ACCOUNTING FOR INCOME TAXES - CURRENT AND DEFERRED TAXES

December 2023

OVERVIEW

This whitepaper is the third in a series of whitepapers to be used as a resource in understanding and analyzing the accounting for income taxes under FASB Accounting Standards Codification (ASC) 740, *Income Taxes*. This whitepaper addresses determining the current taxes payable or refundable, deferred tax assets (DTAs), and deferred tax liabilities (DTLs), which form the basis for the income tax amounts recorded on an entity's financial statements. ASC 740 takes a balance sheet approach to income tax calculations and thus the amounts recorded in the income statement are generally the differences between the income tax amounts on the current year and prior year balance sheets. This whitepaper also addresses the rate reconciliation, which is not only a required public company financial statement disclosure but also an important check on the reasonableness of the amounts recorded within the financial statements. This whitepaper does not address every aspect of accounting for income taxes and should therefore be read in conjunction with ASC 740.

For ease of use, definitions for acronyms are included in Appendix A. In addition, several terms with specific meaning are used throughout this whitepaper. Those terms and the corresponding definition are provided in Appendix B.

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1. Background

ASC 740-10-05-1

The Income Taxes Topic addresses financial accounting and reporting for the effects of income taxes that result from an entity's activities during the current and preceding years. Specifically, this Topic establishes standards of financial accounting and reporting for income taxes that are currently payable and for the tax consequences of all of the following:

a. Revenues, expenses, gains, or losses that are included in taxable income of an earlier or later year than the year in which they are recognized in financial income.

b. Other events that create differences between the tax bases of assets and liabilities and their amounts for financial reporting

c. Operating loss or tax credit carrybacks for refunds of taxes paid in prior years and carryforwards to reduce taxes payable in future years.

ASC 740-10-10-1

There are two primary objectives related to accounting for income taxes:

a. To recognize the amount of taxes payable or refundable for the current year

b. To recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns.

As it relates to the second objective, some events do not have tax consequences. Certain revenues are exempt from taxation and certain expenses are not deductible. In some tax jurisdictions, for example, interest earned on certain municipal obligations is not taxable and fines are not deductible.

ASC 740 covers the accounting and financial reporting of taxes that are based on income and provides guidance for the recognition and measurement of tax positions in an entity's income tax return that would directly or indirectly affect amounts reported in the financial statements.

ASC 740 10-10-1 to 10-2 requires an entity to calculate its income tax provision (income tax expense within the financial statements) in two steps.

1. Recognize the amount of estimated taxes payable or refundable for the current year (i.e., the amount expected to be reflected on its income tax returns for the current year).
2. Recognize deferred taxes for the estimated future tax effects attributable to temporary differences and carryforwards.

The objective of the second step is to ensure that the recorded income tax expense includes the current and future tax effects of all items reflected in the financial statements.

Current taxes payable may also be impacted by:

- Available tax credits
- Adjustments to prior year tax liabilities that occur in the current year (e.g., state tax notices, return-to-provision adjustments)
- Income tax payments made or refunds received.

The current taxes payable or refundable amount appearing on an entity's balance sheet at the end of the year represents the gross income tax payable or refundable, as adjusted for any payments made or refunds received during the year. The deferred tax asset or liability amounts appearing on an entity's

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balance sheet at the end of the year represent the future tax consequences of temporary differences and carryforwards.

1.1 Measuring income taxes payable

ASC 740-10-30-2

The following basic requirements are applied to the measurement of current and deferred income taxes at the date of the financial statements:

a. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated.

b. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

ASC 740-10-30-3

Total income tax expense (or benefit) for the year is the sum of deferred tax expense (or benefit) and income taxes currently payable or refundable.

The measurement and recognition of total income taxes requires an understanding of a few concepts, including identification of permanent and temporary differences, operating losses and tax credit carryforwards, and determining the applicable tax rate. These concepts can be complex and have specific rules to consider as outlined under ASC 740. Refer to our separate ASC 740 whitepaper entitled “Book versus tax basis differences and carryforwards” for further discussion.

Most revenue and expense transactions that are included in pretax income are also included in taxable income in the same year. However, as discussed in ASC 740-10-25-19, taxable income may differ from financial statement income when revenue and expense transactions are recognized under tax laws in a different period than they are recognized under U.S. Generally Accepted Accounting Principles (U.S. GAAP). Additionally, some revenues are tax-exempt, and some expenses may not be deducted on a tax return. Differences between revenues and expenses recognized for financial statement purposes and tax return purposes are commonly referred to as book to tax differences and are either permanent or temporary differences. Tax consequences of operating loss or tax credit carrybacks or carryforwards also need to be reflected within the current year financial statements.

Permanent differences, which is not a defined term within ASC 740, do not have tax consequences in future periods. An entity would, therefore, not record deferred tax assets or liabilities related to permanent differences.

The concept of temporary differences is the basis of deferred tax accounting (or the liability method) under ASC 740. ASC 740 and the FASB Codification Master Glossary define a “temporary difference” as a difference between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. Temporary differences also result from events that have not been recognized in the financial statements but have been reflected in the income tax return based on provisions of the tax law.

All temporary differences must be considered in terms of the expected future tax consequences when the reported amounts of assets are recovered, and the reported amounts of liabilities are settled. Taxable temporary differences lead to taxable amounts in the future when the related asset is recovered, or the liability is settled. Deductible temporary differences will result in deductible amounts in the future when the related asset is recovered, or the liability is settled.

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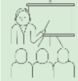
Certain jurisdictions have tax laws that permit losses to be carried forward to future years while other jurisdictions have tax laws that permit operating losses to be carried back to prior years, which may result in a refund of income taxes previously paid. These tax laws vary by jurisdiction and may be complex. ASC 740 requires that entities consider the tax laws and any related limitations on use of net operating loss (NOL) and tax credit carryforwards.

The following example illustrates the process for identifying temporary differences and operating loss and tax credit carryforwards.



Example 1-1: Identify temporary and permanent differences and operating loss and tax credit carryforwards

ABC Company reviewed its trial balances and noted the following items that were treated differently for financial statement ("book") and tax return ("tax") purposes as of December 31, 20X2:

Permanent Differences:

- U.S. federal Government bond interest revenue of $100,000 reflected as income for book purposes but not for tax purposes.
- Meal expense of $50,000, of which is 50% was deemed deductible but only $25,000 is included as expenses for tax purposes.

ABC Company's book income will exceed its taxable (or tax return) income by $75,000 ($100,000-$25,000) because of the permanent differences identified above.

Temporary Differences:

- The book balance of the allowance for expected credit losses was $1,450,000 as of December 31, 20X2 as compared to $1,000,000 as of December 31, 20X1. The tax balance of the allowance for expected credit losses as of December 31, 20X2 and 20X1 was $0.
- The book balance of the inventory reserve was $7,250,000 at the end of 20X2 as compared to $6,750,000 at the end of 20X1.
- The accrued compensation (book) balance was $3,500,000 as of December 31, 20X2 (of which $0 was deemed deductible) as compared to a book balance of $1,000,000 as of December 31, 20X1 (of which $0 was deemed deductible). The tax balance of accrued compensation as of December 31, 20X2 and 20X1 was $0.
- The accrued bonus (book) balance was $4,250,000 as of December 20X2 (of which $0 was deemed deductible) as compared to a book balance of $2,750,000 as of December 31, 20X1 (of which $0 was deemed deductible). The tax balance of accrued bonus as of December 31, 20X2 and 20X1 was $0.
- The cumulative accumulated depreciation for tax purposes at the end of 20X2 was $19,000,000 as compared to $16,000,000 at the end of 20X1.The cumulative accumulated depreciation for book purposes at the end of 20X2 was $9,000,000 as compared to $8,000,000 at the end of 20X1.
- ABC Company has a NOL carryforward of $2,000,000, which was fully used in 2022.

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Below is a summary of ABC Company's cumulative deductible (taxable) temporary differences as of December 31, 20X2 and 20X1 and the related change in such temporary differences:

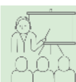
	December 31, 20X2	December 31, 20X1	Year to year Change
Allowance for expected credit losses	$1,450,000	$1,000,000	$450,000
Inventory reserve	7,250,000	6,750,000	500,000
Accrued compensation	3,500,000	1,000,000	2,500,000
Accrued bonuses	4,250,000	2,750,000	1,500,000
Accumulated depreciation-Tax	(19,000,000)	(16,000,000)	(3,000,000)
Accumulated depreciation-Book	9,000,000	8,000,000	1,000,000
Net operating loss carryforward	-	2,000,000	(2,000,000)
Total temporary differences	**$6,450,000**	**$5,500,000**	**$950,000**

The above items are temporary differences, as these amounts will be deductible or taxable for ABC Company in the future.

An entity considers the jurisdictions where it conducts business in order to determine its applicable tax rate. Entities may be subject to income taxes in multiple tax jurisdictions and at different tax rates. State or foreign taxes may be deducted when calculating the U.S. federal income tax rate; therefore, there is a federal income tax benefit for amounts paid to state or foreign jurisdictions.

Only enacted tax rates should be used to determine total income tax expense (benefit). A tax law is enacted when tax legislation has been signed into law. ASC 740 requires an entity to recognize changes in tax law once the enactment date has occurred. The effective date of a tax law may occur after the enactment date. In such cases, different rates may be applicable to the current and deferred tax calculations. Refer to RSM's separate ASC 740 whitepaper entitled "Applicable Tax Rate" for further discussion.

The following example illustrates the calculation of a federal and state combined applicable tax rate.



Example 1-2: Combining Federal and State Rates-Single State

ABC Company is a U.S. taxpaying entity which conducts its business activities in a single state. The applicable federal and state tax rates are 21% and 5%, respectively.

	Effective tax rate
U.S. federal statutory income tax rate	21%
State income tax rate	5%
Less federal benefit for state income taxes (21% x 5%)	(1%)
Total effective tax rate (federal and state)	**25%**

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2. Current taxes payable or refundable

ASC 740-10-25-18

Income taxes currently payable for a particular year usually include the tax consequences of most events that are recognized in the financial statements for that year.

ASC 740-10-25-2

Other than the exceptions identified in the following paragraph, the following basic requirements are applied in accounting for income taxes at the date of the financial statements:

a. A tax liability or asset shall be recognized based on the provisions of this Subtopic applicable to tax positions, in paragraphs 740-10-25-5 through 25-17, for the estimated taxes payable or refundable on tax returns for the current and prior years.

b. A deferred tax liability or asset shall be recognized for the estimated future tax effects attributable to temporary differences and carryforwards.

ASC 740-10-25-2 states that current i tax payable or refundable is determined by applying the provisions of the enacted tax law to the taxable income or loss for the year. An entity would also consider tax positions it has taken or expects to take and whether such position is more-likely-than-not to be sustained upon examination or based on its technical merits. The more-likely-than-not recognition criteria is not covered in this white paper; see ASC 740-10-25-5 to ASC 740-10-25-14 for further information related to uncertain tax positions.

Enacted tax rates are defined as tax rates for each applicable jurisdiction that have been signed into law as of the reporting date. Refer to our separate ASC 740 whitepaper entitled “Applicable Tax Rate” for further discussion.

Current taxes payable (refundable) is a balance sheet amount which is calculated as follows:

- Applying the enacted tax rate to the entity’s taxable income (loss) for the year
- Adding the prior year current tax payable (refundable)
- Subtracting payments (refunds) during the year

Current taxes payable (refundable) also includes adjustments which generally referred to as return-to-provision (RTP) adjustments. See Chapter 4 for further discussion of RTP adjustments.

Example 2-1: Calculating current taxes payable (refundable)

As noted in Example 1-1 and Example 1-2, for the year ended December 31, 20X2, ABC Company has permanent differences of $75,000 that decrease taxable income, temporary differences of $950,000 that increase taxable income and a blended U.S. federal and state effective rate of 25%. In addition, ABC Company has pretax book income of $50,000,000 and had current taxes payable of $5,000,000 as of December 31, 20X1. ABC Company made income tax payments of $10,000,000 during 20X2.

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The following table computes ABC Company's current taxes payable (refundable) as of December 31, 20X2:

	Amount
Pretax book income-year ended December 31,20X2	$50,000,000
Permanent differences- year ended December 31,20X2	(75,000)
Temporary differences- year ended December 31,20X2	950,000
Taxable income- year ended December 31, 20X2	50,875,000
Blended federal and state tax rate- year ended December 31, 20X2	25%
Current tax expense- year ended December 31, 20X2	12,718,750
Add: Current taxes payable- beginning of year	5,000,000
Less: Income tax payments made during the year	(10,000,000)
Current taxes payable (refundable)- end of year	**$7,718,750**

As demonstrated above, the end of the year current taxes payable is the sum of the balance at the beginning of the year and the current year activity, which is comprised of the current tax expense reported on ABC Company's tax return and any payments made during the year.

3. Deferred tax assets and liabilities

ASC 740-10-05-7

A temporary difference refers to a difference between the tax basis of an asset or liability, determined based on recognition and measurement requirements for tax positions, and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. Deferred tax assets and liabilities represent the future effects on income taxes that result from temporary differences and carryforwards that exist at the end of a period. Deferred tax assets and liabilities are measured using enacted tax rates and provisions of the enacted tax law and are not discounted to reflect the time-value of money.

ASC 740-10-30-5

Deferred taxes shall be determined separately for each tax-paying component (an individual entity or group of entities that is consolidated for tax purposes) in each tax jurisdiction. That determination includes the following procedures:

a. Identify the types and amounts of existing temporary differences and the nature and amount of each type of operating loss and tax credit carryforward and the remaining length of the carryforward period.

b. Measure the total deferred tax liability for taxable temporary differences using the applicable tax rate (see paragraph 740-10-30-8).

c. Measure the total deferred tax asset for deductible temporary differences and operating loss carryforwards using the applicable tax rate.

d. Measure deferred tax assets for each type of tax credit carryforward.

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e. Reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance shall be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized.

ASC 740-10-30-8

Paragraph 740-10-10-3 establishes that the objective is to measure a deferred tax liability or asset using the enacted tax rate(s) expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realized. Deferred taxes shall not be accounted for on a discounted basis.

ASC 740 requires a balance sheet approach to income tax accounting and assumes that assets and liabilities on the balance sheet will eventually be recovered and settled, respectively, at their reported amounts. The deferred tax expense (benefit) is the change in the deferred tax balances from the beginning to end of the year. ASC 740-10-30-5 outlines a five-step approach to determine the deferred tax asset and liability balances:

1. Identify the types and amounts of existing temporary differences, the nature and amount of each type of operating loss and tax credit carryforward, and the remaining length of the carryforward period.
2. Measure the total deferred tax liability for taxable temporary differences using the applicable tax rate.
3. Measure the total deferred tax asset for deductible temporary differences and operating loss carryforwards using the applicable tax rate.
4. Measure deferred tax assets for each type of tax credit carryforward.
5. Reduce deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The valuation allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized.

A temporary difference is created when an item is treated differently for financial statement and tax return purposes in the same period, provided that the difference is expected to reverse in a future period. A deferred tax asset or liability is computed by multiplying the applicable tax rates by the difference between the book basis and the tax basis of the asset or liability. Because of this assumption, a difference between the tax basis of an asset or a liability and its reported amount in the financial statements will eventually result in a taxable or deductible amount in future years.

Applicable tax rates for deferred taxes are the enacted tax rates expected to be applied to taxable income in the periods and jurisdictions in which the deferred tax assets or liabilities are expected to be realized or settled, respectively. Refer to our separate ASC 740 whitepaper entitled “Applicable Tax Rate” for further discussion.

It may appear logical that deferred tax accounting would give some consideration to the time value of money, because a deduction today may be worth more than a deduction in the future, however present valuing or discounting when measuring deferred taxes is prohibited by ASC 740.

Deferred tax liabilities are measured as the total taxable temporary difference multiplied by the tax rate expected to apply to the taxable income in the periods in which the deferred tax liability is expected to be settled.

Deferred tax assets are similarly measured as the total deductible temporary difference and any NOL carryforwards multiplied by the tax rate expected to apply to the taxable income in the periods in which

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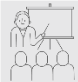
the deferred tax asset or NOL carryforward is expected to be realized. Deferred tax assets also include tax credit carryforwards which are not multiplied by an applicable tax rate as they are already tax-affected.

In certain cases, an entity may need to schedule, or assess when temporary differences may reverse. Scheduling future taxable income is generally relevant when assessing the need for a valuation allowance. This topic is outside of the scope of this whitepaper.

ASC 740-10-10-3 discusses other situations which may also require scheduling, specifically when changes to tax rates have been enacted but will only become effective in a future year. In this case, entities would need to prepare an analysis that projects the periods where the temporary difference will reverse, as the applicable rate for deferred taxes may fluctuate depending on when the temporary difference is expected to reverse. Scheduling may also be required in years where graduated tax rates are applied, since the rates applied to the temporary differences will vary based on the estimated timing of the reversal of such differences.

The following example illustrates the impact of changes to enacted tax rates on deferred tax assets and liabilities.



Example 3-1: Phased-in Changes in Tax Rates (ASC 740-10-55-129 to 55-130)

This Example illustrates the guidance in paragraph 740-10-55-23 for determination of the tax rate for measurement of a deferred tax liability for taxable temporary differences when there is a phased-in change in tax rates. At the end of Year 3 (the current year), an entity has $2,400 of taxable temporary differences, which are expected to result in taxable amounts of approximately $800 on the future tax returns for each of Years 4-6. Enacted tax rates are 35 percent for Years 1-3, 40 percent for Years 4-6, and 45 percent for Year 7 and thereafter.

The tax rate that is used to measure the deferred tax liability for the $2,400 of taxable temporary differences differs depending on whether the tax effect of future reversals of those temporary differences is on taxes payable for Years 1-3, Years 4-6, or Year 7 and thereafter. The tax rate for measurement of the deferred tax liability is 40 percent whenever taxable income is expected in Years 4-6. If tax losses are expected in Years 4-6, however, the tax rate is:

- 35 percent if realization of a tax benefit for those tax losses in Years 4-6 will be by loss carryback to Years 1-3
- 45 percent if realization of a tax benefit for those tax losses in Years 4-6 will be by loss carryforward to Year 7 and thereafter.

The example above demonstrates that the entity would apply the enacted tax rate in the respective years that the taxable temporary differences are expected to reverse, and also demonstrates certain additional considerations when the entity predicts tax losses rather than taxable income.

If the entity predicts income in years 4–6, then it would apply the 40% applicable rate to the cumulative temporary differences, resulting in a deferred tax liability of $960. If the entity predicts losses in years 4–6 but had the ability to carry back these losses to years 1–3 (which is no longer available under U.S. Federal Tax Law), the entity would apply the 35% applicable tax rate from years 1–3 to the cumulative temporary differences, which would result in a deferred tax liability of $840. If the entity predicts losses in years 4–6 but did not have the ability to carryback such losses, then it would apply the 45% applicable rate to these cumulative taxable temporary differences, resulting in a deferred tax liability of $1,080.

The following example illustrates the calculation of deferred tax assets and liabilities.

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Example 3-2: Measuring the net deferred tax asset (liability)

ABC Company is a U.S. taxpaying entity which conducts its business activities in a single state. The applicable federal and state tax rates are 21% and 5%, respectively. ABC Company also provides the following financial information:

- The balance in the allowance for expected credit losses was $1,450,000 at December31, 20X2 as compared to $1,000,000 at December 31, 20X1.
- The balance in the inventory reserve was $7,250,000 at December 31, 20X2 as compared to $6,750,000 at December 31, 20X1.
- The balance in the compensation accrual was $3,500,000 at December 31, 20X2 as compared to $1,000,000 at December 31, 20X1. None of the accrued amounts were deductible as of either year end.
- The balance in the accrued bonus was $4,250,000 at December 31, 20X2 as compared to $2,750,000 at December 31, 20X1. No portion of the accrued bonus was paid timely to qualify for a tax deduction in the year of the accrual.
- The cumulative accumulated depreciation for tax purposes at December 31, 20X2 was $19,000,000 as compared to $16,000,000 at December 31, 20X1.
- The cumulative accumulated depreciation for book purposes at December 31, 20X2 was $9,000,000 as compared to $8,000,000 at December 31, 20X1.
- ABC Company has a pre-2017 NOL carryforward of $2,000,000 which will expire on December 31, 20X3, which was considered a temporary difference as of December 31, 20X1 and used in 20X2.

ABC Company calculates the deferred tax assets and liabilities as of December 31, 20X2 in the schedule below.

(Notes 1 & 2)	Cumulative (taxable) deductible temporary difference	Effective tax rate	Deferred tax asset (liability)
Accumulated depreciation (accelerated) for tax purposes	$(19,000,000)	25%	($4,750,000)
Accumulated depreciation for book purposes	9,000,000	25%	2,250,000
Allowance for expected credit losses	1,450,000	25%	362,500
Inventory reserve	7,250,000	25%	1,812,500
Accrued bonuses	4,250,000	25%	1,062,500
Accrued vacation	3,500,000	25%	875,000
Net operating loss carryforward	-	25%	-
Total	**$6,450,000**		**$1,612,500**

Note 1: This table does not include any realizability considerations related to the net deferred tax asset (i.e., whether a valuation allowance is required). Such considerations are beyond the scope of this publication.

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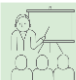
Note 2: ASC 740 requires net presentation of deferred tax liabilities and assets within a taxpaying jurisdiction on a single line as a long-term asset or liability. Deferred tax assets and liabilities arising from different jurisdictions should be shown separately (i.e., a deferred asset related to the U.S. should not be netted against a deferred tax liability related to a foreign jurisdiction).

Deferred tax expense is generally the change between the beginning and end of period deferred tax assets or liabilities balance. In some cases, notably business combinations, there may be additional changes between the beginning and end of period deferred tax asset and liability balances that would not be reflected in deferred tax expense. The tax impact of business combinations is beyond the scope of this publication.



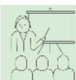
Example 3-3: Measuring deferred tax expense

ABC Company is a U.S. taxpaying entity which conducts its business activities in a single state. The applicable federal and state tax rates are 21% and 5%, respectively. ABC Company calculates its deferred tax expense using the December 31, 20X2 deferred tax assets and liabilities from Example 3-2 and the December 31, 20X1 deferred tax assets and liabilities from their prior year schedules.

(Note 1)	Deferred Tax Asset (Liability) -2022	Deferred Tax Asset (Liability) -2021	Deferred Tax Expense (Benefit) -2022
Allowance for credit losses	$362,500	$250,000	($112,500)
Inventory reserve	1,812,500	1,687,500	(125,000)
Accrued compensation	875,000	250,000	(625,000)
Accrued bonuses	1,062,500	687,500	(375,000)
Accumulated depreciation for tax purposes	(4,750,000)	(4,000,000)	750,000
Accumulated depreciation for book purposes	2,250,000	2,000,000	(250,000)
Net operating loss carryforward	-	500,000	500,000
Total	**$1,612,500**	**$1,375,000**	**($237,500)**

Note 1: This example assumes that there were no business combinations that occurred during the year.

Income tax expense for the period includes the current tax payable (refundable) and the future tax consequences of items included in different periods in the financial statements and the income tax returns. Total income tax expense, therefore, reflects the tax effect of all items within book income, whether or not the tax effects are reported in the tax return in that period.



Example 3-4: Total income tax expense

ABC Company is a U.S. taxpaying entity which conducts its business activities in a single state. The applicable federal and state tax rates are 21% and 5%, respectively. ABC Company's total income tax

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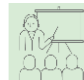
expense is the sum of current tax expense (calculated in Example 2-1) and deferred tax benefit (calculated in Example 3-3). The following table calculates total income tax expense.

	Amount
Current tax expense	$12,718,750
Deferred tax expense (benefit)	(237,500)
Total income tax expense	**$12,481,250**

4. Changes in estimates or errors

Generally, financial statements are issued before the tax returns are prepared and filed. Thus, there may be differences between the current tax amounts recorded within the financial statements and the amounts reported on the tax return. Such differences are known as return to provision adjustments or RTP adjustments. Entities must consider whether these adjustments are changes in accounting estimates or error corrections in accordance with ASC 250.

Entities may estimate certain amounts to close their books on a timely basis. Such estimates would be based on information available at the time. Under ASC 250, if the entity had a reasonable basis for its estimate, and the information was not readily available at the time the entity closed its books, the adjustment would typically be a change in estimate. An adjustment of a prior-period income tax payable due to new information or later identification of information that was not known or knowable prior to the issuance of the financial statements would generally be a change in estimate. These changes in estimate are accounted for either in the period of change or prospectively (ASC 250-10-45-17).



Example 4-1: RTP Adjustments

On February 5, 2023, ABC Company issued its financial statements for the year ended December 31, 20X2. Key tax amounts included within the financial statements are reflected in Example 3-2 and Example 3-3. ABC Company also prepared and filed its tax return on September 15, 20X3.

Subsequent to filing its tax return, ABC Company noted the following differences between the income tax amounts reflected within the financial statements and the tax return:

- On February 10, 2023, ABC Company's board of directors approved disbursing $500,000 of the accrued bonuses to the financial personnel on February 14, 2023. The remainder of the accrued bonuses were paid on March 31, 20X3. The payment of the accrued bonus on February 15, 2023, reduced the temporary difference since the amount became deductible in 20X2.
- The cumulative accumulated depreciation for tax purposes included in the tax return was $19,327,000 as compared to $19,000,000 included in the financial statements. This difference was primarily due to rounding of the amounts included in the financial statements which were not rounded in the tax return.

The net impact of these two RTP adjustments is illustrated below.

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	Cumulative temporary differences - per income tax return	Cumulative temporary differences - per financial statements	Effect on deferred taxes Debit (credit)
Accumulated depreciation for tax purposes	($19,327,000)	($19,000,000)	($327,000)
Accumulated depreciation for book purposes	9,000,000	9,000,000	-
Accrued bonuses	3,750,000	4,250,000	(500,000)
Total	**($6,577,000)**	**($5,750,000)**	($827,000)
Effective tax rate	N/A	N/A	25%
Increase in deferred tax liability	N/A	NA	**($206,750)**

ABC Company would evaluate its specific facts and circumstances to conclude whether these adjustments would be considered changes in estimates rather than errors. ABC Company would consider both the timing of the board decision to accelerate the payment of the bonuses and the nature and amount of the of the accumulated depreciation difference. If, based on the evidence, ABC Company concludes that it had a reasonable basis for its original estimate, and that the additional information was not readily available when it closed its books, ABC Company would consider these adjustments to be changes in estimates and not errors.

An adjustment of a prior period income tax payable due to information that was either known or knowable prior to the issuance of the financial statements may be considered an error. If material, error corrections are accounted for by restating the prior-period financial statements (ASC 250-10-45-23). Examples of errors may include:

- The entity's taxes payable included a calculation error; for example, a permanent difference was treated as a temporary difference or deducted twice from taxable income.
- Despite information being readily available, the entity estimated an amount, and that estimate was significantly different from the actual amount.
- The entity did not appropriately apply the provisions of ASC 740 to facts and circumstances that were known or knowable at the time of the issuance of the financial statements.

The above examples are not all-inclusive. Consideration of whether an RTP adjustment is a change in estimate, or an error requires significant judgment and careful consideration of all the relevant facts and circumstances.

5. Exceptions to the comprehensive model for recognizing deferred taxes

ASC 740-10-25-3 details exceptions to the comprehensive model for recognizing deferred taxes. The comprehensive model requires the recognition of deferred tax assets (DTAs) and deferred tax liabilities (DTLs) for temporary differences between the financial reporting and tax bases of assets and liabilities. Such exceptions include items for which the recognition of a DTA or DTL is prohibited.

5.1 Specific exemptions

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As noted in section ASC 740-10-25-3(a), a deferred tax liability would not be recorded for the specific temporary differences listed in that section unless it becomes apparent that they will reverse in the foreseeable future. Thus, a deferred tax liability is not recognized for temporary differences unless it becomes apparent that those temporary differences will reverse (i.e., be realized or settled) in the foreseeable future. Deferred tax liabilities which would not be recorded are:

- An excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary or a foreign corporate joint venture that is essentially permanent in duration. (A corporate joint venture is a corporation owned and operated by a small group of investors for the mutual benefit of the venturers who have an interest or relationship other than passive investors. An entity that is a subsidiary of one of the venturers is not a corporate joint venture for this purpose. Further, the life of the joint venture may not be limited by the nature of the venture or other business activity.)
- Undistributed earnings of a domestic subsidiary or a domestic corporate joint venture that is essentially permanent in duration that arose in years beginning on or before December 15, 1992. (A last-in, first-out pattern determines whether reversals pertain to differences that arose in years beginning on or before December 15, 1992.)
- Bad debt reserves for tax purposes of thrifts (stock or mutual savings and loan associations and mutual savings banks) that arose in tax years beginning before December 31, 1987 (the base-year amount).
- Policyholders' surplus of stock life insurance companies that arose in years beginning on or before December 15, 1992.

The above exceptions are absolute and specific and may not be applied to other types of temporary differences. The most common item referenced in the section above relates to outside basis differences as discussed in Section 5.2.

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5.2 Outside basis differences

ASC 740-30-25-7

Whether an excess of the amount for financial reporting over the tax basis of an investment in a more-than-50-percent-owned domestic subsidiary is a taxable temporary difference shall be assessed. It is not a taxable temporary difference if the tax law provides a means by which the reported amount of that investment can be recovered tax-free, and the entity expects that it will ultimately use that means. For example, tax law may provide that:

a. An entity may elect to determine taxable gain or loss on the liquidation of an 80-percent-or-more-owned subsidiary by reference to the tax basis of the subsidiary's net assets rather than by reference to the parent entity's tax basis for the stock of that subsidiary.

b. An entity may execute a statutory merger whereby a subsidiary is merged into the parent entity, the noncontrolling shareholders receive stock of the parent, the subsidiary's stock is cancelled, and no taxable gain or loss results if the continuity of ownership, continuity of business entity, and certain other requirements of the tax law are met.

ASC 740-30-25-8

Some elections for tax purposes are available only if the parent owns a specified percentage of the subsidiary's stock. The parent sometimes may own less than that specified percentage, and the price per share to acquire a noncontrolling interest may significantly exceed the per-share equivalent of the amount reported as noncontrolling interest in the consolidated financial statements. In those circumstances, the excess of the amount for financial reporting over the tax basis of the parent's investment in the subsidiary is not a taxable temporary difference if settlement of the noncontrolling interest is expected to occur at the point in time when settlement would not result in a significant cost. That could occur, for example, toward the end of the life of the subsidiary, after it has recovered and settled most of its assets and liabilities, respectively. The fair value of the noncontrolling interest ordinarily will approximately equal its percentage of the subsidiary's net assets if those net assets consist primarily of cash.

ASC 740-30-25-9

A deferred tax asset shall be recognized for an excess of the tax basis over the amount for financial reporting of an investment in a subsidiary or corporate joint venture that is essentially permanent in duration only if it is apparent that the temporary difference will reverse in the foreseeable future.

The general rule in ASC 740 related to investments in domestic subsidiaries is that a deferred tax liability would be recognized for the excess of the basis for financial reporting purposes in a subsidiary over the tax basis of such investment in the subsidiary. However, the deferred tax liability does not have to be recognized if the tax law provides a means by which the basis difference can be recovered on a tax-free basis. For example, under the U.S. federal tax law, a basis difference in an 80% or more owned subsidiary can be recovered through a tax-free liquidation. If a taxpaying entity intends to recover its investment basis in this manner, then the deferred tax liability would not need to be recorded.

ASC 740-30-25-9 discusses the recognition of deferred taxes for outside tax-basis differences in investments in subsidiaries or corporate joint ventures. Outside tax basis differences are differences in the book basis and tax basis of an investment. For example, an entity may have an investment in a consolidated subsidiary, which is the book basis, while the subsidiary’s stock basis is the tax basis. Differences between these two bases are considered outside tax basis differences. A deferred tax asset

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is recognized for the excess of the tax basis over the book basis for an investment that is essentially permanent in duration only if it is apparent that the temporary difference will reverse in the foreseeable future. Entities would then need to assess whether a valuation allowance would be needed on the deferred tax asset.

While partnerships are generally not subject to entity-level income taxes as described in ASC 740, a corporation with an investment in a partnership must account for the current and deferred tax obligations arising from its investment in the partnership. Accordingly, for deferred tax purposes, a deferred tax asset or liability would be recorded for the book and tax basis differences on the investment in partnership. Outside basis differences for partnerships are not addressed under ASC 740-30-25-7 through 25-9 and accordingly would be subject to the general rules in ASC 740 regarding DTAs and DTLs for basis differences.

In practice, we believe there are two acceptable views on measuring the basis difference between book and tax for an entity's investment in a partnership. The first approach would be to record a deferred tax liability for the entire outside basis difference (i.e., the book and tax basis difference). The second approach, typically referred to as the "look-through" approach, allows a corporate (taxable) entity to look through to the underlying partnership items and apply certain exceptions under ASC 740 when measuring the amount of the outside basis difference. For example, the amount of deferred tax liability recorded for the outside basis difference in the partnership would be reduced for any amount for the second component of goodwill where book goodwill is in excess of tax at the partnership level, as discussed in Section 5.4 below. Other exceptions, such as the indefinite reversal exception described below, may also be applied. Entities must choose an approach to measuring the amount of outside basis difference for the investment in a partnership and apply it consistently to all investments in partnerships reflected within the entity's consolidated financial statements.

For partnerships with a tax basis in excess of the book basis, a question arises as to whether the foreseeable future criteria for recording a DTA for other outside basis differences should be applied to partnership investments. We believe that it would be acceptable to apply these rules by analogy to partnerships, but recording the DTA would be equally acceptable. However, when a DTA is recorded for the outside basis difference, careful consideration should be given to whether the DTA will reverse and if the reversal will result in a capital loss. If so, entities would need to consider whether they will have sufficient capital gains to realize the DTA or whether a valuation allowance is required.

5.3 Leveraged leases

ASC 740 does not change the accounting for leveraged leases required by ASC 842-50.

For all leveraged leases acquired under a business combination or by a not-for-profit entity under ASC 842-50, there would not be any recognition of a deferred tax credit. A leveraged lease acquired in a business combination is generally valued "based on the remaining future cash flows and giving appropriate recognition to the estimated future tax effects of those cash flows" (ASC 842-50-30-2). Differences between the book value and the tax basis would not be accounted for under deferred tax accounting and instead would be accounted for under ASC 842-50 as component parts.

5.4 Goodwill

Goodwill arises through business combinations when the purchase price exceeds the fair value of the assets acquired net of liabilities assumed. Goodwill may be fully tax deductible, partially tax deductible or not deductible depending on the structure of the transaction.

ASC 805-740 prohibits the recognition of a deferred tax liability for the reported amount of goodwill, or a portion thereof, when it is not deductible for tax purposes.

When the amortization of goodwill is deductible for tax purposes, the book amount of goodwill and the tax basis of goodwill are each separated into two components as of the acquisition date. The first component

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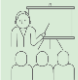
of each equals the lesser of goodwill for book purposes or tax-deductible goodwill. The second component of each equals the remainder, if any, of goodwill for book purposes or the remainder, if any, of tax-deductible goodwill. Any difference that arises between the book and tax basis of that first component of goodwill in future years is a temporary difference for which a deferred tax liability or asset is recognized. If the second component of goodwill is an excess of tax-deductible goodwill over the book amount of goodwill, the tax benefit for that excess is a temporary difference for which a deferred tax asset is recognized. However, if the second component of goodwill is an excess of goodwill for book purposes over the tax-deductible amount of goodwill, no deferred taxes are recognized either at the acquisition date or in future years.

Entities would need to use a simultaneous equation to calculate the deferred tax asset arising from an excess of tax-deductible goodwill over book goodwill because allocating a portion of the fair value of the entity to the deferred tax asset reduces the remaining excess purchase price allocated to goodwill, which then increases the temporary difference and the related deferred tax asset. The following illustrates the application of the simultaneous equations:

- Preliminary temporary difference (PTD) = tax basis in goodwill - preliminary book goodwill
- Deferred tax asset (DTA) = (tax rate/(1 - tax rate)) x preliminary temporary difference
- Final book goodwill = preliminary book goodwill - DTA

The following example illustrates the application of the above simultaneous equations when accounting for tax consequences of goodwill when tax-deductible goodwill exceeds the book goodwill at the acquisition date.



Example 5-1: Tax consequences of goodwill

ABC Company acquired DEF Company on April 1, 20X2, and is now preparing its financial statements for the year ended December 31, 20X2. Its assumptions are:

- The reported amount of goodwill for book purposes is $600,000 before taking into consideration the tax benefit associated with goodwill.
- The tax basis of goodwill is $900,000.
- The tax rate is 21% for all years.

ABC Company calculates the PTD before taking into consideration any tax benefit associated with goodwill. The PTD is the excess of tax goodwill over book goodwill, before taking into consideration the tax benefit associated with goodwill. The deferred tax asset represents the tax effected preliminary temporary difference.

As of April 1, 20X2, Component 1 goodwill has a book basis of $600,000 and a tax basis of $600,000. Component 2 goodwill has a book basis of $0 and a tax basis of $300,000. In this case, Component 2 goodwill is an excess of tax-deductible goodwill over book goodwill, and therefore a tax benefit for that excess is also a temporary difference which results in a deferred tax asset. As of April 1, 20X2, the goodwill for book purposes is adjusted for the tax benefit associated with goodwill by using the following simultaneous equation:

(Tax Rate ÷ (1-Tax Rate)) × PTD = DTA

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The calculation of the PTD and the deferred tax asset follows:

	Amount
Tax basis-goodwill	$900,000
Less: Book basis-goodwill	(600,000)
PTD	$300,000
Tax rate ÷ (1-Tax rate) 21%/ (1-21%)	26.58%
Deferred tax asset	**$79,747**

Goodwill for book purposes would be established at the acquisition date at $520,253 ($600,000- $79,747 =$520,253).

5.5 Intra-entity / intercompany inventory transfers

Entities that file consolidated financial statements may have subsidiary entities that file separate tax returns. Generally, income taxes (both current and deferred) are recorded to reflect transactions between separate taxpaying entities, even when they are members of a consolidated group. However, the one exception is for inventory, where there will generally be no temporary differences recorded in either the seller entity's or the buyer entity's separate financial statements. Inventory is usually transferred between entities at a profit. To the extent intercompany profit is deferred in consolidation, a similar entry would be required to defer the taxes paid by the seller entity. Therefore, reporting entities should maintain records tracking inter-company transactions so that deferred taxes are not misstated. Further any current tax amounts related to intra-entity transfers of inventory would be treated as prepaid taxes and not a deferred tax asset.

5.6 Functional currency

When a foreign operation has the U.S. dollar as its functional currency, the carrying amounts of nonmonetary assets and liabilities (e.g., property and equipment) are based on U.S. dollar amounts derived by using historical exchange rates. The realization of the U.S. dollar carrying amount of a nonmonetary asset would result in taxable income in the foreign jurisdiction equal to the foreign-currency equivalent, measured at the current exchange rate, of the U.S. dollar carrying amount.

The foreign tax basis of the asset would have been initially established when the asset was acquired. That tax basis was the amount of foreign currency paid to acquire the asset, which was the amount translated at the exchange rate then in effect (the historical rate) to arrive at the U.S. dollar carrying amount before depreciation. The foreign tax basis, especially in hyperinflationary countries, may have been subject to indexing under the foreign tax law.

For any nonmonetary asset, the temporary difference for foreign tax purposes is made up of:

- The difference between the foreign tax basis before any adjustment for indexing and the carrying amount in the pre-remeasurement foreign-currency financial statements (i.e., after adjustment to U.S. accounting principles and before remeasurement into U.S. dollars)
- The changes in tax basis, if any, resulting from indexing provisions of the foreign tax law
- The difference arising in remeasurement (i.e., the difference between the historical-rate and current-rate translations of the U.S. dollar carrying amount).

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In hyperinflationary countries, the second component would generally partially offset the impact of the third component.

ASC 740 precludes deferred taxes for the third component. Because no deferred taxes are recognized for the third component, the effect of indexing on the tax basis (the second component) is also eliminated when determining deferred taxes.

For property and equipment, deferred taxes should be computed in the foreign currency by comparing the historical book and tax basis in the foreign currency after the respective depreciation but before any indexing for either book or tax purposes. The foreign-currency deferred tax is then remeasured into U.S. dollars using the current exchange rate. Any additional tax depreciation on the current return that results from indexing will reduce the current tax provision.

The tax bases of assets and liabilities of entities located in countries with highly inflationary economies that prepare financial statements adjusted for general price-level changes in accordance with U.S. GAAP are often adjusted for the effects of inflation. For those entities, the accounting issues are how temporary differences should be determined as of the current reporting date and how the deferred tax expense or benefit for the period should be determined.

First, temporary differences should be determined based on the difference between the indexed tax bases of the assets and liabilities and the related price-level restated amounts reported in the financial statements. Second, the deferred tax expense or benefit for the period is based on the difference between the deferred tax assets and liabilities at the end of the current period and the deferred tax assets and liabilities at the end of the prior period after the amounts at the end of the prior period have been remeasured to units of general purchasing power at the end of the current year. The remeasurement of deferred tax assets and liabilities at the end of the prior year is reported as a restatement of beginning equity, like the remeasurement of all other assets and liabilities.

5.7 Cash value of life insurance

The excess of cash value of life insurance over the premiums paid is generally not a temporary difference if, under the provisions of the tax law, there would be no taxable amount if the insurance policy is held until the death of the insured. Therefore, deferred taxes are not recognized on basis differences related to cash surrender value amounts for life insurance when it is management's intent to maintain the policy until the death of the insured. However, if management intends to surrender the policy for its cash value, a deferred tax liability should be recognized for the excess of cash value over cumulative premiums paid. That excess is a temporary difference if the cash surrender value is expected to be recovered by surrendering the policy but is not a temporary difference if the asset is expected to be recovered without tax consequence upon the death of the insured.

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6. Rate reconciliation

ASC 740-10-50-12

A public entity shall disclose a reconciliation using percentages or dollar amounts of the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The statutory tax rates shall be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item shall be disclosed.

ASC 740-10-50-13

A nonpublic entity shall disclose the nature of significant reconciling items but may omit a numerical reconciliation.

For all publicly held entities, the income tax expense attributable to income from continuing operations must be reconciled to the amount of tax which would result from the application of the domestic federal statutory tax rate applicable to the highest level of taxable income to the pretax income from continuing operations. This reconciliation, which is required for each year for which an income statement is presented, may be performed in dollars or in percentages of pretax income, with each significant source of difference disclosed separately. Statutory rates for this disclosure are the enacted regular tax rates, i.e., without considering rates from an alternative tax system. In accordance with Rule 4-08(h)(2) of Regulation S-X, if no individual reconciling item amounts to more than 5% of the amount computed by multiplying the income before tax by the applicable statutory federal income tax rate, and the total difference to be reconciled is less than 5% of such computed amount, no reconciliation need be provided unless it would be significant to understanding the trend of earnings. In other words, for U.S. entities reconciling to the U.S. statutory rate of 21%, this would generally require disclosure of reconciling items that impact the rate by 1.05% or more (21% x 5%). Reconciling items that are individually less than 5% of the computed amount may be aggregated within the rate reconciliation. Nonpublic entities may forgo the numerical reconciliation but must still provide a qualitative description of significant reconciling items.

Typical reconciling items between recorded income tax expense and the income tax expense that would be computed at the statutory rate include the effect of:

- Enacted tax law and tax rate changes on existing temporary differences
- Differences between the enacted tax rate for the current year for net originating temporary differences and tax rates in future periods (or rates used in carryback computations, if applicable)
- Permanent differences on the current and deferred tax provision (e.g., tax-exempt interest income; income taxed at other rates, such as alternative minimum taxes or graduated rates; investment credits; fines; penalties)
- The change in the valuation allowance on deferred tax assets
- Differing tax rates in effect in different taxpaying jurisdictions (e.g., state tax rate, net of the federal tax benefit)

RSM COMMENTARY: Although not required for nonpublic entities, the numerical reconciliation is a useful disclosure. This reconciliation provides a much better understanding of the factors which cause an unusual relationship between the income tax provision and the income from continuing operations.

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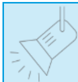
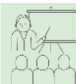


Spotlight on change: FASB Proposed Accounting Standards Update – Improvements to Income Tax Disclosures

The proposed ASU would require public business entities to disclose, on an annual basis, specific categories in the rate reconciliation, in percentages and amounts, and provide additional information for reconciling items that meet a quantitative threshold equal to 5% or more of the amount determined by multiplying pretax income (loss) from continued operations by the applicable statutory rate. For entities reconciling to the U.S. statutory rate of 21%, this would generally require disclosing any reconciling items that impact the rate by 1.05% or more.

Additional information can be found here.

The following example illustrates a simple rate reconciliation.



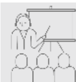
Example 6-1: Rate Reconciliation

ABC Company, a public entity, prepared its rate reconciliation for the year ended December 31, 20X2. ABC Company had pretax book income of $50,000,000 and permanent differences of $75,000 that decrease taxable income. ABC Company also had a blended tax rate of 25%, which consisted of a 21% U.S. federal tax rate and a 4% net state tax rate. ABC Company also determined that its total income tax expense was $12,481,250, which consisted of current tax expense of $12,718,750 offset by a deferred tax benefit of ($237,500).

ABC Company prepared the rate reconciliation as follows:

	Currency	Percentages
Income taxes at U.S. Federal rate ($50,000,000 x 21%)	$10,500,000	21.0%
Effect of permanent differences ($75,000 x 25%)	(18,750)	0.0%
State income taxes net of federal benefit ($50,000,000 x 4%)	2,000,000	4.0%
Total income tax expense	**$12,481,250**	**25.0%**

The following provides another example of the rate reconciliation calculation.



Example 6-2: Statutory Rate Reconciliation

ASC 740-10-55-213 provides the following assumptions:

a. An entity has $100 of investment tax credits for the current year. The $100 deferred tax asset for operating loss carryforwards was fully reserved at the beginning of the current year.

b. Pretax financial income from continuing operations is $5,000.

c. Income tax expense from continuing operations is $1,500.

d. Effective tax rate is 30%.

e. Statutory tax rate is 34%.

ASC 740-10-55-216 illustrates the statutory tax rate reconciliation as follows.

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Tax expense at statutory rate ($5,000 x 34%)	$1,700
Benefit of investment tax credits	(100)
Benefit of operating loss carryforwards	(100)
Tax expense from continuing operations ($5,000 x 30%)	**$1,500**

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Appendix A: Acronyms

Acronym	Definition
ASC	Accounting Standards Codification
DTA	Deferred Tax Asset
DTL	Deferred Tax Liability
FASB	Financial Accounting Standards Board
NOL	Net Operating Loss
PTD	Preliminary Temporary Difference
RTP	Return to Provision

Appendix B: Definitions

Several terms with specific meaning are used throughout this whitepaper. Those terms and the corresponding definitions based on the Master Glossary of the FASB's Accounting Standards Codification are provided in the table that follows.

Term	Definition
Carrybacks	Deductions or credits that cannot be utilized on the tax return during a year that may be carried back to reduce taxable income or taxes payable in a prior year. An operating loss carryback is an excess of tax deductions over gross income in a year; a tax credit carryback is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried back and the length of the carryback period.
Carryforwards	Deductions or credits that cannot be utilized on the tax return during a year that may be carried forward to reduce taxable income or taxes payable in a future year. An operating loss carryforward is an excess of tax deductions over gross income in a year; a tax credit carryforward is the amount by which tax credits available for utilization exceed statutory limitations. Different tax jurisdictions have different rules about whether excess deductions or credits may be carried forward and the length of the carryforward period. The terms carryforward, operating loss carryforward, and tax credit carryforward refer to the amounts of those items, if any, reported in the tax return for the current year.
Current Tax Expense (or Benefit)	The amount of income taxes paid or payable (or refundable) for a year as determined by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues for that year.

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Term	Definition
Deductible Temporary Difference	Temporary differences that result in deductible amounts in future years when the related asset or liability is recovered or settled, respectively. See Temporary Difference.
Deferred Tax Asset	The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. A deferred tax asset is reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.
Deferred Tax Consequences	The future effects on income taxes as measured by the applicable enacted tax rate and provisions of the enacted tax law resulting from temporary differences and carryforwards at the end of the current year.
Deferred Tax Expense (or Benefit)	The change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets acquired in a purchase business combination during the year, it is the change since the combination date. Income tax expense (or benefit) for the year is allocated among continuing operations, discontinued operations, and items charged or credited directly to shareholders' equity.
Deferred Tax Liability	The deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law.
Event	A happening of consequence to an entity. The term encompasses both transactions and other events affecting an entity.
Income Tax Expense (or Benefit)	The sum of current tax expense (or benefit) and deferred tax expense (or benefit).
Income Taxes	Domestic and foreign federal (national), state, and local (including franchise) taxes based on income.
Income Taxes Currently Payable (Refundable)	See Current Tax Expense (or Benefit).
Public Entity	A business entity or a not-for-profit entity that meets any of the following conditions: a. It has issued debt or equity securities or is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets). b. It is required to file financial statements with the Securities and Exchange Commission (SEC).

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Term	Definition
	It provides financial statements for the purpose of issuing any class of securities in a public market.
Tax Consequences	The effects on income taxes—current or deferred—of an event.
Tax Position	A position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred tax assets and liabilities for interim or annual periods. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The term tax position also encompasses, but is not limited to: a. A decision not to file a tax return. b. An allocation or a shift of income between jurisdictions c. The characterization of income or a decision to exclude reporting taxable income in a tax return. d. A decision to classify a transaction, entity, or other position in a tax return as tax exempt. e. An entity's status, including its status as a pass-through entity or a tax-exempt not-for-profit entity.
Taxable Income	The excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority.
Taxable Temporary Difference	Temporary differences that result in taxable amounts in future years when the related asset is recovered, or the related liability is settled. See Temporary Difference.
Temporary Difference	A difference between the tax basis of an asset or liability computed pursuant to the requirements in Subtopic 740-10 for tax positions, and its reported amount in the financial statements that will result in taxable or deductible amounts in future years when the reported amount of the asset or liability is recovered or settled, respectively. Paragraph 740-10-25-20 cites examples of temporary differences. Some temporary differences cannot be identified with a particular asset or liability for financial reporting (see paragraphs 740-10-05-10 and 740-10-25-24 through 740-10-25-25), but those temporary differences do meet both of the following conditions: a. Result from events that have been recognized in the financial statements. b. Will result in taxable or deductible amounts in future years based on provisions of the tax law.

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Term	Definition
	Some events recognized in financial statements do not have tax consequences. Certain revenues are exempt from taxation and certain expenses are not deductible. Events that do not have tax consequences do not give rise to temporary differences.
Valuation Allowance	The portion of a deferred tax asset for which it is more likely than not that a tax benefit will not be realized.

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