

FASB's New Income Tax Disclosure Requirements (ASU 2023-09): An Explainer



Bloomberg Tax

ASU 2023-09 Explainer: FASB's New Tax Disclosure Requirements

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Yosef Barbut is an international tax accounting consultant and university instructor who previously was a partner in BDO USA's National Office, and prior to that, an income tax accounting consultant in PwC's National Accounting Office. The Explainer is a collaboration with the BTAX Financial Accounting team.

A. Summary: What You Need to Do

FASB's new disclosure requirements for income taxes, published in December 2023 under ASU 2023-09, *Improvements to Income Tax Disclosures*, will go into effect in 2025 for public business entities and one year later (in 2026) for all other entities. A central feature of these new requirements is a prescriptive format, described in detail below.

Companies can elect an early adoption in annual periods which have not been issued (for example, in 2024 annual financial statements for calendar year companies).

Companies can adopt the new requirements prospectively without revisions of comparative-period disclosures but the income tax footnote disclosures in the year of adoption would not be comparable (2025 disclosures would follow the new requirements of ASU 2023-09, while the comparative-period disclosures of 2024 would follow the current disclosure requirements in ASC 740-50 and related SEC requirements). To maintain comparability, retroactive application to comparative-period disclosures is allowed (this would, of course, involve the extra work of putting "old" disclosure into the new format). Companies might consider retroactive adoption if they expect to receive questions about comparability of the effective tax rates of the adoption year and the prior year.

1. Present Tax Data in Footnotes, Tabular Format

The new requirements for income tax disclosure in financial statement footnotes are prescriptive, intended to enhance transparency, comparability, and decision usefulness – which are lacking in the current requirements.

With the effective date fast approaching, tax departments must be ready – they must be able to accumulate, process, and assemble income tax data into the footnotes. Whether the decision is to go for early adoption, or wait for mandatory-date adoption, tax departments should prepare to be compliance-ready with the new requirements.

Income taxes information regarding the annual effective tax rate is now to be disclosed in a newly designed and expanded tabular format with mandatory prescriptive captions.

Income tax payments, net of refunds received, will now be disclosed in the income tax footnotes, the disclosure of which would need to agree with the longstanding disclosure in the cash flow statement; and will be disaggregated by federal, states, and foreign jurisdictions and by "significant" jurisdictions within "states" and "foreign."

2. Consider Any Necessary Organizational Changes

For some companies, compliance with the new disclosure requirements might trigger a need for a reconfiguration of jurisdictional and consolidated income tax processes, data flow, and income tax provisions.

To successfully implement ASU 2023-09, tax, legal, and accounting departments should acquaint themselves with the new requirements, determine the necessary changes to be made to existing disclosures, and redesign relevant disclosure processes and templates. Companies need to consider existing and new internal controls necessary to verify that income tax data is accumulated, checked, and assembled for disclosure consistent with the new requirements. Internal controls will need to be tweaked and added to monitor and check compliance with the new requirement.

B. Central Requirements

The central requirements of ASU 2023-09 are two-fold:

- Reconciliation of Statutory Income Tax Rate to Effective Income Tax Rate
- Income Taxes Paid

1. Reconciliation of Statutory Income Tax Rate to Effective Income Tax Rate

The requirement to provide a tabular rate reconciliation applies only to public business entities; other entities have a qualitative disclosure

requirement (discussed in detail below). The following table illustrates the new and enhanced rate reconciliation disclosures where the reporting entity is a U.S. public entity.

Rate Reconciliation Tabular Disclosure

Category ASC 740-10-50-12A	Dollar (Currency), % Effect	Disaggregation (Required for 5%-or-Greater Jurisdictions or Tax Effects)	Comment
U.S. Federal Income Tax	21% of pre-tax income: amount and percentage effect		Non-U.S. reporting entities should use, in lieu of 21%, their domicile country's national income tax rate and a disclosure explaining why a particular rate is used.
(a)(1) State & Local Tax 5%-or-greater jurisdiction(s) Combined non-5%-or-greater jurisdictions	___% of pre-tax income: amount and percentage effect	By jurisdiction(s) if tax effect is $\geq 5\%$ of statutory federal tax of $21\% \times$ pre-tax income	State and local taxes net of federal (national) tax effect.*
(a)(2) Foreign Tax 5%-or-greater jurisdiction(s) 5%-or-greater tax effect by "nature" Combined non-5%-or-greater jurisdictions			For U.S. companies, all non-U.S. income taxes including foreign local/canton taxes and Global Minimum Tax incurred by non-U.S. constituent entities.
(a)(3) Effect of Tax Laws/Rates Changes		Not required/relevant	Federal tax (changes in foreign tax laws/rates go into the Foreign Tax category).
(a)(4) Effect of Cross-Border Tax		By tax "nature" if tax effect is $\geq 5\%$ of statutory federal tax of $21\% \times$ pre-tax income	Federal income tax incurred on foreign income of U.S. companies (including GILTI tax, Subpart F tax, FIID, certain U.S.-to-foreign intra-entity transfer tax, etc.) net of related U.S. foreign tax credits (FTCs).
(a)(5) Tax Credits		By credit "nature" if tax effect is $\geq 5\%$ of statutory federal tax of $21\% \times$ pre-tax income	Non-refundable federal income tax credits (e.g., R&D credits, "Green Energy" tax credits) net of related U.S. unrecognized tax benefits.
(a)(6) Valuation Allowance Changes		Not required	Federal tax effects only (foreign valuation allowance goes into category "a2" and domestic state & local valuation allowance goes into category "a1").
(a)(7) Nontaxable/Nondeductible Items		By tax effect "nature" if tax effect is $\geq 5\%$ of statutory federal tax of $21\% \times$ pre-tax income	Federal tax effects only (foreign items go into category "a2" and domestic state & local items go into category "a1").
(a)(8) Unrecognized Tax Benefits (UTBs)		Not required	Effect of Changes in Federal + Foreign + State & Local unrecognized tax benefits from Prior Periods Positions (changes in UTBs due to settlements and lapsing statutes of limitations also included).
Other Adjustments		Disaggregate by tax effect "nature" if tax effect is $\geq 5\%$ of statutory federal tax of $21\% \times$ pre-tax income	A "Default" category for everything not fitting within eight mandatory categories.
Effective Income Tax Rate	Total net taxes paid to all jurisdictions		Reporting entity's global effective tax rate.

*Footnote disclosure requirement for public companies of the "Majority of State & Local" Tax effect (category "a1") (ASC 740-10-50-12B):

"List all states and locals that account for more than 50% of total tax disclosed in category "a1" in descending order from the highest-contributing jurisdiction to the lowest until the more-than-50% of total states & local tax is disclosed."

2. Income Tax Payments Net of Refunds Disaggregated by Major Jurisdictions

This is required of both public and private entities. The following format is not required in the ASU; rather, it is used to illustrate the organization of the required disclosure (the required disclosure could be made through a table or/and in a narrative). [ASC 740-10-50-22 and ASC 740-10-50-23]

Income Tax Payments (Net of Refunds) Disclosure				
Jurisdiction		Income Tax		
		Payments	Refunds	Disaggregation
Federal		Net of income tax paid to and income tax refunds received from federal government		Not relevant.
State & Local	–5%-or-greater jurisdiction(s)	Net of income taxes paid to and income tax refunds received from state/local, governments		By jurisdiction(s) if tax paid (net of refund received) is ≥ 5% of total income tax paid (net of refunds received) for all jurisdictions.
Foreign	–Combined non-5%-or-greater jurisdictions			
Total		Net of income taxes paid to and income tax refunds received from all jurisdictions		Required disclosure in Income Tax Footnote should agree/be consistent with cash flow statement disclosure of total income tax payments (ASC 230-10-50-2A).

C. Practical Tips/Considerations

Rate Reconciliation Tabular Disclosure

1 The new tabular format is prescriptive: eight mandatory categories codified in **ASC 740-10-50-12A(a1)** through **(a8)** with a ninth default category for “other adjustments” that do not fit into one of eight mandatory categories. The disclosure flexibility inherent in the current requirements is replaced by a prescriptive format intended to enhance transparency, decision usefulness, and comparability. However, tax departments will face additional compliance and internal control checks to ensure disclosed information is categorized according to the prescribed nine buckets.

2 FASB’s Tax Disclosure Update to Topic 740 does not provide definitions for the eight prescribed categories. The FASB believes that the eight categories are self-descriptive and should not be difficult to comply with. However, tax

departments are expected to exercise professional judgment when deciding the categorization and/or further disaggregation by “nature” of some income tax effects (e.g., book minimum tax, stock options windfalls, etc.).

3 When applying professional judgment, tax departments should be guided by the FASB’s stated disclosure principles codified in **ASC 740-10-50-11A**, which states: “The objective of these disclosure requirements is for an entity, particularly an entity operating in multiple jurisdictions, to disclose sufficient information to enable users of financial statements to understand the nature and magnitude of factors contributing to the difference between the effective tax rate and the statutory tax rate.”

4 The reconciliation column amount in dollars (or another currency for non-U.S. companies with non-USD reporting currency) will be the current and deferred income tax provisions attributable to a particular category disclosure. That is, the rate reconciliation disclosure is only for income taxes recognized in income statement (income taxes recognized through discontinued operation, other comprehensive income, equity, and goodwill should not be included in this tabular disclosure). The dollar amount measurement unit could be “thousands” or “millions.” The reconciliation column in percentage will show the relative contribution effect of a category’s current and deferred income tax provisions (the numerator) to consolidated pre-tax income (the denominator), except for the foreign tax category which includes, among other reconciling items, the effect of federal-to-foreign differential tax rate. The total dollar amount of the

effective rate reconciliation should agree with the disclosure of Income tax expense (or benefit) allocated to continuing operations (**ASC 740-10-50-10**).

Refer to "Income Tax Data Flow," below, for illustration of a control check on total income tax provisions.

5 The category "a1" disclosure is for state and local income taxes recognized in income statement. The federal (national) income tax effect (current and deferred) of state and local income taxes should also be included in this disclosure. Tax departments that track the federal (national) effect of state and local income taxes as a separate "federal" temporary difference in the federal deferred income tax provision should have a control check to ensure its effect is disclosed in rate reconciliation category "a1" disclosure. The disclosure in all categories (except category "a8") should include the effects of UTBs arising from current year positions. For example, if a current year tax return position in a particular state jurisdiction does not qualify for recognition under the state's income tax laws and thus the position's benefit is fully reserved, the state's income tax provision disclosure (category "a1") must also include the effect of the uncertain income tax benefit (the reserve amount).

6 The category "a2" disclosure is for foreign income taxes (current and deferred) recognized in income statement (foreign income taxes recognized in discontinued operation, other comprehensive income, equity, and in goodwill should not be included in this disclosure). The name of a foreign country and/or the nature of one of more items within a foreign country must be disclosed using the 5% disaggregation threshold.

Therefore, the first step is to determine whether a foreign country's income tax (current and deferred) is at least 5% of consolidated pre-tax income $\times$ 21%.

If it is, the country's name and income tax effect must be disclosed separately from other foreign countries. Foreign countries that are not required to be disaggregated (countries whose income taxes are individually less than 5% of consolidated pre-tax income $\times$ 21%) will be aggregated and disclosed as one.

In **Step 2**, specific tax-drivers in all foreign countries in which the reporting entity generates income (or a loss) will be considered for disaggregated disclosure if the effect(s) is at least 5% of consolidated pre-tax income $\times$ 21%. It is possible for a particular tax-driver item, such as the effect of changes in valuation allowance or/and certain income tax credits or changes in law, to be disaggregated in the disclosure while the foreign country is not required to be disaggregated. Practically, the tabular disclosure format is a reconciliation of the federal statutory rate of 21% to an effective tax rate. Therefore, a foreign country's disclosure includes the effect of U.S.-to-foreign tax rates differential for both 5%-jurisdiction(s) and for all non-5% jurisdictions.

Refer to the Foreign Income Tax Disclosure Control Check Flowchart, below, for an illustration of "Step 1" and "Step 2" and disclosure determination of a 5%-jurisdiction.

7 Foreign income taxes include income tax incurred in local states or cantons of foreign countries. It also includes foreign withholding tax from foreign-source income that is payable to a U.S. reporting company. Foreign deferred income taxes include changes in foreign tax laws and rates, changes in foreign valuation allowances, and foreign income tax credits (for example Research & Development credits) to name three common foreign deferred income tax effects.

8 The category "a2" disclosure incorporates the effect of unrecognized income tax benefits from current period foreign income. For example, if a foreign subsidiary's book taxable income (before translations into USD reporting currency) is 800,000

but the more-likely-than-not sustainable income is determined to be 1,000,000 and if its income tax rate is 16%, the foreign income tax effect included in the category "a2" disclosure is 160,000 and not 128,000 (the foreign UTB effect of 32,000 which is the difference between the tax return filing position and the more-likely-than-not taxable income arises in the current year and is included in the UTBs disclosures under **ASC 740-10-50-15A(2)**).

9 Companies that have historically combined a rate reconciliation effect of foreign income taxes with the U.S. federal incremental income tax of foreign income such as the effects of Subpart F income inclusion and GILTI tax will need to change their disclosure methodology to comply with the new disclosure requirements. Tax departments will also need to consider the impact of the OECD's Pillar 2 Global Minimum Tax, the discussion of which is beyond the scope of this Explainer. When a constituent entity (foreign subsidiary or branch) of a U.S. company (the "ultimate parent") incurs an incremental tax under these rules, the effect should be included in foreign income tax category "a2" disclosure. Disaggregation by specific foreign jurisdiction(s) and/or by "nature" (for example, foreign valuation allowance) based on the 5% threshold should be carefully observed. For example, if a change in valuation allowance in a particular foreign jurisdiction is at least 5% of consolidated pre-tax income $\times$ 21%, it requires a disaggregated disclosure even though the foreign jurisdiction's disclosure might not be disaggregated. Tax departments should implement a process to screen foreign countries that should be separately disclosed from all other countries and specific items that should be separately disclosed on the face of the rate reconciliation disclosure.

Refer to the Foreign Income Tax Disclosure Flowchart, below, for an illustration.

10 The category “a3” disclosure is for current and deferred federal income tax effects of changes in federal income tax laws (for example enactment of a corporation income tax rate reduction or increase). Federal current income tax effects could arise, for example, when a federal tax law enactment retroactively applies to the start of the fiscal year of enactment (or affect carry-back provisions with implications on current income tax). The effects of state & local tax law changes (net of the federal or national tax effect) and foreign tax law changes should be disclosed in category “a1” and category “a2” disclosures, respectively.

11 The category “a4” disclosure encompasses the federal income tax effect, net of related federal foreign income tax credits, of special rules in U.S. federal income tax law pertaining to taxation of foreign income. The more common federal income tax effects in this category would be Subpart F income inclusion, GILTI tax, Foreign Intangible Income deduction, and federal tax of deemed royalties from transferring U.S. intellectual property to name a few.

Companies that recognize a U.S. federal tax on the outside-basis difference in the stock of a foreign subsidiary(s) (unmerited foreign earnings) would include the deferred income tax effect, net of foreign tax credits, in this category disclosure. The tax effects disclosure will include the effects of unrecognized income tax benefits related to the current year positions that give rise to these income tax effects. This category disclosure should provide transparency into the U.S. federal tax effects of foreign income, separately from the foreign tax effects of foreign income which will be disclosed in category “a2.” Tax departments should be careful to “allocate” the associated federal foreign tax credits (FTCs) to this category disclosure and not to category “a5” disclosure which aggregates all other federal income tax credits.

12 The category “a5” is reserved for federal income tax credits, of which there are many, initially recognized in the income statement (other than those required to be included in category “a4”). Income tax credits that are least 5% of consolidated pre-tax income $\times$ 21% will be disaggregated from other income tax credits and disclosed separately to enhance transparency and understanding of federal income tax credits that provide material federal tax savings. The tax credits disclosure will include the effect of unrecognized income tax benefits related to current year income tax credits. For example, if a research and development tax credit expected to be claimed on the current year federal income tax return is \$1,000,000 but the more-likely-than-not sustainable credit is \$700,000, the disclosure included in category “a5” is \$700,000 (the \$300,000 difference is a UTB arising in the current year and included in the disclosure required by ASC 740-10-50-15A2). Valuation allowances that are required for current year federal income tax credits will not be included in this category disclosure (all federal valuation allowances are disclosed in category “a6”). When relevant, companies should consider augmenting the disclosure (in a footnote consistent with the new guidelines in **ASC 740-10-50-12C**) to explain when the federal income tax credits disclosed in category “a5” are fully or partially reserved. Tax departments should be careful to exclude refundable income tax credits which are recognized in pre-tax income. Particular attention is required for the treatment of tax credits that are not within income taxes accounting (for example, certain transferable income tax credits). The disclosure should be consistent with the accounting policy choice for recognition of transferable credits and only include transferable federal income tax credits which are recognized in income taxes.

U.S. companies subject to the federal book minimum tax and having applicable financial book income exceeding \$1 billion may need to recognize book minimum tax credits which will need to be disclosed in category “a5” (some companies might conclude that book minimum tax credits belong in other adjustments category) regardless of whether a valuation allowance is also provided (for example, when a company concludes that it is more likely than not to be “perpetually” paying book minimum tax). Disaggregated disclosure by the credit “nature” based on the 5% threshold will enhance transparency and understanding of important tax benefits and “drivers” of the effective tax rate.

13 Category “a6” is reserved for federal valuation allowances impacting the income statement. Federal valuation allowances initially recognized in discontinued operation, other comprehensive income, equity, and goodwill will not affect the category “a6” disclosure (however, subsequent changes will follow intraperiod allocation and may eventually affect the income statement). There is no requirement for further disaggregation of federal valuation allowances recognized in the income statement, presumably because valuation allowances accounting tends to be “whole or nothing” and other disclosures are required by **ASC 740-10-50-2** (that is, the components of deferred income taxes, the valuation allowance recognized, and net change in valuation allowance during the year). Companies should consider augmenting valuation allowance disclosure to explain the nature and effect of federal valuation allowance accounting in circumstances when “partial” valuation allowance is used and/or the current year effect on the income statement includes a material adjustment related to prior years’ deferred income tax balances that rolled into the current year.

14 Category “a7” is reserved for federal income tax effects of nondeductible or nontaxable items affecting current year income (so-called “permanent” differences). The more obvious items include fines and penalties recognized in pre-tax income but are not deductible, and certain exclusions from taxable income.

Also included in category “a7” is the federal tax accounting effect of impairment of certain intangible assets (for example, nondeductible goodwill). However, there are less obvious items (for example, gains from the sale of transferable federal income tax credits recognized in pre-tax income, the federal tax effect of Low-Income Housing Tax Credits, and “tax windfalls” or “tax shortfalls” from stock options).

When deciding whether the federal tax effect of a particular item should be included in category “a7” disclosure, the FASB’s codification glossary definition of “temporary differences” should be reviewed: “Some events recognized in the 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.” Tax departments should have control checks that accurately track and allocate such federal tax effects consistent with the pre-tax accounting policy choices.

15 The accounting for unrecognized income tax benefits (a/k/a “FIN 48 liabilities” or “UTB”) affects recognition and measurement of current and deferred income taxes and should be included in all nine disclosure categories. However, special care should be given to category “a8” which aggregates cross-jurisdiction changes in UTBs due to positions taken in prior periods. Disaggregation based on the 5% threshold is not required (consistent with Topic 740 requiring disclosure of globally aggregated UTBs).

Tax departments should have internal control checks to verify that the rate reconciliation disclosure separates the effects of FIN 48 due to “current year” positions from FIN 48 changes due to “prior year positions” (the latter is required to be shown in category “a8”). For example, an internal control check for public companies could involve a comparison of the disclosure required under **ASC 740-10-50-15A(1)** (“gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period”) to the new disclosure requirement of **ASC 740-10-50-12A(a)(8)**. They should be the same except for: (i) the effects of decreases due to settlements which are disclosed in **ASC 740-10-50-15A(3)**,

(ii) the effects of decreases due to lapsing statute of limitations which are disclosed in **ASC 740-10-50-15A(4)**, and

(iii) the effects of unrecognized tax benefits recognized outside the income statement (that is, backward tracing changes to equity).

When the changes in UTBs due to settlements and lapsing statutes of limitation are included in category “a8” (because they relate to prior year(s) positions), the difference is narrowed down to changes in UTBs recognized in equity.

Refer to “Income Tax Data Flow,” below, for an illustration of this internal control check.

16 Public companies should consider providing additional disclosures outside the tabular format of the rate reconciliation (for example, in footnotes) consistent with the new guidelines in **ASC 740-10-50-12C** to explain the nature, effect, and underlying causes of an individual reconciling item(s) when it is not otherwise apparent. For example, the reason for disclosure changes of foreign jurisdiction(s) from one period to the next period might not be apparent and additional explanatory disclosure (in a footnote outside the rate reconciliation) is helpful to explain the drivers causing the removal of a foreign jurisdiction(s) and the inclusion of a new foreign jurisdiction(s).

C. Practical Tips/Considerations (cont'd)

Income Tax Payments (Net of Refunds) Disclosure

1 There is a bright-line requirement for disaggregation of individual jurisdiction(s) based on a quantitative threshold of 5%-or-more (a jurisdiction's income tax paid, net of refunds received, is at least 5% of income tax paid, net of refunds received, in *all* jurisdictions). This requirement applies to any country, state, or local territory relevant to the reporting entity.

2 The materiality guidance in **ASC 105-10-05-6** could be considered to mean disaggregation should not apply to an immaterial tax payment (net of refunds received). However, the codification does not provide specific quantities for materiality and the analysis must follow general U.S. auditing and/or SEC guidelines. The analysis is complex and beyond the scope of this Explainer.

3 The income tax payments (net of refunds received) disclosed in the Income Tax footnotes should agree with the supplemental cash tax disclosure in the cash flow statements (FASB's Codification Topic **ASC 230** now includes a new paragraph **ASC 230-20-50-2A** that requires consistent disclosure as in **ASC 740**).

4 Tax departments should internally reconcile total income tax payments (net of refunds received) for a fiscal year period with the current income tax provision for the fiscal year period; key differences would include:

- (1) unrecognized income tax benefits related to tax return positions taken in the current fiscal year,
- (2) income tax payable for the current year's provisions,
- (3) tax payments made in the current year for prior and/or subsequent periods' tax estimates and final payments, and
- (4) refunds received in the current year (this includes refundable income tax credits recognized in pre-tax income). Nevertheless, companies should be able to reconcile the difference as a "check figure" control.

Refer to the Data Analytics section of this Explainer, below, for an illustration of this control check.

D. Income Tax Data Flow and Internal Control Checks

Income Tax Provisions-to-Disclosures					
Jurisdiction	Total Income Tax Provisions ¹	(Less): Income Tax Provisions Allocated to Non-Income Statement Components ²	Income Tax Provisions from Continuing Operations	(Less): UTBs Related to Prior Period(s) Positions Including Settlements and Expiration of Statutes of Limitations	Income Tax Provisions from Continuing Operations Without Effects of UTBs Changes Due to Prior Period(s) Positions
Federal (National)	Current Income Tax	Intraperiod allocation per ASC 740-20-45-2 through 45-14	Required income tax footnote disclosure: ASC 740-10-50-9 to 50-10	Required disclosure in income tax footnote: UTBs change globally due to prior period 740-10-50-15A(1); due to settlements 15A(3); and due to expiration of statutes of limitation 15(A)(4)	Rate reconciliation tabular disclosures categories "a3," "a4," "a5," "a6," "a7"
	Deferred Income Tax			Aggregated disclosure in income tax footnote	
State & Local	Current Income Tax		Required disclosure: ASC 740-10-50-9 to 50-10	Required disclosure in income tax footnote: UTBs change globally due to prior period 740-10-50-15A(1); due to settlements 15A(3); and due to expiration of statutes of limitation 15(A)(4)	Rate reconciliation tabular disclosure category "a1"
	Deferred Income Tax			Aggregately disclosed in income tax footnote	
Foreign	Current Income Tax			Required disclosure in income tax footnote: UTBs change globally (aggregated) due to prior period 740-10-50-15A(1); due to settlements 15A(3); and due to expiration of statutes of limitation 15(A)(4)	Rate reconciliation tabular disclosure category "a2"
	Deferred Income Tax			Aggregately disclosed in income tax footnote	
Total Income Tax	[control check] Income tax provisions allocated to income and to non-income components are required disclosures (ASC 740-10-50-10).	[control check] Required income tax footnote disclosure: ASC 740-10-50-10.	[control check] Should tie to newly required disclosure in the effective tax rate tabular reconciliation (ASC 740-10-50-12A).	[control check] Total of all jurisdictions should agree to newly required disclosure in the effective tax rate reconciliation (ASC 740-10-50-12A category "a8").*	[control check] Total of all jurisdictions should agree to newly required disclosures in the effective rate reconciliation (ASC 740-10-5-12A categories "a1" through "a7").

* There are rare circumstances when backward tracing to equity component is required (tax departments should review the requirement in ASC 740-20-45-11(c) and (f) and ASC 740-20-45-3).

¹ From All Components of Financial Statements and After Application of FIN 48 Accounting
² Other Comprehensive Income; Discontinued Operation; Goodwill; Equity

Foreign Income Tax Rate Reconciliation Disclosure Internal Control Check Illustration

U.S. Company "X" operates and pays income taxes in seven foreign countries (Countries A through G) and in two foreign cantons (states) within Country E. X maintains financial reporting books and records and pre-tax income for each jurisdiction

[Note: Some companies follow "divisional" financial reporting books and records and pre-tax income determination and thus the flowchart presented would have to be modified].

STEP 1

Determine Foreign Country(ies) Disaggregation

	Any of Countries A-G, Cantons A-B	Combined	Observation
Current + Deferred Income Tax Provisions	Total Country Income Tax	Total Income Tax	Data populated from internal work paper Files. Combined total should tie in to required footnote disclosure (ASC 740-10-50-9 through 50-10 and 50-10B).
Consolidated PTI $\times 21\% \times 5\%$	PTI $\times 21\% \times 5\%$	PTI $\times 21\% \times 5\%$	
Disaggregation if Country's Tax Equal or Greater Than 5% of PTI $\times 21\%$	Yes/No	Combined income tax of all 5% jurisdictions	Countries meeting the 5% threshold are presented separately in the rate reconciliation disclosure (refer to illustration of 5% country disclosure).
Aggregation of All Countries Below 5% Threshold	Yes/No	Combined income tax of all non-5% jurisdictions	Countries below 5% are aggregated in the rate reconciliation disclosure.
Pre-Tax Income (Loss) of Non-5% Countries	PTI of non-5%	Combined PTI of ALL non-5%	This equates to total pre-tax income in ALL foreign countries less combined PTI of all 5% countries.
Rate Differential Disclosure in Dollar Amount of Aggregated Foreign Countries	(PTI of non-5% country $\times 21\%$) - income tax of non-5% country	Combined PTIs of non-5% countries $\times 21\%$ - Combined income tax of non-5% countries	Category "a2" aggregated disclosure in dollar amount.
Rate Reconciliation Disclosure in Percent of Aggregated Foreign Countries	Non-5% country total income tax / non-5% country pre-tax income (loss)	[Combined non-5% countries income tax / Combined non-5% countries pre-tax income] - federal rate of 21%	Category "a2" aggregated disclosure in percent %.

STEP 2

Determine Individual Foreign Tax Effects ("Drivers") Disaggregation

	Any of Countries A-G, Cantons A-B	Disaggregation	Observation
Consolidated PTI $\times 21\% \times 5\%$	PTI $\times 21\% \times 5\%$	PTI $\times 21\% \times 5\%$	
Foreign Tax Effects:			
Valuation Allowance Exceeding 5% Threshold?	Yes/No	Valuation allowance effects requiring disaggregated disclosure	Category "a2" disclosure by Valuation Allowance
Income Tax Credits Exceeding 5% Threshold?		Income tax credits effects requiring disaggregated disclosure	Category "a2" disclosure by Income taxes
Nondeductible/Nontaxable Items Exceeding 5% Threshold?		Nondeductible / nontaxable effects requiring disaggregated disclosure	Category "a2" disclosure nondeductible / taxable items
Effect of Changes in Tax Laws / Rates Exceeding 5% Threshold?		Effect of Foreign Tax law / rate changes requiring disaggregated disclosure	Category "a2" disclosure by effect of tax law/rate changes
Other Items (e.g., Share-Based Compensation; Global Minimum Tax) Exceeding 5% Threshold?		Other items / effects requiring disaggregated disclosure	Category "a2" disclosure by other items / effects
Rate Reconciliation Effect in Percentage	Tax effect requiring disaggregation / consolidated pre-tax income (loss)		Category "a2" disclosures by tax effect nature in percentage

Determine Disclosures for a 5%-Jurisdiction (Illustration)

The following facts are given for illustration using the seven foreign countries associated with Company X:

Consolidated Pre-Tax Income	19,000
Domestic Pre-Tax Income	6,000
Foreign Pre-Tax Income	13,000

Consolidated Pre-Tax Income $\times$ 21% $\times$ 5% = 199.5 (Company X's 5%-disclosure threshold)

Foreign Country/Canton	A	B	C	D	E	F	G	Canton A	Canton B	Combined	Observation
Pre-Tax Income (Loss)	3,500	1,500	2,000	(1,000)	4,000	1,800	1,200	2,000	2,000	13,000	Data from internal files / combined total for all foreign countries is required footnote disclosure (740-10-50-10B).
Country Tax Rate	10%	15%	19%	25%	28%	20%	12.5%	5%	7%		
Tax on Pre-Tax Income (Loss)	350	225	380	(250)	1,120	360	150	100	140		
Income Tax Credits	0	(50)	0	0	(150)	(100)	0	0	(60)		
Valuation Allowance	0	0	(200)	250	0	0	0	0	0		
Nondeductible / Nontaxable	0	0	0	0	(250)	(150)	50	150	70		
Change in Tax Laws / Rates	0	0	0	0	0	0	0	0	0		
Others (e.g, Stock Options, Global Minimum Tax)	0	100	0	0	(400)	0	60	0	0		
Total Country Income Tax	350	275	180	0	320	110	260	250	150	1,895	
Disaggregation if country's total income tax $\geq$ than 199.5	Yes	Yes	No	No	Yes	No	Yes	Yes	No	Combined Income Tax of all 5% jurisdictions: 1,455 .	Countries A, B, E, and G and Canton A are required separate disclosures in the rate reconciliation (see below).
Aggregate if country's total income tax < 199.5	No	No	Yes	Yes	No	Yes	No	No	Yes	Combined income tax of all non-5% jurisdictions.	Countries C, D, and F, and Canton B are aggregated in the rate reconciliation disclosure (see below).

Company "X" Rate Reconciliation Tabular Disclosure (Foreign Tax – Category "a2") (ASC 740-10-50-12A)

Category "a2"	Dollar Amount	Percentage	Explanations
Country A Rate Differential Rate Benefit	(385)	(11%)	– Pre-tax income of 3,500 $\times$ (21% - 10%) = 385 – (385) / 3,500 = 11%
Country B Rate Differential Benefit (Less) Other Effects	(40)	(2.7%)	– Pre-tax income of 1,500 $\times$ (21% - 15%) + (50) tax credits +100 other non- deductible = (40) – (40) / 1,500 = (2.7%)
Country C Valuation Allowance Benefit	(200)	(10%)	– Valuation allowance calculation file (200 benefit) [the rate differential savings of 40 ((2,000 $\times$ (21% - 19%)) is included in the non-5% countries aggregated disclosure] – (200) / 2,000 = (10%)
Country D Valuation Allowance Expense	250	25%	– Valuation allowance calculation file (250 expense) [the rate differential savings of 40 ((1,000) $\times$ (21% - 25%)) is included in the non-5% countries aggregated disclosure] – (250) / (1,000) = 25%
Country E Rate Differential Benefit (Less) Other Effects	130	3.25%	– Tax rate differential expense 280 (4,000 $\times$ (21% - 28%)) + (150) tax credits = 130 130/4,000
Country E Nontaxable Income	(250)	(6.25%)	– (250) / 4,000
Country E Stock Option Windfall Benefit	(400)	(10%)	– (400) / 4,000
Country G Foreign Rate Differential Benefit (Less) Other Effects	8	0.7%	– Tax rate differential saving of 102 (1,200 $\times$ (21% - 12.5%)) + Nondeductible of 50 + Other expense of 60 – 8 / 1,200 = 0.7%
Canton A Book Tax Income	250	12.5%	– Canton A incremental tax expense of 100 (2,000 $\times$ 5%) + 150 nondeductible = 250 – Canton A tax 250 / Country E pre-tax income 2,000 = 12.5%
All Other Foreign Countries	(198)	(7.1%)	– See below for summary of non-5% jurisdictions – (198) / 2,800 = (7.1%)

Determine Aggregated Disclosure of Company "X" Non-5% Jurisdictions

Non-5% Foreign Country/Canton	Pre-Tax Income (Loss)	Total Income Tax	Tax at 21%	Tax Increase (Saving) (Aggregated Disclosure)	Tax Increase (Saving) Separately Disclosed
C	2,000	180	420	(40)	(200)
D	(1,000)	0	(210)	(40)	250
F*	1,800	110	378	(268)	0
Canton B	Included in Country E pre-tax income	150	0	150	0
Total	2,800	440	588	-198	50

* Country F tax (tax rate differential savings of 18 ($1,800 \times (21\% - 20\%)$) plus tax credits of 100 plus nontaxable income saving of 150.

Check the Accuracy of Company X's Calculation

	Control Check Dollar Amount	Control Check Percentage
Combined Foreign Countries Pre-Tax Income	13,000	
U.S. Tax Expense at 21%	2,730	21%
Plus (Minus)		
– Country A Rate Reconciliation	(385)	(3%)
– Country B Rate Reconciliation	(40)	(0.3%)
– Country E Rate Reconciliation	(520)	(4%)
– Country G Rate Reconciliation	8	0.06%
– Canton A Rate Reconciliation	250	2%
– All Other Jurisdictions (C, D, F, Canton B)	(148)	(1%)
Total Tax at 21% +/- Category "a2" Rate Reconciliation	1,895	$1,895 / 13,000 = 14.6\%$

Current Income Tax Provision to Cash Payment (Net of Refunds) Disclosure Internal Control Check

The cash tax payment disclosure now required under ASC 740-10-50-22 through 50-23 will provide a useful control check on the accuracy and completeness of current income tax provisions for the three main jurisdictions. Below is an illustration of a potential internal control check:

Reported / Disclosed Item	Federal	State & Local	Foreign	All Jurisdictions	Observations
Current Income Tax Provisions	Disclosed (ASC 740-10-50-9(a))				Public companies disclose current income tax provision by three major jurisdictions. UTBs arising from current period positions are disclosed in the footnote (ASC 740-10-50-15A(2)); however, the disclosure may include UTBs recognized in deferred income tax and outside income tax expense (for example, goodwill or equity) which would result in a difference from the UTBs disclosure now required in the rate reconciliation (ASC 740-10-50-12A).
(Adjusted for) Unrecognized Tax Benefits (UTBs) Reflected in Current Income Tax Provisions	UTBs from current period positions should be disclosed in the Rate Reconciliation categories “a1” through “a7” and “a9”				
(Adjusted for) Income Tax Payable for the Current Year	Available in tax provisions working files				
(Adjusted for) Tax Payments Made for Prior and Subsequent Periods (Tax Estimates and Final Payments)	Available in tax provisions working files				
(Adjusted for) Refunds Received					
Cash Flow Payment for Income Taxes Net of Refunds (ASC 740 and ASC 230)	[control check] Should tie to newly required disclosure	[control check] Should agree with required disclosure	[control check] Should agree with required disclosure	[control check] Required disclosures (ASC 740 and ASC 230)	

E. Income Tax Disclosures Data Analytics

The new disclosure requirements could provide valuable data analytics about a company's domestic and international income tax expenditures, benefits, trends, opportunities, and risks, in relation to assessing future cash flows.

1. Jurisdictional Effective Income Rate Analysis

The new annual tabular disclosure of the effective tax rate could be reconfigured by three main jurisdictions and compared with pre-tax income (loss) and the actual jurisdictional provisions to provide insights into trends, benefits, and risks from income taxes. For example, U.S. companies that earn significant income from foreign countries can use analytics to understand the reasonableness and trend of their foreign income tax, such as the impact the global minimum tax has on the effective tax rate (the global minimum tax is generally expected to cause the foreign effective tax rate of U.S. companies to approximate 15%)

The following presentation is a suggested reconfiguration of the pre-tax income and effective tax rate disclosures by three main jurisdictions based on relative percent of jurisdiction effective tax rate to relative percent of jurisdiction pre-tax income (loss):

	Federal	State & Local	Foreign	Global (Consolidated)	Comments / Observations
Pre-Tax Income (Loss) in Percentage % (ASC 740-10-50-10A)	Federal domestic pre-tax income (loss) / global pre-tax Income (loss)	State & local domestic pre-tax income (loss) / global pre-tax income (loss)	Foreign pre-tax income (loss) / global pre-tax income (loss)	Global pre-tax income (loss) (ASC 740-10-50-10A)	This information is obtained from the Income Tax Footnote and Segment Reporting Footnote.
Effective Tax Rate (ETR)	Federal tax rate of 21% +/- sum of disclosure categories "(a3 through a9)" +/- adjustment for category "a8" (ASC 740-10-50-12A)	Disclosure category "a1" plus/minus adjustment for category "a8" (ASC 740-10-50-12A)	Disclosure category "a2" +/- adjustment for category "a8" (ASC 740-10-50-12A)	Tie to global ETR disclosure in ASC 740-10-50-12A	Adjustments for category "a8" disclosure amount (split UTB changes from prior period positions into federal, state, and foreign).
Income Tax Provisions	Federal (national) provisions	State & local provisions	Foreign income tax provisions	Required disclosure ASC 740-10-50-10B	Should agree to required disclosure in ASC 740-10-50-10B.
Trend / Reasonableness	Normal/High/Low				

Additional analysis can be done in combination with segment reporting & disclosures (ASC 280) to understand trends and risks in significant foreign jurisdictions. Companies are required to disclose revenues from external customers attributable to a foreign country(s) when such revenues are material and also disclose the basis for attributing revenues to a material foreign country(s) (ASC 280-10-50-41(a)).

Material jurisdictions for segment reporting disclosure purposes generally account for at least 10% of consolidated revenue.

Footnote segment disclosures of material foreign jurisdiction(s) can be compared to the income tax rate reconciliation (category "a2") for potential disaggregated disclosures of material "country(s)" and tax "natures." The absence of specific-country

disclosure in the income tax rate reconciliation when the jurisdiction's name and revenue are disclosed in segment reporting could suggest that its effective tax rate is low and/or there are other tax reasons (for example, valuation allowance release that offset income tax expense).

2. Cash Income Tax Effective Rate Analysis

Getting a granular view of a company's annual cash tax rate is now possible with the introduction of a new disclosure of cash flow payments for income taxes by major jurisdictions. The cash tax rate by major jurisdictions can be further refined with certain adjustments derived from information in a company's internal income tax working papers/files.

The tabular format below illustrates a cash tax rate data analysis:

Required Disclosure (Tax Working Papers/Files)	Federal	State & Local	Foreign	Combined	Comments / Observations
Pre-Tax Income (Loss) (ASC 740-10-50-10A)	pre-tax income (loss) from continuing operations				This is required disclosure in income taxes footnote and segment reporting footnote.
(A) Income Tax Cash Payments Made (Net of Refunds Received) (ASC 740-10-50-22 to 50-23)	net tax payments / refunds				Should tie to the statement of cash flow disclosure (ASC 230-10-50-2A).
Cash Income Tax Rate (%)	tax payments / pre-tax income (loss) %				Should reflect actual outlays for income tax as percent of pre-tax income.
Further Adjustments (Tax Working Papers/Files)					
(B) Add Back	refunds received				Available internally in working papers/files.
(C) Add (Subtract)	income tax receivable (payable)				Some companies include this figure in footnote/supplemental disclosures of current liabilities (assets).
(A+B+C) Adjusted Cash Tax Outlay	adjusted income tax payments				Should reflect adjusted outlays for income tax.
Adjusted Cash Income Tax Rate (%)	adjusted tax payments / pre-tax income (loss) %				This rate should be higher than the rate of actual outlay for tax "(A)" and closer to the effective tax rate.

F. Requirements for Entities Other Than Public Business Entities

Income tax disclosure requirements for nonpublic business entities will moderately increase starting with the 2026 fiscal year financial statements, unless they elect early adoption. Private companies that have not provided these disclosures in the past would benefit from implementing control checks to verify compliance with the requirements.

The FASB codified a requirement for all companies to disclose pre-tax income (loss) from continuing operations disaggregated by domestic and foreign (ASC 740-10-50-10A) and a requirement to disclose income tax expense (or benefit) from continuing operations disaggregated by federal (national), state, and foreign (ASC 740-10-50-10B). FASB clarified in the codification that the income tax imposed by the country of domicile (the United States for U.S. companies) on foreign earnings are to be included and disclosed within the country of domicile (U.S. domestic tax).

In lieu of a numerical tax rate reconciliation in a tabular format, private companies will provide a qualitative disclosure (a narrative) of the nature and effect of specific categories of reconciling items and individual jurisdictions that result in a significant difference between statutory rate and the effective tax rate (ASC 740-10-50-13). This disclosure would be a narrative that provides a basic understanding of the most significant effects on financial statements.

The Disclosure Update provides the following illustration of a narrative disclosure for a private company:

The difference between Entity W's effective tax rate and its statutory tax rate is primarily attributed to tax credits, state taxes, and foreign taxes. More specifically, the foreign tax effects of Entity W's operations in Ireland had a decreasing effect on its effective tax rate, while the foreign tax effects of Entity W's operations in France had an increasing effect on effective tax rate. Entity W received federal research and development tax credits, which decreased its effective tax rate, while state taxes in California increased its effective tax rate. (ASC 740-10-55-233)

Nonpublic entities operating in multiple countries will face more work than nonpublic entities with only U.S. domestic business due to specific disclosure requirements of foreign income and foreign income tax expense. It is therefore important that nonpublic entities begin preparation for adoption sooner than 2026 even if they do not elect early adoption of ASU 2023-09

APPENDIX

EXAMPLE - Foreign Tax Disclosure (Category a2)
Aggregation/Disaggregation of Country Tax and Nature Tax

Note: This table reconciles TOTAL foreign income tax expense (benefit) as disclosed in the footnote to the Rate Reconciliation Disclosure

According to ASU 2023-09 Disaggregation Requirements (countries and/or items meeting the 5%-Threshold)

	Foreign Countries / Foreign Cantons										Comments
	A	B	C	D	E	F	G	CANTON A	CANTON B	TOTAL	
Country/Canton Statutory Tax Rate	10%	15%	19%	25%	28%	20%	12.50%	5%	7%		
Pretax Income (Loss)	3500	1500	2000	-1000	4000	1800	1200	2000	2000	13000	Tie to Foreign Pretax Income Disclosure (ASC 740-10-50-10A)
Foreign Income Tax	350	275	180	0	320	110	260	250	150	1895	Tie to Foreign Income Tax Disclosure (ASC 740-10-50-9 through 50-10)
Country Disaggregation (If total Tax => 199.5)	YES	YES	NO	NO	YES	NO	YES	YES	NO	N/R	
Note: Cantons A and B pretax income is included in Country E											
Rate Reconciliation Calculation and Aggregation/Disaggregation											
Tax Rate Differential (Benefit):	A	B	C	D	E	F	G	CANTON A	CANTON B	TOTAL	Comments
3500 x (21%-10%)	-385										
1500 x (21%-15%)		-90									
2000 x (21%-19%)			-40								
(1000) x (21% - 25%)				-40							
4000 x (21%-28%)					280						
1800 x (21%-20%)						-18					
1200 x (21% - 12.5%)							-102				
2000 x 5% (included in E's pretax)								100			
2000 x 7% (included in E's pretax)									140		
Income Tax Credits	0	-50	0	0	-150	-100	0	0	-60		
Valuation Allowance	0	0	-200	250	0	0	0	0	0		
Non-deductible/Non-taxable	0	0	0	0	-250	-150	50	150	70		
Change in Tax Laws/Rates	0	0	0	0	0	0	0	0	0		
Others	0	100	0	0	-400	0	60	0	0		
Total Rate Reconciliation Difference "Category a2" Disclosures	-385	-40	-240	210	-520	-268	8	250	150		
CONTROL CHECK:											
U.S. Statutory tax -21%	735	315	420	-210	840	378	252	0	0	2730	
Plus(Minus): Rate Reconciliation("a2")	-385	-40	-240	210	-520	-268	8	250	150	-835	
Foreign Income Tax (As Reported)	350	275	180	0	320	110	260	250	150	1895	
Disaggregated Foreign Courts/Cantons	350	275			320		260	250		1455	
Aggregated Foreign Countries/Cantons			180	0		110			150	440	
										1895	

Rate Reconciliation Disclosure (ASC 740-10-50-12A Category "a2"):

Country A	-385	Country E - Stock Option Windfalls	-400
Country B	-40	Country G - Rate Differential Benefit Plus Others	8
Country C - Valuation Allowance Benefit	-200	Canton A - Rate Differential Expense Plus Others	250
Country D - Valuation Allowance Expense	250	All Other Countries/Cantons	-198
Country E - Rate Differential Expense Less Credits	130	Control Check - U.S. Tax Rate (Less) Foreign Tax	-835
Country E - Non-taxable Benefits	-250		



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