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Example Disclosure: Accounting for Income Taxes

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Example Disclosure: Accounting for Income Taxes

General

This example disclosure summarizes accounting and disclosure requirements outlined in SEC Regulation S-K, SEC Regulation S-X, and FASB Accounting Standard Codification (ASC) Topic 740, *Income Taxes*. The information in this example disclosure reflects pronouncements that are effective as of December 31, 2013. You should also consider pronouncements issued or effective subsequently that may be applicable to the financial statements as well as other professional literature, such as AICPA Audit and Accounting Guides.

Portions of certain sample disclosures in this document are based, in part, on actual disclosures from public filings. Any information related to the registrant has been removed, including dollar amounts and specific references to the business.

Use of This Example Disclosure

The example disclosure may be used to assist in determining compliance with U.S. GAAP and SEC requirements. It is not a substitute for your understanding of such requirements and the exercise of your judgment. You are presumed to have a thorough understanding of the requirements and should refer to the text of the accounting literature and SEC regulations as necessary when considering particular items in this example disclosure.

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Management's Discussion and Analysis (MD&A) — General

Before the enactment of tax law proposals or changes to existing tax rules, SEC registrants should consider whether the potential changes represent an uncertainty that management reasonably expects to have a material effect on the results of operations, financial position, liquidity, or capital resources. If so, registrants should consider disclosing information about the scope and nature of any potential material effects of the changes.

After the enactment of a new tax law, when material, registrants should consider disclosing the anticipated current and future impact on their results of operations, financial position, liquidity, and capital resources. In addition, registrants should consider disclosures in the critical accounting estimates section of MD&A to the extent the changes could materially affect existing assumptions used in making estimates of tax-related balances.

The SEC staff expects registrants to provide early warning disclosures to help users understand various risks and how these risks potentially affect the financial statements. Examples of these risks include (1) the registrant may have to repatriate foreign earnings to meet current liquidity demands, resulting in a tax payment that may not be accrued for; (2) the historical effective tax rate is not sustainable and may change materially; (3) the valuation allowance on net deferred tax assets may change materially; and (4) tax positions taken during the preparation of returns may ultimately not be sustained. Early warning disclosures give investors insight into the underlying assumptions made by management and conditions and risks facing the entity before a material change or decline in performance is reported.

MD&A — Results of Operations

Note: Click on the yellow highlighted text to access related guidance that is embedded within this document.

SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Sample

Our effective tax rate for fiscal years 20X3, 20X2, and 20X1 was XX%, XX%, and XX%, respectively. Our tax rate is affected by recurring items, such as tax rates in foreign jurisdictions and the relative amounts of income we earn in those jurisdictions, which we expect to be fairly consistent in the near term. It is also affected by discrete items that may occur in any given year, but are not consistent from year to year. In addition to state income taxes, the following items had the most significant impact on the difference between our statutory U.S. federal income tax rate of XX% and our effective tax rate:

20X3

1. A $XXX (XX%) reduction resulting from changes in tax positions taken in prior periods, related primarily to favorable developments in an IRS position *(note: a detailed explanation of the change and the amount previously recorded as an unrecognized tax benefit would be expected).*
2. A $XXX (XX%) increase resulting from multiple unfavorable foreign audit assessments *(note: a detailed explanation of the change and the amount previously recorded as an unrecognized tax benefit would be expected).*
3. A $XXX (XX%) reduction resulting from rate differences between U.S. and non-U.S. jurisdictions. No U.S. taxes were provided for those undistributed foreign earnings that are intended to be indefinitely reinvested outside the United States *(note: an explanation of the countries significantly affecting the overall effective rate would be expected).*

4. A $XXX (XX%) increase from noncash impairment charges for goodwill that is nondeductible for tax purposes.

20X2 *(see parenthetical notes accompanying the 20X3 items above)*

1. A $XXX (XX%) increase resulting from the resolution of U.S. state audits.
2. A $XXX (XX%) increase resulting from a European Commission penalty, which was not tax deductible.
3. A $XXX (XX%) reduction resulting from rate differences between U.S. and non-U.S. jurisdictions.

20X1 *(see parenthetical notes accompanying the 20X3 items above)*

1. A $XXX (XX%) reduction resulting from the reversal of previously accrued taxes from an IRS settlement.
2. A $XXX (XX%) reduction resulting from rate differences between U.S. and non-U.S. jurisdictions.

MD&A — Critical Accounting Policies[1]

SEC Interpretation Release Nos. 33-8350, 34-48960, FR-72, *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*

Sample

Our income tax expense, deferred tax assets and liabilities, and liabilities for unrecognized tax benefits reflect management's best assessment of estimated current and future taxes to be paid. We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgments and estimates are required in determining the consolidated income tax expense.

Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, which will result in taxable or deductible amounts in the future. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax-planning strategies, and results of recent operations. In projecting future taxable income, we begin with historical results adjusted for the results of discontinued operations and incorporate assumptions about the amount of future state, federal, and foreign pretax operating income adjusted for items that do not have tax consequences. The assumptions about future taxable income require significant judgment and are consistent with the plans and estimates we are using to manage the underlying businesses. In evaluating the objective evidence that historical results provide, we consider three years of cumulative operating income (loss).

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[1] At the 2013 AICPA Conference on Current SEC and PCAOB Developments (the AICPA Conference), in remarks related to registrants' disclosures about valuation allowances on deferred tax assets, the SEC staff discouraged registrants from providing "boilerplate disclosures" and instead recommended that they discuss registrant-specific factors (e.g., limitations on their ability to use net operating losses and foreign tax credits). The SEC staff also stated that it has asked registrants to disclose the effect of each source of taxable income on their ability to realize a deferred tax asset, including the relative magnitude of each source of taxable income. In addition, the staff recommended that registrants consider disclosing the material negative evidence they evaluated, since such disclosures could provide investors with information about uncertainties related to a registrant's ability to recover a deferred tax asset. For additional information, see Deloitte's December 16, 2013, *Heads Up* on the AICPA Conference.

As of December 31, 20X3, we have federal and state income tax net operating loss (NOL) carryforwards of $XXX and $XXX, which will expire at various dates from 20X4 through 20Y8. Such NOL carryforwards expire as follows:

20X4–20X8	$ XXX
20X9–20Y3	XXX
20Y4–20Y8	XXX
	$ XXX

We believe that it is more likely than not that the benefit from certain state NOL carryforwards will not be realized. In recognition of this risk, we have provided a valuation allowance of $XX on the deferred tax assets relating to these state NOL carryforwards. If our assumptions change and we determine we will be able to realize these NOLs, the tax benefits relating to any reversal of the valuation allowance on deferred tax assets as of December 31, 20X3, will be accounted for as follows: approximately $XXX will be recognized as a reduction of income tax expense and $XXX will be recorded as an increase in equity.

Changes in tax laws and rates may affect recorded deferred tax assets and liabilities and our effective tax rate in the future. In January 20X4, Country X made significant changes to its tax laws, including certain changes that were retroactive to our 20X3 tax year. Because a change in tax law is accounted for in the period of enactment, the retroactive effects cannot be recognized in the Company's 20X3 financial results and instead will be reflected in the Company's 20X4 financial results. We estimate that a benefit of approximately $XXX will be accounted for as a discrete item in our tax provision for the first quarter of 20X4. In addition, we expect this tax law change will favorably affect our estimated annual effective tax rate for 20X4 by approximately X percentage points as compared to 20X3.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in a multitude of jurisdictions across our global operations. ASC 740 states that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, on the basis of the technical merits.

We (1) record unrecognized tax benefits as liabilities in accordance with ASC 740 and (2) adjust these liabilities when our judgment changes as a result of the evaluation of new information not previously available. Because of the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the unrecognized tax benefit liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which new information is available.

We believe that it is reasonably possible that an increase of up to $XX in unrecognized tax benefits related to state exposures may be necessary within the coming year. In addition, we believe that it is reasonably possible that approximately $XX of our currently remaining unrecognized tax benefits, each of which are individually insignificant, may be recognized by the end of 20X4 as a result of a lapse of the statute of limitations.

We consider the earnings of certain non-U.S. subsidiaries to be indefinitely invested outside the United States on the basis of estimates that future domestic cash generation will be sufficient to meet future domestic cash needs and our specific plans for reinvestment of those subsidiary earnings. We have not recorded a deferred tax liability of approximately $XX related to the U.S. federal and state income taxes and foreign withholding taxes on approximately $XX of undistributed earnings of foreign subsidiaries indefinitely invested outside the United States. Should we decide to repatriate the foreign earnings, we would need to adjust our income tax

provision in the period we determined that the earnings will no longer be indefinitely invested outside the United States.

MD&A — Liquidity and Capital Resources[2]

SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Sample 1

We earn a significant amount of our operating income outside the United States, which is deemed to be indefinitely reinvested in foreign jurisdictions. As a result, as discussed above under Cash and Investments, most of our cash and short-term investments are held by foreign subsidiaries. We currently do not intend nor foresee a need to repatriate these funds. We expect existing domestic cash and short-term investments and cash flows from operations to continue to be sufficient to fund our domestic operating activities and cash commitments for investing and financing activities, such as regular quarterly dividends, debt repayment, and capital expenditures, for at least the next 12 months and thereafter for the foreseeable future.

If we should require more capital in the United States than is generated by our domestic operations, for example to fund significant discretionary activities such as business acquisitions and share repurchases, we could elect to repatriate future earnings from foreign jurisdictions or raise capital in the United States through debt or equity issuances. These alternatives could result in higher effective tax rates, increased interest expense, or dilution of our earnings. We have borrowed funds domestically and continue to believe we have the ability to do so at reasonable interest rates.

Note: The SEC staff expects the registrant to disclose the amount of cash and short-term investments held by foreign subsidiaries that would not be available to fund domestic operations unless the funds were repatriated. In the above sample, the registrant had disclosed this information in the Cash and Investments section of its MD&A.

Sample 2

We consider the undistributed earnings of our foreign subsidiaries as of December 31, 20X3, to be indefinitely reinvested and, accordingly, no U.S. income taxes have been provided thereon. As of December 31, 20X3, the amount of cash associated with indefinitely reinvested foreign earnings was approximately $XX. We have not, nor do we anticipate the need to, repatriate funds to the United States to satisfy domestic liquidity needs arising in the ordinary course of business, including liquidity needs associated with our domestic debt service requirements.

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[2] At the 2011 AICPA Conference, Nili Shah, deputy chief accountant in the SEC's Division of Corporation Finance, and Mark Shannon, associate chief accountant in the SEC's Division of Corporation Finance, discussed certain income tax matters in relation to registrants' significant foreign operations. Ms. Shah indicated that when a registrant with significant amounts of cash and short-term investments overseas has asserted that such amounts are indefinitely reinvested in its foreign operations, the SEC staff would expect the registrant to provide the following disclosures in an MD&A liquidity analysis: (1) the amount of cash and short-term investments held by foreign subsidiaries that is not available to fund domestic operations unless the funds were repatriated; (2) a statement that the company would need to accrue and pay taxes if repatriated; and (3) if true, a statement that the company does not intend to repatriate those funds.

At the 2013 AICPA Conference, the SEC staff also reminded registrants when making the assertion of indefinitely reinvested foreign earnings, companies are required to disclose (1) the amount of the unrecognized deferred tax liability or (2) a statement that estimating an unrecognized tax liability is not practicable. In addition, the staff indicated that it evaluates the indefinite reinvestment assertion in taking into account registrants' potential liquidity needs and the availability of funds in U.S. and foreign jurisdictions.

MD&A — Contractual Obligations

SEC Regulation S-K, Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Sample 1

The following table includes information about the Company's contractual obligations that affect its short- and long-term liquidity and capital needs. The table also includes information about payments due under specified contractual obligations and is aggregated by type of contractual obligation. It includes the maturity profile of the Company's consolidated long-term debt, operating leases, and other long-term liabilities.

	Total	Less Than 1 Year	1–3 Years	3–5 Years	More Than 5 Years
			(in millions)		
Long-term debt obligations	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
Interest payments on long-term debt	XXX	XXX	XXX	XXX	XXX
Operating lease obligations	XXX	XXX	XXX	XXX	XXX
Capital lease obligations	XXX	XXX	XXX	XXX	XXX
Unrecognized tax benefits, including interest and penalties	XXX	XXX	XXX	XXX	XXX
Other liabilities reflected on consolidated balance sheet	XXX	XXX	XXX	XXX	XXX
Total	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX

The unrecognized tax benefits, including interest and penalties shown in the table above, represent unrecognized tax benefits related to temporary differences. The years for which the temporary differences related to the unrecognized tax benefits will reverse have been estimated in scheduling the obligations within the table. In addition to the obligations in the table above, approximately $XX of unrecognized tax benefits have been recorded as liabilities, and we are uncertain about if or when such amounts may be settled. Related to the unrecognized tax benefits not included in the table above, the Company has also recorded a liability for potential penalties of $XX and interest of $XX.

Sample 2

The following table presents certain payments due by the Company under contractual obligations with minimum firm commitments as of December 31, 20X3:

	Payments Due In				
	Total	**Less Than 1 Year**	**1–3 Years**	**3–5 Years**	**More Than 5 Years**
			(in millions)		
Operating lease obligations	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
Purchase obligations	XXX	XXX	XXX	XXX	XXX
Other obligations	XXX	XXX	XXX	XXX	XXX
Total	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX

The Company's other noncurrent liabilities in the Consolidated Balance Sheets consist primarily of deferred tax liabilities, gross unrecognized tax benefits, and the related gross interest and penalties. As of December 31, 20X3, the Company had noncurrent deferred tax liabilities of $XX. In addition, as of December 31, 20X3, the Company had gross unrecognized tax benefits of $XX and an additional $XX for gross interest and penalties classified as noncurrent liabilities. At this time, the Company is unable to make a reasonably reliable estimate of the timing of payments in individual years in connection with these tax liabilities; therefore, such amounts are not included in the above contractual obligation table.

Note: A liability for unrecognized tax benefits for which reasonable estimates about the timing of payment cannot be made may either be disclosed in a footnote to the table or within an "other" column added to the table.

For additional information, see Discussion Document E, Disclosure of FIN 48 Liabilities in the Contractual Obligations Table, *from the April 2007 SEC Regulations Committee joint meeting.*

Notes to Consolidated Financial Statements

Note A — Summary of Significant Accounting Policies

Income Taxes

Sample

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined on the basis of the differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

We recognize deferred tax assets to the extent that we believe these assets are more likely than not to be realized. In making such a determination, we consider all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning

strategies, and results of recent operations. If we determine that we would be able to realize our deferred tax assets in the future in excess of their net recorded amount, we would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes.

We record uncertain tax positions in accordance with ASC 740 on the basis of a two-step process whereby (1) we determine whether it is more likely than not that the tax positions will be sustained on the basis of the technical merits of the position and (2) for those tax positions that meet the more-likely-than-not recognition threshold, we recognize the largest amount of tax benefit that is more than 50 percent likely to be realized upon ultimate settlement with the related tax authority.

Classification of Interest and Penalties (ASC 740-10-50-19)

Sample 1

The Company recognizes interest and penalties related to unrecognized tax benefits within the income tax expense line in the accompanying Consolidated Statement of Operations. Accrued interest and penalties are included within the related tax liability line in the Consolidated Balance Sheet.

Sample 2

The Company recognizes interest and penalties related to unrecognized tax benefits within the interest expense line and other expense line, respectively, in the accompanying Consolidated Statement of Operations. Accrued interest and penalties are included within the related liability lines in the Consolidated Balance Sheet.

Investment Tax Credit Recognition Policy (ASC 740-10-50-20)

Sample 1

In 20X3, the Company recognized investment tax credits from the state of X’s economic development program. These credits, which expire in 20X9, reduced income tax expense by $XX million. The Company uses the deferral method of accounting for its investment tax credits.

Sample 2

The Company uses the flow-through method to account for investment tax credits earned on eligible scientific research and development expenditures. Under this method, the investment tax credits are recognized as a reduction to income tax expense.

Note B — Statements of Cash Flows

Supplemental cash flows and noncash investing and financing activities are as follows:

	Years Ended December 31		
	20X3	20X2	20X1
		(in millions)	
Noncash Investing and Financing Activities:			
Acquisition of property and equipment on account	$ XXX	$ XXX	$ XXX
Acquisition of property and equipment through long-term financing	XXX	XXX	XXX
Supplemental Cash Flow Information:			
Income taxes paid, net of refunds	XXX	XXX	XXX
Interest paid	XXX	XXX	XXX

Note: The supplemental cash flow information for income taxes paid is required when an indirect method is used. (ASC 230-10-50-2, Statement of Cash Flows) Such disclosure can be included in the company's statements of cash flows or in a footnote.

Note C — Acquisitions

Financial effects of adjustments that relate to business combinations that occurred in the current or previous reporting periods (ASC 805-10-50-6, *Business Combinations*)

Total amount of goodwill that is expected to be deductible for tax purposes (ASC 805-30-50-1(d), *Business Combinations*)

Sample 1

The preliminary purchase price allocation resulted in goodwill of $XX million, which is not deductible for income tax purposes. Goodwill consists of the excess of the purchase price over the fair value of the acquired assets and represents the estimated economic value attributable to future operations.

The purchase price allocation is preliminary and subject to revision. At this time, except for the items noted below, the Company does not expect material changes to the value of the assets acquired or liabilities assumed in conjunction with the transaction. Specifically, the following assets and liabilities are subject to change:

- Intangible customer contracts.
- Payments due from and to related parties.
- Deferred income tax assets and liabilities.

As management receives additional information during the measurement period, these assets and liabilities may be adjusted.

Under the acquisition method of accounting for business combinations, if we identify changes to acquired deferred tax asset valuation allowances or liabilities related to uncertain tax positions during the measurement

period and they relate to new information obtained about facts and circumstances that existed as of the acquisition date, those changes are considered a measurement period adjustment, and we record the offset to goodwill. We record all other changes to deferred tax asset valuation allowances and liabilities related to uncertain tax positions in current period income tax expense. This accounting applies to all of our acquisitions regardless of acquisition date.

Sample 2

Goodwill of $XX million was assigned to the X and Y segments in the amounts of $XX million and $XX million, respectively, and is deductible for tax purposes. The amounts of intangible assets and goodwill have been assigned to the X and Y segments on the basis of the respective profit margins of the acquired customer contracts. The transaction was taxable for income tax purposes, and all assets and liabilities have been recorded at fair value for both book and income tax purposes. Therefore, no deferred taxes have been recorded.

Note D — Income Taxes

SEC Regulation S-X, Rule 4-08(h), "General Notes to Financial Statements: Income Tax Expense"[3]

Sample 1

For financial reporting purposes, income before income taxes includes the following components:

	Years Ended December 31		
	20X3	20X2	20X1
		(in millions)	
United States	$ XXX	$ XXX	$ XXX
Foreign	XXX	XXX	XXX
Total	$ XXX	$ XXX	$ XXX

[3] At the 2010 AICPA Conference, Jill Davis, associate chief accountant in the SEC's Division of Corporation Finance, stated that one of the requirements in SEC Regulation S-X, Rule 4-08(h), is to disclose the components of income (loss) before income tax expense (benefit) as either domestic or foreign. Ms. Davis indicated that some registrants' disclosures about these components have been limited in circumstances in which the registrants had a very low income tax expense because a substantial amount of profits were derived from countries with little or no tax. She explained that the disclosures provided should allow an investor to easily determine the effective tax rate for net income attributable to domestic operations and foreign operations and stated that the lack of such disclosure may result in SEC staff comments.

The expense (benefit) for income taxes consists of:

	Years Ended December 31		
	20X3	20X2	20X1
Current:		(in millions)	
Federal	$ XXX	$ XXX	$ XXX
State	XXX	XXX	XXX
Foreign	XXX	XXX	XXX
	$ XXX	$ XXX	$ XXX
Deferred and other:			
Federal	$ XXX	$ XXX	$ XXX
State	XXX	XXX	XXX
Foreign	XXX	XXX	XXX
	$ XXX	$ XXX	$ XXX
Total tax expense	$ XXX	$ XXX	$ XXX

Sample 2

For financial reporting purposes, income before income taxes includes the following components:

	Years Ended December 31		
	20X3	20X2	20X1
		(in millions)	
United States	$ XXX	$ XXX	$ XXX
Foreign	XXX	XXX	XXX
Total	$ XXX	$ XXX	$ XXX

The provision for income taxes for 20X3, 20X2, and 20X1, consisted of the following:

	20X3	20X2	20X1
U.S. Federal:		(in millions)	
Current	$ XXX	$ XXX	$ XXX
Deferred	XXX	XXX	XXX
	$ XXX	$ XXX	$ XXX
U.S. State:			
Current	$ XXX	$ XXX	$ XXX
Deferred	XXX	XXX	XXX
	$ XXX	$ XXX	$ XXX
Foreign:			
Current	$ XXX	$ XXX	$ XXX
Deferred	XXX	XXX	XXX
	$ XXX	$ XXX	$ XXX
Provision for income taxes	$ XXX	$ XXX	$ XXX

Components of Income Tax Expense or Benefit (ASC 740-10-50-9)

Sample 1

	Years Ended December 31		
	20X3	20X2	20X1
		(in millions)	
Current tax expense (benefit)	$ XXX	$ XXX	$ XXX
Deferred tax expense (benefit)	XXX	XXX	XXX
Tax expense (benefit) related to an increase (decrease) in unrecognized tax benefits	XXX	XXX	XXX
Interest expense — gross of related tax effects	XXX	XXX	XXX
Interest income — gross of related tax effects	XXX	XXX	XXX
Penalties — gross of related tax effects	XXX	XXX	XXX
Tax expense recorded as an increase of paid-in capital	XXX	XXX	XXX
Total tax expense	$ XXX	$ XXX	$ XXX

Note: The current tax expense (benefit) line and the total tax expense line in Sample 1 above and Sample 2 below should agree with the total of the current line (sum of federal, state, and foreign) and the total tax expense line, respectively, within the table for components of income tax expense or benefit according to SEC Regulation S-X, Rule 4-08(h).

Sample 2

	Years Ended December 31		
	20X3	20X2	20X1
		(in millions)	
Current tax expense (benefit)	$ XXX	$ XXX	$ XXX
Deferred tax expense (benefit)	XXX	XXX	XXX
Other tax expense (benefit)	XXX	XXX	XXX
Total tax expense	$ XXX	$ XXX	$ XXX

Note: If presented, the other tax expense (benefit) line in Sample 2 would include items affecting the expense that neither meet the definition of a deferred tax item (ASC 740-10-30-4) nor the definition of a current tax item (ASC 740-10-20). If material, the components of the other tax expense (benefit) should be separately described below the table.

Rate Reconciliation (ASC 740-10-50-12 Through 50-14)

Sample 1

The reconciliation between the Company's effective tax rate on income from continuing operations and the statutory tax rate is as follows:

	Years Ended December 31		
	20X3	20X2	20X1
		(in millions)	
Income tax expense (benefit) at federal statutory rate	$ XXX	$ XXX	$ XXX
State and local income taxes net of federal tax benefit	XXX	XXX	XXX
Foreign tax rate differential[4]	XXX	XXX	XXX

[4] At the 2013 AICPA Conference, the SEC staff noted the following issues with registrants' tax rate reconciliation disclosures:

- Labels related to reconciling items were unclear, and disclosures about material reconciling items did not adequately describe the underlying nature of these items.
- For material reconciling items related to foreign tax jurisdictions, registrants did not disclose in MD&A (1) each material foreign jurisdiction and its tax rate and (2) how each jurisdiction affects the amount in the tax rate reconciliation.
- Registrants have inappropriately aggregated material reconciling items. The SEC staff reminded registrants that Regulation S-X requires separate-line-item disclosure for reconciling items whose amount is greater than 5 percent of the amount calculated by multiplying the pretax income by the statutory tax rate.
- Amounts reflected in the tax rate reconciliation were inconsistent with related amounts disclosed elsewhere in a registrant's filing.
- Corrections of errors were inappropriately reflected as changes in estimates.

For additional information, see Deloitte's December 16, 2013, *Heads Up* on the AICPA Conference.

Change in valuation allowance	XXX	XXX	XXX
Effect of flow-through entity	XXX	XXX	XXX
Effect of double taxation net of dividend received deduction	XXX	XXX	XXX
Noncontrolling interest	XXX	XXX	XXX
Nondeductible/nontaxable items	XXX	XXX	XXX
Stock-based compensation	XXX	XXX	XXX
Tax audit settlements	XXX	XXX	XXX
Other — net	XXX	XXX	XXX
Income tax expense (benefit)	$ XXX	$ XXX	$ XXX

Note: SEC Regulation S-X, Rule 4-08(h)(2), indicates that for public entities, the reconciliation should disclose all components of the income tax expense or benefit that comprise 5 percent or more of income tax expense or benefit from continuing operations determined using the statutory tax rate. Nonpublic entities are permitted to omit this reconciliation but are required to disclose the nature of significant reconciling items.

Sample 2

The differences between income taxes expected at the U.S. federal statutory income tax rate of 35 percent and the reported income tax (benefit) expense are summarized as follows:

	Years Ended December 31		
	20X3	20X2	20X1
		(in millions)	
Expected income tax (benefit) expense at federal statutory rate	$ XXX	$ XXX	$ XXX
Valuation allowance for deferred tax assets	XXX	XXX	XXX
Fair value of preferred stock equity conversion feature	XXX	XXX	
Residual tax on foreign earnings	XXX	XXX	XXX
Foreign rate differential[5]	XXX	XXX	XXX
Bargain purchase gain		XXX	
Gain on contingent purchase price reduction	XXX		
Permanent items	XXX	XXX	XXX
Exempt foreign income	XXX	XXX	XXX
Unrecognized tax benefits	XXX	XXX	XXX
State and local income taxes	XXX	XXX	XXX
Dividends received deduction	XXX		
Capitalized transaction costs	XXX	XXX	
Other	XXX	XXX	XXX
Reported income tax (benefit) expense	$ XXX	$ XXX	$ XXX
Effective tax rate	XX%	XX%	XX%

[5] See footnote 4.

Unrecognized Deferred Tax Liability Related to Investments in Foreign Subsidiaries (ASC 740-30-50-2)[6]

Sample 1

U.S. income and foreign withholding taxes have not been recognized on the excess of the amount for financial reporting over the tax basis of investments in foreign subsidiaries that is indefinitely reinvested outside the United States. This amount becomes taxable upon a repatriation of assets from the subsidiary or a sale or liquidation of the subsidiary. The amount of such temporary differences totaled $XXX as of December 31, 20X3. Determination of the amount of any unrecognized deferred income tax liability on this temporary difference is not practicable because of the complexities of the hypothetical calculation.

Sample 2

In general, it is the practice and intention of the Company to reinvest the earnings of its non-U.S. subsidiaries in those operations. As of December 31, 20X3, the Company has not made a provision for U.S. or additional foreign withholding taxes on approximately $XXX of the excess of the amount for financial reporting over the tax basis of investments in foreign subsidiaries that is indefinitely reinvested. Generally, such amounts become subject to U.S. taxation upon the remittance of dividends and under certain other circumstances. It is not practicable to estimate the amount of deferred tax liability related to investments in these foreign subsidiaries.

Components of the Net Deferred Tax Asset or Liability (ASC 740-10-50-2, ASC 740-10-50-6, ASC 740-10-50-8, and ASC 740-10-50-16)

	December 31	
	20X3	**20X2**
	(in millions)	
Receivable allowances	$ XXX	$ XXX
Reserves and accruals not currently deductible for tax purposes	XXX	XXX
Stock-based compensation	XXX	XXX
Capitalized research and development costs	XXX	XXX
NOL and tax credit carryforwards	XXX	XXX
Restructuring and settlement reserves	XXX	XXX
Other	XXX	XXX
Subtotal	$ XXX	$ XXX
Less: valuation allowance	XXX	XXX
Total net deferred tax assets	$ XXX	$ XXX
Basis differences for inventory valuation and other assets	$ XXX	$ XXX
Basis difference for fixed assets	XXX	XXX

[6] See footnote 2.

Basis difference for intangibles	XXX	XXX
Other	XXX	XXX
Total deferred tax liabilities	$ XXX	$ XXX
Net deferred tax liability	$ XXX	$ XXX
Current net deferred tax liability	$ XXX	$ XXX
Long-term net deferred tax asset	XXX	XXX
Net deferred tax liability	$ XXX	$ XXX

Operating Loss and Tax Credit Carryforwards (ASC 740-10-50-3)

We have income tax NOL carryforwards related to our international operations of approximately $XXX, which have an indefinite life. The Company has recorded a deferred tax asset of $XXX reflecting the benefit of $XXX in loss carryforwards. Such deferred tax assets expire as follows:

20X4–20X8	$ XXX
20X9–20Y3	XXX
20Y4–20Y8	XXX
	$ XXX

Valuation Allowance[7] and Risks and Uncertainties (ASC 275-10-50-8)

Sample 1

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss incurred over the three-year period ended December 31, 20X3. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth.

On the basis of this evaluation, as of December 31, 20X3, a valuation allowance of $XXX has been recorded to record only the portion of the deferred tax asset that is more likely than not to be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income during the carryforward period are reduced or increased or if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as our projections for growth.

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[7] At the 2011 AICPA Conference, Mark Shannon advised that entities must consider all available evidence, both positive and negative, in determining whether a valuation allowance is needed to reduce a deferred tax asset to an amount that is more likely than not to be realized. Mr. Shannon said that some registrants are placing less weight on recent losses when weighing the positive and negative evidence because they view the current economic downturn as an aberration, as given in an example in ASC 740-10-30-22. He stated that while each company's facts and circumstances could differ, in general it would be difficult to conclude the economic downturn is an aberration. He also reminded participants that overcoming such negative evidence would require significant objective positive evidence. At the 2012 AICPA Conference, Mr. Shannon reiterated these comments. He also emphasized the importance of evidence that is objectively verifiable and noted that it carries more weight than evidence that is not.

Sample 2

We have federal and state income tax NOL carryforwards of $XXX and $XXX, which will expire at various dates in the next 15 years. Such NOL carryforwards expire as follows:

20X4–20X8	$ XXX
20X9–20Y3	XXX
20Y4–20Y8	XXX
	$ XXX

We believe that it is more likely than not that the benefit from certain state NOL carryforwards will not be realized. In recognition of this risk, we have provided a valuation allowance of $XXX on the deferred tax assets relating to these state NOL carryforwards. If or when recognized, the tax benefits related to any reversal of the valuation allowance on deferred tax assets as of December 31, 20X3, will be accounted for as follows: approximately $XXX will be recognized as a reduction of income tax expense and $XXX will be recorded as an increase in equity.

The federal, state, and foreign NOL carryforwards in the income tax returns filed included unrecognized tax benefits taken in prior years. The NOLs for which a deferred tax asset is recognized for financial statement purposes in accordance with ASC 740 are presented net of these unrecognized tax benefits.

Because of the change of ownership provisions of the Tax Reform Act of 1986, use of a portion of our domestic NOL and tax credit carryforwards may be limited in future periods. Further, a portion of the carryforwards may expire before being applied to reduce future income tax liabilities.

Valuation Allowance Reversal[8]

Sample

As of December 31, 20X3, the Company's deferred tax assets were primarily the result of U.S. NOL, capital loss, and tax credit carryforwards. A valuation allowance of $XXX and $XXX was recorded against its gross deferred tax asset balance as of December 31, 20X3, and December 31, 20X2, respectively. For the years ended December 31, 20X3, and December 31, 20X2, the Company recorded a net valuation allowance release of $XXX (comprised of a full-year valuation release of $XXX related to the X segment, partially offset by an increase to valuation allowance of $XXX related to the Y segment) and $XXX, respectively, on the basis of management's reassessment of the amount of its deferred tax assets that are more likely than not to be realized.

As of each reporting date, the Company's management considers new evidence, both positive and negative, that could impact management's view with regard to future realization of deferred tax assets. As of December

[8] At the 2012 AICPA Conference, Mark Shannon noted that registrants who have returned to profitability may be considering whether they should reverse a previously recognized valuation allowance. He indicated that factors to consider in making this determination include (1) the magnitude and duration of past losses and (2) the magnitude and duration of current profitability as well as changes in the factors that drove losses in the past and those currently driving profitability. Nili Shah further noted that registrants should assess the sustainability of current profits as well as their track record of accurately forecasting future financial results. She pointed out that registrants' disclosures should include a discussion of the factors or reasons that led to a reversal of a valuation allowance that effectively answers the question "why now." Such disclosures would include a comprehensive analysis of all available positive and negative evidence and how the entity weighed each piece of evidence in its assessment. She also reminded registrants that the same disclosures would be expected when there is significant negative evidence and a registrant concludes that a valuation allowance is necessary.

31, 20X3, in part because in the current year, the Company achieved three years of cumulative pre-tax income in the U.S. federal tax jurisdiction, management determined that sufficient positive evidence exists as of December 31, 20X3, to conclude that it is more likely than not that additional deferred taxes of $XXX are realizable, and therefore, reduced the valuation allowance accordingly.

As of December 31, 20X3, and December 31, 20X2, the Company has NOL carryforwards of $XXX and $XXX, respectively, which, if unused, will expire in years 20Y6 through 20Z2. The Company has capital loss carryforwards totaling $XXX and $XXX as of December 31, 20X3, and December 31, 20X2, respectively, which if unused, will expire in years 20X4 through 20X8. In addition, as of December 31, 20X3, and December 31, 20X2, the Company has low income housing tax credit carryforwards totaling $XXX and $XXX, respectively, which, if unused, will expire in years 20X8 through 20Z3, and alternative minimum tax credits of $XXX and $XXX, respectively, that may be carried forward indefinitely. Certain tax attributes are subject to an annual limitation as a result of the acquisition of Subsidiary A by the Company, which constitutes a change of ownership as defined under Internal Revenue Code Section 382.

Deferred Tax Asset Attributable to Excess Stock Option Deductions

Sample 1

As a result of certain realization requirements of ASC 718, *Compensation — Stock Compensation*, the table of deferred tax assets and liabilities shown above does not include certain deferred tax assets as of December 31, 20X3, and December 31, 20X2, that arose directly from (or the use of which was postponed by) tax deductions related to equity compensation that are greater than the compensation recognized for financial reporting. Equity will be increased by $XXX if and when such deferred tax assets are ultimately realized. The Company uses ASC 740 ordering when determining when excess tax benefits have been realized.

Sample 2

As a result of certain realization requirements of ASC 718, the table of deferred tax assets and liabilities shown above does not include certain deferred tax assets as of December 31, 20X3, and December 31, 20X2, that arose directly from tax deductions related to equity compensation greater than compensation recognized for financial reporting. Equity will be increased by $XXX if and when such deferred tax assets are ultimately realized. The Company uses tax law ordering when determining when excess tax benefits have been realized.

Note: As of the date of adoption of FASB Statement No. 123(R), Share-Based Payment (now codified in ASC 718), an entity that previously recognized a deferred tax asset for excess tax benefits before its realization was required to discontinue that practice prospectively. As a result, some entities may continue to have deferred tax assets for an NOL carryforward that includes such excess tax benefits until the NOL carryforward is either used or expires. In this case, it may not be appropriate to reverse any related valuation allowance recorded in the same year the related deferred tax asset was first recorded, even if the facts and circumstances indicate that it is more likely than not that the deferred tax asset will be realized. These entities should modify the above samples accordingly.

Entities are required to present in the consolidated statements of cash flows the impact of the tax benefit of any realized excess tax deduction in accordance with ASC 230-10-45-14(e). The excess tax benefit is separate from taxes paid and is reported as a component of cash inflows from financing activities. The excess tax benefit should be determined on a gross basis (i.e., not netted with tax deficiencies related to share-based payment awards). Operating cash outflows are increased by the same amount, resulting in including in operating cash flows the income taxes that the entity would have paid had it not been for the excess tax benefit.

Tax holidays (SAB Topic 11.C)

We operate under tax holidays in other countries, which are effective through December 31, 20X3, and may be extended if certain additional requirements are satisfied. The tax holidays are conditional upon our meeting certain employment and investment thresholds. The impact of these tax holidays decreased foreign taxes by $XXX, $XXX, and $XXX for 20X3, 20X2, and 20X1, respectively. The benefit of the tax holidays on net income per share (diluted) was $.XX, $.XX, and $.XX for 20X3, 20X2, and 20X1, respectively.

Tabular reconciliation of unrecognized tax benefits (ASC 740-10-50-15A(a))

Note: This tabular reconciliation disclosure is not required for nonpublic entities.

The following is a tabular reconciliation of the total amounts of unrecognized tax benefits:

Sample 1

	20X3	20X2	20X1
		(in millions)	
Unrecognized tax benefits — January 1	**$ XXX**	**$ XXX**	**$ XXX**
Gross increases — tax positions in prior period	XXX	XXX	XXX
Gross decreases — tax positions in prior period	XXX	XXX	XXX
Gross increases — tax positions in current period	XXX	XXX	XXX
Settlement	XXX	XXX	XXX
Lapse of statute of limitations	XXX	XXX	XXX
Unrecognized tax benefits — December 31	**$ XXX**	**$ XXX**	**$ XXX**

Sample 2

Note: The following sample illustrates a selection of reconciling items that may be reported separately or aggregated together on the basis of the specific facts and circumstances. The list is not intended to be all-inclusive. If reported separately, the descriptions should be appropriately titled so that the user of the financial statements will understand the nature of the reconciling item being reported.

	20X3	20X2	20X1	
		(in millions)		
Unrecognized tax benefits — January 1	**$ XXX**	**$ XXX**	**$ XXX**	
Current year — increase	XXX	XXX	XXX	*Recorded to profit and loss (P&L) (income tax expense, discontinued operations, etc.)*
Current year — increase	XXX	XXX	XXX	*Offset by changes in deferred tax asset/liability*
Prior year — increase	XXX	XXX	XXX	*Recorded to P&L*
Prior year — increase	XXX	XXX	XXX	*Offset by changes in deferred tax asset/liability*
Claims	XXX	XXX	XXX	*No P&L expected — change is offset*

	20X3	20X2	20X1	
				by new item in balance sheet not there previously (income tax receivable, deferred tax asset)
Prior year — decrease	XXX	XXX	XXX	*Recorded to P&L*
Prior year — decrease	XXX	XXX	XXX	*Offset by changes in deferred tax asset/liability*
Accrual to return changes	XXX	XXX	XXX	*No P&L expected — change is offset by new item in balance sheet not there previously (income tax receivable/payable, deferred tax asset/liability)*
Settlements	XXX	XXX	XXX	*Requiring cash payment*
Settlements	XXX	XXX	XXX	*Utilization/reduction of tax attributes*
Statute expiration	XXX	XXX	XXX	*Recorded to P&L*
Statute expiration	XXX	XXX	XXX	*Offset by changes in deferred tax asset/liability*
Current year acquisitions	XXX	XXX	XXX	*Goodwill increased*
Divestitures	XXX	XXX	XXX	*Removed from balance sheet through equity*
Divestitures	XXX	XXX	XXX	*Moved to ASC Topic 460,* Guarantees, *guarantor liability account*
Dispositions	XXX	XXX	XXX	*Removed from balance sheet through gain/loss computation*
Dispositions	XXX	XXX	XXX	*Moved to ASC Topic 460 guarantor liability account*
Currency	XXX	XXX	XXX	*Functional currency is local currency — booked to currency translation adjustment*
Currency	XXX	XXX	XXX	*Functional currency is U.S.$ — booked as currency transaction gain or loss*
Unrecognized tax benefits — December 31	**$ XXX**	**$ XXX**	**$ XXX**	

Unrecognized tax benefits that, if recognized, would affect the effective tax rate (ASC 740-10-50-15A(b))

Note: This disclosure is not required for nonpublic entities.

Included in the balance of unrecognized tax benefits as of December 31, 20X3, December 31, 20X2, and December 31, 20X1, are $XXX, $XXX, and $XXX, respectively, of tax benefits that, if recognized, would affect the effective tax rate. Also included in the balance of unrecognized tax benefits as of December 31, 20X3, December 31, 20X2, and December 31, 20X1, are $XXX, $XXX, and $XXX, respectively, of tax benefits that, if recognized, would result in adjustments to other tax accounts, primarily deferred taxes.

The total amounts of interest and penalties recognized in the Statement of Operations and the total amounts of interest and penalties recognized in the Statements of Financial Position (ASC 740-10-50-15(c))

The Company recognizes interest accrued related to unrecognized tax benefits and penalties as income tax expense. Related to the unrecognized tax benefits noted above, the Company accrued penalties of $XX and interest of $XX during 20X3 and in total, as of December 31, 20X3, has recognized a liability for penalties of $XX and interest of $XX. During 20X2, the Company accrued penalties of $XX and interest of $XX and in total, as of December 31, 20X2, had recognized a liability for penalties of $XX and interest of $XX. During 20X1, the Company accrued penalties of $XX and interest of $XX.

Tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits that will significantly increase or decrease within 12 months of the reporting date (ASC 740-10-50-15(d))

The Company believes that it is reasonably possible that a decrease of up to $XX in unrecognized tax benefits related to state exposures may be necessary within the coming year. In addition, the Company believes that it is reasonably possible that approximately $XX of its currently other remaining unrecognized tax benefits, each of which are individually insignificant, may be recognized by the end of 20X4 as a result of a lapse of the statute of limitations. As of December 31, 20X2, the Company believed that it was reasonably possible that a decrease of up to $XX in unrecognized tax benefits related to state tax exposures would have occurred during the year ended December 31, 20X3. During the year ended December 31, 20X3, unrecognized tax benefits related to those state exposures actually decreased by $XX as illustrated in the table above.

A description of tax years that remain subject to examination by major tax jurisdictions (ASC 740-10-50-15(e))

The Company is subject to taxation in the United States and various states and foreign jurisdictions. As of December 31, 20X3, the Company's tax years for 20X0, 20X1, and 20X2 are subject to examination by the tax authorities. With few exceptions, as of December 31, 20X3, the Company is no longer subject to U.S. federal, state, local, or foreign examinations by tax authorities for years before 20X0. Tax year 20XX was open as of December 31, 20X2.

Tangible Property Regulations

Sample 1

On September 13, 2013, the U.S. Treasury Department released final income tax regulations on the deduction and capitalization of expenditures related to tangible property. These final regulations apply to tax years beginning on or after January 1, 2014. Several of the provisions within the regulations will require a tax accounting method change to be filed with the IRS, resulting in a cumulative effect adjustment. To account for the adoption of these regulations, for the quarter ended September 30, 2013, plant-related, long-term deferred tax liabilities decreased by $XX, with the offsetting decrease to current deferred income tax assets. Before these

regulations were issued, this $XX would have been repaid over 20 years through lower tax depreciation deductions.

Sample 2

On September 13, 2013, the U.S. Treasury Department and the IRS issued final regulations that address costs incurred in acquiring, producing, or improving tangible property (the "tangible property regulations"). The tangible property regulations are generally effective for tax years beginning on or after January 1, 2014, and may be adopted in earlier years. The Company intends to early adopt the tax treatment of expenditures to improve tangible property and the capitalization of inherently facilitative costs to acquire tangible property as of January 1, 2013. The estimated tax impact of these accounting method changes reduces noncurrent deferred tax assets in the amount of $XX, with a corresponding reduction in current taxes payable, and has been reflected in the consolidated balance sheet as of September 30, 2013. The tangible property regulations will require the Company to make additional tax accounting method changes as of January 1, 2014; however, management does not anticipate the impact of these changes to be material to the Company's consolidated financial position, its results of operations, or both.

Note: The above examples relating to tangible property regulations are samples of one legislative change. Entities should consider whether any disclosure is needed for other significant legislative changes enacted during the fiscal year.

Subsequent Events Disclosure (ASC 855-10-50-2)

Sample

In January 20X4, the Company received notice of a tax incentives award of $XX from the XXX, which will allow the Company to monetize approximately $XX of state research and development tax credits. In exchange for these incentives, the Company pledged to hire an incremental XX employees and to maintain the additional headcount through at least December 31, 20X8. Failure to do so could result in the Company being required to repay some or all of these incentives.

Note: Disclosure of a nonrecognized subsequent event is required only when the financial statements would be considered misleading without such disclosure.

Schedule II — Valuation and Qualifying Accounts

The table and accompanying footnote below are reproduced from SEC Regulation S-X, Rule 12-09.

Column A — Description[1]	Column B — Balance at beginning of period	Column C — Additions		Column D — Deductions — describe	Column E — Balance at end of period
		(1) — Charged to costs and expenses	(2) — Charged to other accounts — describe		

[1] List, by major classes, all valuation and qualifying accounts and reserves not included in specific schedules. Identify each class of valuation and qualifying accounts and reserves by descriptive title. Group (a) those valuation and qualifying accounts that are deducted in the balance sheet from the assets to which they apply and (b) those reserves which support the balance sheet caption, Reserves. Valuation and qualifying accounts and reserves as to which the additions, deductions, and balances were not individually significant may be grouped in one total and in such a case the information called for under columns C and D need not be given.

Note: A liability for unrecognized tax benefits is not a valuation or qualifying account, whereas a valuation allowance on a deferred tax asset is a valuation account.

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