

be determined on a separate entity basis by each bank that was a subsidiary of a holding company. The use of a separate entity approach for income tax sharing agreements (including intercompany tax payments and current and deferred taxes) is generally required by the FDIC's 1978 Statement of Policy on Income Tax Remittance by Banks to Holding Company Affiliates, and similar policies are followed by the other federal banking agencies. Thus, any change to the separate entity approach for deferred tax assets would also need to consider changes to this policy statement, which is outside the scope of this rulemaking. The FDIC also notes that income tax data in bank regulatory reports generally are required to be prepared using a separate entity approach and consistency between these reports would be reduced if institutions were permitted to use other methods for calculating deferred tax assets in addition to a separate entity approach. Thus, while a number of the commenters suggested that the FDIC consider permitting other approaches, the FDIC has decided that the final rule should retain the separate entity approach.

The final rule departs from the separate entity approach in one situation. This situation arises when a bank's parent holding company, if any, does not have the financial capability to reimburse the bank for tax benefits derived from the bank's carryback of net operating losses or tax credits. If this occurs, the amount of carryback potential the bank may consider in calculating the amount of deferred tax assets that may be included in Tier 1 capital may not exceed the amount which the bank could reasonably expect to have refunded by its parent. This provision of the final rule is consistent with the proposed rule.

**Gross-up of Intangibles:** As noted above, the manner in which FASB 109 must be applied when accounting for purchase business combinations can lead to a large increase (i.e., "gross-up") in the reported amount of certain intangible assets, such as core deposit intangibles, which are deducted for purposes of computing regulatory capital. Commenters stated that the increased carrying value of such an intangible posed no risk to an institution, because a reduction in the value of the asset would effectively extinguish the related deferred tax liability. The FDIC agrees with these commenters and, consequently, will permit, for capital adequacy purposes, the netting of deferred tax liabilities arising from this gross-up effect against related intangible assets. This will result

in the same treatment for intangibles acquired in purchase business combinations as under the accounting standards in effect prior to FASB 109. However, a deferred tax liability netted in this manner may not also be netted against deferred tax assets when determining the amount of deferred tax assets that are dependent upon future taxable income. Netting will not be permitted against purchased mortgage servicing rights and purchased credit card relationships, since these intangible assets are deducted for capital adequacy purposes only if they exceed specified capital limits.

**Leveraged Leases:** While not expected to significantly affect many banks, one commenter stated that future net tax liabilities related to leveraged leases acquired in a purchase business combination are included in the value assigned to the leveraged leases and are not shown on the balance sheet as part of an institution's deferred taxes. This artificially increases the amount of deferred tax assets for those institutions that acquire leveraged leases. Thus, this commenter continued, the future taxes payable included in the valuation of a leveraged lease portfolio in a purchase business combination should be treated as a taxable temporary difference whose reversal would support the recognition of deferred tax assets, if applicable. The FDIC agrees with this commenter and, therefore, banks may use the deferred tax liabilities that are embedded in the carrying value of a leveraged lease to reduce the amount of deferred tax assets subject to the capital limit.

#### V. Regulatory Flexibility Act Analysis

The FDIC does not believe that the adoption of this final rule will have a significant economic impact on a substantial number of small business entities (in this case, small banks), in accordance with the spirit and purposes of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). In this regard, the vast majority of small banks currently have very limited amounts of net deferred tax assets, which are the subject of this proposal, as a component of their capital structures. Furthermore, adoption of this final rule, in combination with the adoption of FASB 109 for regulatory reporting purposes, will allow many banks to increase the amount of deferred tax assets they include in regulatory capital.

#### VI. Paperwork Reduction Act

The FDIC has previously received approval from the Office of Management and Budget (OMB) to collect in the Reports of Condition and Income (Call Reports) information on the amount of

deferred tax assets disallowed for regulatory capital purposes. (OMB Control Number 3064-0052.) Therefore, this final rule will not increase banks' existing regulatory paperwork burden.

#### List of Subjects in 12 CFR Part 325

Bank deposit insurance, Banks, banking, Capital adequacy, Reporting and recordkeeping requirements, Savings associations, State nonmember banks.

For the reasons set forth in the preamble, the Board of Directors of the Federal Deposit Insurance Corporation hereby amends part 325 of title 12 of the Code of Federal Regulations as follows:

#### PART 325—CAPITAL MAINTENANCE

1. The authority citation for Part 325 continues to read as follows:

**Authority:** 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(m), 1828(o), 1831o, 3907, 3909; Pub. L. 102-233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102-242, 105 Stat. 2236, 2355, 2386 (12 U.S.C. 1828 note).

#### § 325.2 [Amended]

2. Section 325.2 is amended in paragraphs (t) and (v) by adding "minus deferred tax assets in excess of the limit set forth in § 325.5(g)," after "12 CFR part 567),".

3. Section 325.5 is amended:

a. In paragraphs (f)(3)(i) and (f)(4)(i), by removing the word "and", by adding a comma after "rights", and by adding "and any disallowed deferred tax assets" after "relationships"; and

b. By adding a new paragraph (g) to read as follows:

#### § 325.5 Miscellaneous.

\* \* \* \* \*

(g) *Treatment of deferred tax assets.*

For purposes of calculating Tier 1 capital under this part (but not for financial statement purposes), deferred tax assets are subject to the conditions, limitations, and restrictions described in this section.

(1) *Deferred tax assets that are dependent upon future taxable income.* These assets are:

(i) Deferred tax assets arising from deductible temporary differences that exceed the amount of taxes previously paid that could be recovered through loss carrybacks if existing temporary differences (both deductible and taxable and regardless of where the related deferred tax effects are reported on the balance sheet) fully reverse at the calendar quarter-end date; and

(ii) Deferred tax assets arising from operating loss and tax credit carryforwards.