

these calculations should not pose any problems, provided they are done on a consolidated basis. One other commenter, who did not appear to oppose the concept of income projections, nevertheless reported that requiring banks to project their taxable income for the next year at the end of each interim quarter presents a potentially difficult burden to smaller banks.

In addition, one commenter who did not directly address the burden of income projections recommended that the FDIC clarify the term "expected to be realized within one year." This commenter suggested that the term should mean the amount of deferred tax assets that could be absorbed by the expected amount of income taxes that would result from an institution's projected future taxable income for the next 12 months, and not the amount of deferred tax assets that actually will be used.

In contrast, three commenters specifically opposed an income approach, preferring that a limit be determined by other means. These commenters opposed the income approach because they believe that projecting future earnings involves either too much subjectivity or complexity. Instead, the three commenters expressed a preference for setting the regulatory capital limit for deferred tax assets solely as a percentage of capital. Two of these commenters suggested that the deferred tax asset limit should be a function of an institution's capital level for prompt corrective action purposes, with the highest limit for "well capitalized" banks. The other commenter recommended that the FDIC adopt percentage of capital limits consistent with those applicable to purchased mortgage servicing rights and purchased credit card receivables. On the other hand, one commenter specifically opposed the establishment of a capital limitation based upon the perceived "health" of an institution, stating that this method could lead to arbitrary and inconsistent measures of capital adequacy.

Question (3)(b): Seven commenters expressed opinions concerning the separate entity method. The FDIC's proposal stated that the capital limit for deferred tax assets would be determined on a separate entity basis for each insured state nonmember bank. Under this method, a bank (together with its consolidated subsidiaries) that is a subsidiary of a holding company is treated as a separate taxpayer rather than as part of a consolidated group.

All of these commenters opposed the separate entity approach, although one commenter appeared to support this approach for banks that do not have a "strong" holding company. Commenters argued that the separate entity approach is artificial and that tax-sharing agreements between financially capable bank holding companies and bank subsidiaries should be considered when evaluating the recognition of deferred tax assets for regulatory capital purposes. Commenters also stated that the separate entity method is unnecessarily restrictive and is contrary to bank tax management practices. It was suggested that any systematic and rational method that is in accordance with GAAP should be permitted for the calculation of the limitation for each bank.

One commenter's opposition to the separate entity approach was based on the view that the limitation is not consistent with the Federal Reserve Board's 1987 "Policy Statement on the Responsibility of Bank Holding Companies to Act as Sources of Strength to Their Subsidiary Banks" and the FDIC's 1990 "Statement of Policy Regarding Liability of Commonly Controlled Depository Institutions," which, in some respects, treat a controlled group as one entity. Another commenter contended that the effect of a separate entity calculation would be to reduce bank capital which is needed for future lending, an outcome that would be inconsistent with the objectives of the March 10, 1993, "Interagency Policy Statement on Credit Availability." This same commenter as well as one other further noted that the required use of the separate entity method creates significant regulatory burden and adds to the cost and complexity of calculating deferred tax assets for both bankers and regulators.

Question (4): The FDIC's fourth question requested comment on the appropriateness of the provisions of the proposal that would (a) consider tax planning strategies as part of an institution's projections of taxable income for the next year and (b) assume that all temporary differences fully reverse at the report date.

Question (4)(a): The FDIC's proposal stated that the effect of tax planning strategies that are expected to be implemented to realize tax carryforwards that will otherwise expire during the next year should be included in taxable income projections. Five commenters addressed this issue. All of these commenters expressed support for including tax planning strategies in an institution's projection of taxable income. However, one commenter went

on to state that the proposal should be modified to permit institutions to consider strategies that would ensure realization of deferred tax assets within the one-year time frame.

Question (4)(b): Six commenters specifically addressed the full reversal of temporary differences assumption and all but one agreed that this assumption is appropriate. One commenter observed that this assumption would eliminate the burden of scheduling the "turnaround" of temporary differences. In contrast, one commenter felt that this assumption was not realistic.

Question (5): The FDIC's final question asked whether the definition for the term "deferred tax assets that are dependent upon future taxable income" should appear in the rule, as proposed, or in the Call Report instructions. The only commenter who responded to this question indicated that the Call Report instructions should reference definitions in the tax rules and FASB 109.

IV. Final Rule

Limitation on Deferred Tax Assets

After considering the comments received on the proposed rule and consulting with the other federal banking agencies, the FDIC is limiting the amount of deferred tax assets that are dependent on future taxable income that can be included in Tier 1 capital for risk-based and leverage capital purposes. The limitation is consistent with both the FDIC's proposal and the recommendation of the FFIEC's Task Force on Supervision to the agencies as announced by the FFIEC on November 18, 1994. Under the final rule, for regulatory capital purposes, deferred tax assets that are dependent upon future taxable income are limited to the lesser of:

- (1) the amount of such deferred tax assets that the institution expects to realize within one year of the quarter-end report date, based on its projection of future taxable income (exclusive of tax carryforwards and reversals of existing temporary differences), or
- (2) ten percent of Tier 1 capital before deducting any disallowed purchased mortgage servicing rights, any disallowed purchased credit card relationships, and any disallowed deferred tax assets.

Deferred tax assets that can be realized from taxes paid in prior carryback years and from the reversal of existing taxable temporary differences generally are not limited under the final rule. The reported amount of deferred tax assets, net of its valuation