TB 49 was rescinded 12/15/92. Rendered obsolete by FAS 109

Handbook: Thrift Activities
Subject: Tax Issues

Section: 521
TB 49

August 19, 1991

RESCINDED

Accounting for Income Tax Benefits Associated with Bad Debts

Summary: This Thrift Bulletin discusses accounting practice for income tax benefits associated with bad debts. The attached Securities and Exchange Commission ("SEC") Staff Accounting Bulletin No. 91 ("SAB No. 91") provides interim guidance for public institutions until the proposed amendment to the Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes" ("SFAS No. 96") is adopted. Institutions that make securities filings with the OTS must comply with SAB No. 91 in their securities filings.

For Further Information Contact: Your Regional Office, or Policy Division, OTS - Washington, D.C.

Thrift Bulletin 49

General Policy

In general, the OTS believes there are valid reasons to recognize the deferred income tax benefits associated with an institution's book bad debt reserves, even though the institution has not recognized the deferred income tax liability related to its tax bad debt reserve. However, the Financial Accounting Standards Board ("FASB") has proposed in an amendment to SFAS No. 96, "Accounting for Income Taxes," that a potential deferred tax asset should be recognized only if the difference between the tax bad debt reserve and the book bad debt reserve is a net deductible temporary difference. The FASB exposed the proposed statement for public comment on June 5, 1991. As a result, the SEC issued SAB No. 91. Institutions that make securities filings with the OTS must comply with SAB No. 91 (attached) in their securities filings until the proposed statement is adopted.

Per SAB No. 91, institutions that applied the "two-difference method" under SFAS No. 96 or the "annual method" under Accounting Principles Board Opinion No. 11, "Accounting for Income Taxes" ("APB Opinion No. 11"), before May 10, 1991, may continue to recognize the deferred tax benefit. However, the deferred tax benefit should not increase and should reverse when the bad debt provisions or bad debt reserve reverse. Also, such institutions should adopt the "one-difference method" under SFAS No. 96 or the "cumulative method" under APB Opinion No. 11 on a prospective basis for periods beginning on or after July 1, 1991, and make the additional disclosures as described at SAB No. 91 - Question 3.

Although the OTS only requires prospective application, SAB No. 91 encourages institutions to adopt the "one-difference method" under SFAS No. 96 or the "cumulative method" under APB Opinion No. 11 and report it as a change in accounting principles. The reversal of previously recognized income tax benefits would be included in the reported cumulative effect. SAB No. 91 will accept retroactive restatements of previously filed financial statements as an alternative. Any required accounting adjustments should be made in the current period for purposes of the Thrift Financial Reports.

Attachment

—Jonathan L. Fiechter
Deputy Director for
Washington Operations

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 211

[Release No. SAB 91]

Staff Accounting Bulletin No. 91

AGENCY: Securities and Exchange Commission.

ACTION: Publication of Staff Accounting Bulletin.

SUMMARY: Staff Accounting Bulletin No. 91 ("SAB 91"), which was released on July 16, 1991, expresses the staff's views regarding the accounting for income tax benefits of thrift bad debt losses. This staff accounting bulletin is intended to serve as interim guidance until a new standard on accounting for income taxes is adopted.

FOR FURTHER INFORMATION CONTACT: Margaret Ruffin Horvath, Office of the Chief Accountant (202-272-2130); or Robert A. Bayless, Division of Corporation Finance (202-272-2553); Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The statements in staff accounting bulletins are not rules or interpretations of the Commission nor are they published as bearing the Commission's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the Federal securities laws.

Jonathan G. Katz
Secretary

July 16, 1991

Accordingly, Part 211 of Title 17 of the Code of Federal Regulations is amended by adding Staff Accounting Bulletin No. 91 to the table found in Subpart B.

STAFF ACCOUNTING BULLETIN NO. 91

The staff hereby adds Section X to Topic 5 of the Staff Accounting Bulletin Series. Topic 5-X discusses accounting for the income tax benefits associated with bad debts of thrifts.

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Topic 5: Miscellaneous Accounting

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X. Accounting for Income Tax Benefits Associated with Bad Debts of Thrifts

Facts: The tax code provides thrifts with a deduction for bad debts based on a percentage of taxable income ("PTI"). For many years, actual bad debt losses were far less than the PTI deduction available to most thrifts. Consequently, many thrifts accumulated a large tax reserve for bad debts. The tax code limits the recapture of the benefit provided the thrifts through PTI deductions to events which typically are controlled by the thrift's management (such as the payment of excess dividends or the failure to meet thrift definitional tests). As a result, Accounting Principles Board ("APB") Opinion No. 23 does not require thrifts to provide deferred income taxes related to the difference between taxable income and pretax accounting income attributable to a reserve for bad debts until it is likely that taxes will be paid.

Recent economic conditions in the industry have significantly increased the actual bad debt losses experienced by many thrifts. In addition, the Tax Reform Act of 1986 ("TRA 86") reduced the amount of PTI deduction available to thrifts. The resulting increases in the bad debt reserve for financial reporting purposes ("book reserve") have focused attention on the accounting for the potential tax benefit that may arise in future periods when the book reserve is deducted for tax purposes.

Some thrifts have interpreted the guidance in APB Opinion No. 23 to apply only to the deferred income tax liability related to the bad debt reserve for tax purposes ("tax reserve") and not to the book reserve. Under this interpretation, referred to as the "two-difference method" by those applying Statement of Financial Accounting Standards ("SFAS") No. 96 and the "annual method" by those applying APB Opinion No. 11, deferred income taxes related to the tax reserve are not recognized but income tax benefits related to some or all of the book reserve are recognized. Other thrifts have interpreted the guidance in APB Opinion No. 23 to prohibit recognition of a deferred tax benefit related to the book reserve if a deferred tax liability has not been recognized related to the tax reserve (referred to as the "one-difference" or "cumulative" method by those applying SFAS

No. 96 and APB Opinion No. 11, respectively). Still other thrifts have applied variations of these methods.

Members of the accounting profession acknowledged that practice was diverse on accounting for deferred income taxes related to reserves for bad debts of thrifts and referred the issue to the FASB's Emerging Issues Task Force ("EITF"). The EITF discussed the issue (Issue No. 91-3) on May 9, 1991 and did not reach a consensus as to the preferability of the methods. However, at the meeting, the FASB staff announced its belief "...that no tax benefit may be recognized in income unless and until the book bad debt reserve exceeds the tax bad debt reserve." The FASB staff position was supported by the Financial Accounting Standard Board's ("Board") tentative decision, related to a proposed statement that would supersede SFAS No. 96, "...that the difference between a thrift's book bad debt reserve and tax bad debt reserve is a single temporary difference."[1]

Because uncertainty regarding the alternative accounting methods was not resolved by the EITF and continuation of the present diversity of accounting practices reduces the

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[1] On May 2, 1991, as reported in the minutes of the May 9, 1991 open meeting of the EITF, the FASB tentatively concluded that "...a potential deferred tax asset would be recognized only if the difference between the tax bad debt reserve and the book bad debt reserve is a net deductible temporary difference." The tentative decision was reached during deliberations on the proposed statement that will supersede SFAS No. 96 which was exposed for public comment on June 5, 1991. The final statement is expected to be issued during the first quarter of 1992.

comparability and reliability of financial reporting by thrifts, the staff is publishing its interpretation of the current accounting literature to serve as interim guidance for public companies until a new standard on accounting for income taxes is adopted.

Question 1: Is it appropriate for a thrift to recognize the deferred income tax benefits associated with its book reserve when the thrift has not recognized the deferred income tax liability related to its tax reserve?

Interpretive Response: No. The staff believes that the difference between the book and tax reserves represents a single timing or temporary difference. As the staff stated at the May 9, 1991 EITF meeting, the staff will challenge the preferability of the adoption of the two-difference or annual method after May 9, 1991, including the initial selection of either method in an initial public offering.

However, if a thrift's book reserve exceeds its tax reserve, the staff would not object to the recognition of the income tax benefit related to the excess, as long as there is a likelihood that future benefits will result.[2]

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[2] SAB Topic 5-C.2, "Realization of Tax Benefit," addresses the conditions that must be met in order to record a deferred tax benefit.

Question 2: If a thrift's existing practice with respect to accounting for the income tax benefits of bad debts differs from the staff's interpretation, must the thrift adopt the one-difference or cumulative method through restatement of prior periods?

Interpretive Response: No. The staff will not object if a thrift adopts the one-difference or cumulative method prospectively for periods beginning on or after July 1, 1991, without restatement of prior periods, provided the disclosures noted below in Question 3 are provided by the thrift. However, the staff encourages thrifts to account for the change to the one-difference or cumulative method as a change in accounting principle in accordance with the accounting and disclosure guidance provided in paragraphs 18 through 22 of APB Opinion No. 20. The reversal of income tax benefits that were recognized previously would be included in the cumulative effect of the change in accounting principle. Alternatively, the staff encourages but would not require retroactive restatement of previously filed financial statements.

Question 3: If a thrift adopts the one-difference or cumulative method prospectively, rather than as a cumulative adjustment or through retroactive restatement, what disclosures regarding the tax benefit recognized under the two-difference or annual method should be included in the financial statements?

Interpretive Response: To facilitate comparability of financial statements among thrifts, the staff believes that those institutions that adopt the one-difference or cumulative method prospectively should include the following in a note to financial statements filed with the Commission, in addition to the disclosure requirements of APB Opinion No. 23 and SFAS No. 96:

a. A description of the method used in calculating deferred income taxes related to bad debts and the date the method was adopted initially. If the method used by the registrant differs from the methods described in the EITF Issue Summary 91-3, this should be disclosed and the effect quantified;

b. The amount of the income tax benefit included in the latest balance sheet presented that is attributable to the use of the two-difference or annual method, as compared to the use of the one-difference or cumulative method;

c. Quantification of the effect on net income and earnings per share, in each period for which an operating statement is presented, of applying the two-difference or annual method as compared to the one-difference or cumulative method, as applicable; and,

d. Discussion of the tentative decision reached by the FASB that the difference between the tax and financial reporting basis of a thrift's bad debt reserves is a single temporary difference and the effect that decision will have, if adopted in final form, on net income, earnings per share and stockholder's equity.

Question 4: If a thrift, following the guidance in this SAB, adopts the one-difference or cumulative method prospectively, will the income tax benefits previously recognized under the two-difference or annual method reverse?

Interpretive Response: Yes. The amount of previously recognized income tax benefits related to the book reserve should not be "frozen" on the balance sheet. The deferred tax benefits should be subject to reversal when realized.

Question 5: How does the staff's interpretation affect the accounting for the potential consequences of the difference between the book and tax reserve for bad debts as specified in APB Opinion No. 23?

Interpretive Response: Paragraph 23 of APB Opinion No. 23 specifies that deferred income taxes do not have to be provided for differences between the taxable income and pretax accounting income related to bad debts unless "the association is likely to pay income taxes, either currently or in later years, because of known or expected reductions in the bad debt reserve." The staff's interpretation does not change that guidance; however, due to changes in the tax law occurring in 1986,[3] the staff believes that, currently, there is a presumption that taxes will be paid on any increase in the tax bad debt reserve in excess of the base-year tax reserve.

[3] TRA 86 provides for the potential recapture of PTI deductions added to the tax reserve in excess of the "base-year tax reserve" (as defined in TRA 86).