refer to the portion of an entity’s income that is deducted by the payer entity and paid directly to the government within the tax jurisdiction where the income is generated. This type of tax is commonly applied to cross-border transactions, such as payments of dividends, interest, royalties or fees for services rendered.

Withholding taxes that are accounted for under ASC 740 are included in the effective tax rate reconciliation either within the “Effect of cross-border tax laws” or “Foreign tax effects” category. Specifically, if the taxes are collected by a foreign jurisdiction, they are reflected within the “Foreign tax effects” category. If collected by the entity’s jurisdiction of domicile, they are reflected within the “Effect of cross-border tax laws” category (See Section 2.6).

Withholding taxes that fall outside the scope of ASC 740, such as those described in ASC 740-10-15-4(b), are excluded from the effective tax rate reconciliation.

4.5 Pillar Two taxes

The Organisation for Economic Co-operation and Development issued the Global Anti-Base Erosion Model Rules framework in 2021. This framework, also known as Pillar Two, would require entities that meet certain criteria to pay a minimum level of taxes (a “top-up tax”) when their effective tax rate falls below 15% in a jurisdiction. The Pillar Two framework becomes applicable only after relevant legislation is enacted in a tax jurisdiction.[3] While the specific legislative measures may vary by jurisdiction, they are expected to include one or more of the following taxing mechanisms, tailored to meet the needs of the respective jurisdiction. The following is an overview of the key tax collection mechanisms expected to be incorporated into Pillar Two tax legislation within a jurisdiction:

- Qualified Domestic Minimum Tax: Enables the entity's low-tax jurisdiction of domicile to collect the top-up tax.
- Income Inclusion Rule: Allows the parent’s jurisdiction to collect the top-up tax.
- Undertaxed Profit Rule: Permits jurisdictions of brother/sister or subsidiary entities within a group to collect the top-up tax.

Based on guidance provided by the FASB staff in 2023, Pillar Two taxes are treated as alternative minimum taxes and are therefore accounted for as period costs within the effective tax rate reconciliation.

Similar to withholding taxes discussed in Section 4.4, where the Pillar Two taxes are reported within the effective tax rate reconciliation depends on the jurisdiction assessing the tax. Pillar Two taxes should be reported under the “Cross-border taxes” category when assessed by the entity’s country of domicile or the “Foreign tax effects” category when they are assessed by a foreign jurisdiction. In addition, taxes reported within the “Foreign tax effects” category may need to be further disaggregated by country if the threshold for further disaggregation is met.

[3] As of the date of this publication, although Pillar Two has not yet been enacted in the U.S., many foreign jurisdictions have enacted this legislation. As a result, some U.S. entities meeting the Pillar Two criteria may be subject to top-up taxes if their parent or subsidiaries operate in foreign jurisdictions that have enacted the laws.

4.6 Refundable and transferable tax credits

The Inflation Reduction Act of 2022 and the CHIPS and Science Act of 2022 introduced additional mechanisms for monetizing certain U.S. federal tax credits, including the ability for entities to either:

- Receive payments directly from the government that are not related to the entity's tax liability (refundable credits)
- Transfer the credits to a third party in exchange for cash (transferable credits)

These refundable or transferable credits may, under certain circumstances, be accounted for under other generally accepted accounting principles (GAAP) (e.g., by analogy to International Accounting Standards (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance),* rather than under ASC 740.

Entities should be mindful that only tax credits that are accounted for under ASC 740 are reflected in the effective tax rate reconciliation. As a result, those credits that are accounted for under other GAAP (e.g., IAS 20) would not be included in the reconciliation.

5. INCOME TAXES PAID

Annually, all entities are required to disclose the amount of income taxes paid, net of refunds received and disaggregated by federal (national), state and foreign jurisdiction. All entities are also required to disclose the amount of income taxes paid, net of refunds received, to each individual jurisdiction that comprises 5% or more of total income taxes paid (net of refunds received). The 5% threshold is evaluated using the absolute value of the net refund or net payment in each jurisdiction compared to the absolute value of the total income taxes paid (net of refunds received) (see ASC 740-10-50-22 and 50-23).

For this purpose, each domestic or foreign federal, state or local jurisdiction is considered an individual jurisdiction. If an entity has separate tax-paying components filing separate tax returns with an individual taxing authority, then all amounts paid by the various tax-paying components to each individual taxing authority is combined when determining:

- The amount paid to an individual jurisdiction
- Whether that amount meets or exceeds the 5% disclosure threshold

See Section 7.3 for an example of an income taxes paid disclosure.

6. DISCLOSURES ADDED OR ELIMINATED BY ASU 2023-09

6.1 Pretax income and income tax expense disclosures

ASU 2023-09 added a disclosure requirement to further disaggregate income from continuing operations and the related income tax expense from continuing operations by jurisdiction. Specifically, for each annual reporting period, ASC 740-10-50-10A through 50-10B requires entities to disaggregate:

- Income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between its domestic and foreign components
- Income tax expense (or benefit) from continuing operations disaggregated between its federal (national), state and foreign components
    - Components of income tax expense (or benefit) are classified based on the jurisdiction that assesses the tax (e.g., for a U.S. domiciled entity, withholding taxes paid to a foreign jurisdiction are classified as foreign income taxes while the effects of cross-border taxes that are assessed by the U.S. government on the entity's earnings from a foreign jurisdiction are classified as domestic (federal) income taxes)

These new disclosures are incremental to the existing disclosures required under ASC 740-10-50-9 through 50-10 and Item 4.08(h) of Regulation S-X.

6.2 Changes in unrecognized tax benefits

Prior to ASU 2023-09, ASC 740-10-50-15 required disclosure of unrecognized tax benefits that could change in the next 12 months. ASU 2023-09 removes the disclosure in ASC 740-10-50-15(d) because, in part, the requirement to disclose the nature and estimate of the range of the reasonably possible change in unrecognized tax benefits in the next 12 months is difficult to reliably predict and may not provide meaningful information to investors.[4] However, as noted in paragraph BC91 of ASU 2023-09, entities will still need to consider whether disclosure is required under ASC 275, *Risks and Uncertainties*. ASC 275-10-50-8 requires disclosure of estimates that should be made when known information available before the financial statements are issued or are available to be issued indicates that both of the following criteria are met:

- It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events.
- The effect of the change would be material to the financial statements.

6.3 Undistributed earnings of subsidiaries and corporate joint ventures

ASC 740-30-50-2 requires specific disclosures when a deferred tax liability is not recognized because of the exceptions to the comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures. ASU 2023-09 retains substantially all of the disclosure requirements but removes ASC 740-30-50-2(b), which required disclosure of the cumulative amount of each type of such temporary differences. The FASB's decision to remove this paragraph was based on the reduced relevance of such disclosures after the Tax Cuts and Jobs Act (the Jobs Act), which generally allows repatriation of foreign earnings without incurring U.S. federal income taxes. Stakeholders indicated that the tax consequences of indefinite reinvestment assertions are significantly less impactful post-Jobs Act, and that the disclosures required by ASC 740-30-50-2(b) could be misleading and costly to prepare.

7. ILLUSTRATIVE EXAMPLES

7.1 Effective tax rate reconciliation for PBEs

7.1.1 Example from the FASB Accounting Standards Codification

Example 7-1: Rate Reconciliation Between Income Tax Expense (or Benefit) and Statutory Expectations - Case A: Public Business Entity (ASC 740-10-55-231)

The following illustrates the specific categories and the reconciling items disclosed by a public business entity in its tabular rate reconciliation in accordance with paragraphs 740-10-50-12A through 50-12B. The entity is domiciled in the United States and presents comparative financial statements. For the disclosure of foreign tax effects in accordance with paragraph 740-10-50-12A(b)(2), it is assumed that the 5 percent threshold, computed by multiplying the income (or loss) from continuing operations before income taxes by the applicable statutory federal (national) income tax rate of the United States, is met:

a. For Ireland, both at the jurisdiction level and for certain individual reconciling items of the same nature within Ireland

b. For the United Kingdom, for certain individual reconciling items of the same nature within the United Kingdom, but not at the jurisdiction level

[4] See paragraph BC88 of ASU 2023-09.

c. For Switzerland and Mexico, at the jurisdiction level, but not for any individual reconciling items of the same nature within each jurisdiction.

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

	Year Ended December 31, 20X2		Year Ended December 31, 20X1		Year Ended December 31, 20X0	
	Amount	Percent	Amount	Percent	Amount	Percent
Foreign-derived intangible income	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Bare erosion and anti-abuse tax	AA	aa	BB	bb	CC	cc
Other	AA	aa	-	-	-	-
Tax Credits						
Research and development tax credits	-	-	(BB)	(bb)	(CC)	(cc)
Energy-related tax credits	(AA)	(aa)	-	-	-	-
Other	-	-	(BB)	(bb)	-	-
Changes in Valuation Allowances	AA	aa	(BB)	(bb)	(CC)	(cc)
Nontaxable or Nondeductible Items						
Share-based payment awards	AA	aa	BB	bb	CC	cc
Goodwill impairment	AA	aa	BB	bb	-	-
Other	AA	aa	(BB)	(bb)	CC	Cc
Changes in Unrecognized Tax Benefits	(AA)	(aa)	BB	bb	(CC)	(cc)
Other Adjustments	AA	aa	(BB)	(bb)	(CC)	(cc)
Effective Tax Rate	$AA	aa%	$BB	bb%	$CC	cc%

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

7.1.2 Example rate reconciliation with references to supporting calculations

Example 7-2: Effective Tax Rate Reconciliation Disclosure

The following illustrates the specific categories and the reconciling items disclosed by Entity A in its tabular effective tax rate reconciliation disclosure in accordance with ASC 740-10-50-12A through 50-12B.

Entity A is a corporation that is domiciled in the U.S. and conducts business in the U.S., Macau, the United Kingdom and China. Within the U.S., Entity A operates in New York, New Jersey, Illinois and Indiana. For the year ended December 31, 20X6, consolidated pretax income from continuing operations totaled $10,500,000.

The assumptions used to prepare Entity A's effective tax rate reconciliation disclosure are primarily derived from earlier illustrations:

- Income taxes calculated at the federal statutory rate (Example 2-1)
- State and local income taxes, net of federal income tax effect (Example 2-2)
- Foreign tax effects (Example 2-4)
- Changes in enacted tax laws and rates (Example 2-5)
- Effect of cross border tax laws (Example 2-6)
- Changes in valuation allowances (Example 2-7)
- Nontaxable or nondeductible items (Example 2-8)

Other assumptions include:

- U.S. federal research and development tax credits totaled $197,050. Entity A is not eligible for any other U.S. federal income tax credits, except for those related to cross-border tax laws (which are addressed separately in the effective tax rate reconciliation).
- Changes in estimates related to the prior year unrecognized tax benefits totaling ($595,000) on a gross basis were made after determining that the related income tax position was sustained upon audit. The income tax effect of these changes is ($124,950).
- There was no income from discontinued operations, other comprehensive income or cumulative effect of change in accounting principles during the year.
- Other adjustments include reconciling items that do not pertain to any of the reconciling item categories specified in ASC 740-10-50-12A(a). In addition, none of the items included in the other adjustments category meet the 5% threshold for separate disclosure by nature.

	Year ended December 31, 20X6	
	Amounts	Percentages [5]
Income taxes at the U.S. federal statutory tax rate	$2,205,000	21.0%
State and local income taxes, net of federal income tax benefit [(1)]	420,000	4.0
Foreign tax effects		
Macau:		
Statutory tax rate differential	(166,500)	(1.6)
Change in valuation allowance	(125,000)	(1.2)
Other foreign jurisdictions	52,000	0.5
Effect of changes in tax laws and rates enacted in the current period	(150,000)	(1.4)
Effect of cross-border tax laws	35,000	0.3
Tax credits	(197,050)	(1.9)
Changes in valuation allowances	(700,000)	(6.6)
Nontaxable or nondeductible items		
Tax exempt interest income	(210,000)	(2.0)
Meals and entertainment	147,000	1.4
Changes in unrecognized tax benefits	(124,950)	(1.2)
Other adjustments	210,000	2.0
Total	$1,395,500	13.3%

Note 1: Taxes in New York and Illinois make up the majority of the effect of the state and local tax category.

7.2 Effective tax rate reconciliation for entities other than PBEs

Example 7-3: Rate Reconciliation Between Income Tax Expense (or Benefit) and Statutory Expectations - Case B: Entity Other Than Public Business Entity (ASC 740-10-55-232 through 55-233)

The following illustrates significant reconciling items disclosed by an entity other than a public business entity in accordance with paragraph 740-10-50-13.

The difference between Entity W's effective tax rate and its statutory tax rate is primarily attributed to tax credits, state taxes, and foreign taxes. More specifically, the foreign tax effects of Entity W's operations in Ireland had a decreasing effect on its effective tax rate, while the foreign tax effects of Entity W's operations in France had an increasing effect on its effective tax rate. Entity W received federal research and development tax credits, which decreased its effective tax rate, while state taxes in California increased its effective tax rate.

[5] Percentages shown on the effective tax rate reconciliation are calculated as Reconciling Item Amount ÷ Consolidated Pretax Income from Continuing Operations.

RSM COMMENTARY: Effective tax rate reconciliation for entities other than public business entities

Although a numerical reconciliation table is not required, entities other than PBEs will likely need to prepare comprehensive supporting documentation similar in nature to that prepared by PBEs to support the qualitative disclosures required under ASC 740-10-50-13.

7.3 Income taxes paid

Example 7-4: Income taxes paid disclosure

ABC Corp is a U.S.-domiciled corporation that conducts business in New York, New Jersey, Connecticut and Massachusetts, and also in Italy, Spain and France through its wholly-owned subsidiaries. Assumptions for the year ended December 31, 20X6, include the following:

- Total income taxes paid were $2,140,000, of which $1,525,000 relates to U.S. federal income taxes.
- State and local income taxes paid in New York, New Jersey, Connecticut and Massachusetts were $162,000; $110,000; $83,000; and $65,000, respectively.
- Foreign income taxes paid in Italy, Spain and France were $120,000; $40,000; and $35,000, respectively.
- The 5% threshold used to determine whether further disaggregation of information is required is $107,000, calculated as $2,140,000 (total income taxes paid) x 5%.

Based on the above assumptions, ABC Corp presents the following amounts within its income tax paid disclosure in accordance with ASC 740-10-50-22 and 50-23 for the year ended December 31, 20X6:

U.S. federal taxes	$ 1,525,000
State and local taxes	
New York	162,000
New Jersey	110,000
Other states	148,000
Foreign taxes	
Italy	120,000
Other foreign	75,000
Total income taxes paid	$ 2,140,000

8. EFFECTIVE DATE AND TRANSITION REQUIREMENTS

For PBEs, the amendments in ASU 2023-09 are effective for annual periods beginning after December 15, 2024. For entities other than PBEs, the amendments are effective for annual periods beginning after December 15, 2025.

Early adoption is permitted for annual financial statements that have not yet been issued or made available for issuance.

The amendments in ASU 2023-09 should be applied on a prospective basis; however, retrospective application is permitted.

+1 800 274 3978
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