



Capital Standards

FIL-16-95
February 17, 1995

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: *Final Rule Placing Regulatory Capital Limit on Deferred Tax Assets*

The Board of Directors of the FDIC has amended its capital standards to establish a limit on the amount of deferred tax assets an FDIC-supervised bank may include in Tier 1 capital for risk-based and leverage capital purposes. A copy of the Federal Register notice explaining this capital limitation is attached.

Deferred tax assets are assets that reflect, for financial reporting purposes, amounts that will be realized as reductions of future taxes or as future receivables from a taxing authority. These assets represent the deferred tax consequences attributable to two items: (1) deductible temporary differences, which are items reported differently for tax and financial statement purposes that result in deductible amounts in future periods for tax purposes; and (2) carryforwards, which are deductions or credits that cannot be used for tax purposes during a year but that can be carried forward to reduce taxable income or taxes payable in future periods.

Under the final rule, deferred tax assets that can only be realized if a bank earns sufficient taxable income in the future will be limited for regulatory capital purposes. However, deferred tax assets that can be realized through carrybacks to taxes paid on income earned in prior periods and from the reversal of existing taxable temporary differences generally will not be limited.

For deferred tax assets that depend on future taxable income, the limit is the lesser of the amount that the bank is expected to realize within one year of the most recent calendar quarter-end date, based on the institution's projection of taxable income for that year, or ten percent of Tier 1 capital. Deferred tax assets in excess of this limit will be deducted from a bank's Tier 1 capital and from its assets when calculating the risk-based and leverage capital ratios. The effective date for this final rule is April 1, 1995.

The regulatory capital limit for deferred tax assets was developed by the federal banking regulators in response to Financial Accounting Standards Board Statement No. 109, "Accounting for Income Taxes." This accounting standard generally allows institutions to report higher amounts of deferred tax assets than permitted under previous generally accepted accounting principles (GAAP) and prior regulatory reporting policies.

Because of supervisory concerns about the realizability of deferred tax assets that depend on future taxable income, the banking agencies considered how deferred tax assets should be treated for regulatory reporting and capital purposes. The regulators worked under the auspices of the Federal Financial Institutions Examination Council (FFIEC). The FFIEC decided in December 1992 that banks and savings associations should report deferred taxes in their regulatory reports in accordance with Statement No. 109. At the same time, however, the FFIEC also recommended that the banking agencies amend their regulatory capital standards to limit the amount of deferred tax assets that depend on future taxable income that can be included in regulatory capital.

In response, the FDIC issued a proposed rule in May 1993 to place a regulatory capital limit on deferred tax assets. The FDIC's final rule retains the proposed limit, but certain technical aspects have been modified or clarified in order to lessen the regulatory burden. This final rule is consistent with a November 1994 recommendation by the FFIEC's Task Force on Supervision.

The capital limitation is intended to balance the FDIC's concerns about deferred tax assets that depend on future taxable income against the fact that such assets will, in many cases, be realized. The limitation

also ensures that FDIC-supervised banks do not place excessive reliance on deferred tax assets to satisfy the minimum capital standards.

Banks should continue to report deferred taxes on the balance sheet and income statement of the Reports of Condition and Income (Call Report) in accordance with Statement No. 109 and the applicable Call Report instructions. If a bank's deferred tax assets exceed the regulatory capital limit, the excess amount should be separately disclosed in a memorandum item in the Call Report's Schedule RC-F--Other Assets.

For further information, please contact Robert F. Storch, Accounting Section Chief in the FDIC's Division of Supervision (202-898-8906).

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Director

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