FASB adds stock compensation tax accounting topics to its agenda

October 2014

In brief

During its meeting on October 8, 2014, the Financial Accounting Standards Board (‘FASB’ or ‘Board’) decided to add the following stock-based compensation topics to its agenda as part of its simplification initiative:

- Whether to require recognition of all excess tax benefits (“windfalls”) and deficiencies (“shortfalls”) within income tax expense and remove the current requirement that cash taxes payable be reduced in order to record a windfall tax benefit, and
- Whether to eliminate the requirement to display the gross amount of windfalls as an operating outflow and financing inflow in the statement of cash flows.

These income tax accounting topics will be addressed along with certain other stock-based compensation topics which were also added to the agenda. The Board’s deliberation of these topics is expected to result in an exposure draft that will be issued to solicit broad stakeholder input.

In detail

On October 8, 2014, the FASB voted onto its technical agenda various topics related to improvements and simplifications to the current accounting for stock-based compensation. The topics include certain broadly applicable areas of income tax accounting.

The impetus for the consideration of these topics came from several sources. For more information, please refer to our recent TAS publications regarding the August agenda prioritization meeting FASB adds income tax accounting topics to its agenda and September pre-agenda discussion meeting FASB discusses income tax accounting for stock compensation.

After conducting research as directed by the Board, the FASB staff presented the Board with specific topics relating to tax accounting for stock-based compensation. The Board voted to include two income tax accounting topics to a stock-based compensation project and encouraged the FASB staff to continue researching the possibility of entirely eliminating the intraperiod tax allocation rules as a separate project.

Several of the issues presented to the Board were recently highlighted in PwC’s Point of view: Accounting for income taxes – A case for simplification.
**Topics added to the agenda**

The Board agreed to address the possible recognition of all windfalls and shortfalls within income tax expense. (Windfalls occur when a stock-based award results in a larger tax deduction than the amount of compensation recorded for book purposes, whereas shortfalls occur when the award results in zero or less of a tax deduction than the related book charge.)

That proposed treatment would replace the current guidance which allocates tax effects between equity and income tax expense.

The FASB staff presented two alternatives to the Board:

- **Alternative A:** Record all windfalls and shortfalls in income tax expense
- **Alternative B:** Record all windfalls and shortfalls in equity

The FASB staff noted that either alternative would eliminate the necessity of maintaining a windfall “pool” and the potential asymmetry in the classification of tax effects. Both alternatives included the staff’s recommendation to remove the current requirement that cash taxes payable must be reduced in order to record a windfall. The staff had also considered potential convergence with IFRS but concluded that convergence would not result in simplification.

Ultimately, the Board voted to include only alternative A in the stock-based compensation project.

Additionally, the Board agreed with the staff’s recommendation to include the possible elimination of the current requirement to display the gross amount of windfall as an operating outflow and financing inflow in the cash flow statement. The FASB staff noted that this presentation does not reflect actual cash flows, and represents the only exception from single-line presentation of taxes within operating cash flows.

**The takeaway**

The steps recently taken by the FASB and the ongoing efforts of the FASB staff may lead to significant near-term improvements that will reduce the complexity of accounting for income taxes. At present, there are two projects that address the simplification of income tax accounting: the income tax project and the stock-based compensation project. Income taxes are also included in the Disclosure Framework project and the FASB staff continues to study intraperiod tax allocation.

Organizations should be giving attention to the implications of potential near-term changes in these tax accounting areas. There are also likely to be further developments as the FASB works through the widely relevant tax accounting topics now on its agenda.

**Let’s talk**

For a deeper discussion of how the FASB actions may affect your business, please contact:

**Tax Accounting Services**

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>David Wiseman, Partner</td>
<td>US Tax Accounting Services Leader</td>
<td>+1 (617) 530-7274</td>
<td><a href="mailto:david.wiseman@us.pwc.com">david.wiseman@us.pwc.com</a></td>
</tr>
<tr>
<td>Edward Abahoonie, Partner</td>
<td>Tax Accounting Services Technical Leader</td>
<td>+1 (973) 236-4448</td>
<td><a href="mailto:edward.abahoonie@us.pwc.com">edward.abahoonie@us.pwc.com</a></td>
</tr>
<tr>
<td>Kyle Quigley, Director</td>
<td>US Tax Accounting Services</td>
<td>+1 (973) 236-7843</td>
<td><a href="mailto:kyle.quigley@us.pwc.com">kyle.quigley@us.pwc.com</a></td>
</tr>
</tbody>
</table>

© 2014 PricewaterhouseCoopers LLP, a Delaware limited liability partnership. All rights reserved. PwC refers to the United States member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.

SOLICITATION

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.