Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue:** *ASU 2013-11, Presentation of an Unrecognized Tax Benefit*

**Check (applicable entity):**

P/C Life Health

Modification of existing SSAP

New Issue or SSAP

Interpretation

Description of Issue:

*Topic 740, Income Taxes* did not include explicit guidance for the financial statement presentation of an “unrecognized tax benefit” when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. An unrecognized tax benefit generally reflects a tax position that does not meet the ASC 740 more-likely-than-not recognition threshold, but to a certain extent owes their existence to an uncertain tax position. A more-likely-than-not threshold requires a recognized benefit of having a greater than 50 percent likelihood of being realized upon settlement. Prior to *ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*, there was diversity in the U.S. GAAP presentation of unrecognized tax benefits. Some entities reported unrecognized tax benefits as a liability in certain circumstances, while others presented unrecognized tax benefits as a reduction of a deferred tax asset for net operating loss or tax credit carryforwards.

The objective of ASU 2013-11 is to eliminate the reporting diversity to better reflect the manner in which an entity would settle additional income taxes that would result from the disallowance of a tax position when a net operating loss carryforward, similar tax loss, or tax credit carryforward exists.

ASU 2013-11 states that unrecognized tax benefits should generally be presented in the financial statements as a reduction to a deferred tax asset when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This presentation should be followed except in circumstances in which a net operating loss / tax credit carryforward is not available as of the reporting date to settle any additional income taxes that would result from the disallowance of a tax position, or the entity does not intend to use the deferred tax asset for such purpose. In these cases, the unrecognized tax benefit should be presented in the financial statements as a liability and not combined with deferred tax assets.

The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exists at the reporting date and should be made presuming disallowance of the tax position at that reporting date.

The FASB definition of an Unrecognized Tax Benefit (per the FASB Codification Glossary) is as follows:

Unrecognized Tax Benefit - The difference between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to Subtopic 740-10.

Existing Authoritative Literature:

By definition, unrecognized tax benefits have a lower than 50 percent likelihood of being realized upon final settlement. As required in *SSAP No. 5R—Liabilities, Contingencies and Impairment of Assets* and again referenced in *SSAP No. 101—Income Taxes*, for the purposes of determining a tax contingency, it shall be presumed that the reporting entity will be examined by a relevant taxing authority. Further, as there is a lower than 50 percent likelihood of these items being sustained, they should be recognized in current income taxes as covered in SSAP No. 101.

SSAP No. 101, paragraph 3 excerpts:

1. “Income taxes incurred” shall include current income taxes, the amount of federal and foreign income taxes paid (recovered) or payable (recoverable) for the current year. Current income taxes are defined as:
2. Current year estimates (including quarterly estimates) of federal and foreign income taxes payable or refundable, based on tax returns for the current and prior years, except as addressed in paragraph 3.b., and tax loss contingencies (including related interest and penalties) for current and all prior years, computed in accordance with SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets with the following modifications:
   * 1. The term “probable” as used in SSAP No. 5R shall be replaced by the term “more likely than not **(a likelihood of more than 50 percent)”** for federal and foreign income tax loss contingencies only.
     2. For purposes of the determination of a federal and foreign income tax loss contingency, it shall be presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.
     3. If the estimated tax loss contingency is greater than 50% of the tax benefit originally recognized, the tax loss contingency recorded shall be equal to 100% of the original tax benefit recognized.
3. Amounts incurred or received during the current year relating to prior periods, to the extent not previously provided, as such amounts are deemed to be changes in accounting estimates as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors*.
4. In determining when tax loss contingencies associated with temporary differences should be included in current income taxes under paragraph 3.a., and therefore included in deferred taxes under paragraph 7, a reporting entity is not required to “gross-up” its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the reporting entity’s (or its affiliate or parent in a consolidated income tax return) receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an Information Document Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of tax contingency as determined in accordance with paragraph 3.a., make any necessary adjustment to deferred taxes, and re-determine the admissibility of any adjusted gross deferred tax asset as provided in paragraph 11.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): None

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:** None

**Convergence with International Financial Reporting Standards (IFRS):**

IFRS does not include specific guidance on the presentation of unrecognized tax benefits.

Staff Recommendation: NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose revisions to SSAP No. 101 to reject *ASU 2013-11* for statutory accounting.

By definition, unrecognized tax benefits have a lower than 50 percent likelihood of being utilized (resulting in future tax savings), and as such, should be recognized in current income taxes as required by SSAP No. 101, paragraph 3. This ASU allows, as an election of the reporting entity, reporting of unrecognized tax benefits on the balance sheet (as a reduction to deferred tax assets) while statutory accounting requires immediate recognition through current income tax expense. As these unrecognized tax benefits are not deferred tax items and NAIC SAP tries to limit optionality in the financial statements, NAIC staff proposes to reject the ASU and retain existing statutory accounting guidance.

Proposed Revisions to SSAP No. 101:

31. This statement rejects *ASU 2013-11, Income Taxes: Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, ASU 2015-17 Balance Sheet Classification of Deferred Taxes*, *FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods…an interpretation of APB Opinion No. 28* and *FIN 48: Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*.

**Staff Review Completed by Jim Pinegar – August 2019**

**Status:**

On December 7, 2019, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 101—Income Taxes,* illustrated above, to reject *ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* for statutory accounting.

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