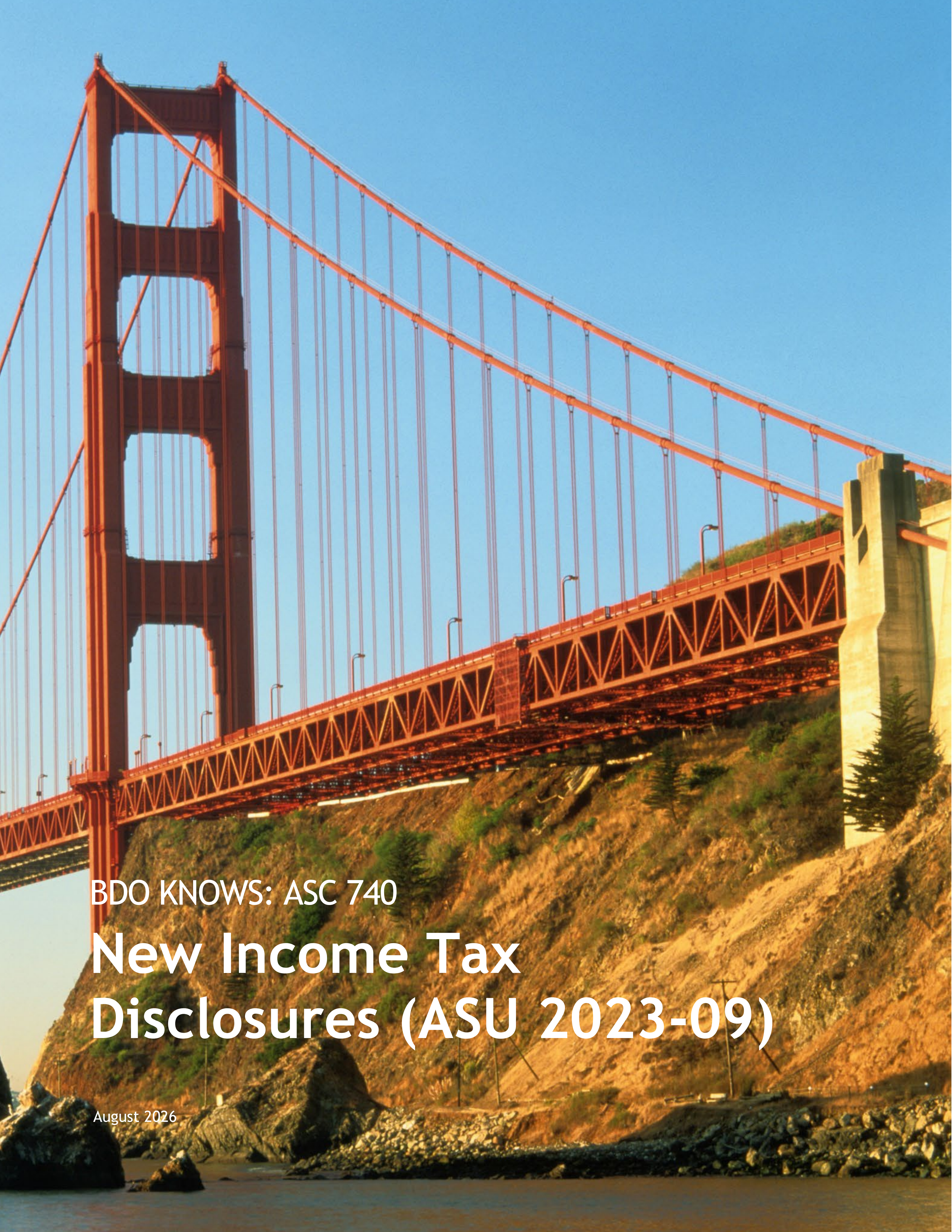

BDO KNOWS: ASC 740

New Income Tax Disclosures (ASU 2023-09)

August 2026

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About This Publication

This publication can be a useful tool to help management comply with the accounting and reporting requirements under U.S. generally accepted accounting principles (U.S. GAAP). It is designed to raise issues for awareness and provide a resource for more detailed analysis. An entity's facts and circumstances might vary from those described in this publication; therefore, an entity's conclusions might vary.

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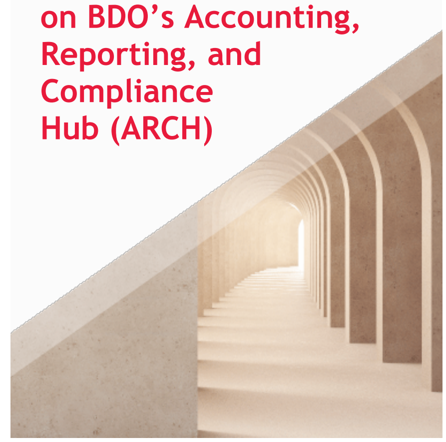


1. INTRODUCTION

Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2023-09, *Income Taxes (Topic 740) — Improvements to Income Tax Disclosures*, introduces new requirements clarifying and expanding specific income tax disclosures to increase their transparency and usefulness. ASU 2023-09 also replaces the term "public entity" used in Accounting Standards Codification (ASC) 740 with the term "public business entity" (PBE) for consistency with more recent standard setting. ASU 2023-09 provides a disclosure objective and significantly expands the rate reconciliation disclosure requirements for PBEs. It also introduces requirements for all entities to disclose income taxes paid to individual jurisdictions meeting or exceeding a specified threshold and updates disclosures about unrecognized tax benefits (UTBs) and undistributed earnings of subsidiaries.

While the most stringent quantitative requirements are reserved for PBEs, entities other than PBEs (non-PBEs) are subject to a specific subset of the new guidance, including new jurisdictional disaggregation of income taxes paid and a qualitative framework for rate reconciliations. This publication has been updated with additional insights, examples, and implementation considerations for non-PBEs as they adopt the new guidance.

2. KEY PROVISIONS OF ASU 2023-09

2.1 Income Taxes Paid

FASB REFERENCES

ASC 105-10-05-6 and ASC 740-10-50-22 through 50-23

The ASU requires that all entities annually disclose the amount of income taxes paid (net of refunds received) disaggregated by federal, state, and foreign jurisdictions. All entities must also annually disclose the amount of income taxes paid (net of refunds received) to each individual jurisdiction where that amount is equal to or greater than 5% of total income taxes paid (net of refunds received). In quantifying the 5% threshold for income taxes paid, the numerator of the fraction is the absolute value of any net income taxes paid or income taxes received for each jurisdiction and the denominator is the absolute value of total income taxes paid (net of refunds received) for all jurisdictions in the aggregate. The calculation is based on total income taxes paid (net of refunds received) during the period.

The ASU does not require disclosure of comparative information for income taxes paid by jurisdiction for all years presented.

BDO INSIGHT 2-1: INCOME TAXES PAID DISCLOSURES

The new disclosure requirements on income taxes paid apply equally to PBEs and non-PBEs. Entities must be prepared to explain the relationship between income tax expense and cash paid for income taxes. We believe the explanation should address timing, withholding taxes, attribute use, and credit mechanics. We also believe companies should be prepared to articulate to lenders and other financial statement users the drivers behind their largest cash-tax jurisdictions and whether that profile is expected to continue.

BDO INSIGHT 2-2: MATERIALITY AND INCOME TAXES PAID DISCLOSURE

While ASU 2023-09 introduces a bright-line threshold for disclosing income taxes paid, the FASB states in its general principles[1] that the provisions of U.S. GAAP need not be applied to immaterial items. The Board observed in Basis of Conclusions BC67 of ASU 2023-09:

> *The materiality guidance in paragraph 105-10-05-6 is applicable to the amendments in [ASU 2023-09], as it is to all Codification guidance. Therefore, the amendments on the disclosure of income taxes paid do not apply to immaterial items. That is, an entity does not need to separately disclose income taxes paid for any jurisdiction (whether that is federal, state, or foreign groupings or individual jurisdictions based on a quantitative threshold of 5 percent) if the amount is immaterial.*

Reaching a conclusion about what is material and immaterial to an entity's financial statements requires the application of professional judgment based on the facts and circumstances.

EXAMPLE 2-1: DISCLOSURE OF INCOME TAXES PAID

Company G made tax payments and received refunds during the year ended December 31, 20X5, as follows:

JURISDICTION	PAYMENT (REFUND) AMOUNT (IN THOUSANDS)	PERCENTAGE OF NET INCOME TAXES PAID	PERCENTAGE AS AN ABSOLUTE VALUE
U.S.	$ 250	93%	93%
Massachusetts	45	17%	17%
Rhode Island	(10)	(4%)	4%
Mexico	5	2%	2%
Canada	(21)	(8%)	8%
Net Payment (Refund)	$ 269	100%	N/A

Company G must separately disclose payments made to and refunds received from the U.S., Massachusetts, and Canada for the year ended December 31, 20X5. The remaining amount of income taxes paid, and refunds received do not meet the 5% disaggregation threshold and would be included in the "Other" category. For example, Company G would present Rhode Island refunds received in "Other — State" and Mexico taxes paid in "Other — Foreign."

BDO INSIGHT 2-3: INCOME TAXES PAID DISCLOSURE

The ASU does not require a specific format for the income taxes paid disclosure (that is, tabular or narrative). It also does not specify whether to include the disclosure in the statement of cash flows or the tax footnote disclosure. Based on our review of financial statements of several first adopters of the ASU, we expect that most entities will elect to present a table of income taxes paid within the tax footnote. An entity should select and consistently apply a reasonable disclosure approach. Examples 2-2 and 2-3 illustrate the concepts.

[1] ASC 105-10-05-6.

EXAMPLE 2-2: TABULAR DISCLOSURE WITH RETROSPECTIVE APPLICATION

An entity early adopted ASU 2023-09 and applied it retrospectively beginning in 2025. It elects to present income taxes paid in tabular format. The entity includes the following in its income tax footnote:

($ IN MILLIONS)	2025	2024	2023
U.S. Federal	$ 185	$ 275	$ 95
State:			
State #1	55	30	15
State #2	(a)	(a)	10
Other	20	25	10
State Subtotal	75	55	35
Foreign:			
Foreign Jurisdiction #1	(a)	(a)	15
Other	5	3	—
Foreign Subtotal	5	3	15
Total Cash Paid for Income Taxes (Net of Refunds)	$ 265	$ 333	$ 145

(a) The amount of income taxes paid (net of refunds received) during the year does not meet the 5% disaggregation threshold and is included in "Other."

EXAMPLE 2-3: TABULAR DISCLOSURE WITH PROSPECTIVE APPLICATION

Assume the same facts as in Example 2-2, except the entity applied ASU 2023-09 prospectively. The entity includes the following in its income tax footnote:

($ IN MILLIONS)	2025	2024	2023
U.S. Federal	$ 185		
State:			
State #1	55		
Other	20		
State Subtotal	75		
Foreign:			
Other	5		
Foreign Subtotal	5		
Total Cash Paid for Income Taxes (Net of Refunds)	$ 265		
Total Cash Paid for Income Taxes (Before ASU 2023-09)		$ 333	$ 145

2.1.1 Income Taxes Paid: Alignment with Income Tax Expense and Cash Flow

Stakeholders are using cash payments for income taxes more directly in cash-flow modeling, raising the importance of those taxes beyond compliance disclosures.

Stakeholders commonly ask why income taxes paid diverge from income tax expense, with particular focus on the impact of prior-year true-ups, audit settlements, withholding taxes, intercompany payments, and the use of loss carryovers and other tax attributes. Jurisdictional income taxes paid disclosures are frequently incorporated into near-term liquidity and forecasting models, raising stakeholder expectations regarding consistency and clear explanations.

External stakeholders might incorrectly assume that income taxes paid in a jurisdiction correlate with profitability. Instead, timing differences, withholding taxes, and audit settlements can distort that relationship. For example, an entity that elects to recognize bonus depreciation benefits from lower tax payments early in an asset's life but will face higher tax payments in future years as book depreciation continues with no additional tax deduction available.

2.2 Rate Reconciliation for Public Business Entities

FASB REFERENCES

ASC 740-10-50-1A, ASC 740-10-50-2, ASC 740-10-50-11 through 50-12C, and ASC 740-10-50-14

ASU 2023-09 provides an overall disclosure objective and significantly expands the rate reconciliation disclosure requirements for PBEs. On adoption, PBEs must disclose specified categories within the rate reconciliation for federal, state, and foreign income taxes. The ASU also requires greater detail about individual reconciling items to the extent the impact of those items equals or exceeds a quantitative threshold (5% of the entity's pretax income (loss) from continuing operations multiplied by the applicable federal statutory income tax rate of the jurisdiction of domicile). The ASU prescribes a tabular format, to be disclosed annually, that includes both percentages and dollar amounts for each reconciling item. If any reconciling item meets or exceeds the 5% quantitative threshold in any of the years disclosed, all comparative amounts and percentages must be disclosed for all years presented. Further disaggregation may be required based on the nature of the item and location of the jurisdiction. The specific categories required in the annual rate reconciliation disclosures include:

- State and local income tax, net of federal (national) income tax effect
- Foreign tax effects
- Effects of changes in tax laws or rates enacted in the current period
- Effect of cross-border tax laws
- Tax credits
- Changes in valuation allowances
- Nontaxable or nondeductible items
- Changes in UTBs

Except for the tax effects related to changes in UTBs, all income taxes imposed by states and local jurisdictions are captured in the "State and Local Income Tax" category. Similarly, all income taxes imposed by foreign jurisdictions are captured in the "Foreign Tax Effects" category. For example, the tax effects of a new tax law enacted by a foreign country, a tax credit granted by a foreign country, or state or local taxes in a foreign country must be included in the "Foreign Tax Effects" category. Accordingly, the remaining categories, other than the "Changes in UTB" category, reflect the effect of taxes in an entity's jurisdiction of domicile. When determining how to disaggregate these reconciling items by nature, an entity should consider the reconciling item's fundamental or essential characteristics, such as the event that caused the reconciling item and the activity with which the reconciling item is associated.

An entity generally is required to present all reconciling items on a gross basis, with two exceptions:

- Changes in UTBs
- The related tax effects of some cross-border tax laws net of associated tax credits

EXAMPLE 2-4: CALCULATING THE THRESHOLD PERCENTAGE AND AMOUNT

An entity is domiciled in the U.S. and has pretax income from continuing operations of $3.32 million for the year ended December 31, 20X5.

Disaggregation is required by nature and category for any reconciling item that is at least 5% of the amount computed by multiplying the entity's pretax income (loss) by the applicable statutory income tax rate.

The entity calculates the reconciling item percentage by multiplying the U.S. statutory tax rate of 21% by the disclosure threshold of 5% to arrive at 1.05%. The entity calculates the reconciling item amount by multiplying its pretax income of $3.32 million by 1.05% to arrive at $34,860. Therefore, the entity must separately disclose reconciling items meeting or exceeding 1.05%, or $34,860, of pretax income in its 20X5 rate reconciliation table.

CALCULATING THE QUANTITATIVE THRESHOLD

The quantitative threshold must be applied to both expenses and benefits that affect the effective tax rate. In other words, both positive and negative impacts must be disclosed. For example, if the entity in Example 2-4 has a significant U.S. federal research and development (R&D) credit with a negative impact of 1.7% to the effective tax rate, it must be separately disclosed.

Also, the quantitative threshold is required to be determined for each reporting period based on the statutory tax rate and the pretax income in that period.

2.2.1 State and Local Income Tax, Net of Federal (National) Income Tax Effect

This category includes income taxes imposed at the state or local level, net of federal benefit, in the jurisdiction of domicile and all implications of state taxes (other than UTBs, as explained in Section 2.2.8), including tax credits and valuation allowances. Also, no further disaggregation is required and PBEs must qualitatively disclose the state and local jurisdictions that contribute to the majority (greater than 50%) of the effect of the "State and Local Income Tax" category. A PBE would present that disclosure as, for example:

EXAMPLE 2-5: QUALITATIVE DISCLOSURE OF JURISDICTIONS COMPRISING THE MAJORITY

During the year ended December 31, 2025, state taxes in California, Florida, and Illinois made up the majority of the tax effect in this category. During the year ended December 31, 2024, state taxes in California and Florida made up the majority of the tax effect in this category. During the year ended December 31, 2023, state taxes in California made up the majority of the tax effect in this category.

BDO INSIGHT 2-4: KEY TAKEAWAYS FROM THE FIRST YEAR OF ADOPTION

Requiring only qualitative disclosure of jurisdictions comprising the majority may limit transparency by allowing significant state tax activity to remain undisclosed. Apportionment changes, footprint shifts, nonrecurring items, valuation allowance, and state tax credits may all be embedded in a single line with limited explanation.

A qualitative description conveys where the bulk of state activity is located but might not offer much other useful insight to stakeholders. Some stakeholders might attempt to infer information from the new jurisdictional income taxes paid disclosure, but that disclosure has its own limitations.

With greater disaggregation across the rest of the disclosure in rate reconciliation and income taxes paid, stakeholders are increasingly expecting more specific explanations about effective state tax rate effects including state credits, state valuation allowances and other state tax activity drivers, even when the standard does not explicitly require them.

EXAMPLE 2-6: DETERMINING THE STATE AND LOCAL JURISDICTIONS THAT CONTRIBUTE TO THE MAJORITY OF THE EFFECT OF THE STATE AND LOCAL INCOME TAX CATEGORY

An entity is domiciled in the U.S. and has tax expense in the state and local jurisdictions listed in the table below.

STATE	STATE TAX EXPENSE	PERCENTAGE
Michigan	$ 19	19%
California	18	18%
New York	14	14%
Illinois	12	12%
Alabama	9	9%
South Carolina	8	8%
Missouri	7	7%
Virginia	7	7%
Wisconsin	6	6%
Total	$ 100	100%

The entity must qualitatively disclose that state taxes in Michigan, California and New York made up the majority (greater than 50%) of the tax effect in the “State and Local Income Tax” category.

2.2.2 Foreign Tax Effects

This category includes income taxes imposed by foreign jurisdictions. Also:

- Reconciling items in this category are to be disaggregated by jurisdiction and nature. If a foreign jurisdiction meets the 5% threshold, it must be disclosed as a reconciling item. Irrespective of whether any foreign jurisdiction satisfies the 5% threshold, any individual reconciling item in a foreign jurisdiction meeting the threshold must be disaggregated and disclosed by nature.
- Any nonfederal taxes within a foreign jurisdiction, such as Canada’s provincial taxes and Switzerland’s cantonal taxes, must be disaggregated and separately presented if they meet the quantitative threshold.

BDO INSIGHT 2-5: KEY TAKEAWAYS FROM THE FIRST YEAR OF ADOPTION

The above requirements create just a handful of new line items for some entities while significantly expanding rate reconciliation for others, depending on the geographic profile of their operations.

For multinational entities, the new disclosures could meaningfully expand the size of the rate reconciliation. For example, a company with operations in Ireland, Mexico, Switzerland, and the U.K. might need to disaggregate statutory rate differences, valuation allowance changes, and other reconciling items for each country where those items met the threshold, even if the country's total tax effect did not. The 5% threshold requires entities to exercise judgment because it can translate to a relatively small dollar amount if pretax income is low in any given year.

Looking ahead, if a jurisdiction or line item was separately disclosed in the first filing, companies must continue presenting it in rate reconciliation for subsequent years — even if it falls below the 5% threshold — until it naturally cycles off the three-year comparative window.

Also, during the first year of adoption, we observed diversity in how companies approached foreign tax effect disclosures. Some companies provided detailed country-level disaggregation, while others presented more aggregated disclosures. The level of disaggregation often reflected management's assessment of which information would be most meaningful to financial statement users. See the discussion in BDO Insight 2-11: Materiality and the Rate Reconciliation (Section 2.2.9) for additional considerations regarding the application of materiality to the ASU's disclosure requirements.

2.2.3 Effect of Changes in Tax Laws or Rates Enacted in the Current Period

This category includes the cumulative tax effects of changes in enacted tax laws or rates in a jurisdiction of domicile. No further disaggregation is required.

2.2.4 Effect of Cross-Border Tax Laws

This category includes federal (national) income taxes imposed by jurisdiction (country) of domicile on foreign-earned income.

- Disaggregation is required for reconciling items in this category if the reconciling item meets the 5% threshold.
- When the jurisdiction of domicile taxes cross-border income but also provides a tax credit on that income during the same reporting period, the tax effect of both the cross-border tax and its related tax credit can be presented on a net basis.

BDO INSIGHT 2-6: INCOME (LOSS) FROM A FOREIGN DISREGARDED ENTITY TAXED IN THE JURISDICTION (COUNTRY) OF DOMICILE

Although the ASU provides no specific guidance, we believe the income (loss) from a foreign disregarded entity taxed in the jurisdiction of domicile should be disaggregated if the rate reconciling item meets the 5% quantitative threshold. Any reconciling item related to local taxes should be presented under "Foreign Tax Effects," and any tax implications to the jurisdiction of domicile should be presented in "Cross-Border" taxes.

2.2.5 Tax Credits

This category includes federal (national) income tax credits received in the jurisdiction (country) of domicile. Disaggregation is required for reconciling items in this category that meet the 5% threshold.

2.2.6 Changes in Valuation Allowances

This category includes income tax effects of the initial recognition of valuation allowances, as well as subsequent changes to valuation allowances in the federal (national) jurisdiction (country) of domicile during the reporting period.

BDO INSIGHT 2-7: HIGHLIGHTS FROM THE FIRST YEAR OF ADOPTION

In reviewing the financial statements of first adopters, we found that if applicable, all entities included the “Changes in Valuation Allowances” category. Several entities also included a separate tabular disclosure for change in valuation allowance.

CHANGE IN VALUATION ALLOWANCE DISCLOSURE IS STILL REQUIRED

Although ASU 2023-09 expanded the requirements for valuation allowances in the rate reconciliation, it did not change the requirement to disclose the net change during the year in the total valuation allowance. Entities must still include this disclosure despite the new rate reconciliation format. Example 2-7 demonstrates an example of tabular disclosure that would satisfy this requirement.

EXAMPLE 2-7: CHANGES IN VALUATION ALLOWANCES TABULAR DISCLOSURE

The table below presents the changes in a company’s valuation allowance.

	2025		2024		2023	
Valuation allowance — beginning of period	$	13,500	$	15,000	$	20,000
Charged/(credited) to income tax expense		500		—		—
Other adjustments		(100)		(1,500)		(5,000)
Valuation allowance — end of period	$	13,900	$	13,500	$	15,000

2.2.7 Nontaxable or Nondeductible Items

This category includes tax effects of nontaxable or nondeductible items in the federal (national) jurisdiction (country) of domicile during the reporting period. Disaggregation is required for reconciling items in this category that meet the 5% threshold.

BDO INSIGHT 2-8: NONTAXABLE OR NONDEDUCTIBLE ITEMS

ASC 740 does not define the terms “nontaxable” or “nondeductible,” which could lead to diversity in presentation, especially when some tax effects have multiple characteristics (for example, share-based compensation). The FASB acknowledged that in BC29 of ASU 2023-09:

> *The Board also acknowledges that judgment may be necessary when determining how to categorize certain income tax effects that have characteristics of multiple categories or when assessing the nature of reconciling items for further disaggregation in paragraph 740-10-50-12A(b). In situations in which judgment has been applied, the Board noted that an entity should assess whether the disclosure objective in paragraph 740-10-50-11A is met. An entity also should consider whether an accompanying explanation is needed in accordance with paragraph 740-10-50-12C. For example, an entity may decide to include the tax effects of share-based payment awards (such as nondeductible expenses, shortfalls, and windfalls) in the nontaxable*

or nondeductible items category, although the windfall on a standalone basis might not be viewed as exclusively relating to this category. In that situation, the entity should consider providing an accompanying explanation to describe the types of tax effects of share-based payment awards (including windfalls) that are included in the nontaxable or nondeductible items category.

An entity should apply judgment and apply its approach consistently.

2.2.8 Changes in Unrecognized Tax Benefits

The changes in judgment related to UTBs taken in prior annual reporting periods are disclosed on an aggregated basis for all jurisdictions under “Changes in the UTB” category. No disaggregation is required.

BDO INSIGHT 2-9: CHANGES IN UTBS

Unlike the other categories, “Changes in UTB” allows the presentation of changes for all jurisdictions in the aggregate. While this category includes impacts from positions taken in prior periods, the guidance allows an entity to present UTBs related to current-year positions on a net basis with the related reconciling item. Thus, we expect diversity in practice and presentation.

For example, an entity claims $500 of U.S. federal R&D tax credits in the current annual reporting period, of which $100 of benefit might not be recognized. The entity can present the $500 benefit in the “Tax Credits” category and the related $100 of UTBs in the “Changes in UTBs” category or can present the net $400 benefit in the “Tax Credits” category. Both approaches are permissible, but the effective tax rate could be interpreted differently by an external stakeholder.

In reviewing first adopters, we observed that many companies opted to present all UTB changes on a single line, likely in the interest of simplicity and consistency.

2.2.9 Other Adjustments

If a federal reconciling item of the jurisdiction of domicile does not fall in a specific category but does meet the 5% threshold, it must be disaggregated by its nature and presented as a separate line item in “Other Adjustments.”

BDO INSIGHT 2-10: HIGHLIGHTS FROM THE FIRST YEAR OF ADOPTION

In reviewing the financial statements of first adopters, we found that most entities included reconciling items such as return to provision and other true-ups, excess tax benefits on share-based payments, and deferred taxes for investments in subsidiaries in the “Other Adjustments” category.

Also, we anticipate diversity in presentation related to the category in which return to provision and other true-up adjustments are disclosed. We believe judgment must be applied in determining the category in which to disclose such adjustments. Further, depending on the nature of any adjustments and the specific facts and circumstances, those adjustments might be more useful when presented in the categories to which they relate.

BDO INSIGHT 2-11: MATERIALITY AND THE RATE RECONCILIATION

While the ASU introduces a quantitative threshold for separately disclosing reconciling items, the FASB states in its general principles[2] that GAAP need not be applied to immaterial items. In ASU 2023-09 BC22, the FASB said:

> *The Board observed that the guidance in paragraph 105-10-05-6, which states that the provisions of the Codification need not be applied to immaterial items, is applicable to the amendments in this Update, as it is to all Codification guidance. Therefore, the amendments on the disclosure of reconciling items by specific categories with further disaggregation of reconciling items based on the application of a quantitative threshold do not apply to immaterial items. That is, an entity does not need to separately disclose the required specific categories or reconciling items if they are immaterial, even if the quantitative threshold is met.*

An entity must apply judgment to determine what is and is not material to its financial statements based on all the facts and circumstances.

2.2.10 Stakeholder Reactions and Questions

In response to initial disclosures by PBEs, stakeholders raised questions regarding data quality, classification judgments, and consistency. Stakeholders closely examined the largest reconciling items and the year-over-year movement of those items. They considered whether those items represented structural elements of a company's tax profile — such as jurisdictional mix, permanent incentives, and recurring credits — versus discrete or one-time items, events, audit settlements, releases of valuation allowances, or return-to-provision adjustments. For example, stakeholders are increasingly interpreting foreign rate differential less as a technical adjustment and more as a proxy for geographic-earnings mix and tax strategy. Common lines of inquiry from stakeholders include significant cash tax payments to foreign jurisdictions and whether changes in rate reconciliation are driven by profit-mix shifts into lower-tax jurisdictions versus actual rate changes, incentives, or other tax law changes.

Analysts are increasingly reconstructing a normalized or run-rate effective tax rate using the expanded categories introduced by ASU 2023-09, at times challenging management when the implied normalized rate differs from externally communicated expectations. As a result, reconciling items that were previously aggregated as "Other" are now more likely to attract scrutiny — particularly credits, valuation allowance changes, foreign rate differentials, and permanent items tied to entity or supply-chain structures.

Auditors and audit committees focused on how companies mapped legacy tax accounts, including controls over jurisdiction tagging, withholding identification, uncertain tax positions, and return to provision adjustments, to new required categories, as well as the basis for aggregation versus separate presentation. Auditors often scrutinized any changes in allocation methodologies or classification between periods — particularly reclassification out of "Other" categories — even when the underlying economics had not changed.

SEC STAFF COMMENTS

The SEC's early comments on ASU 2023-09 suggest a focus on transparency and consistency. Registrants should expect scrutiny if management's discussion and analysis (MD&A) includes significant tax rate drivers that are not separately reflected in the rate reconciliation and should be prepared to support materiality judgments when aggregating tax effects within "Other Adjustments." The SEC is also examining tax law change disclosures to ensure investors can understand how those items affect cash taxes, deferred taxes, and the effective tax rate.

For example, if a registrant attributes a change in its effective tax rate in MD&A to a reduction in U.S. cross-border taxes, the rate reconciliation should include a corresponding separately identified reconciling item. Similarly, if the registrant discusses a one-time tax adjustment resulting from a change in tax law as a source of cash-flow benefit,

[2] *Id.*

management should evaluate whether the same matter also affects the effective tax rate disclosure to ensure consistency and transparency across disclosures.

BDO INSIGHT 2-12: CLEAR AND SUPPORTABLE DISCLOSURES

Expanded disclosures provide stakeholders with greater visibility into tax planning strategies and geographic profit allocation, and entities must factor that visibility into how they frame their disclosures. Entities may face greater pressure to demonstrate that disclosures are defensible, consistently applied, and clearly explained. Changes in classification, rather than underlying economics, can alter how those stories read to outside observers.

Accordingly, companies should develop a robust narrative that clearly explains the underlying drivers of the effective tax rate, including but not limited to the impact of permanent book-to-tax differences, nonrecurring tax items, changes in tax laws, and the geographic mix of earnings.

Early coordination among tax, accounting, and finance teams on classification within the rate reconciliation decisions can help entities manage reporting requirements more effectively. Given the expanded disclosure requirements, companies should incorporate footnote preparation earlier in the close process rather than treating it as a final-step activity.

2.3 Rate Reconciliation for Entities Other Than Public Business Entities

FASB REFERENCES

ASC 740-10-50-1A and ASC 740-10-50-13 through 50-14

ASU 2023-09 expands the rate reconciliation disclosure requirements for both PBEs and non-PBEs. The primary distinction for non-PBEs is how they explain the difference between the statutory and effective tax rates. Non-PBEs are exempt from the numerical tabular reconciliation required of PBEs. Instead, non-PBEs must provide a narrative that qualitatively describes the nature and effect of the items below that significantly influence the difference between the statutory and effective tax rates:

- The eight categories of primary reconciling items for PBEs listed in Section 2.2
- Individual jurisdictions that result in a significant difference between the statutory and effective tax rates

The objective is to provide financial statement users with an understanding of the primary drivers of the effective tax rate without the burden of precise quantitative disaggregation.

BDO INSIGHT 2-13: NON-PBE ELECTION TO PRESENT TABULAR RECONCILIATION

The FASB allows non-PBEs to elect a quantitative approach. ASC 740-10-50-1A states that an entity can disclose additional information about its rate reconciliation to assist investors in understanding the entity. Although ASC 740 requires non-PBEs to provide only qualitative disclosures, a non-PBE could elect to report incremental information, such as a tabular reconciliation, similar to that required of a PBE.

If a non-PBE elects to present a quantitative tabular rate reconciliation, we recommend applying the full disclosure framework prescribed for PBEs so that the disclosure is not misleading. That includes disaggregating reconciling items using the eight categories specified by the FASB (see Section 2.2) and complying with the prescribed 5% threshold for further disaggregation by both nature and jurisdiction, subject to materiality.

EXAMPLE 2-8 (ADAPTED FROM ASC 740-10-55-230 AND 740-10-55-232 THROUGH 55-233): NON-PBE DISCLOSURE OF SIGNIFICANT RECONCILING ITEMS

The difference between the Company's effective and statutory tax rates is primarily attributed to tax credits, state taxes, and foreign taxes. More specifically, the foreign tax effects of the Company's operations in Ireland and the U.K., as well as its U.S. federal R&D and energy tax credits decreased the Company's effective tax rate. NCTI (formerly known as GILTI) increased the rate (net of U.S. foreign tax credits or deductions), while the FDDEI (formerly known as FDII) deduction decreased the effective tax rate.

EXAMPLE 2-9: NON-PBE QUALITATIVE DISCLOSURE

The Company's effective tax rate for the year ended December 31, 2026, was 24.3%, which differs from the statutory income tax rate of 21%. That increase in the tax rate is primarily attributable to state taxes; nondeductible goodwill impairment; share-based compensation; UTBs; and foreign taxes, partially offset by tax credits. The Company received federal R&D and energy tax credits, which reduced its effective tax rate, while state taxes in Michigan, New York, and California increased its effective tax rate. Further, the foreign tax effects of the Company's operations in Ireland increased its effective tax rate, while the foreign tax effects of the Company's operations in the U.K. and Switzerland decreased its effective tax rate.

2.4 Unrecognized Tax Benefits

FASB REFERENCES

ASC 740-10-50-15 through 50-15A

ASU 2023-09 retained the requirement for PBEs to annually disclose a tabular rollforward of UTBs from the beginning of the period to the end of the period.

For all entities, the ASU removed the disclosure requirement in ASC 740-50-15(d) related to positions expected to significantly increase or decrease within 12 months of the reporting date and updated the example disclosure in the implementation guidance accordingly. The ASU did not materially change other disclosure requirements for UTBs (see Section 2.2.8).

Example 2-10 illustrates a disclosure related to uncertainty in income taxes as updated by the ASU.

EXAMPLE 2-10 (ADAPTED FROM ASC 740-10-55-217): DISCLOSURES RELATED TO UNCERTAINTY IN INCOME TAXES

The Company or one of its subsidiaries files U.S. federal and state, as well as foreign, income tax returns. With few exceptions, the Company is no longer subject to U.S. federal, state and local or non-U.S. income tax examinations by tax authorities for years before 20X1. In the first quarter of 20X7, the IRS commenced an examination of the Company's U.S. income tax returns for 20X2 through 20X4 that is anticipated to be completed by the end of 20X8. A reconciliation of the beginning and ending amounts of UTBs is shown in the table below (in thousands).

	20X7	20X6	20X5
Balance at January 1	$ 370,000	$ 380,000	$ 415,000
Additions based on tax positions related to the current year	10,000	5,000	10,000
Additions for tax positions of prior years	30,000	10,000	5,000
Reductions for tax positions of prior years	(60,000)	(20,000)	(30,000)
Settlements	(40,000)	(5,000)	(20,000)
Balance at December 31	$ 310,000	$ 370,000	$ 380,000

On December 31, 20X7, 20X6, and 20X5, there are UTBs of, respectively, $60 million, $55 million, and $40 million that, if recognized, would affect the annual effective tax rate.

The Company recognizes interest and penalties accrued related to UTBs in operating expenses. During the years ended December 31, 20X7, 20X6, and 20X5, the Company recognized approximately $10 million, $11 million, and $12 million, respectively, in interest and penalties. The company had approximately $60 million and $50 million of interest and penalties accrued as of December 31, 20X7, and 20X6, respectively.

The table below compares UTB disclosures for PBEs and non-PBEs before and after adopting ASU 2023-09.

BEFORE ASU 2023-09	AFTER ASU 2023-09
All entities (PBEs and non-PBEs) must disclose: ▶ The total amount of interest and penalties recognized in the statement of operations and the statement of financial position. ▶ For positions for which it is reasonably possible that the amount of UTBs will significantly change within 12 months of the reporting date, **all** of the following: • The nature of the uncertainty • The nature of the event that could occur in the next 12 months that would cause the change • An estimate of the range of the reasonably possible changes or a statement that such estimate cannot be determined ▶ A description of tax years that remain subject to examination by major tax jurisdictions.	All entities (PBEs and non-PBEs) must disclose: ▶ The total amount of interest and penalties recognized in the statement of operations and the statement of financial position. ▶ A description of tax years that remain subject to examination by major tax jurisdictions.
A PBE must also disclose: ▶ A tabular rollforward of UTBs for annual periods, including specified information.	A PBE must also disclose: ▶ A tabular rollforward of UTBs for annual periods, including specified information.

2.5 Other Income Statement Disclosures

FASB REFERENCES

ASC 740-10-50-9 through 50-10B

ASU 2023-09 updated the required income statement disclosures relating to income taxes, stipulating that income (loss) from continuing operations before income tax expense (benefit) be disclosed and disaggregated between domestic and foreign sources. The ASU also requires the disclosure of income tax expense (benefit) from continuing operations to be disaggregated by federal, state, and foreign jurisdictions. Income tax expense and taxes paid relating to foreign earnings that are imposed by the entity's jurisdiction of domicile would be included in tax expense and taxes paid for the jurisdiction of domicile. The amendments to ASC 740-10-50-10A and 50-10B are consistent with previous SEC reporting requirements.

BDO INSIGHT 2-14: DISAGGREGATED DISCLOSURES BY NON-PBES

The FASB incorporated into ASC 740 previous SEC requirements to disclose disaggregated information about income (loss) from continuing operations and income tax expense (benefit). While PBEs are already familiar with those disclosure requirements, they are new to non-PBEs. Non-PBEs might need to implement new systems and controls to disaggregate income statement information.

2.6 Interim Reporting

The ASU did not amend interim disclosure requirements. ASC 740 does not require specific interim disclosures, so entities must refer to the principles in ASC 270, *Interim Reporting,* to determine appropriate disclosures for quarterly or other interim periods.

2.7 Eliminated Disclosures

FASB REFERENCES

ASC 740-30-50-2

ASU 2023-09 streamlines some existing requirements for all entities. It eliminated the required disclosure of the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures. Entities still must disclose the types of temporary differences for which deferred tax liabilities have not been recognized under ASC 740-30-50-2(a), (c), and (d).

Also, as noted in Section 2.4, the ASU removed the requirement to disclose information concerning UTBs having a reasonable possibility of significantly increasing or decreasing in the 12 months following the reporting date. That change reduces the forecasting burden on tax departments.

EXAMPLE 2-11: DISCLOSURE OF DEFERRED TAX LIABILITY NOT RECOGNIZED AFTER ADOPTING ASU 2023-09

The crossed-out words are no longer part of required disclosure.

As of December 31, 2025, the Company did not record income taxes on ~~approximately $XXX million of~~ undistributed earnings of some foreign subsidiaries because those earnings were indefinitely reinvested in the operation of those subsidiaries. Determining the unrecognized deferred tax liability on those unremitted earnings is not practicable because of the complexity of the hypothetical calculation and the inherent uncertainty regarding the timing and manner of any potential future repatriation. If such earnings were to be distributed, the Company could be subject to additional U.S. federal and state income taxes, foreign withholding taxes, and other tax consequences.

3. TRANSITION AND EFFECTIVE DATES

FASB REFERENCES

ASC 740-10-65-9

For PBEs and non-PBEs, the requirements of ASU 2023-09 are effective for annual periods beginning after December 15, 2024, and December 15, 2025, respectively. Entities may apply the ASU prospectively or retrospectively and must disclose their selected transition method on initial adoption.

BDO INSIGHT 3-1: TRANSITION APPROACH

Early coordination among tax, accounting, and finance teams on classification within the rate reconciliation decisions can help entities manage reporting requirements more effectively. Given the expanded disclosure requirements, companies should incorporate footnote preparation earlier in the close process rather than treating it as a final-step activity.

Entities must exercise judgment when deciding whether to adopt the ASU 2023-09 disclosure requirements retrospectively or prospectively.

- **Prospective adoption:** Apply the new disclosure rules for the year of adoption, with prior years continuing under the legacy format. This is simpler to execute but limits comparability across periods presented. For entities adopting prospectively, no disaggregation is required for prior years, but they can add qualitative disclosure for comparative purposes.
- **Retrospective adoption:** Restate prior years presented under the new disclosure rules. While this requires more effort, it provides consistency across all periods presented.

Although not required, an entity may elect retrospective adoption to enhance comparability with current-year presentation and understanding of changes in the effective tax rate. However, an entity should consider the extensive data required to recast prior periods presented. An entity electing to adopt retrospectively must implement all aspects of the ASU, such as disclosures of income taxes paid in prior periods, on a fully retrospective basis. An entity adopting prospectively is not required to update prior-period disclosures but may add qualitative disclosure for comparative purposes. The decision whether to apply the new guidance prospectively or retrospectively requires the application of judgment based on all facts and circumstances.

BDO INSIGHT 3-2: SPOTLIGHT ON EMERGING GROWTH COMPANIES

Emerging growth companies (EGCs) may elect to adopt new or revised accounting standards using non-PBE effective dates. In making their disclosure decisions, EGCs that elected to defer adoption of ASU 2023-09 can learn from the experiences of other PBEs.

Tax leaders at EGCs must collaborate with their financial reporting group to weigh whether to adopt retrospective or prospective disclosures, considering the kinds of questions PBEs fielded about their tax stories during the first filing season.

When making that decision, EGCs must also remember that the choices they make in their first filings will establish comparability baselines they will need to maintain in subsequent years.

EXAMPLE 3-1: TRANSITION DISCLOSURE

A PBE adopts ASU 2023-09 for the year ended December 31, 2025, and elects retrospective transition.

The entity includes the following disclosure in its new accounting pronouncements footnote in the annual report:

> *ASU 2023-09: Income Taxes (Topic 740) — Improvements to Income Tax Disclosures*
>
> *The ASU standardizes categories for the effective tax rate reconciliation, requires disaggregation of income taxes paid and additional income tax-related disclosures, and is effective for the Company for annual fiscal periods beginning after December 15, 2024. The Company has adopted ASU 2023-09 for the 2025 calendar year retrospectively. Because the ASU affects disclosures only, the adoption did not affect the Company's Consolidated Statements of Operations or Consolidated Balance Sheets.*

EXAMPLE 3-2: ILLUSTRATION OF DISCLOSURE REQUIREMENTS ON ADOPTION (ADAPTED FROM ASC 740-10-55-231 THROUGH 55-233)

Case A: PBE

> *A PBE discloses specific categories and the reconciling items in its tabular rate reconciliation in accordance with ASC 740-10-50-12A through 50-12B. The entity is domiciled in the U.S. and presents comparative financial statements. For the disclosure of foreign tax effects in accordance with ASC 740-10-50-12A(b)(2), the 5% threshold, computed by multiplying the income (loss) from continuing operations before income taxes by the applicable statutory federal (national) income tax rate of the U.S., is met:*
>
> a. *For Ireland, both at the jurisdiction level and for some individual reconciling items of the same nature within Ireland*
>
> b. *For the U.K., for some individual reconciling items of the same nature within the U.K., but not at the jurisdiction level*
>
> c. *For Switzerland and Mexico, at the jurisdiction level, but not for any individual reconciling items of the same nature within those jurisdictions.*

	YEAR ENDED DECEMBER 31, 20X2		YEAR ENDED DECEMBER 31, 20X1		YEAR ENDED DECEMBER 31, 20X0	
	AMOUNT	PERCENT	AMOUNT	PERCENT	AMOUNT	PERCENT
U.S. federal statutory tax rate	$AA	aa%	$BB	bb%	$CC	cc%
State and local income taxes, net of federal income tax effect (a)	AA	aa	BB	bb	CC	cc
Foreign tax effects						
U.K.						
Statutory tax rate difference between U.K. and U.S.	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Share-based payment awards	AA	aa	BB	bb	CC	cc
R&D tax credits	(AA)	(aa)	(BB)	(bb)	CC	cc
Other	(AA)	(aa)	BB	bb	(CC)	(cc)
Ireland						
Statutory tax rate difference between Ireland and U.S.	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Changes in valuation allowances	(AA)	(aa)	(BB)	(bb)	CC	cc
Enacted changes in tax laws or rates	—	—	BB	bb	—	—
Other	(AA)	(aa)	BB	bb	(CC)	(cc)
Switzerland	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Mexico	AA	aa	BB	bb	CC	cc
Other foreign jurisdictions	(AA)	(aa)	(BB)	(bb)	CC	cc
Effect of changes in tax laws or rates enacted in the current period	—	—	—	—	(CC)	(cc)
Effect of cross-border tax laws						
NCTI	AA	aa	BB	bb	CC	cc
FDDEI	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
BEAT	AA	aa	BB	bb	CC	cc
Other	AA	Aa	—	—	—	—
Tax credits						
R&D tax credits	—	—	(BB)	(bb)	(CC)	(cc)
Energy-related tax credits	(AA)	(aa)	—	—	—	—
Other	—	—	(BB)	(bb)	—	—
Changes in valuation allowances	AA	aa	(BB)	(bb)	(CC)	(cc)
Nontaxable or nondeductible items						
Share-based payment awards	AA	aa	BB	bb	CC	cc
Goodwill impairment	AA	aa	BB	Bb	—	—
Other	AA	aa	(BB)	(bb)	CC	cc
Changes in UTBs	(AA)	(aa)	BB	bb	(CC)	(cc)
Other adjustments	AA	aa	(BB)	(bb)	(CC)	(cc)
Effective tax rate	$AA	aa%	$BB	bb%	$CC	cc%

(a) State taxes in California and New York made up the majority (greater than 50%) of the tax effect in this category.

Case B: Non-PBE

In accordance with ASC 740-10-50-13, a non-PBE discloses significant reconciling items.

The difference between the entity's effective and statutory tax rates is primarily attributed to tax credits, state taxes, and foreign taxes. More specifically, the foreign tax effects of the entity's operations in Ireland decreased its effective tax rate, while the foreign tax effects of its operation in France increased its effective tax rate. The entity received U.S. federal R&D tax credits, which decreased its effective tax rate, while state taxes in California increased its effective tax rate.

4. OPERATIONAL CHALLENGES AND DATA READINESS FOR ENTITIES OTHER THAN PUBLIC BUSINESS ENTITIES

The transition to ASU 2023-09 presents several operational challenges for non-PBEs, including:

Jurisdictional Data Capture	A key implementation challenge relates to the timing and availability of jurisdiction-specific tax information. Obtaining data on income taxes paid on a disaggregated basis across state, local, and foreign jurisdictions can be operationally complex because the underlying information is often not finalized until after the close of the financial reporting period. As a result, entities can face difficulties in compiling complete and accurate jurisdiction-level data within their reporting timelines.
Resource and Systems Considerations	The expanded disclosure requirements, including disaggregated disclosures of income taxes paid and enhanced qualitative disclosures, might necessitate more robust data collection, aggregation, and control processes. Many non-PBEs rely on manual processes and spreadsheet-based solutions rather than dedicated tax provision systems. Consequently, compiling tax payment information across multiple jurisdictions and identifying significant rate-reconciling items might be more complex and could increase the risk of errors, omissions, or inconsistencies in the reported information.
Stakeholder Communication	The increased emphasis on qualitative disclosures could require entities to provide more comprehensive explanations of the factors driving their effective tax rate and other significant tax-related matters. Entities must develop disclosures that are both clear and helpful in decision making, while avoiding unnecessary complexity. Because qualitative disclosures are inherently more judgmental than standardized quantitative information, entities should consider how such disclosures might be interpreted by lenders, investors, and other financial statement users.

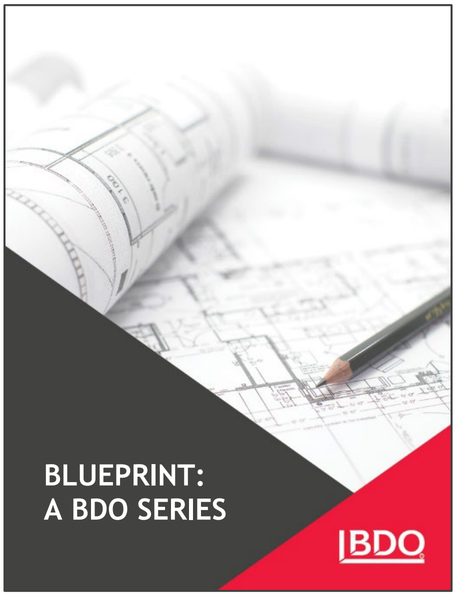
BDO INSIGHT 4-1: NON-PBE STRATEGIC PREPARATION AND DOCUMENTATION

To support effective implementation of ASU 2023-09, we believe non-PBEs could consider adopting various strategies. For example:

- Perform a targeted gap analysis: Review tax reporting processes and systems to determine whether there are jurisdictions that meet the 5% income tax payment threshold, as well as to capture the information necessary to support robust qualitative disclosures of significant rate-reconciling items. This assessment should also consider the completeness and reliability of underlying data sources.
- Establish supporting reconciliations: Even if the standard allows qualitative disclosure in lieu of a quantitative tabular format, an entity could maintain internal quantitative analyses of the effective tax rate reconciliation. These internal schedules can serve as support for management's determination of which items are considered significant and provide audit-ready documentation. Early development of such analyses can facilitate a more controlled and efficient transition process.
- Develop a consistent narrative framework: While qualitative disclosures provide flexibility, establishing a consistent and structured approach is important. Align disclosures with the eight prescribed categories (see Section 2.2), ensuring that significant drivers of the effective tax rate are clearly communicated in a manner that is both decision-useful and comparable across reporting periods.
- Enhance jurisdiction-level data capture: Evaluate whether updates to the chart of accounts, tax reporting templates, or data tagging protocols are needed to enable the real-time tracking of income tax payments by jurisdiction.

- Leverage process automation where feasible: To the extent practical, consider using technology solutions to assist with the disaggregation of effective tax rate components and the aggregation of jurisdictional data for income tax payments and refunds. Increased automation can enhance accuracy, improve consistency, and reduce the operational burden associated with transitioning from raw data to finalized disclosures.
- Partner with the outside advisor: Assess how outside advisors can help fill gaps in capabilities. In evaluating potential partners, seek advisors that can provide ready-made models and technology built specifically to handle the new disclosures, particularly if that infrastructure has not been built internally.

Appendix A: Other BDO Publications



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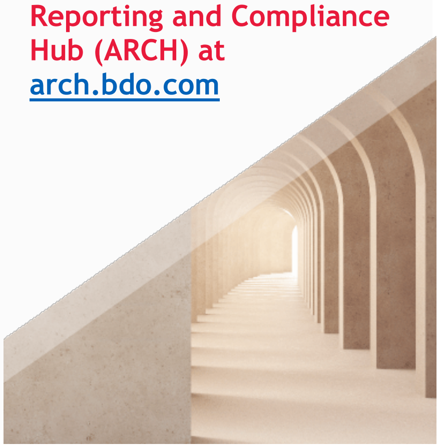

BDO's Professional Practice — Accounting Group has issued the following Blueprints, which provide detailed accounting guidance, interpretive insights, and practical examples on complex areas of U.S. GAAP:

- Accounting for Software Costs
- Statement of Cash Flows Under ASC 230
- Segment Reporting Under ASC 280
- Equity Method Investments Under ASC 323
- Revenue Recognition Under ASC 606
- Share-based Payments Under ASC 718
- Business Combinations Under ASC 805
- Control and Consolidation Under ASC 810
- Accounting for Leases Under ASC 842
- Issuer's Accounting for Complex Financial Instruments

BDO's Professional Practice — SEC Services Group has issued the following Blueprints to help SEC registrants apply the SEC's rules and regulations related to financial reporting:

- Guide to Going Public

Series Overview: Building Knowledge

In addition to Blueprints, BDO's Professional Practice has issued a suite of publications related to U.S. GAAP and SEC rules and regulations:

- Bulletins: short, timely communications delivering essential news, alerts, and developments in accounting and SEC reporting
- Snapshots: summaries of SEC rules and regulations
- SEC Reporting Insights, updated annually
- Conference Highlights: Current SEC & PCAOB Developments, updated annually
- Effective Date Reminders, updated annually
- Industry Supplements
- Other publications on new accounting standards and SEC rules and regulations.

For more on IFRS, visit BDO's IFRS and Corporate Reporting for more information.

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