ACCOUNTING FOR INCOME TAXES - DETERMINING THE APPLICABLE TAX RATE

November 2025

OVERVIEW

This Financial Reporting Insights is intended to be used as a resource in understanding and analyzing how to determine the applicable income tax rates to be applied to the entity's taxable income and cumulative temporary differences in order to calculate the current taxes payable (refundable) and deferred tax assets (liabilities), respectively. The scope of this publication includes identifying the entity's federal (national) tax rate, any state, local and foreign tax rates, as well as the impact of changes in these rates and alternative tax systems, such as alternative minimum taxes.

This publication does not address every aspect of accounting for income taxes and should therefore be read in conjunction with the FASB Accounting Standards Codification (ASC) 740, *Income Taxes*.

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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 740-10-10-2

Ideally, the second objective might be stated more specifically to recognize the expected future tax consequences of events that have been recognized in the financial statements or tax returns. However, that objective is realistically constrained because:

a. The tax payment or refund that results from a particular tax return is a joint result of all the items included in that return.

b. Taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years.

c. Information available about the future is limited. As a result, attribution of taxes to individual items and events is arbitrary and, except in the simplest situations, requires estimates and approximations.

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.

Most revenue and expense transactions included in pretax financial statement 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.

Entities must determine their income tax provision (income tax expense or benefit reflected within the financial statements) through a two-step process:

1. Recognize the amount of estimated taxes payable or refundable for the current year (i.e., the amount expected to be reflected on its tax returns for the current year). This requires an entity to calculate its taxable income, which typically is pretax financial statement income plus or minus any temporary and permanent differences and carryforwards. The current period expense (benefit) is calculated by applying the applicable tax rates to taxable income.
2. Recognize deferred taxes for the estimated future tax effects of events that have been recognized in either the financial statements or tax returns, but not both (to ensure that the recorded income tax expense includes the current and future tax effects of all items reflected in the financial statements). Deferred tax expense (benefit) is calculated by applying the applicable tax rates to the change in the cumulative temporary differences and carryforwards between the current and the prior year.

Current taxes payable (refundable) may also be impacted by available tax credits, adjustments to prior year tax liabilities that become known in the current year (i.e., return to provision adjustments), and income tax payments made, or refunds received during the year.

An entity must determine its applicable tax rates to calculate its current taxes payable (refundable) and its deferred tax assets and liabilities, as applicable.

2. Applicable tax rate

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.

ASC 740-10-30-26

The reported tax effect of items not included in income from continuing operations (for example, discontinued operations, cumulative effects of changes in accounting principles, and items charged or credited directly to shareholders' equity) that arose during the current fiscal year and before the date of enactment of tax legislation shall be measured based on the enacted rate at the time the transaction was recognized for financial reporting purposes.

2.1 General

The entity's applicable tax rates are the enacted tax rates that apply to taxable income in the current period and are expected to apply in the periods in which the deferred tax asset or liability is expected to be realized or settled. In most cases, the enacted tax rates will be the same for both current and deferred tax purposes, but there may be differences in some cases, which we will discuss later in this publication.

The tax rates applied to taxable income and temporary differences must be the enacted tax rates in each jurisdiction in which the entity pays taxes, and they may not be a form of an effective tax rate.

The applicable tax rates are used to measure the deferred tax asset on deductible temporary differences and operating loss carryforwards, and the deferred tax liability on taxable temporary differences. In concept, the deferred tax asset or liability should approximate the incremental effect of reversing temporary differences and operating loss carryforwards on future taxes refundable or payable. Therefore, determining the applicable tax rates is an important step in measuring deferred taxes.

A deferred tax asset expected to be realized in future years through carryback of a future loss to the current or prior year (or a deferred tax liability expected to reduce the refund claimed for the carryback of a future loss to the current or prior year) is measured using tax laws and rates for the current or a prior year (i.e., the year for which a refund is expected to be realized based on loss carryback provisions of the tax law).

2.2 Apportionment of state taxes

Spotlight on change:

ASU 2023-09 became effective for public business entities for annual periods beginning after December 15, 2024, and will become effective for other entities one year later. The ASU includes, among other things, specific disclosure requirements related to state and local taxes within the annual effective tax rate reconciliation. Entities should ensure that their processes, systems and controls in place related to state and local taxes, especially when they use an apportionment approach when calculating the state portion of the income tax provision, will enable them to comply with the new disclosure requirements. While the ASU does not affect recognition and measurement within the financial statements, entities that use a blended state tax rate, for example, may need to adjust their approach to comply with the disclosure requirements of the ASU, since the disaggregated information required for the disclosure may not be readily available. For further information, please see our publications entitled Accounting Brief - ASU 2023-09 Planning Considerations and ASU 2023-09-Expanded Income Tax Disclosure Requirements.

Reporting entities must consider their legal entity structure and the jurisdictions in which they conduct business in order to determine the applicable tax rates. A reporting entity may have multiple subsidiaries (i.e., legal entities), and each subsidiary entity may be a separate taxpaying entity. An individual taxpaying entity may be subject to multiple taxing authorities which will make the applicable tax rate a blend of many different jurisdictions and rates. Taxpaying entities should compute their current and deferred taxes separately for each jurisdiction. Careful consideration should be given before combining applicable tax rates. A U.S. taxpaying entity may conduct business domestically and overseas and therefore may owe U.S. federal, state, local and foreign taxes. Relevant tax rates in a particular taxing jurisdiction are based on the enacted tax laws of the prevailing governing tax authority.

As noted in the previous paragraph, a reporting entity may include multiple legal taxpaying entities. Many reporting entities finalize their consolidated financial statements prior to preparation of the individual tax returns for each taxpaying entity. For purposes of financial statement reporting, many reporting entities will aggregate taxpaying entities and applicable tax rates (and the resultant tax computations) for two or more tax jurisdictions. ASC 740-10-55-25 allows entities to combine tax computations across jurisdictions when the same operations are taxed in multiple jurisdictions and the tax laws are substantially similar or any differences would not significantly affect the outcome. Combining tax computations generally occurs when the taxpaying entities have similar tax attributes or the same income is taxed in two or more tax jurisdictions and there are no significant differences between the tax laws of those jurisdictions (e.g., the same carryback and carryforward periods and there are no significant effects from graduated tax rates). For example, in the U.S., many state income taxes are based on federal taxable income. When evaluating the appropriateness of combining the tax computations, consideration also needs to be given regarding deferred taxes and whether a valuation allowance would be necessary for deferred tax assets in one jurisdiction but not another. Federal and state calculations may be combined when the temporary differences are the same. However, some states may have laws that are different from federal income tax laws, which may materially impact the bases of assets and liabilities for state tax purposes. Further, some states may automatically incorporate federal income tax law changes into their legislation, while others may require further legislation. These facts must be identified and considered in evaluating whether combining federal and state calculations is proper. Additionally, while combining federal and state rates may otherwise be appropriate, this approach of combining rates may not provide enough detail to comply with the disaggregated disclosure requirements of ASU 2023-09.

When an entity concludes that it is appropriate to combine its federal and state computations, the combined applicable tax rate is the federal applicable tax rate plus the applicable state tax rate net of the federal income tax effect at the federal applicable tax rate.

Example 2-1: Combined applicable income tax rate

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 10%, respectively. ABC Company determines its applicable tax rate as follows:

	Effective tax rate
U.S. federal statutory income tax rate	21%
State income tax rate	10%
Less federal benefit for state income taxes (21% x 10%)	(2%)
Total effective tax rate (federal and state)	29%

This example is very simple because ABC Company conducts business in a single state. Most large U.S. entities conduct business in more than one state and, therefore, taxable income would be apportioned among the states where it conducts business. Apportionment is the term used for the allocation of taxable income to a particular jurisdiction. U.S. states apportion income based on a mixture of percentages and weightings which may include one or more factors or multiples of property, payroll and sales located within a particular state. Each state's unique apportionment varies based on relevant income tax laws. Apportionment factors must be considered as part of the applicable tax rate determination. The applicable state tax rate is calculated as the product of each applicable state's apportionment factor and the applicable state's enacted tax rate (i.e., the expected apportionment factors × state tax rates = applicable state tax rate).

The following example illustrates the calculation of a federal state combined applicable tax rate when apportionment of taxable income is needed.

Example 2-2: Apportionment of taxable income to multiple states

ABC Company is a U.S. taxpaying entity which conducts business within four states. ABC Company had taxable income of $1,000,000 for the year ended December 31, 20X2. The applicable U.S. federal income tax rate is 21%. The applicable state income tax rates were:

- State A- 5%
- State B- 6%
- State C- 6%
- State D- 8%

ABC Company determined, based on the relevant apportionment factors, that income is apportioned to each state as follows:

- State A- 11%
- State B- 9%
- State C- 27%
- State D- 53%

ABC Company calculated its state income taxes in the table below.

	State A	State B	State C	State D	Total
State taxable income	$1,000,000	$1,000,000	$1,000,000	$1,000,000	N/A
State apportionment percentage	11%	9%	27%	53%	100%
Income apportioned to the states	110,000	90,000	270,000	530,000	$1,000,000
State tax rate	5.0%	6.0%	6.0%	8.0%	N/A
State income taxes	$5,500	$5,400	$16,200	$42,400	$69,500

ABC Company calculated its federal tax provision and federal and state applicable tax rate in the table below.

	Amount
Federal taxable income ($1,000,000 - $69,500)	$930,500
Federal tax rate	21%
Federal income taxes	195,405
State income taxes (from above table)	69,500
Total federal and state income taxes	$264,905
Federal and state applicable tax rate ($264,905 / $1,000,000)	26.5%

Entities are encouraged to continually review state apportionment factors, as amounts may change based on business activity or tax law changes. Further, if an entity expands its business to a new state jurisdiction or ceases operations in a state jurisdiction, the entity is encouraged to review and update its apportionment analysis. Entities should consult their tax advisors for further assistance.

2.3 Changes in enacted tax laws or rates

ASC 740-10-25-47

The effect of a change in tax laws or rates shall be recognized at the date of enactment.

ASC 740-10-25-48

The tax effect of a retroactive change in enacted tax rates on current and deferred tax assets and liabilities shall be determined at the date of enactment using temporary differences and currently taxable income existing as of the date of enactment.

Spotlight on change:

The One Big Beautiful Bill Act (OBBBA), enacted on July 4, 2025, includes several changes that may affect U.S. federal income tax provisions. These provisions include changes to bonus depreciation, interest expense limitations, and domestic research and development expenses.

ASC 740-10-25-47 to 25-48 require an entity to recognize the effect of a change in tax law in the period that the tax law is enacted. Tax laws are enacted when tax legislation is signed into law. For example, in the U.S., federal income tax legislation is enacted when approved by Congress and signed by the president. The enactment date may precede the effective date of the law in some cases. For example, the OBBBA was enacted on July 4, 2025, but many provisions are not effective until tax years beginning after December 15, 2025, or December 31, 2025, as appropriate.

A change in tax law may also affect the measurement of deferred taxes since temporary differences that exist as of the enactment date but are expected to reverse after the effective date of the tax law are adjusted to reflect the change in tax rate. Enacted changes in tax laws and rates that become effective for a particular future years are to be considered in determining the tax rate to apply to temporary differences reversing in those years. The effect on deferred tax assets and liabilities from an enacted change in tax laws or rates is recognized in income from continuing operations in the period of enactment.

The reported tax effect of items not included in income from continuing operations (e.g., discontinued operations and items charged or credited directly to equity) that arose during the current year and before the date of enactment of tax legislation should be measured based on the enacted rate at the time the transaction was recognized for financial reporting purposes. Further, entities should ensure that the tax effects of business combinations or asset acquisitions are measured based upon the enacted tax rates at the time that the transaction occurs.

The following example sourced directly from ASC 740 illustrates the measurement of a deferred tax asset for deductible temporary differences when there is a change in tax rates.

Example 2-3: Change in Tax Rates (ASC 740-10-55-131 to 55-135)

Example 15- Change in Tax Rates

This Example illustrates the guidance in paragraph 740-10-55-23 for determination of the tax rate for measurement of a deferred tax asset for deductible temporary differences when there is a change in tax rates. This Example has the following assumptions:

a. Enacted tax rates are 30 percent for Years 1-3 and 40 percent for Year 4 and thereafter.

b. At the end of Year 3 (the current year), an entity has $900 of deductible temporary differences, which are expected to result in tax deductions of approximately $300 on the future tax returns for each of Years 4-6.

The tax rate is 40 percent if the entity expects to realize a tax benefit for the deductible temporary differences by offsetting taxable income earned in future years. Alternatively, the tax rate is 30 percent if the entity expects to realize a tax benefit for the deductible temporary differences by loss carryback refund.

Further assume for this Example both of the following:

a. The entity recognizes a $360 ($900 at 40 percent) deferred tax asset to be realized by offsetting taxable income in future years.

b. Taxable income and taxes payable in each of Years 1-3 were $300 and $90, respectively.

Realization of a tax benefit of at least $270 ($900 at 30 percent) is assured because carryback refunds totaling $270 may be realized even if no taxable income is earned in future years. Recognition of a valuation allowance for the other $90 ($360 - $270) of the deferred tax asset depends on management's assessment of whether, based on the weight of available evidence, a portion or all of the tax benefit of the $900 of deductible temporary differences will not be realized at 40 percent tax rates in future years.

Alternatively, if enacted tax rates are 40 percent for Years 1-3 and 30 percent for Year 4 and thereafter, measurement of the deferred tax asset at a 40 percent tax rate could only occur if tax losses are expected in future Years 4-6.

The following example illustrates the impact of a change in tax law and rates on an entity with a calendar year-end.

Example 2-4: Changes in tax laws and rates

ABC Company is a U.S. entity which conducted its business activities in a single state with no state income tax. The U.S federal government enacted a tax law change in November 20X7; however, many of the provisions became effective on January 1, 20X8. As a result of this legislation, ABC Company's federal income tax rate decreased from 35% to 21%, effective January 1, 20X8. ABC Company had the following additional information as of and for its financial statement year ended December 31, 20X7:

- Taxable income (pretax income less permanent differences) of $10,000,000
- Prior year net deferred tax liability balance of $1,750,000 as of December 31, 20X6 ($5,000,000 of cumulative taxable temporary differences at an applicable tax rate of 35%)
- Cumulative taxable temporary differences as of December 31, 20X7, of $3,000,000.
- Current income tax payable (receivable) of zero as of December 31, 20X6, and no estimated payments made during the year ended December 31, 2017
- All taxable temporary differences are expected to settle in the near term

ABC Company's year-end (December 31, 20X7) occurred after the enactment date of the new law, but before its effective date. Therefore, ABC Company recorded its current income tax provision (payable) using the then-enacted tax rate of 35%, since its financial reporting year end occurred before the effective date of the new law. ABC Company recorded its net deferred tax liability using the newly-enacted tax rate of 21%, since this net liability was expected to reverse after the effective date of the new law, which was enacted before the entity's financial reporting year end. Deferred tax expense was recognized for the differences between the 20X7 and 20X6 deferred tax liability balances.

The following table illustrates the calculation of the ABC Company's net deferred tax liability as of December 31, 20X7, which was after the enactment date but before the effective date of the new legislation.

	Cumulative Taxable Temporary Differences	Applicable Tax Rate	Net Deferred Tax Liability
Balance, December 31, 20X6	($5,000,000)	35%	($1,750,000)
Balance, December 31, 20X7	(3,000,000)	21%	(630,000)
Change in cumulative temporary differences/ deferred tax (benefit)	($2,000,000)	N/A	($1,120,000)

The following table illustrates ABC Company's calculations of current and deferred tax expense (benefit) and the impact on its applicable tax rate for the year ended December 31, 20X7, due to the enacted legislation.

	Amount	Applicable Tax Rate
Current income tax expense ($10,000,000 x 35%)	$3,500,000	35%
Deferred tax benefit (from above table)	(1,120,000)	(11%)
Total tax expense	$2,380,000	24%

Note: The current federal income tax expense calculated above equals the current federal income tax payable since current income tax payable (receivable) was zero as of December 31, 20X6, and there were no estimated payments made during the year ended December 31, 20X7.

The above example illustrates a prospective change in income tax rates (i.e., the change begins after the enactment date and affected periods after the effective date.) Jurisdictions also may enact tax laws that apply retroactive changes, including retroactive changes in tax rates. The tax effect of a retroactive change in enacted tax rates on current and deferred tax assets and liabilities should be determined using temporary differences and taxable income existing at the date of enactment. The cumulative tax effect of a retroactive change in enacted tax rates on current or deferred tax assets and liabilities is recognized in the period of enactment and is included in income from continuing operations. Further, some legislation may be anticipated (e.g., a provision is due to expire and has historically been renewed or there has been press activity around a particular law). An entity may not record the effects of anticipated legislation until the legislation is enacted, even if the entity believes it is probable that such legislation will be enacted.

2.4 Time value of money (discounting)

Certain deferred tax assets and liabilities may not be recovered or settled within a year. Similarly, some current tax payments or refunds may be due or collectible over a longer term. Generally, assets and liabilities that will not be recovered or settled in the near term are discounted to their present value. However, ASC 740-10-05-7 and 10-30-8 do not permit discounting deferred tax assets and liabilities to reflect the time value of money. With respect to current taxes payable or refundable, ASC 835-30-15-3(e) specifically removes income taxes from its scope.

2.5 Graduated tax rate structure

The U.S. federal corporate tax structure included graduated tax rates prior to 2018, and certain state or foreign tax jurisdictions may continue to incorporate such rate structures. Graduated tax rate structures incorporate lower tax rates with increasing rates as income levels rise. ASC 740-10-30-9 states that in jurisdictions with graduated tax rate structures, when the entity’s taxable income substantially exceeds the highest tax rate threshold, all taxable income is effectively taxed at a single flat tax rate. Graduated tax rates, therefore, would only be a significant factor for entities with lower taxable income. If an entity does not expect graduated taxes to be significant, the entity may use a single tax rate for its current and deferred taxes. If, however, graduated taxes are expected to be significant for the entity, ASC 740-10-30-9 requires that the average graduated tax rate be used. The average graduated tax rate applied to deferred taxes depends on the projected taxable income including reversing temporary differences, in the years where the temporary differences are expected to reverse. The average graduated tax rate is applied to the amount of estimated annual taxable income in the periods in which the deferred tax liability or asset is estimated to be settled or realized. If the entity expects the average graduated tax rate to be zero, the lowest graduated tax rate should be used, instead of a tax rate of zero.

The following example sourced directly from ASC 740 illustrates the determination of the average graduated tax rate where such rates are a significant factor for the entity.

Example 2-5: Graduated tax rates (ASC 740-10-55-136 to 55-138)

Example 16: Graduated Tax Rates

This Example illustrates the guidance in paragraph 740-10-55-23 for determination of the average graduated tax rate for measurement of deferred tax liabilities and assets by an entity for which graduated tax rates ordinarily are a significant factor. At the end of Year 3 (the current year), an entity has $1,500 of taxable temporary differences and $900 of deductible temporary differences, which are expected to result in net taxable amounts of approximately $200 on the future tax returns for each of Years 4-6. Enacted tax rates are 15 percent for the first $500 of taxable income, 25 percent for the next $500, and 40 percent for taxable income over $1,000. This Example assumes that there is no income (for example, capital gains) subject to special tax rates.

The deferred tax liability and asset for those reversing taxable and deductible temporary differences in Years 4-6 are measured using the average graduated tax rate for the estimated amount of annual taxable income in future years. Thus, the average graduated tax rate will differ depending on the expected level of annual taxable income (including reversing temporary differences) in Years 4-6. The average tax rate will be:

1. 15 percent if the estimated annual level of taxable income in Years 4-6 is $500 or less.
2. 20 percent if the estimated annual level of taxable income in Years 4-6 is $1,000.
3. 30 percent if the estimated annual level of taxable income in Years 4-6 is $2,000.

Temporary differences usually do not reverse in equal annual amounts as in the Example above, and a different average graduated tax rate might apply to reversals in different future years. However, a detailed analysis to determine the net reversals of temporary differences in each future year usually is not warranted. It is not warranted because the other variable (that is, taxable income or losses exclusive of reversing temporary differences in each of those future years) for determination of the average graduated tax rate in each future year is no more than an estimate. For that reason, an aggregate calculation using a single estimated average graduated tax rate based on estimated average annual taxable income in future years is sufficient. Judgment is permitted, however, to deal with unusual situations, for example, an abnormally large temporary difference that will reverse in a single future year, or an abnormal level of taxable income that is expected for a single future year. The lowest graduated tax rate should be used whenever the estimated average graduated tax rate otherwise would be zero.

The following example illustrates the determination of whether graduated tax rates may be significant.

Example 2-6: Graduated tax rates

In this example, the following graduated tax rates were applicable in Jurisdiction X as of December 31, 20X1.

- 15% for the first $50,000 of taxable income
- 25% for the next $25,000 of taxable income
- 34% for the next $25,000 of taxable income
- 39% for the next $235,000 of taxable income
- 34% for the next $9,665,000 of taxable income
- 35% for the next $5,000,000 of taxable income

- 38% for the next $3,333,333 of taxable income
- 35% for taxable income over $18,333,333

The following table computes the average graduated tax rates applicable to ABC Company based on various levels of estimated taxable income.

Estimated Taxable Income Level	Average Graduated Income Tax Rate
$50,000	15.00%
75,000	18.33%
100,000	22.25%
150,000	27.83%
200,000	30.63%
300,000	33.42%
500,000	34.00%
1,000,000	34.00%
15,000,000	34.33%
Over 18,333,333	35.00%

Based on the above table, the impact of the graduated tax rates is most significant for estimated taxable income levels of $300,000 or less, where the average tax rates range from 15.00% to 33.42%.

3. Alternative minimum taxes

3.1 General

The U.S. had a federal corporate alternative minimum tax (AMT) through 2017, when it was repealed. In 2022, the Inflation Reduction Act of 2022 (IRA) was enacted, establishing a new Corporate Alternative Minimum Tax (CAMT) system with different thresholds than the prior system. See Section 3.2 for further discussion of the CAMT.

An AMT system is generally designed to increase income taxes for those entities with higher income by mandating an alternative method to calculate income taxes. Generally, entities subject to the AMT would calculate their current income tax liability as the greater of the tax computed using a regular tax system or the tax computed under an AMT system. AMT systems are designed to ensure that corporations pay a minimum amount of tax. Pursuant to ASC 740-10-30-10, an entity would also recognize a deferred tax asset for any allowable AMT credit carryforwards. Such deferred tax asset is measured using the entity's regular tax rate rather than the AMT rate,

ASC 740-10-30-11 further notes that an entity may not utilize the AMT rate for its deferred taxes solely because it is a current AMT taxpayer and expects to always be an AMT taxpayer, since it is not possible to predict that the entity will always be an AMT taxpayer. Further, it would be illogical if the result utilizing the AMT provisions would in effect reduce the entity's income tax expense for financial reporting purposes. Similarly, it would also be illogical to assume that the entity would allow an AMT credit carryforward to expire unused at the end of the life of the entity, which would naturally occur under the assumption that the entity would always be an AMT taxpayer. The regular tax rate must be used in computing deferred taxes even if the company anticipates remaining subject to an AMT system for the foreseeable future. Therefore, any tax effects of the AMT tax are recognized within the financial statements as current income tax expense in the period incurred.

Alternative tax systems may also exist in other tax jurisdictions under certain state or foreign tax laws. ASC 740-10-30-12 dictates that in such cases, the applicable tax rate should be determined consistent with the tax law after considering any interaction between the regular and the AMT systems.

3.2 The CAMT

The CAMT imposes a 15% tax on the adjusted financial statement income (AFSI) of certain large corporations with a three-year average financial statement income in excess of $1 billion and U.S. corporations that have at least $100 million in financial statement income with a foreign parent that has at least $1 billion in financial statement income. AFSI is a defined term in the IRA and is generally financial statement net income or loss adjusted for certain items. Once an entity meets the criteria and is subject to CAMT, the entity continues to be subject to CAMT, even if its average AFSI falls below $1 billion, unless specific exceptions apply.

After determining the AFSI for the entity, the CAMT is calculated by determining the regular tax, which is taxable income multiplied by the regular tax rate, and the Tentative Minimum Tax (TMT), which is 15% of AFSI minus any CAMT foreign tax credit. If the TMT is higher than the regular tax (plus Base Erosion and Anti-Abuse Tax [BEAT]) the difference is the additional corporate alternative minimum tax owed by the entity. BEAT is an additional global federal income tax that is beyond the scope of this publication.

An entity also earns a tax credit (CAMT credit carryforward) for the portion of the CAMT tax payment that exceeds the regular tax amount. The CAMT credit carryforward, which does not expire, may be used to reduce future regular income tax, but only to the extent of the computed CAMT tax. The entity recognizes a deferred tax asset for the CAMT credit carryforwards which under ASC 740-10-30-11, are measured using the entity's regular tax rate and not the CAMT tax rate, even if the entity expects that it will continue to indefinitely owe taxes under the CAMT.

To determine its U.S. federal income tax liability, the entity must calculate its taxes under both the regular tax system and the CAMT framework, then pay whichever amount is higher for that tax year.

Example 3-1: Applying the CAMT

In 20X3, ABC Company, in its first year of operation, had pretax income of $10 billion, permanent differences that reduced taxable income of $1 billion and $2.5 billion of net taxable temporary differences. ABC Company calculated its AFSI for CAMT purposes as $10 billion. The regular tax rate and CAMT tax rate are 21% and 15%, respectively. For simplicity, assume that the entity is not subject to BEAT.

ABC Company determined its income tax expense under the CAMT as follows:

	Current tax expense (in millions)	Deferred tax expense (in millions)
Pretax income	$10,000	N/A
Permanent differences	(1,000)	N/A
Temporary differences	(2,500)	$2,500
Taxable income	6,500	2,500
Regular tax rate	21%	21%
Regular tax (A)	**$1,365**	**$525**
AFSI	$10,000	N/A
Minimum tax rate	15%	N/A
TMT (B)	**$1,500**	N/A
CAMT (C=B-A)	135	(135)
Total (C+A)	**$1,500**	**$390**

ABC Company recognized total income tax expense of $1.89 billion in 20X3. At the end of 20X3, ABC Company also recognized current taxes payable of $1.5 billion and deferred tax liabilities of $390 million.

3.3 Global Anti-Base Erosion Rules (GloBE)

Over 130 countries came together for a historic agreement on a two-pillar approach to reform international tax rules and ensure that multinational entities pay a minimum level of tax regardless of where they operate. The Organisation for Economic Co-operation and Development (OECD) released the model known as the Global Anti-Base Erosion (GloBE) rules ("OECD Model" or "GloBE minimum tax"). The OECD model sets a framework for a global minimum tax of 15% on multinational entities with consolidated group revenue exceeding EUR750 million. The OECD is not a government entity, but rather an international organization that creates policies and international standards. Therefore, individual taxing jurisdictions must enact legislation for this framework to become law.

At the February 1, 2023 FASB Meeting, the FASB staff replied to an inquiry related to the accounting for deferred taxes for the GloBE minimum tax. The inquiry centered on whether the OECD Model would result in recognizing GloBE-specific deferred taxes or remeasuring existing deferred taxes at the GloBE minimum tax rate.

The FASB staff responded to the inquiry, stating that it believes the GloBE minimum tax is an AMT as discussed in ASC 740-10-30-10 through 30-12 and ASC 740-10-55-31 through 55-32. As an AMT, deferred tax assets and liabilities would not be recognized or adjusted for the estimated future effects of the minimum tax. The FASB staff also noted the GloBE minimum tax qualifies as a separate but parallel tax system that is designed to ensure that certain taxpayers pay at least a minimum amount of income tax.

Based on the FASB staff's conclusion that the GloBE minimum tax is an AMT pursuant to ASC 740, the GloBE minimum tax as described in the OECD Model are recorded as a period cost. Ultimately, entities would evaluate the legislation enacted within their taxpaying jurisdictions to assess the impact on their financial statements and reflect such impact in the period in which the legislation is enacted.

Multinational entities are advised to monitor Pillar Two legislation within jurisdictions where they operate to ensure they have the latest available information to apply the above accounting guidance.

4. Applicable rate considerations within certain foreign jurisdictions

ASC 740-10-25-39

Certain foreign jurisdictions tax corporate income at different rates depending on whether that income is distributed to shareholders. For example, while undistributed profits in a foreign jurisdiction may be subject to a corporate tax rate of 45 percent, distributed income may be taxed at 30 percent. Entities that pay dividends from previously undistributed income may receive a tax credit (or tax refund) equal to the difference between the tax computed at the undistributed rate in effect the year the income is earned (for tax purposes) and the tax computed at the distributed rate in effect the year the dividend is distributed.

ASC 740-10-25-40

In the separate financial statements of an entity that pays dividends subject to the tax credit to its shareholders, a deferred tax asset shall not be recognized for the tax benefits of future tax credits that will be realized when the previously taxed income is distributed; rather, those tax benefits shall be recognized as a reduction of income tax expense in the period that the tax credits are included in the entity's tax return.

ASC 740-10-25-41

The accounting required in the preceding paragraph may differ in the consolidated financial statements of a parent that includes a foreign subsidiary that receives a tax credit for dividends paid if the parent expects to remit the subsidiary's earnings. Assume that the parent has not availed itself of the exception for foreign unremitted earnings that may be available under paragraph 740-30-25-17. In that case, in the consolidated financial statements of a parent, the future tax credit that will be received when dividends are paid and the deferred tax effects related to the operations of the foreign subsidiary shall be recognized based on the distributed rate because, as assumed in that case, the parent is not applying the indefinite reversal criteria exception that may be available under that paragraph. However, the undistributed rate shall be used in the consolidated financial statements to the extent that the parent has not provided for deferred taxes on the unremitted earnings of the foreign subsidiary as a result of applying the indefinite reversal criteria recognition exception.

As noted in ASC-74-10-25-39, some foreign jurisdictions may tax distributed income at a lower rate than undistributed income. If the entity subsequently pays a dividend from income that was taxed at a higher rate, the entity may receive a tax credit (or tax refund) equal to the difference between the income tax calculated at the enacted rate for undistributed income in the year the income was earned, and the income tax calculated at the enacted rate for distributed income in the year that the dividend was paid. The entity would not recognize a deferred tax asset related to the expected future tax benefit of the tax credit. Rather, the foreign entity would only recognize the tax benefit in the period that the entity pays the dividend and earns the credit.

Under ASC 740-10-25-41, the applicable tax rate used by a parent entity to reflect a local foreign subsidiary’s income taxes within its consolidated financial statements is the rate for distributed income unless the parent entity applies the indefinite reversal criteria in ASC 740-30-25-17. The rationale for this treatment is that the parent may require its foreign subsidiary to distribute its income to the parent, and therefore the consolidated financial statements should include the related tax effect of the repatriation of the income. If, however, the parent does not record deferred taxes on any unremitted earnings of its foreign subsidiary, (i.e., the parent entity applies the indefinite reversal exception), the parent entity would use the rate for undistributed income to compute its deferred taxes related to the foreign subsidiary.

Appendix A: Acronyms

Acronym	Definition
AFSI	Adjusted Financial Statement Income
AMT	Alternative Minimum Tax
ASC	Accounting Standards Codification
BEAT	Base Erosion and Anti-Abuse Tax
CAMT	Corporate Alternative Minimum Tax
FASB	Financial Accounting Standards Board
GloBE	Global Anti-Base Erosion Rules
IRA	Inflation Reduction Act of 2022
OBBBA	One Big Beautiful Bill Act
OECD	Organisation for Economic Co-operation and Development
TMT	Tentative Minimum Tax
U.S. GAAP	U.S. Generally Accepted Accounting Principles

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
Alternative Minimum Tax	A tax that results from the use of an alternate determination of a corporation's federal income tax liability under provisions of the U.S. Internal Revenue Code.
Business combination	A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations.
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.

Term	Definition
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.
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.

Term	Definition
Income Taxes Currently Payable (Refundable)	See Current Tax Expense (or Benefit).
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 income 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 decision not to file a tax return. An allocation or a shift of income between jurisdictions The characterization of income or a decision to exclude reporting taxable income in a tax return. A decision to classify a transaction, entity, or other position in a tax return as tax exempt. 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. 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.

Term	Definition
Tentative Minimum Tax	An intermediate calculation used in the determination of a corporation's federal income tax liability under the alternative minimum tax system in the United States. See Alternative Minimum Tax.
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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