FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2016-16
October 2016

# Income Taxes (Topic 740)

## Intra-Entity Transfers of Assets Other Than Inventory

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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# Summary

## Why Is the FASB Issuing This Accounting Standards Update (Update) and What Are the Main Provisions?

The Board is issuing this Update to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. Stakeholders submitted the idea for this project as part of the Board's initiative to reduce complexity in accounting standards (the Simplification Initiative). The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements.

Current GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. In addition, interpretations of this guidance have developed in practice over the years for transfers of certain intangible and tangible assets. This prohibition on recognition is an exception to the principle of comprehensive recognition of current and deferred income taxes in GAAP. Stakeholders informed the Board that the limited amount of authoritative guidance about the exception has led to diversity in practice and is a source of complexity in financial reporting, particularly for an intra-entity transfer of intellectual property. The Board also learned from stakeholders that this exception results in an unfaithful representation of the economics of an intra-entity asset transfer because the exception requires deferral of the income tax consequences of the transfer, including income taxes payable or paid.

The Board decided that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Consequently, the amendments in this Update eliminate the exception for an intra-entity transfer of an asset other than inventory. Two common examples of assets included in the scope of this Update are intellectual property and property, plant, and equipment. On the basis of stakeholders' feedback about the anticipated benefits and costs, the Board decided not to change GAAP for an intra-entity transfer of inventory.

The amendments in this Update do not include new disclosure requirements; however, existing disclosure requirements might be applicable when accounting for the current and deferred income taxes for an intra-entity transfer of an asset other than inventory. For example, GAAP requires an entity to disclose a comparison of income tax expense (benefit) with statutory expectations (a rate reconciliation for public entities or a description of the nature of each significant reconciling item for nonpublic entities) and also requires an entity to disclose the types of temporary differences and carryforwards that give rise to a significant portion of deferred income taxes.

The amendments in this Update align the recognition of income tax consequences for intra-entity transfers of assets other than inventory with International Financial Reporting Standards (IFRS). Specifically, IAS 12, *Income Taxes,* requires recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset (including inventory) when the transfer occurs.

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

For public business entities, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. For all other entities, the amendments are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual periods beginning after December 15, 2019. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. That is, earlier adoption should be in the first interim period if an entity issues interim financial statements.

The amendments in this Update should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption.

# Amendments to the *FASB Accounting Standards Codification*®

## Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–16. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

## Amendments to Master Glossary

2. Amend the Master Glossary term *Temporary Difference*, with a link to transition paragraph 740-10-65-5, as follows:

**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 ~~eight~~ 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 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.

3. Add the Master Glossary term *Inventory* to Subtopics 740-10 and 810-10, as follows:

**Inventory**

The aggregate of those items of tangible personal property that have any of the following characteristics:

a. Held for sale in the ordinary course of business
b. In process of production for such sale
c. To be currently consumed in the production of goods or services to be available for sale.

The term inventory embraces goods awaiting sale (the merchandise of a trading concern and the finished goods of a manufacturer), goods in the course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies). This definition of inventories excludes long-term assets subject to depreciation accounting, or goods which, when put into use, will be so classified. The fact that a depreciable asset is retired from regular use and held for sale does not indicate that the item should be classified as part of the inventory. Raw materials and supplies purchased for production may be used or consumed for the construction of long-term assets or other purposes not related to production, but the fact that inventory items representing a small portion of the total may not be absorbed ultimately in the production process does not require separate classification. By trade practice, operating materials and supplies of certain types of entities such as oil producers are usually treated as inventory.

# Amendments to Subtopic 740-10

4. Amend paragraphs 740-10-25-3, 740-10-25-20 through 25-23, and 740-10-25-55, with a link to transition paragraph 740-10-65-5, as follows:

## Income Taxes—Overall

## Recognition

**740-10-25-1** This Section establishes the recognition requirements necessary to implement the objectives of accounting for **income taxes** identified in Section 740-10-10. The following paragraph sets forth the basic recognition requirements while paragraph 740-10-25-3 identifies specific, limited exceptions to the basic requirements.

**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**.

**740-10-25-3** The only exceptions in applying those basic requirements are:

a. Certain exceptions to the requirements for recognition of deferred taxes whereby a deferred tax liability is not recognized for the following types of temporary differences unless it becomes apparent that those temporary differences will reverse in the foreseeable future:
   1. 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. See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.
   2. Undistributed earnings of a domestic subsidiary or a domestic corporate joint venture that is essentially permanent in duration that arose in fiscal years beginning on or before December 15, 1992. A last-in, first-out (LIFO) pattern determines whether reversals pertain to differences that arose in fiscal years beginning on or before December 15, 1992. See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.
   3. Bad debt reserves for tax purposes of U.S. savings and loan associations (and other qualified thrift lenders) that arose in tax years beginning before December 31, 1987. See paragraphs 942-740-25-1 through 25-3 for the specific requirements related to this exception.
   4. Policyholders' surplus of stock life insurance entities that arose in fiscal years beginning on or before December 15, 1992. See paragraph 944-740-25-2 for the specific requirements related to this exception.
b. Recognition of temporary differences related to deposits in statutory reserve funds by U.S. steamship entities (see paragraph 995-740-25-2)
c. The pattern of recognition of after-tax income for leveraged leases or the allocation of the purchase price in a purchase business combination to acquired leveraged leases as required by Subtopic 840-30
d. A prohibition on recognition of a deferred tax liability related to goodwill (or the portion thereof) for which amortization is not deductible for tax purposes (see paragraph 805-740-25-3)
e. A prohibition on recognition of a deferred tax asset for the ~~intra-entity~~ difference between the tax basis of ~~the assets~~ <u>**inventory**</u> in the buyer's tax jurisdiction and ~~their cost~~ <u>the carrying value</u> as reported in the consolidated financial statements <u>as a result of an intra-entity transfer of</u>

inventory from one tax-paying component to another tax-paying component of the same consolidated group. Income taxes paid on intra-entity profits on ~~assets~~ inventory remaining within the consolidated group are accounted for under the requirements of Subtopic 810-10.

f. A prohibition on recognition of a deferred tax liability or asset for differences related to assets and liabilities that, under Subtopic 830-10, are remeasured from the local currency into the functional currency using historical exchange rates and that result from changes in exchange rates or indexing for tax purposes. See Subtopic 830-740 for guidance on foreign currency related income taxes matters.

**In addition, amend the following Pending Content for paragraph 740-10-25-3 with no additional link to transition:**

**Pending Content:**

**Transition Date:** *(P) December 16, 2018; (N) December 16, 2019* | **Transition Guidance:** 842-10-65-1

**740-10-25-3** The only exceptions in applying those basic requirements are:

a. Certain exceptions to the requirements for recognition of deferred taxes whereby a deferred tax liability is not recognized for the following types of temporary differences unless it becomes apparent that those temporary differences will reverse in the foreseeable future:
   1. 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. See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.
   2. Undistributed earnings of a domestic subsidiary or a domestic corporate joint venture that is essentially permanent in duration that arose in fiscal years beginning on or before December 15, 1992. A last-in, first-out (LIFO) pattern determines whether reversals pertain to differences that arose in fiscal years beginning on or before December 15, 1992. See paragraphs 740-30-25-18 through 25-19 for the specific requirements related to this exception.
   3. Bad debt reserves for tax purposes of U.S. savings and loan associations (and other qualified thrift lenders) that arose in tax years beginning before December 31, 1987. See paragraphs 942-740-25-1 through 25-3 for the specific requirements related to this exception.
   4. Policyholders' surplus of stock life insurance entities that arose in fiscal years beginning on or before December 15, 1992. See paragraph 944-740-25-2 for the specific requirements related to this exception.

b. Recognition of temporary differences related to deposits in statutory reserve funds by U.S. steamship entities (see paragraph 995-740-25-2)
c. The pattern of recognition of after-tax income for **leveraged leases** or the allocation of the purchase price in a purchase business combination to acquired leveraged leases as required by Subtopic 842-50
d. A prohibition on recognition of a deferred tax liability related to goodwill (or the portion thereof) for which amortization is not deductible for tax purposes (see paragraph 805-740-25-3)
e. A prohibition on recognition of a deferred tax asset for the ~~intra-entity~~ difference between the tax basis of ~~the assets~~ **inventory** in the buyer's tax jurisdiction and ~~their cost~~ the carrying value as reported in the consolidated financial statements as a result of an intra-entity transfer of inventory from one tax-paying component to another tax-paying component of the same consolidated group. Income taxes paid on intra-entity profits on ~~assets~~ inventory remaining within the consolidated group are accounted for under the requirements of Subtopic 810-10.
f. A prohibition on recognition of a deferred tax liability or asset for differences related to assets and liabilities that, under Subtopic 830-10, are remeasured from the local currency into the functional currency using historical exchange rates and that result from changes in exchange rates or indexing for tax purposes. See Subtopic 830-740 for guidance on foreign currency related income taxes matters.

**> Temporary Differences**

**740-10-25-20** An assumption inherent in an entity's statement of financial position prepared in accordance with generally accepted accounting principles (GAAP) is that the reported amounts of assets and liabilities will be recovered and settled, respectively. Based on that assumption, a difference between the tax basis of an asset or a liability and its reported amount in the statement of financial position will result in taxable or deductible amounts in some future year(s) when the reported amounts of assets are recovered and the reported amounts of liabilities are settled. Examples include the following:

a. Revenues or gains that are taxable after they are recognized in financial income. An asset (for example, a receivable from an installment sale) may be recognized for revenues or gains that will result in future taxable amounts when the asset is recovered.
b. Expenses or losses that are deductible after they are recognized in financial income. A liability (for example, a product warranty liability) may be recognized for expenses or losses that will result in future tax deductible amounts when the liability is settled.
c. Revenues or gains that are taxable before they are recognized in financial income. A liability (for example, subscriptions received in advance) may be recognized for an advance payment for goods or services to be provided in future years. For tax purposes, the advance payment is

included in taxable income upon the receipt of cash. Future sacrifices to provide goods or services (or future refunds to those who cancel their orders) will result in future tax deductible amounts when the liability is settled.

d. Expenses or losses that are deductible before they are recognized in financial income. The cost of an asset (for example, depreciable personal property) may have been deducted for tax purposes faster than it was depreciated for financial reporting. Amounts received upon future recovery of the amount of the asset for financial reporting will exceed the remaining tax basis of the asset, and the excess will be taxable when the asset is recovered.

e. A reduction in the tax basis of depreciable assets because of tax credits. Amounts received upon future recovery of the amount of the asset for financial reporting will exceed the remaining tax basis of the asset, and the excess will be taxable when the asset is recovered. For example, a tax law may provide taxpayers with the choice of either taking the full amount of depreciation deductions and a reduced tax credit (that is, investment tax credit and certain other tax credits) or taking the full tax credit and a reduced amount of depreciation deductions.

f. Investment tax credits accounted for by the deferral method. Under the deferral method as established in paragraph 740-10-25-46, investment tax credits are viewed and accounted for as a reduction of the cost of the related asset (even though, for financial statement presentation, deferred investment tax credits may be reported as deferred income). Amounts received upon future recovery of the reduced cost of the asset for financial reporting will be less than the tax basis of the asset, and the difference will be tax deductible when the asset is recovered.

g. An increase in the tax basis of assets because of indexing whenever the local currency is the functional currency. The tax law for a particular tax jurisdiction might require adjustment of the tax basis of a depreciable (or other) asset for the effects of inflation. The inflation-adjusted tax basis of the asset would be used to compute future tax deductions for depreciation or to compute gain or loss on sale of the asset. Amounts received upon future recovery of the local currency historical cost of the asset will be less than the remaining tax basis of the asset, and the difference will be tax deductible when the asset is recovered.

h. Business combinations and combinations accounted for by **not-for-profit entities** (NFPs). There may be differences between the tax bases and the recognized values of assets acquired and liabilities assumed in a business combination. There also may be differences between the tax bases and the recognized values of assets acquired and liabilities assumed in an **acquisition by a not-for-profit entity** or between the tax bases and the recognized values of the assets and liabilities carried over to the records of a new entity formed by a **merger of not-for-profit entities**. Those differences will result in taxable or deductible amounts when the reported amounts of the assets or liabilities are recovered or settled, respectively.

i. Intra-entity transfers of an asset other than **inventory**. There may be a difference between the tax basis of an asset in the buyer's tax jurisdiction and the carrying value of the asset reported in the consolidated financial statements as the result of an intra-entity transfer of an asset other than inventory from one tax-paying component to another tax-paying component of the same consolidated group. That difference will result in taxable or deductible amounts when the asset is recovered.

**740-10-25-21** The examples in (a) through (d) in ~~the preceding~~ paragraph 740-10-25-20 illustrate 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 pretax financial income. Those differences between taxable income and pretax financial income also create differences (sometimes accumulating over more than one year) between the tax basis of an asset or liability and its reported amount in the financial statements. The examples in (e) through (i) ~~(h)~~ in ~~the preceding~~ paragraph 740-10-25-20 illustrate other events that create differences between the tax basis of an asset or liability and its reported amount in the financial statements. For all ~~eight~~ of the examples, the differences result in taxable or deductible amounts when the reported amount of an asset or liability in the financial statements is recovered or settled, respectively.

**740-10-25-22** This Topic refers collectively to the types of differences illustrated by ~~those eight~~ the examples in paragraph 740-10-25-20 and to the ones described in paragraph 740-10-25-24 as temporary differences.

**740-10-25-23** Temporary differences that will result in taxable amounts in future years when the related asset or liability is recovered or settled are often referred to as taxable temporary differences (the examples in paragraph 740-10-25-20(a), (d), and (e) are taxable temporary differences). Likewise, temporary differences that will result in deductible amounts in future years are often referred to as deductible temporary differences (the examples in paragraph 740-10-25-20(b), (c), (f), and (g) are deductible temporary differences). Business combinations and intra-entity transfers of assets other than inventory (the ~~example~~ examples in paragraph 740-10-25-20(h) through (i)) may give rise to both taxable and deductible temporary differences.

**740-10-25-24** Some temporary differences are deferred taxable income or tax deductions and have balances only on the income tax balance sheet and therefore cannot be identified with a particular asset or liability for financial reporting.

**> Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations**

**740-10-25-55** In the event that an entity purchases tax benefits that result from intra-entity ~~transactions~~ transfers of **inventory** between members of a consolidated entity, paragraph 740-10-25-3(e), which prohibits recognition of a deferred tax asset for the difference between the tax basis of ~~assets~~ inventory in the buyer's tax jurisdiction and the cost of ~~those assets~~ that inventory as reported in the consolidated financial statements, shall be applied.

5. Amend paragraph 740-10-55-203, with a link to transition paragraph 740-10-65-5, as follows:

## Implementation Guidance and Illustrations

### > Illustrations

#### > > Example 26: Direct Transaction with Governmental Taxing Authority

**740-10-55-203** In this Example, tax laws in a foreign country enable corporate taxpayers to elect to step up the tax basis for certain fixed assets ($1,000,000) to fair value ($2,000,000) in exchange for a current payment to the government of 3 percent of the step-up ($30,000). An entity would be expected to avail itself of this election (and make the upfront payment) as long as it believed that it was likely that it would be able to utilize the additional deductions (at a tax rate of 35 percent) that were created as a result of the step-up to reduce future taxable income and that the timing and amount of the resulting future tax savings justified the current payment. (For purposes of this Example, it is assumed that the transaction that accomplishes this step-up for tax purposes does not create a taxable temporary difference and is not an intra-entity ~~transaction~~ transfer of **inventory** as discussed in paragraph 740-10-25-3(e). A taxable temporary difference would exist, for example, if the tax benefit associated with the transaction with the governmental taxing authority becomes taxable in certain situations, such as those described in paragraph 830-740-25-7).

6. Add paragraph 740-10-65-5 and its related heading, as follows:

**> Transition Related to Accounting Standards Update No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory***

**740-10-65-5** The following represents the transition and effective date information for Accounting Standards Update No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory:*

a. The pending content that links to this paragraph shall be effective as follows:
   1. For **public business entities**, for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods
   2. For entities other than public business entities, for annual reporting periods beginning after December 15, 2018, and interim reporting

periods within annual reporting periods beginning after December 15, 2019.

b. Earlier application of the pending content that links to this paragraph is permitted for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. That is, earlier application shall be in the first interim period if an entity issues interim financial statements.

c. The pending content that links to this paragraph shall be applied on a modified retrospective basis, with a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption for the recognition of income tax consequences of intra-entity transfers of assets other than **inventory** that occur before the adoption date. Deferred tax assets recognized as a result of this transition guidance shall be assessed for realizability in accordance with this Topic. A valuation allowance recognized as of the beginning of the period of adoption for deferred tax assets recognized as a result of this transition guidance shall be recognized through a cumulative-effect adjustment to retained earnings.

d. An entity shall disclose the following in the first annual reporting period of adoption and the interim reporting periods within the first annual reporting period, if applicable:
   1. The nature of and reason for the change in accounting principle
   2. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item(s), and any affected per-share amounts for the current period
   3. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption.

# Amendments to Subtopic 810-10

7. Amend paragraph 810-10-45-8, with a link to transition paragraph 740-10-65-5, as follows:

## Consolidation—Overall

## Other Presentation Matters

**810-10-45-8** If income taxes have been paid on intra-entity profits on ~~assets~~ **inventory** remaining within the consolidated group, those taxes shall be deferred or the intra-entity profits to be eliminated in consolidation shall be appropriately reduced.

## Amendments to Status Sections

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

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

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Temporary Difference** | Amended | 2016-16 | 10/24/2016 |

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

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

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Inventory** | Added | 2016-16 | 10/24/2016 |
| **Temporary Difference** | Amended | 2016-16 | 10/24/2016 |
| 740-10-25-3 | Amended | 2016-16 | 10/24/2016 |
| 740-10-25-20 through 25-23 | Amended | 2016-16 | 10/24/2016 |
| 740-10-25-55 | Amended | 2016-16 | 10/24/2016 |
| 740-10-55-203 | Amended | 2016-16 | 10/24/2016 |
| 740-10-65-5 | Added | 2016-16 | 10/24/2016 |

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

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

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Temporary Difference** | Amended | 2016-16 | 10/24/2016 |

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

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

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Temporary Difference** | Amended | 2016-16 | 10/24/2016 |

12. Amend paragraph 805-740-00-1, by adding the following item to the table, as follows:

**805-740-00-1** The following table identifies the changes made to this Subtopic.

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Temporary Difference** | Amended | 2016-16 | 10/24/2016 |

13. Amend paragraph 810-10-00-1, by adding the following items to the table, as follows:

**810-10-00-1** The following table identifies the changes made to this Subtopic.

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Inventory** | Added | 2016-16 | 10/24/2016 |
| 810-10-45-8 | Amended | 2016-16 | 10/24/2016 |

14. Add paragraph 830-740-00-1 as follows:

<u>**830-740-00-1** The following table identifies the changes made to this Subtopic.</u>

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Temporary Difference** | Amended | 2016-16 | 10/24/2016 |

15. Amend paragraph 852-740-00-1, by adding the following item to the table, as follows:

**852-740-00-1** The following table identifies the changes made to this Subtopic.

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Temporary Difference** | Amended | 2016-16 | 10/24/2016 |

16. Add paragraph 995-740-00-1 as follows:

**995-740-00-1** The following table identifies the changes made to this Subtopic.

| Paragraph | Action | Accounting Standards Update | Date |
|---|---|---|---|
| **Temporary Difference** | Amended | 2016-16 | 10/24/2016 |

*The amendments in this Update were adopted by the affirmative vote of six members of the Financial Accounting Standards Board. Ms. Botosan abstained.*

*Members of the Financial Accounting Standards Board:*

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Daryl E. Buck
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

# Background Information and Basis for Conclusions

## Introduction

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

BC2. Stakeholders submitted the idea for this project as part of the Board's initiative to reduce complexity in accounting standards (the Simplification Initiative). The objective of the Simplification Initiative is to identify, evaluate, and improve areas of GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. In response to the submission by stakeholders, the Board issued proposed Accounting Standards Update, *Income Taxes (Topic 740): Intra-Entity Asset Transfers.* Some stakeholders raised concerns about whether the project would achieve the objective of the Simplification Initiative because of the potential for greater cost and complexity. The Board decided to limit the scope of the project in response to certain aspects of stakeholders' concerns (discussed more fully below) while retaining a large portion of the project's benefits.

## Background

BC3. Current GAAP prohibits the recognition of current and deferred income taxes for intra-entity asset transfers until the asset has been sold to an outside party. In addition, interpretations of this guidance have developed in practice over the years for transfers of certain intangible and tangible assets. The amendments in this Update eliminate this prohibition for intra-entity transfers of assets other than inventory but retain the prohibition for intra-entity transfers of inventory. Consequently, an entity is required to recognize the current and deferred income taxes resulting from an intra-entity transfer of assets other than inventory when the transfer occurs.

BC4. Under current GAAP, a selling (or transferring) entity defers recognizing, for financial statement purposes, income tax expense resulting from an intra-entity asset transfer, including taxes currently payable or paid. The buying entity (or entity receiving the transfer) does not recognize deferred income taxes for any basis difference for the transferred asset. This is an exception to the accounting model for comprehensive recognition of income taxes in Topic 740.

BC5. The Board decided to eliminate the exception for intra-entity transfers of assets other than inventory because recognition of the income tax consequences of an intra-entity asset transfer when the transfer occurs is more representationally faithful than current GAAP. This is because current GAAP requires deferral of the income tax consequences of the transfer, including the income taxes paid or payable in the selling entity's tax jurisdiction. Intra-entity asset transfers between tax jurisdictions often are taxable events that create current and deferred income tax consequences in the period in which the transfer occurs. Additionally, although GAAP requires deferral of intra-entity pre-tax profit because that profit results from a transaction within the same consolidated group, an intra-entity sale of assets between affiliated entities in different tax jurisdictions involves unrelated third parties—the selling entity's taxing authorities and the buying entity's taxing authorities. The Board does not intend for the amendments in this Update to change the accounting for the pre-tax effects of intra-entity asset transfers under Topic 810, Consolidation.

## Scope and Recognition

BC6. At its October 22, 2014 Board meeting, the Board added to its agenda a project to eliminate the exception in GAAP that prohibits recognizing current and deferred income tax consequences for an intra-entity asset transfer until the asset has been sold to an outside party. At that meeting, the Board tentatively decided to require recognition of the current and deferred income tax consequences resulting from an intra-entity asset transfer when the transfer occurs. On January 22, 2015, the Board issued the proposed Update. The proposed Update was open for public comment for 120 days, and the Board received 31 comment letters. Feedback on the proposed Update was mixed—a majority of financial statement preparers and professional tax and accounting associations opposed the proposed Update, and a majority of users and auditors supported it. Preparers generally asserted that the proposed Update would result in increased cost and complexity when compared with current GAAP. Stakeholders, primarily users and auditors, who supported the amendments in the proposed Update agreed with the Board's view that an intra-entity sale of assets involves unrelated third parties (taxing authorities) and, therefore, has economic consequences even when the asset has not yet been sold to an outside party. Those stakeholders stated that accounting for the economic consequences in the period in which the transfer occurs provides more transparency about the transaction in the financial statements. In addition, some stakeholders provided feedback that practice issues and diversity in accounting for the exception are the result of the increased prevalence, complexity, and magnitude of business transactions, particularly transfers of intellectual property, to which the exception applies. Some stakeholders suggested that the Board consider retaining the exception for intra-entity transfers of inventory.

BC7. After analyzing the feedback on the proposed Update, the Board decided to perform additional research and outreach to (a) further understand preparers' concerns and (b) identify improvements that could be made to the proposed Update that would reduce cost and complexity while retaining many of its benefits. During subsequent outreach, the Board was informed that the cost and complexity concerns primarily were related to intra-entity transfers of inventory. Stakeholders stated that because the volume of intra-entity transfers of inventory is significantly greater than the volume of other asset transfers, significant costs relating to those types of transfers might be incurred by some entities to make operating systems changes, estimate the annual effective tax rate for interim reporting purposes, and implement new processes and internal controls over financial reporting. Stakeholders also asserted that inventory typically turns quickly and that deferring the recognition of the tax consequences resulting from intra-entity inventory transfers does not significantly affect the quality of information reported to financial statement users.

BC8. In response to certain stakeholder concerns (principally concerns about whether the overall benefits of the change justify potentially significant implementation costs for certain types of intra-entity asset transfers), the Board decided to maintain the exception for intra-entity inventory transfers. Therefore, an entity should not recognize the income tax consequences for intra-entity inventory transfers until the inventory has been sold to an outside party. For all other intra-entity asset transfers, the Board decided to require that an entity recognize the current and deferred income tax consequences when the transfers occur. The Board noted that the term *inventory* is defined in GAAP and that the definition is commonly applied in practice for recognition, measurement, and presentation of inventory. In subsequent outreach, stakeholders indicated that the current definition of *inventory* is clear and would not cause unintended consequences or implementation issues if the Board were to retain the exception for only intra-entity inventory transfers. The Board does not intend for the amendments in this Update to result in changes to practice for accounting for intra-entity inventory transfers.

BC9. The Board did not want entities that have a high volume of intra-entity inventory transfers (for example, those with multistate or multinational supply chains) to incur potentially significant transition costs because the proposed amendments would not have resulted in significantly more useful information for users of financial statements. The Board agreed with stakeholders that, in many cases, inventory turns several times each year and that the deferral of the related unrecognized tax consequences could be short-lived. The proposed amendments also might not have simplified the accounting for those entities because those entities have had processes in place for numerous years and frequently account for intra-entity inventory transfers without difficulty. In addition, the Board noted that practice issues were more prevalent with intra-entity transfers of other assets such as intellectual property. Some Board members noted that eliminating the exception for all intra-entity asset transfers is more conceptually pure; however, those Board members did not think the benefits of the change for inventory would justify the costs of the change. Additionally, a few Board members would have provided an accounting policy election to recognize the income tax effects of inventory transfers consistently with the accounting for all other transfers. That approach would have permitted an entity to elect uniform accounting if the benefits were determined to outweigh the costs. Furthermore, it would have permitted an entity a choice to converge with the income tax treatment for intra-entity asset transfers required in IFRS.

BC10. Some Board members questioned whether the project would achieve one of its objectives of reducing costs and complexity in accounting for intra-entity asset transfers. However, those Board members decided that by removing inventory from the scope of the project, the benefits of increased transparency would justify the costs of the change. Other Board members noted that the amendments in this Update make analyzing financial statements less complex for users because the amendments result in a more faithful representation of the economics of an intra-entity transfer of an asset other than inventory, and, thus, the objective of the Simplification Initiative is achieved from a user perspective.

BC11. The Board noted that the amendments in this Update align the recognition of income tax consequences for intra-entity transfers of assets other than inventory with the recognition of income taxes in IFRS. Specifically, IAS 12 requires recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset (including inventory) when the transfer occurs.

## Interim Reporting Considerations

BC12. Some stakeholders raised a concern about how an entity should consider the potentially significant tax effects of intra-entity asset transfers when computing the estimated annual effective tax rate for interim reporting purposes. Those stakeholders indicated that the amendments in the final Update should include guidance addressing whether the income tax consequences of intra-entity asset transfers should be included in the computation of the estimated annual effective tax rate or should be accounted for discretely in the period in which they occur. Stakeholders were concerned that without prescriptive guidance, complexity and diversity in practice for intra-entity asset transfers could be introduced. Other stakeholders indicated that prescriptive guidance should not be added because the guidance already included in Topic 740 is sufficient for an entity to make its assessments and this guidance has long been applied in practice to a wide spectrum of transactions. Those stakeholders also stated that including prescriptive guidance would create an exception in Topic 740, which they said was counterintuitive for a project that involves removing an exception from Topic 740.

BC13. Topic 740 states that the income tax expense (or benefit) related to ordinary income (or loss) shall be computed at an estimated annual effective tax rate and the tax (or benefit) related to all other items shall be individually computed and recognized when the items occur (as discrete items). Topic 740 also states that if an entity is unable to make a reliable estimate of an item of its ordinary income, it shall recognize that item discretely. The Board decided not to provide prescriptive guidance on how the tax consequences of intra-entity asset transfers should be handled for the purposes of the computation beyond the guidance that already exists in Topic 740. This is because the Board agreed with stakeholders who indicated that the current guidance included in Topic 740 has long been applied in practice to a wide spectrum of transactions. Because of the variety of intra-entity asset transfers, the Board did not want to preclude an entity from making its own assessment about how to treat an intra-entity asset transfer for purposes of the estimate. The Board also agreed with stakeholders who indicated that if the Board had decided that all intra-entity asset transfers should be treated similarly for purposes of the estimate, it would have created an exception to the model in Topic 740. The Board's view is that it would not be unusual for entities following the guidance to conclude that many intra-entity transfers of assets other than inventory would be treated as discrete items for purposes of the computation. However, the Board understands from stakeholders' input that because the nature of, frequency of, and ability to estimate these transfers vary among entities, there are circumstances in which an entity could conclude that the transaction should be included in the computation of the estimated annual effective tax rate. The Board understands that an entity will need to apply judgment on the basis of the facts and circumstances to conclude whether the tax consequences of an intra-entity asset transfer other than inventory should be included in the computation of the estimated annual effective tax rate or treated as a discrete item in the interim period in which the transfer occurs.

## Disclosure

BC14. The Board decided not to change the disclosure requirements for income taxes because GAAP includes disclosure requirements that should provide users of financial statements with information about significant intra-entity asset transfers that are accounted for under the amendments in this Update. In addition, the Board noted that it is in the process of evaluating all of the disclosure requirements in Topic 740 as part of its project on income tax disclosures.

BC15. Topic 740 requires an entity to compare income tax expense (benefit) to statutory expectations. A public entity is required to disclose a numeric reconciliation (commonly referred to as the rate reconciliation in practice), and a nonpublic entity is required to disclose the nature of significant reconciling items. The tax effects of intra-entity asset transfers accounted for under the amendments in this Update typically should be apparent in those disclosures if the transfers are significant.

BC16. Topic 740 also requires an entity to disclose the types of temporary differences and carryforwards that give rise to a significant portion of deferred income taxes. A public entity is required to disclose the approximate tax effects of each type of temporary difference and carryforward that gives rise to a significant portion of deferred income taxes, and a nonpublic entity is required to disclose the types of significant temporary differences and carryforwards. The deferred tax effects of intra-entity asset transfers will be included in the amounts disclosed.

BC17. The FASB issued proposed Accounting Standards Update, *Income Taxes (Topic 740): Disclosure Framework—Changes to the Disclosure Requirements for Income Taxes*, on July 26, 2016. The proposed disclosures may provide additional context about the income tax effects of intra-entity asset transfers compared with current GAAP requirements.

## Effective Date and Transition

BC18. The Board decided that for public business entities, the amendments in this Update are effective for financial statements issued for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. For all other entities, the amendments in this Update are effective for financial statements issued for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual periods beginning after December 15, 2019. Because of the delay in issuing this Update to perform additional stakeholder outreach, the Board decided to delay the effective dates included in the proposed Update by one year for all entities. The decisions on the effective date for interim and annual reporting periods for entities other than public business entities are consistent with the guidelines in the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*. The Board decided to permit early adoption for all entities as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance. That is, earlier adoption should be in the first interim period if an entity issues interim financial statements. The Board decided that adoption at the beginning of an annual reporting period is required because, in its view, the approach would be (a) more straightforward for financial statement users to understand the change and (b) less costly because the beginning of an annual period is when many entities are particularly focused on their estimates of the annual effective tax rate.

BC19. The Board decided that an entity is required to apply the amendments on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Deferred tax assets recognized as a result of applying the amendments should be assessed for realizability in accordance with Topic 740. A valuation allowance recognized for deferred tax assets recognized as a result of applying the amendments also should be recognized through a cumulative-effect adjustment to retained earnings. The Board decided that the benefits of requiring or permitting retrospective application of the guidance would not justify the costs. Additionally, retrospective application might require the use of hindsight, which would reduce some of the benefits of restating prior periods.

BC20. The Board considered prospective application of the guidance but rejected this transition method because income tax consequences related to certain prior-period intra-entity asset transfers may continue to be unrecognized for a significant period of time as those assets could remain in the consolidated group indefinitely. The Board decided that this transition approach could be confusing for financial statement users.

BC21. The Board decided that disclosures required at transition should include (a) the nature of and reason for the change in accounting principle and (b) certain quantitative information about the effects of the accounting change. In some cases, an entity's net income might be significantly different if the entity were applying former GAAP for intra-entity asset transfers. Therefore, the Board decided that financial statement users would benefit from quantitative information about the effect of the change.

## Benefits and Costs

BC22. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC23. The amendments in this Update are expected to reduce costs for some entities. Application of current GAAP necessitates that an entity identify and track income taxes paid by the selling entity and recognize those income taxes as a deferred charge on the statement of financial position until the asset is sold to an outside party. The costs associated with this tracking will be eliminated for intra-entity asset transfers within the scope of the amendments because the income taxes that a selling entity paid will be recognized in the income statement at the time the intra-entity asset transfer occurs.

BC24. The amendments in this Update are not expected to result in a cost reduction for all entities. There may be incremental costs for some entities associated with recognizing and measuring deferred income taxes resulting from intra-entity asset transfers within the scope of the amendments. In response to feedback on the potential costs of the proposed Update, the Board altered the scope of the amendments to retain the exception for intra-entity transfers of inventory. In the Board's view, the change in scope will reduce the incremental, recurring costs of recognizing and measuring deferred income taxes for all entities that perform intra-entity inventory transfers compared with the proposed Update while maintaining the primary benefit.

BC25. In the Board's view, the change in scope also will reduce the transition costs incurred for all entities that perform intra-entity inventory transfers when compared with the proposed Update. The Board acknowledges that even with the change in scope, there will be some level of transition costs. Additionally, because the level of intra-entity asset transfers varies among entities, transition costs could vary.

BC26. The amendments in this Update will provide users of financial statements with more transparent and comparable information. The change will address the absence of current GAAP on how to account for the deferred charge after initial recognition. Additionally, the amendments are more consistent with the recognition of other temporary differences in Topic 740 and align the recognition of income tax consequences of in-scope intra-entity asset transfers with the recognition of income taxes in IFRS.

# Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2017 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.