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Transmittal - See OCC 2015-38

OCC BULLETIN 1995-10

**Subject: Regulatory Capital Treatment for
Deferred Tax Assets**
Date: February 15, 1995

**To: Chief Executive Officers of National Banks,
Department and Division Heads, Examining
Personnel and Other Interested Parties**

Description: Final Rule

Purpose

This bulletin announces the Office of the Comptroller of the Currency's (OCC) final rule on the regulatory capital treatment for deferred tax assets. The OCC, in consultation with the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC), decided to adopt its proposal to limit the amount of deferred tax assets dependent upon future taxable income that may be included in regulatory capital. The final rule has been in effect on an interim basis since March 1993. It includes several modifications requested by commenters to reduce the regulatory burden of implementation.

Background

In February 1992, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (FAS 109). The OCC and the other federal banking agencies adopted FAS 109 for regulatory reporting effective January 1, 1993.

FAS 109 allows a bank to record higher amounts of deferred tax assets than they could under previous accounting policy. Specifically, a bank may record deferred tax assets that will only be realized if the bank earns sufficient taxable income in future periods. After analyzing the accounting rule, the OCC concluded that the new standard would allow a bank to rely excessively on deferred tax assets to meet regulatory capital requirements.

To address this concern, on December 23, 1993, the OCC published a notice of proposed rulemaking in the Federal Register to explicitly limit the amount of deferred tax assets dependent upon future taxable income that a bank could include in regulatory capital (58 Federal Register 68065).

SUMMARY

After carefully reviewing the comments and considering the arguments supporting and opposing the limit on deferred tax assets, the OCC decided to adopt its proposed rule with minor changes effective April 1, 1995. Accordingly, the amount of deferred tax assets dependent upon future taxable income that a bank may include in its regulatory capital is limited to the lesser of:

1. The amount of deferred tax assets 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 for that year), or
2. Ten percent of Tier 1 capital, net of goodwill and all identifiable intangible assets other than purchased mortgage servicing rights and purchased credit card relationships, and before any disallowed deferred tax assets are deducted.

Banks should follow the accounting guidance provided in this final rule and in the call report instructions when calculating the deferred tax regulatory capital limit. The amount of disallowed deferred tax assets should be deducted from both total assets and from risk-weighted assets in determining a bank's leverage

and risk-based capital ratios. Except as otherwise noted, banks should follow FAS 109 for calculating and reporting their deferred tax assets.

For further information, contact the Chief National Bank Examiner's Office (202) 649-6370.

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Related Links

- [Final Rule 60 fr 7903](#)

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[Federal Register: February 10, 1995 (Volume 60, Number 28)]
[Rules and Regulations]
[Page 7903-7908]
From the Federal Register Online via GPO Access [wais.access.gpo.gov]
[DOCID:fr10fe95-3]

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DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Part 3

[Docket No. 95-02]
RIN 1557-AB14

Capital Adequacy: Deferred Tax Assets

AGENCIES: Office of the Comptroller of the Currency, Treasury.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency (OCC) is amending its capital adequacy rules with respect to deferred tax assets. This final rule limits the amount of certain deferred tax assets that a bank may include in Tier 1 capital for risk-based capital and leverage capital purposes.

The OCC, in consultation with the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Thrift Supervision (OTS) (banking agencies), developed this final rule in response to the Financial Accounting Standards Board's (FASB) issuance of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (FAS 109), in February 1992. The banking agencies adopted the provisions of FAS 109 for reporting in quarterly Consolidated Reports of Condition and Income (Call Reports) beginning January 1, 1993. This reporting change increased the amount of net deferred tax assets that a bank may record on its balance sheet. This final rule will ensure that national banks do not place excessive reliance on deferred tax assets to satisfy the minimum capital adequacy requirements.

EFFECTIVE DATE: April 1, 1995.

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SUPPLEMENTARY INFORMATION:

Background

In February 1992, the FASB issued FAS 109. FAS 109 provides guidance on how to account for income taxes, including deferred tax assets, and was effective for fiscal years beginning on or after December 15, 1992. FAS 109 generally allows a bank to report certain deferred tax assets it could not previously recognize, which has the effect of increasing bank capital levels. Consequently, the OCC and the other banking agencies were concerned about the impact of the change on the financial institutions they regulate, especially regarding their reported capital levels.

FAS 109--Deferred tax assets are assets that reflect, for financial reporting purposes, the benefits of certain aspects of tax laws and rules. Under FAS 109, a bank reports deferred tax assets that arise from: (1) Tax carryforwards, and (2) deductible temporary differences. Tax carryforwards are deductions or credits that a bank cannot use for current tax purposes, but may carry forward to reduce taxable income or income taxes payable in a future period [[Page 7904]] or periods. For example, when a bank's tax deductions exceed its tax revenues, the result is a net operating loss. Such losses may be used to recover taxes paid in prior years (the carryback period) or may be carried forward to reduce a bank's taxable income in a future period. The situation is similar for some tax credits that a bank cannot use in the current tax period. The bank will realize the benefit of deferred tax assets arising from tax carryforwards if it generates sufficient taxable income in the permissible carryforward period.

Temporary differences arise when a bank records financial events or transactions in one period on the bank's books and recognizes them in another period, or periods, on its tax return. There are two types of temporary differences--deductible and taxable. Deductible temporary differences reduce a bank's future taxable income. When a bank records an addition to its allowance for loan and lease losses, it records that amount as an expense on its books. However, the bank may be unable to take the tax deductions for such losses until it charges off the loans and realizes the losses. The chargeoffs typically occur in subsequent periods. Thus, a bank creates a deferred tax asset when it adds an amount to the allowance on the books, but charges it off in a future period.

Taxable temporary differences produce additional taxable income in future periods. For example, a bank may depreciate its bank building using an accelerated depreciation method on its tax return but may use a straight-line method when recording depreciation on its books. As a result, the bank's tax depreciation will be less than its book depreciation in certain future periods. This taxable temporary difference will cause the bank to have higher taxable income in those future periods.

A bank may only realize deferred tax assets arising from deductible temporary differences by: (1) Recovering taxes paid in prior years, (2) offsetting taxable temporary differences, or (3) earning sufficient future taxable income. Consequently, if deferred tax assets arise from deductible temporary differences and exceed the amount of recoverable taxes paid in prior years plus offsetting taxable temporary differences, the bank will only realize such deferred tax assets if it generates sufficient taxable income in the carryforward period.

Hereafter, these deferred tax assets, and deferred tax assets arising from tax carryforwards, will be called ``deferred tax assets that are dependent upon future taxable income.''

FAS 109 allows a bank to record deferred tax assets that are dependent upon future taxable income. However, the bank must establish a reserve to adjust the recorded deferred tax asset to the amount that it is more likely than not (i.e., likelihood of more than 50 percent) to realize. A bank assesses the probability of realization based on its prospects of earning taxable income in the future. The statutory carryforward period of 15 years provides a limit on the amount of the assessment.

Supervisory Concerns Regarding Deferred Tax Assets

Before adoption of FAS 109, regulatory policy generally limited the recognition of net deferred tax assets to the bank's potential tax carryback amount. In other words, a bank could only record an asset to the extent it potentially could file for a tax refund if all book and tax timing differences reversed at the report date.

Because FAS 109 allows a bank to record a greater amount of deferred tax assets than under previous policy, the OCC and the other banking agencies were concerned about the effect of the accounting standard on bank capital adequacy. Specifically, the OCC was concerned that FAS 109 would allow banks to include excessive amounts of deferred tax assets that are dependent upon future taxable income as part of regulatory capital.

Whether a bank can realize such assets depends on whether it generates enough taxable income during the carryforward period. As new products evolve and market conditions change, a bank's current financial condition and outlook for future income can change rapidly. Such changes make predicting future taxable income more difficult. For many banks, including sound and well-managed banks, the judgment about the likelihood that the bank will realize deferred tax assets that are dependent upon future taxable income is highly subjective. Inaccurate estimates could cause a bank to overstate its deferred tax assets and its capital position. Therefore, allowing banks to recognize significant amounts of assets based on subjective estimates could pose a risk to the deposit insurance funds.

Additionally, the OCC is concerned about the effect of these changes on a bank that is experiencing financial difficulty. Such banks often have net operating loss carryforwards. As a result, these troubled institutions potentially could record deferred tax assets under FAS 109, even though their realistic prospects for generating sufficient future taxable income are uncertain. As a troubled bank's condition deteriorates, it is less likely to realize the financial benefit of deferred tax assets that are dependent upon future taxable income. In such instances, FAS 109 generally requires the bank to reduce its recorded net deferred tax asset by increasing the asset's valuation allowance. The result is a charge to earnings that will reduce the bank's regulatory capital at precisely the time it needs capital the most.

To address these concerns, on August 3, 1992, under the auspices of the Federal Financial Institutions Examination Council (FFIEC), the OCC, along with the other banking agencies requested public comment (57 FR 34135) on alternative approaches for the regulatory capital and reporting treatment of deferred tax assets. Based on the comments received, the FFIEC agreed to adopt FAS 109 for regulatory reporting

effective January 1, 1993.

After discussing the comments and suggestions received, the OCC and the other banking agencies remained concerned about the impact of deferred tax assets that are dependent upon future taxable income on regulatory capital. The OCC believes that many financially sound banks will have net deferred tax assets arising from deductible temporary differences that exceed their taxable temporary differences and the bank's carryback potential. Since many of these deferred tax assets will be realized, the OCC agreed that banks should recognize some amount of these assets in regulatory capital. The OCC and the other banking agencies concluded they could adequately address their supervisory concerns by placing a limit on the amount of such assets that a bank could include in regulatory capital. This approach maintained consistency between generally accepted accounting principles (GAAP) and regulatory reporting.

Proposed Rule--In December 1993, the OCC issued a proposed rule to amend its capital adequacy rules with respect to deferred tax assets (58 FR 68065, December 23, 1993). The FRB (58 FR 8007, February 11, 1993), and the FDIC (58 FR 26701, May 5, 1993) published similar proposed rules.

The OCC proposed to limit the amount of deferred tax assets that are dependent upon future taxable income that a bank may include in regulatory capital to the lesser of:

(1) The amount of deferred tax assets expected to be realized within one year of the quarter-end report date, based on a bank's projection of future taxable income (exclusive of tax carryforwards and reversals of existing temporary differences) for that year, including the effect of tax-planning strategies [[Page 7905]] expected to be implemented during that year, or

(2) 10 percent of Tier 1 capital net of goodwill and other disallowed intangible assets.

Banks have been calculating and reporting the amount of ``Deferred tax assets disallowed for regulatory capital purposes'' in the Call Reports since March 31, 1993.

Comments Received on the Proposed Rule--The comment period for the OCC's proposed rule closed on January 24, 1994. The OCC received a total of 17 comments on the proposed rule. The commenters consisted of 13 banks, three trade groups, and one public accounting firm.

All but one commenter expressed opposition to some portion or all of the proposed rule. Eleven of the commenters indicated that a limit on the amount of deferred tax assets included in regulatory capital was unnecessary. However, six commenters agreed that some form of limit on deferred tax assets was appropriate.

The primary concern of the commenters is that the adoption of a deferred tax limit could increase regulatory burden because regulatory capital policy would be more restrictive than GAAP. Several commenters indicated that no limit on deferred tax assets is necessary because FAS 109 only permits the reporting of deferred tax assets that have a better than 50% probability of being realized. Other commenters indicated that the proposed one year limit was too restrictive because there is a 15-year carryforward period in which a bank could realize the deferred tax assets.

After carefully considering the comments, the OCC believes that a limit on deferred tax assets is necessary. Estimates of future taxable income are very subjective. If a bank does not realize these estimates, the bank insurance fund is exposed to losses because bank capital would be overstated. Moreover, unlike certain types of intangible assets that

a bank can include in regulatory capital at a higher allowable percentage, a bank cannot sell deferred tax assets.

The GAAP standard allows a bank to record deferred tax assets that they may not realize for up to 15 years. The OCC believes that allowing deferred tax assets to constitute a significant portion of a bank's capital is inappropriate, since deferred tax assets may have only a slightly better than 50% possibility of realization. Furthermore, other than the likelihood of realization, there is no specific limit under GAAP on the amount of deferred tax assets that a bank can record. Without a limit on deferred tax assets, a bank could include significant amounts of deferred tax assets in capital.

In addition, the OCC believes that GAAP should guide rather than establish regulatory capital policy. When formulating GAAP, the accounting policy makers do not consider the safety and soundness objectives of the capital standards applicable to banks. Therefore, differences between the GAAP and regulatory capital definitions are justified.

Final Rule

The OCC believes that since banks can only realize deferred tax assets that are dependent upon future taxable income when they achieve positive taxable earnings, a limit based on estimated future earnings is rational. In general, a bank's projections up to 12 months into the future are reliable. However, the OCC believes the reliability of such projections decreases significantly for periods further in the future. Therefore, having a one year cutoff reduces the risk of a bank misstating its deferred tax assets because its estimate of future income is inaccurate. Furthermore, the one year cutoff increases the likelihood of a bank achieving the earnings required to realize the recorded deferred tax asset.

The OCC believes that this final rule will ensure that such deferred tax assets do not make up an unduly large portion of a bank's regulatory capital base. The upper limit of 10 percent of Tier 1 capital provides a ``backstop'' that addresses this concern. This requirement also reduces the risk that an overly optimistic estimate of future taxable income will cause the bank to significantly misstate the deferred tax asset.

The OCC believes that the combination of the one year future income approach and the 10% of Tier 1 capital approach will provide an effective and efficient limit on deferred tax assets. Consequently, under the final rule, the amount of deferred tax assets that are dependent upon future taxable income that a bank may include in its regulatory capital is limited to the lesser of:

- (1) The amount of deferred tax assets 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 reversal of existing temporary differences for that year), or
- (2) 10 percent of Tier 1 capital, net of goodwill and all identifiable intangible assets other than purchased mortgage servicing rights and purchased credit card relationships, and before any disallowed deferred tax assets are deducted.

Banks should note that under this final rule there is no limit on deferred tax assets that a bank can realize from taxes paid in prior carryback years and from reversals of existing taxable temporary differences. In addition, to determine the limit on deferred tax assets, a bank should assume that all temporary differences fully

reverse as of the report date. Also, estimates of future taxable income should include the effect of tax planning strategies the bank is planning to implement within one year of the quarter-end report date to realize net operating loss or tax credit carryforwards that will otherwise expire during the year. With respect to the Call Reports, banks will continue to report deferred tax assets according to GAAP.

The OCC believes that the limit on deferred tax assets will pose little or no additional burden on banks. Banks already follow FAS 109 for Call Report purposes and already are making projections of taxable income. Additionally, the OCC has revised the 10 percent Tier 1 capital calculation to be more straightforward and less burdensome. Under the proposed rule, the 10 percent of Tier 1 capital calculation is based on Tier 1 capital net of goodwill and other disallowed intangible assets. As proposed, the 10 percent of Tier 1 capital calculation would have required banks to first determine the amount of disallowed intangible assets. After consideration of this matter, the OCC believes that this additional computation is not necessary. Consequently, the final rule requires that the 10 percent of Tier 1 capital calculation be based on Tier 1 capital net of goodwill and all identifiable intangible assets other than purchased mortgage servicing rights and purchased credit card relationships, and before any disallowed deferred tax assets are deducted. While this calculation may result in a slightly higher Tier 1 capital base, the OCC believes that this calculation is simpler and imposes less burden on banks.

In response to the comments received, the OCC has decided to incorporate the following additional provisions to reduce the regulatory burden of this final rule.

Method of Estimating Future Income--In Banking Bulletin 93-15, Supplement 1 (BB 93-15), the OCC specified a method of estimating future taxable income. BB 93-15 provided a specific method for treating originating and reversing tax timing differences in the calculation of one year's future taxable income. Several commenters [[Page 7906]] stated that other less restrictive methods of estimating future taxable income, which are acceptable under GAAP, should also be allowed.

After considering these comments, the OCC concluded that banks may calculate one year's future taxable income based on either the specific method in BB 93-15 or another reasonable method that is consistent with GAAP. Since banks routinely make their own projections of future taxable income and have this information readily available, this modification reduces regulatory burden.

Gross-up of Intangibles--FAS 109 requires a bank to record higher amounts of intangible assets acquired in nontaxable purchase business combinations than they would record under previous GAAP for the same transaction. The OCC capital adequacy rules require banks to deduct certain intangible assets from regulatory capital. Consequently, under FAS 109, a bank acquiring such assets would reflect a lower amount of regulatory capital after deducting these disallowed intangibles than it would have under previous accounting standards even though there is no additional risk to capital.

Several commenters indicated that the OCC should not require banks to deduct the additional amounts of identifiable intangible assets required by FAS 109. The OCC agrees with these commenters. Since the higher intangible amounts occur simply because of an accounting rule change, the higher amounts do not present additional risk to capital. Therefore, because the increased value of the intangible assets pose no additional risk to capital adequacy, this final rule permits a bank to

net the deferred tax liability associated with a disallowed intangible asset against that intangible asset in the calculation of its limit on deferred tax assets.

Under this approach, a bank would only deduct the net amount of the disallowed intangible from Tier 1 capital. Netting is not allowed against purchased mortgage servicing rights and purchased credit card receivables since a bank deducts these assets for capital adequacy purposes only if they exceed specified limits on intangible assets. Consequently, this final rule results in the same treatment for intangibles resulting from purchase business combinations as under previous GAAP. However, to ensure this benefit is not double counted, a deferred tax liability netted in this manner could not also be netted against deferred tax assets when determining the amount of deferred tax assets that are dependent upon future taxable income.

Leveraged Leases--Similar to the ``gross up of intangibles'' issue, the OCC agrees with one commenter who recommended that the final rule include a specific provision relating to the accounting treatment for leveraged leases. The commenter noted the valuation of a leveraged lease acquired in a purchase business combination gives recognition to the estimated future tax effect of the remaining cash flows of the lease. Therefore, any future tax liabilities related to acquired leveraged leases are included in the valuation of the leveraged leases and are not shown on the balance sheet as deferred taxes payable. This artificially increases the amount of deferred tax assets for institutions that acquire a leveraged lease portfolio. The commenter suggested that banks treat the future taxes payable included in the valuation of a leverage lease portfolio as a reversing taxable temporary difference available to support the recognition of deferred tax assets.

Although this situation will not affect many banks, the OCC agrees with this commenter. Accordingly, when applying the limit on deferred tax assets, a bank may use the deferred tax liabilities embedded in the carrying value of a leveraged lease to reduce the amount of deferred tax assets subject to the limit.

Tax Jurisdictions--In a response to the proposed rule, a commenter suggested that a bank calculate one overall limit on deferred tax assets to cover all tax jurisdictions in which the bank operates. This provision would reduce burden on large banks that operate in numerous jurisdictions because they would not need to separately calculate a limit on deferred tax assets for each jurisdiction. FAS 109 already requires a jurisdiction-by-jurisdiction approach. The OCC agrees with the commenter that the separate tax jurisdiction requirement in the overall limit on deferred tax assets is unnecessary. Therefore, to reduce regulatory burden, a bank may calculate one overall limit on deferred tax assets that covers all tax jurisdictions in which the bank operates.

Timing--A bank may use the future taxable income projections for its closest fiscal year (adjusted for any significant changes that have occurred or are expected to occur) when applying the limit on deferred tax assets at a report date other than year-end. Therefore, a bank will not have to prepare a new projection each quarter. Several commenters requested this treatment because it reduces the frequency that a bank is required to revise their estimate of future taxable income.

Except for these provisions, banks should follow FAS 109 in determining regulatory capital. Net deferred tax assets included in bank Call Reports under FAS 109, that exceed the limit on deferred tax assets, should be deducted from Tier 1 capital. Banks should also

deduct the amount of disallowed deferred tax assets from both total assets and from risk-weighted assets in determining their leverage capital and risk-based capital ratios. Deferred tax assets included in risk-based capital continue to have a risk weight of 100%.

Other Considerations

Separate Entity Method--Consistent with the policy of applying GAAP individually to banks of a holding company, each subsidiary bank must determine its limit on deferred tax assets separately from the holding company. Under this "separate entity method," a subsidiary of a holding company is treated as a separate taxpayer, and its tax provision is calculated on this basis.

In some cases, a bank's holding company may 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. In these cases, the amount of carryback potential the bank may consider in calculating the limit on deferred tax assets is limited to the amount which it could reasonably expect to have refunded by its parent.

Several commenters suggested that the OCC eliminate the separate entity approach because GAAP does not require it and because the approach ignores Federal tax law and binding intercompany tax settlement agreements. The OCC considered these comments. However, the banking agencies generally require banks to file regulatory reports using a separate entity approach, and consistency between the reports would be reduced if the OCC permitted a bank to use other methods for calculating deferred tax assets. Therefore, the OCC decided that banks must continue to report and calculate the limit on deferred tax assets under the separate entity method.

Tax Effects of Financial Accounting Standard 115 (FAS 115)--The OCC, along with the other banking agencies, adopted Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (FAS 115), for regulatory reporting purposes effective January 1, 1994. FAS 115 requires net unrealized holding gains and losses on available-for-sale securities to be recorded net of taxes. Consequently, when a bank recognizes [[Page 7907]] the FAS 115 unrealized holding gains and losses on available-for-sale securities in financial reports, it also must include any deferred tax effects of these unrealized gains and losses in its determination of the deferred tax asset.

For example, if a bank has an unrealized gain in the available-for-sale portfolio, it must record a deferred tax liability for the taxes that would be due if they sold the assets and realized the gain. On the other hand, if a bank has an unrealized loss in the available-for-sale portfolio, the bank should include the tax benefits from realizing that loss when it records its deferred tax asset.

The OCC and the other banking agencies recently agreed that banks should exclude the net unrealized holding gains and losses on available-for-sale debt securities from regulatory capital calculations. Therefore, it would be consistent to exclude the deferred tax assets and liabilities relating to the FAS 115 gains and losses on available-for-sale debt securities in the calculation of the allowable amount of deferred tax assets for regulatory capital.

It has been argued that failure to eliminate these FAS 115 deferred tax effects would cause a bank to overstate or understate the amount of deferred tax assets disallowed for regulatory capital purposes. For example, a bank with a net unrealized loss in its available-for-sale

account would report a related deferred tax asset in its Call Report. If the bank does not remove the deferred tax asset relating to the net unrealized loss, and has net deferred tax assets that exceed the allowable amount stipulated in this final rule, the bank will overstate the amount of deferred tax assets that it must deduct from regulatory capital. Conversely, if the bank has a net unrealized gain on available-for-sale securities, and does not remove its deferred tax effect, the calculation of the limit on deferred tax assets will understate the amount of deferred tax assets the bank must deduct from regulatory capital.

The OCC believes that identifying and removing the deferred tax components that specifically relate to FAS 115 may be very complicated, and in some situations may place significant burden on banks. Therefore, the OCC has decided to allow, but not require, banks to eliminate the FAS 115 deferred tax items before calculating the limit on deferred tax assets. Consequently, a bank that does not want to deal with the complexity of the adjustment can reduce its implementation burden. On the other hand, a bank that wants to achieve greater precision may make such adjustments. Whether or not a bank chooses to adjust for the FAS 115 deferred tax effects, it must apply that approach consistently in future calculations of the limit on deferred tax assets.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. When considered with the change in the reporting of deferred tax assets in the Call Report, this final rule permits banks to include more deferred tax assets in regulatory capital than under previous policy. However, this change will not significantly impact banks of any size.

Executive Order 12866

The OCC has determined that this final rule is not a significant regulatory action under Executive Order 12866.

List of Subjects in 12 CFR Part 3

Administrative practice and procedure, National banks, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons set out in the preamble, part 3 of title 12, chapter I, of the Code of Federal Regulations is amended as set forth below.

PART 3--MINIMUM CAPITAL RATIOS; ISSUANCE OF DIRECTIVES

1. The authority citation for part 3 continues to read as follows:

Authority: 12 U.S.C. 93a, 161, 1818, 1828(n), 1828 note, 1831n note, 3907, and 3909.

2. Paragraph (a) of Sec. 3.2 is revised to read as follows:

Sec. 3.2 Definitions.

* * * * *

(a) Adjusted total assets means the average total assets figure required to be computed for and stated in a bank's most recent quarterly Consolidated Report of Condition and Income (Call Report) minus end-of-quarter intangible assets and deferred tax assets that are deducted from Tier 1 capital. The OCC reserves the right to require a bank to compute and maintain its capital ratios on the basis of actual, rather than average, total assets when necessary to carry out the purposes of this part.

* * * * *

3. In appendix A to part 3, section 1, paragraphs (c)(9) through (c)(29) are redesignated as paragraphs (c)(10) through (c)(30) and a new paragraph (c)(9) is added to read as follows:

Appendix A to Part 3--Risk-Based Capital Guidelines

Section 1. Purpose, Applicability of Guidelines, and Definitions.

* * * * *

(c) * * *

(9) Deferred tax assets means the tax consequences attributable to tax carryforwards and deductible temporary differences. Tax carryforwards are deductions or credits that cannot be used for tax purposes during the current period, but can be carried forward to reduce taxable income or taxes payable in a future period or periods. Temporary differences are financial events or transactions that are recognized in one period for financial statement purposes, but are recognized in another period or periods for income tax purposes. Deductible temporary differences are temporary differences that result in a reduction of taxable income in a future period or periods.

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4. In appendix A to part 3, section 2, paragraph (c)(1) is revised, a new paragraph heading is added to paragraph (c)(2), paragraph (c)(3) is redesignated as paragraph (c)(4) and a heading is added to newly designated paragraph (c)(4) and the introductory text is revised, and a new paragraph (c)(3) is added, to read as follows:

* * * * *

Section 2. Components of Capital.

* * * * *

(c) * * *

(1) Deductions from Tier 1 capital. The following items are deducted from Tier 1 capital before the Tier 2 portion of the calculation is made:

- (i) All goodwill subject to the transition rules contained in section 4(a)(1)(ii) of this appendix A;
- (ii) Other intangible assets, except as provided in section 2(c)(2) of this appendix A; and
- (iii) Deferred tax assets, except as provided in section 2(c)(3)

of this appendix A, that are dependent upon future taxable income, which exceed the lesser of either:

(A) The amount of deferred tax assets that the bank could reasonably expect to realize within one year of the quarter-end call report, based on its estimate of future taxable income for that year; or

(B) 10% of Tier 1 capital, net of goodwill and all intangible assets other than purchased mortgage servicing rights and purchased credit card relationships, and before any disallowed deferred tax assets are deducted.

(2) Qualifying intangible assets. * * *

(3) Deferred tax assets--(i) Net unrealized gains and losses on available-for-sale securities. Before calculating the amount of deferred tax assets subject to the limit in section 2(c)(1)(iii) of this appendix A, a bank may eliminate the deferred tax effects of any net unrealized holding gains and losses on available-for-sale debt securities. Banks report these net unrealized holding gains and losses in their Call Reports as a separate component of equity capital, but exclude them from the definition of common stockholders' equity for regulatory capital [[Page 7908]] purposes. A bank that adopts a policy to deduct these amounts must apply that approach consistently in all future calculations of the amount of disallowed deferred tax assets under section 2(c)(1)(iii) of this appendix A.

(ii) Consolidated groups. The amount of deferred tax assets that a bank can realize from taxes paid in prior carryback years and from reversals of existing taxable temporary differences generally would not be deducted from capital. However, for a bank that is a member of a consolidated group (for tax purposes), the amount of carryback potential a bank may consider in calculating the limit on deferred tax assets under section 2(c)(1)(iii) of this appendix A, may not exceed the amount that the bank could reasonably expect to have refunded by its parent holding company.

(iii) Nontaxable Purchase Business Combination. In calculating the amount of net deferred tax assets under section 2(c)(1)(iii) of this appendix A, a deferred tax liability that is specifically associated with an intangible asset (other than purchased mortgage servicing rights and purchased credit card relationships) due to a nontaxable purchase business combination may be netted against that intangible asset. Only the net amount of the intangible asset must be deducted from Tier 1 capital. Deferred tax liabilities netted in this manner cannot also be netted against deferred tax assets when determining the amount of net deferred tax assets that are dependent upon future taxable income.

(iv) Estimated future taxable income. Estimated future taxable income does not include net operating loss carryforwards to be used during that year or the amount of existing temporary differences expected to reverse within the year. A bank may use future taxable income projections for their closest fiscal year, provided it adjusts the projections for any significant changes that occur or that it expects to occur. Such projections must include the estimated effect of tax planning strategies that the bank expects to implement to realize net operating losses or tax credit carryforwards that will otherwise expire during the year.

(4) Deductions from total capital. The following items are deducted from total capital:

* * * * *

Dated: February 3, 1995.
Eugene A. Ludwig,
Comptroller of the Currency.
[FR Doc. 95-3364 Filed 2-9-95; 8:45 am]
BILLING CODE 4810-33-P