



Accounting Roundup —
Special Edition
Annual Update on Accounting
for Income Taxes

January 2013



Annual Update on Accounting for Income Taxes

by Deloitte & Touche LLP's Accounting Standards and Communications Group and Deloitte Tax LLP

Introduction

Welcome to this special tax edition of *Accounting Roundup*, which summarizes significant developments that have affected the accounting and financial reporting for income taxes over the past year. The following are some of the topics covered in this publication:

- Tax policy changes related to the January 2013 passage of the American Taxpayer Relief Act of 2012.
- The continuing efforts of tax authorities worldwide to reform tax law to help cover budget shortfalls.
- The SEC's comment letters to registrants regarding their filings of periodic reports (the accounting for income taxes continues to be one of the SEC's top focuses in its reviews of public-company financial filings).
- The FASB's and IASB's continuing convergence efforts on their various projects and the related tax implications.
- The EITF's recent addition of two income-tax-related topics to its agenda.
- The Private Company Council, which was created earlier this year to improve the standard-setting process for U.S. private companies — and the tax-related issues it is researching.

In addition, this publication includes links to other resources that delve deeper into the topics discussed in the articles. You can also [subscribe](#) to receive by e-mail our quarterly publication, *Accounting for Income Taxes Hot Topics*, which highlights certain recent tax and accounting developments that may affect the accounting for income taxes under ASC 740.¹

We hope that this *Accounting Roundup — Special Edition* helps financial professionals stay up to date on current developments and plan for future changes. As always, we welcome your feedback. Please send questions and comments to accountingstandards@deloitte.com.

Sincerely,

Deloitte & Touche LLP and Deloitte Tax LLP

¹ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification](#)."

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Tax Policy and Other Developments

Swerving From the Cliff: Tax Provisions in the American Taxpayer Relief Act of 2012

Affects: All entities.

Summary: As the nation teetered on the edge of the fiscal cliff, Congress approved and President Obama signed into law the American Taxpayer Relief Act of 2012 (the “Act”). The Act permanently extends the reduced Bush-era income tax rates for lower- and middle-income taxpayers, allows the top rates on earned income and investment income to rise for wealthier households, permanently “patches” the individual alternative minimum tax, and increases the estate and gift tax rate for high-value estates. The Act also extends through 2013 an array of temporary business and individual tax “extenders” provisions, such as the research and experimentation credit, the subpart F active financing exception, the look-through rule for payments between related controlled foreign corporations, bonus depreciation, and the deduction for state and local general sales taxes.

Implications and

Next Steps: The passage of the new legislation shortly after December 31 may have unique financial reporting ramifications. Under U.S. GAAP, the effect of a change in tax laws or rates must be recognized as of the enactment date. An entity must use temporary differences and currently taxable income existing as of the enactment date to determine the tax effect of a retroactive change in enacted tax laws or rates on current and deferred tax assets (DTAs) and liabilities (DTLs). When deferred tax accounts are adjusted for the effect of a change in tax laws or rates, the effect would be included in income from continuing operations for the period that includes the enactment date. An entity that has not yet issued its financial statements for the interim or annual period that ended before enactment cannot consider the enactment in preparing those financial statements; however, the entity should consider whether it would be appropriate to disclose the subsequent-period financial statement impact of the enactment.

While the fiscal cliff settlement resolves several of the most pressing tax and budget issues, it leaves a few outstanding items that will need to be addressed in the near term, including the imposition of automatic spending cuts and the need to increase the statutory debt ceiling, which was reached at year-end. Failure to resolve such issues could have wide-reaching economic effects. In what is likely to be a replay of the fiscal cliff drama, the White House and Congress will once again have to work together on a deal. Given the expected focus on tax reform, taxpayers should consider planning ahead, including by identifying key tax benefits, measuring and prioritizing the impact of those benefits, and regularly communicating the status of tax reform efforts to key stakeholders.

Other Resources: The following Deloitte publications provide additional information about the Act:

- [Swerving From the Cliff: Tax Provisions in the American Taxpayer Relief Act of 2012.](#)
- [Financial Reporting Alert 13-1, “Accounting for the Business Income Tax Provisions in the American Taxpayer Relief Act of 2012.”](#) ●

Tangible Property Regulations

Affects: Entities that incur costs for acquiring, maintaining, or improving tangible property.

Summary: On December 27, 2011, the U.S. Department of the Treasury and the IRS issued temporary regulations² that provide guidance on treatment of materials and supplies, dispositions of MACRS³ property, capitalization of amounts paid to acquire or produce tangible property, and the determination of whether an expenditure for tangible property is a deductible repair or must be capitalized. The temporary regulations address a broad range of capitalization and deduction issues related to expenditures associated with tangible property and are likely to affect taxpayers in all industries.

On December 14, 2012, the IRS released amendments to the temporary regulations that revise the effective date of these regulations from taxable years beginning on or after January 1, 2012, to taxable years beginning on or after January 1, 2014; however, taxpayers generally are permitted to apply the temporary regulations as of the original effective date. Further, as indicated in [Notice 2012-73](#),⁴ the IRS

² T.D. 9564, *Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property.*

³ Modified Accelerated Cost Recovery System.

⁴ IRS Notice No 2012-73, *Guidance on Regulations to Be Issued Regarding the Deduction and Capitalization of Expenditures Related to Tangible Property.*

expects to issue final tangible property regulations in 2013. Like the temporary regulations, the final regulations will become effective on January 1, 2014, but may be applied to 2012 or 2013. The final regulations will most likely contain changes to the temporary regulations; however, under Revenue Procedures 2012-19 and 2012-20, a taxpayer that adopts the temporary regulations before the effective date of the final regulations is permitted to change its accounting methods as necessary. The IRS intends to provide transitional guidance on the final regulations when they are issued.

Implications and

Next Steps: Entities that have historically been using permissible tangible property capitalization methods (i.e., entities without unrecognized tax benefits related to such methods) may choose to wait until the final regulations are issued to change their accounting method, in which case they would generally not account for any impact related to the temporary regulations in 2012.

However, entities with existing unrecognized tax benefits related to tangible property should assess the impact that the temporary regulations and related guidance (including the above notice and revenue procedures) have on their unrecognized tax benefits and related interest and penalty accruals.⁵ For example, if an entity intends to change its accounting methods to comply with the temporary regulations within the scope limitation waiver period by filing the required Form 3115 within this period, the entity should assess the impact that such a filing will have on those amounts. When an entity decides and represents that it will file a Form 3115 to change its method of accounting, the entity will generally also reflect both its estimate of the “new” property temporary difference and any other new temporary differences⁶ that will be created as a result of filing Form 3115, as well as update its assessment of unrecognized tax benefits for any uncertainty in the application of the temporary regulations.

Entities are encouraged to consult with their attest firm on this topic, since there may be different interpretations of the temporary regulations and their impact on the financial statements.

Other Resources: For more information about the tangible property temporary regulations, see Deloitte’s [December 2012 Accounting for Income Taxes: Quarterly Hot Topics](#). ●

Changes in Domestic State and International Tax Rates, Laws, and Regulations

Affects: All entities.

Summary: With the 2012 election behind us, U.S. federal tax reform may be on the horizon. In the meantime, various other tax jurisdictions have been active recently in changing their tax rates and laws. The aftermath of the economic downturn has left many tax jurisdictions (domestic and international) in a significant budget shortfall. Therefore, many of these jurisdictions have been ramping up efforts to increase tax revenue by enacting new legislation that mandates higher tax rates, increasing enforcement and collection efforts, restricting the use of tax-loss carryforwards, and restricting the deductibility of interest expense. Some tax jurisdictions have been becoming more creative in their attempts to increase their tax base through changes in their tax rates and laws, including decreases in rates or complete replacement of a tax code.

Implications and

Next Steps: Income tax rates and laws are a constant moving target that could have meaningful financial statement implications for an entity's income tax accounting. The tables below summarize some of the more significant domestic state and international tax law changes that occurred during 2012. For more information on a change that occurred in a specific tax jurisdiction, please click on that jurisdiction's link to go to the applicable issue of *Global Tax Developments Quarterly* or *State Tax Matters*. These publications generally provide additional background on these changes, the implications related to accounting for income taxes, and links to additional resources.

For information on other tax jurisdictions, see the "Other Resources" section below the table.

⁵ Entities may have already accounted for the impact the intended filing will have on their unrecognized tax benefits and any related interest accruals in the interim reporting period that included March 7, 2012 (the publication date of the revenue procedures).

⁶ A cumulative effect of a change in tax accounting method is recognized either (1) over four tax years (beginning with the year of change) when the cumulative difference results in an increase in taxable income or (2) over a one-year period (the year of change) when the cumulative difference results in a decrease in taxable income. This is commonly referred to as an "Internal Revenue Code (IRC) § 481(a) adjustment."

State Tax Jurisdictions	
Tax Jurisdiction	Summary
State of Arizona	<p>In May 2012, the State of Arizona adopted House Bill 2815, which includes the following modifications to Arizona law:</p> <ul style="list-style-type: none"> Beginning with corporate net operating losses (NOLs) arising in tax year 2012, the carryover period is increased to 20 years. Starting in tax year 2014, individuals are allowed to take a bonus depreciation deduction. Starting in tax year 2013, individuals are allowed to take a long-term capital gains deduction. Beginning in tax year 2012 and applicable through tax year 2019, a new individual and corporate income tax (CIT) credit is adopted for investments in qualified facilities. Investment time frames and additional employment requirements are established for the individual and corporate tax credit for new employment that was adopted in 2011.
State of California	<p>In March 2012, a new California code of regulations — Title 18, Section 25136-2 — was published, and applies retroactively to tax years beginning on or after January 1, 2011. The new regulations provide guidance on (1) sales factor assignment for sales of other than tangible personal property under California’s market-sourcing statute applicable to taxpayers electing to use single sales factor apportionment and (2) determining whether an entity is “doing business” in California according to the state’s statutory “economic nexus” standards.</p> <p>In November 2012, California voters approved Proposition 39, which requires most multistate taxpayers to use a sales-factor-only apportionment formula, combined with market-based sales sourcing for sales of other than tangible personal property, and is effective for tax years beginning on or after January 1, 2013. California’s rules on market-based sourcing for sales of other than tangible personal property had previously applied only to taxpayers electing to apportion on a sales-factor-only basis. The election to use a single sales factor formula and the applicable market-based sales sourcing remain intact for the 2011 and 2012 tax years.</p>
State of Massachusetts	<p>In July 2012, legislation was passed that postpones for one additional year the “FAS 109” deduction that was scheduled to begin in 2013 (now scheduled to begin in 2014) and that was part of legislation enacted during 2008 that adopted a combined reporting regime for tax years beginning on or after January 1, 2009. Eligibility for this deduction is generally limited to publicly traded companies.</p>
State of Michigan	<p>In 2011, legislation was passed, which became effective on January 1, 2012, that replaced the Michigan Business Tax and imposed a 6 percent CIT. The original Michigan CIT generally required flow-through entities to withhold tax (at the 6 percent CIT rate) relative to a corporate partner’s or member’s share of apportioned business income. On June 28, 2012, Senate Bill 1104 was enacted, amending Michigan’s CIT law to permit corporations to seek an exemption from this withholding requirement. The new law also amends the due dates for quarterly withholding.</p>
State of Nebraska	<p>In April 2012, the Nebraska governor signed into law Legislative Bill 872 (“LB 872”), a revenue committee bill that contains various modifications to Nebraska’s CIT. LB 872 added new defined terms to the Nebraska CIT and adopted market-based apportionment sourcing for sales other than sales of tangible personal property. These law changes are effective for all tax years beginning on or after January 1, 2014.</p>
State of New Jersey	<p>In September 2012, the New Jersey Division of Taxation announced a limited voluntary disclosure initiative that began on September 15, 2012, and ran through January 15, 2013. Under this program, entities that owned intangible assets and derived income from the use of those assets in New Jersey had the opportunity to come forward and voluntarily comply with their state corporation business tax filing requirements.</p>
State of New York	<p>In December 2012, New York State revised its regulations regarding when general business corporations and insurance companies will be required to file combined returns. The revised regulations, which are effective for taxable years beginning on or after January 1, 2013, largely reflect the New York State Department of Taxation and Finance’s positions that were stated in its Technical Services Bulletin Memorandum, TSB-M-08(2)C. However, the revisions made significant changes to certain aspects of TSB-M-08(2)C, such as the treatment of intercompany interest in analyzing the existence of intercorporate transactions, the incorporation of previously unincorporated operating units, the transfer of ownership of pass-through entities among related corporations, and the treatment of allocated expenses.</p>

State Tax Jurisdictions (continued)

Tax Jurisdiction	Summary
State of Texas	In June 2012, the Texas comptroller announced that it has changed its position regarding the election to take the cost of goods sold (COGS) or compensation deduction to compute margin for purposes of the Texas franchise tax. Taxpayers are now allowed to amend reports for open periods to change their election to use the COGS or the compensation deduction. Previously, the comptroller had required the election to be made by the original due date of the return and it could not be changed on an amended report.

Select International Tax Jurisdictions

Tax Jurisdiction	Summary
Belgium	<p>The law of December 13, 2012, which contains several fiscal and financial measures, was published in the official gazette on December 20, 2012. The main CIT measure included in this new law is the abolition of the seven-year carryforward period for unused notional interest deduction (NID), applicable to unused NIDs generated in or after the financial year closing as of December 31, 2012. Under a transitional regime, the seven-year carryforward period will remain available for the unused NID available as of December 31, 2011.</p> <p>The law containing the “second wave” of the 2012 Belgian budget tax measures was published in the official gazette on April 6, 2012. Along with changes to the general thin capitalization and anti-abuse rules, there are changes to the taxation of capital gains derived from the disposal of certain shares.</p>
Chile	On September 27, 2012, the Chilean government enacted a tax reform bill that includes an increase in the CIT rate (First Category Income Tax) from 18.5 percent to 20 percent on earnings accrued as of January 1, 2012 (or as of September 1, 2012, to the extent of income subject to the First Category Tax as a single tax). Other measures include an expansion of the scope of the corporate tax as a single tax to apply to certain capital gains, a broadening of the concept of Chile-source income to include certain disposals, and changes to the taxation of a Chilean permanent establishment.
France	<p>On December 30, 2012, the 2013 Finance Bill was published in the official gazette. The law promulgated a series of tax measures, which include new rules globally limiting the deductibility of certain finance charges. Interest on loans generally is deductible for French CIT purposes, although under the thin capitalization rules, interest paid on related-party debt may be disallowed. Further, in certain circumstances, a deduction for interest may also be disallowed for entities liable for CIT when such entities own a participation in another entity. In addition, the deductibility of net finance charges in excess of €3 million incurred by entities liable for CIT are capped at 85 percent of their net amount as of the end of the December 31, 2012, fiscal year. The cap will be further reduced to 75 percent for fiscal years closing on December 31, 2014.</p> <p>The 2013 Finance Bill also extended the additional surcharge of 5 percent to fiscal years ending on or after December 31, 2011, and until December 30, 2015 (previously December 30, 2013). The additional surcharge of 5 percent is based on the income tax due at the standard tax rates and applies to entities with turnover exceeding €250 million.</p> <p>In addition, the amount of loss carryforwards available in any given year is capped at €1 million, plus 50 percent (previously 60 percent) of the portion of taxable profits of the relevant fiscal year exceeding €1 million. The remaining 50 percent of income is taxed at the standard CIT rate. This measure is effective for fiscal years ending on or after December 31, 2012.</p> <p>In addition, the rules with respect to a particular exemption for long-term capital gains were tightened for fiscal years ending on or after December 31, 2012.</p> <p>Effective with its publication in the Official Journal on August 17, 2012, France introduced several significant measures in the revised budget law for 2012. One of the key changes enacted is a 3 percent surtax that is levied on dividends and certain other distributions paid on or after August 17, 2012, by French and foreign entities subject to CIT in France (including permanent establishments of foreign entities). The surtax applies to all dividends, even to those paid to a parent company that holds more than 10 percent of the distributing entity. The provision, however, does provide for specific exemptions from the surtax for dividends/distributions paid between members of a French tax consolidated group, dividends paid by small and medium-sized enterprises, and dividends paid by their qualifying subsidiaries to SIFCs and SPICAVs (i.e., real estate funds).</p>

Select International Tax Jurisdictions (continued)

Tax Jurisdiction	Summary
India	<p>India's 2012 budget, signed into law as the Finance Act 2012 on May 28, 2012, includes a number of significant tax measures. One of the key changes is the retroactive amendment to Section 9(1)(i) of the 1961 Income Tax Act, which is intended to allow the Indian tax authorities to extend the taxation of capital gains to a nonresident's transfer of shares or interest in an entity incorporated/registered outside India that, in turn, has "substantial" interests in India. This measure effectively overrules the Indian Supreme Court's decision in favor of the taxpayer in the landmark <i>Vodafone</i> case and is effective beginning on April 1, 1962. Another retroactive measure broadens the definition of royalty so that, with effect from June 1, 1976, payments for the use of a software license and transmission by satellite, cable, optic fiber, etc., are taxable as royalties under domestic law (i.e., 10 percent, plus the applicable surcharge and education cess). Also under the new rules, long-term capital gains derived by a nonresident on the sale of unlisted shares held for more than one year will be taxed at a 10 percent rate (plus the applicable surcharge and education cess) instead of the previously applicable 20 percent rate (plus the applicable surcharge and education cess).</p>
Ireland	<p>Finance Bill 2012, enacted on March 31, 2012, contains a range of corporate tax measures. The key measures enacted include an increase of the capital gains tax rate from 25 percent to 30 percent for gains on disposals occurring on or after December 7, 2011.</p>
Mexico	<p>Mexico's 2013 budget was published in the official gazette on December 17, 2012, passing into law several key CIT changes. One of the key measures is the deferral of the previously enacted tax rate reduction to 29 percent, which was scheduled to take effect on January 1, 2013. The 30 percent income tax rate will continue to apply in 2013 and will be reduced to 29 percent as of January 1, 2014, and further reduced to 28 percent as of January 1, 2015.</p>
The Netherlands	<p>The government of the Netherlands enacted new legislation on July 17, 2012, that partially disallows the deduction of interest expense for entities that have "excessive" debt in relation to their participations (i.e., investments). Under previous law, interest expense related to debt connected to a participation was, in principle, deductible for Dutch CIT purposes, while dividend income from the same participation would not have been treated as taxable (to the extent of a qualifying participation). To address this situation, the deductibility of interest expense (and related costs) for entities that have excessive debt compared with the value of their participations is now limited. The new rules apply to intragroup and external (third-party) debt as well as Dutch and non-Dutch participations.</p>
Peru	<p>Relying on a temporary delegation of authority granted by the Peruvian parliament, the executive branch enacted a number of tax measures in the official gazette on July 18, 2012. The decrees cover a wide range of tax rules, including the addition of a new chapter to the income tax law; this new chapter contains controlled foreign company rules that apply to the passive income of nonresident entities owned by resident taxpayers that are subject to tax in Peru on their foreign-source income. The decrees also expand the scope of taxation of certain capital gains and provide for changes in the treatment of gains and losses in corporate reorganizations. Unless otherwise noted, the measures generally become effective on January 1, 2013.</p>
Spain	<p>Royal Decree Law 20/2012 was published in the official gazette on July 14, 2012. The new law includes a number of changes to the CIT rules, including a further restriction on the offset of tax loss carryforwards. Under the new rules, for fiscal years beginning during 2012 and 2013, companies with revenues between €20 million and €60 million during the previous 12 months will be able to offset up to 50 percent of taxable income with operating losses brought forward. Companies with revenues exceeding €60 million during the previous 12 months will be able to offset only up to 25 percent of taxable income with operating losses brought forward.</p> <p>A temporary repatriation incentive, effective until November 30, 2012, was enacted in March 2012, and introduced a special tax of 8 percent for profits derived by overseas subsidiaries in the performance of business activities that do not qualify for the participation exemption because they fail the "subject to tax test." In principle, dividends received by a Spanish company from a foreign subsidiary located in a no- or low-tax jurisdiction or a tax haven will be taxed at a reduced rate of 8 percent rather than the general CIT rate of 30 percent. Under the newly enacted rules, the temporary repatriation incentive, enacted in March 2012, is extended to provide for a special 10 percent tax rate on foreign-source income in the form of dividends or gains on the disposition of shares earned by Spanish taxpayers that do not qualify for the participation exemption but meet the minimum 5 percent ownership requirement. The extended incentive applies from July 15, 2012, until November 30, 2012.</p> <p>In addition, effective for tax years beginning in 2012 and 2013, the maximum annual tax deduction limitation for intangible assets with an indefinite useful life has been reduced from 10 percent to 2 percent.</p>

Select International Tax Jurisdictions (continued)

Tax Jurisdiction	Summary
United Kingdom	On July 17, 2012, the UK Finance Act 2012 received Royal Assent, passing into law a number of tax measures announced in the UK's 2012 budget. A key measure included in this legislation is the phased-in reduction of 2 percentage points of the CIT rate. Pursuant to the newly enacted legislation, a 24 percent CIT rate became effective on April 1, 2012, in place of the previously enacted 25 percent tax rate, and is followed by a further tax rate reduction to 23 percent, which will become effective on April 1, 2013. In addition to the CIT rate reduction, the measures passed by the Finance Act 2012 include CFC reform, which became effective on January 1, 2013; introduction of a "patent box" regime, which will become effective on April 1, 2013; and other investment-promoting measures.

Other Resources: Deloitte's *Global Tax Developments Quarterly*, *Accounting for Income Taxes Hot Topics*, and *State Tax Matters* archives. ●

Tax Policy: U.S. Tax Reform and the Impact on Non-U.S. Earnings of U.S.-Based Multinationals

Affects: U.S.-based multinationals.

Summary: Central to the tax position of many U.S.-based multinationals is the treatment of non-U.S. earnings. More specifically, one key component of a U.S.-based multinational's tax position is the potential for the U.S. taxation of non-U.S. business earnings generated by foreign subsidiaries. Under the current worldwide system of taxation in the United States, non-U.S. earnings are generally not subject to U.S. tax until the earnings are repatriated. When such repatriation does occur, the U.S. tax liability imposed on non-U.S. earnings is generally reduced via the U.S. foreign tax credit to the extent that such earnings were also subject to taxation (as an income tax) abroad. Notwithstanding the availability of U.S. foreign tax credits, the current trend in the decline of non-U.S. statutory tax rates (thereby reducing any potential U.S. foreign tax credit), coupled with the fact that the U.S. tax rate remains one of the highest among industrialized nations, means that a U.S. parent may incur a significant U.S. tax cost to bring these earnings home, which in turn may affect an entity's global effective tax rate.

In view of the potential incremental U.S. tax cost of repatriation, the core concept of deferral (i.e., the temporary, or perhaps even permanent, deferral of the actual or deemed repatriation of non-U.S. earnings) has arguably become even more significant to U.S.-based multinationals. However, while deferral remains a common approach to achieving competitiveness in the effective tax rate, it also restricts the ability of U.S.-based entities to reallocate capital to the most attractive and efficient global markets. Comparable restrictions do not exist in most other Organisation for Economic Co-operation and Development countries that have adopted a territorial system of taxation, which generally (subject to certain anti-abuse rules) limits taxation to only those earnings derived from within such a country. Because this may put U.S.-based multinationals at a competitive disadvantage, there has been bipartisan support for a territorial system as part of U.S. tax reform, provided that such a system would be enacted in a revenue-neutral manner.

In addition to international taxation, tax reform is emphasizing the relatively high U.S. CIT rate compared with the tax rates imposed on competing corporations in other countries. Tax reform efforts have focused on reducing the corporate tax rate and broadening the base of income on which the tax is imposed. Broadening the tax base will require analysis of tax reduction provisions in the tax code that are designed to encourage certain economic activity (referred to as tax expenditures). These provisions often increase the complexity of the tax provisions. The Taxpayer Advocate Services, an independent organization within the IRS, noted in its 2012 annual report to Congress that tax complexity is the number one issue for taxpayers and that Congress should simplify the tax code. In addition, Congress requested the U.S. Government Accountability Office (GAO) to study the effectiveness of tax expenditures and provide a framework on evaluating the effectiveness of such expenditures. The GAO released its findings in a [report](#) on January 8, 2013 (report dated November 29, 2012).

Implications and

Next Steps: Whatever form tax or regulatory reform takes, the financial statement impact may be significant. Effective stakeholder communications regarding financial statement changes and effective implementation planning for reform can be strengthened through better tax transparency, modeling of reform options, and scenario planning. Once tax reform legislation has been enacted, entities will have to revise earnings projections and update balance sheet accounts for the statutory change.

For example, given the potentially significant impact of the lack of deferral on a U.S.-based multinational's effective tax rate, the lack of appropriate disclosure and discussion, including consideration of circumstances that may lead management to consider a change in its indefinite reinvestment assertion with respect to non-U.S. earnings, may catch investors off guard. For this reason, the SEC continues to focus on transparency and early-warning disclosures regarding indefinite reinvestment as well as other potential legislative and regulatory changes. ●

SEC Developments

SEC Issues Final Report on Incorporation of IFRSs

Affects: Public entities.

Summary: On July 13, 2012, the SEC issued its [final staff report](#)⁷ summarizing the staff's analyses and observations related to the work plan that the SEC initiated in February 2010 to evaluate the implications of incorporating IFRSs into the financial reporting system for U.S. companies. The report emphasizes that the SEC has not made "any policy decision as to whether [IFRSs] should be incorporated into the financial reporting system for U.S. issuers, or how any such incorporation, if it were to occur, should be implemented." Further, the report indicates that before making a decision, the SEC must further analyze and consider "the fundamental question of whether transitioning to IFRS is in the best interests of the U.S. securities markets generally and U.S. investors specifically." The report does not include any timetable for this effort.

The incorporation of IFRSs was also a topic of discussion at the 2012 AICPA National Conference on Current SEC and PCAOB Developments. Paul Beswick, then acting as the chief accountant in the SEC's Office of the Chief Accountant, explained that since issuing its final report on the IFRS work plan, the SEC staff has "continued to receive feedback" on the project and understands that uncertainty will remain until a decision is made. Although Mr. Beswick did not indicate when a final decision would be reached, he noted that the staff will work with the SEC chairman to determine the path forward. Mr. Beswick also emphasized that while convergence is an important factor in the decision about whether to adopt IFRSs in the United States, the ability to consistently enforce the application of such standards within and across jurisdictions is equally important.

Implications and

Next Steps: For both U.S. organizations and their foreign affiliates, the following four tax-related areas could be particularly affected by a conversion from U.S. GAAP to IFRSs:

- *Accounting guidance* — The income tax accounting guidance in U.S. GAAP differs significantly from that in IFRSs on topics such as uncertain tax positions, share-based payments, taxable intercompany transactions, and the determination of in-country temporary differences for foreign operations subject to remeasurement. U.S. and international accounting officials have agreed that the existing standards governing the accounting for income taxes should be revised after the current major accounting convergence projects are completed. However, neither board has an income tax project on its current work plan.
- *Local tax compliance* — Each pretax accounting change that an entity makes as a result of the conversion to IFRSs could have an impact on its tax accounting methods, book-tax differences, and cash taxes to the extent that such data are used for tax filings.

⁷ SEC Staff Final Report, *Work Plan for the Consideration of Incorporating International Financial Reporting Standards Into the Financial Reporting System for U.S. Issuers*.

- *Global tax and treasury planning* — Many jurisdictions around the world have been moving the basis for statutory reporting toward IFRSs through conversion or convergence. This shift may have a significant impact on global tax and treasury planning, including intercompany financing arrangements, cash repatriation planning, and transfer pricing.
- *Tax department operations* — The adoption of IFRSs may allow an entity's tax department to become involved in enterprise-wide finance transformation planning that can improve automation and efficiency in tax accounting processes. It is critical that these entity-wide initiatives be IFRS-ready and fully integrated into tax processes and data requirements.

Other Resources: For more information about the SEC's final staff report on IFRSs, see Deloitte's July 19, 2012, [Heads Up](#). ●

Tax-Related Topics Discussed at the 2012 AICPA National Conference on Current SEC and PCAOB Developments

Affects: All entities.

Summary: On December 3–5, 2012, the AICPA held its annual National Conference on Current SEC and PCAOB Developments. Several tax-related topics were discussed at the conference, including the realizability of DTAs and the reversal of valuation allowances.

Mark Shannon, associate chief accountant in the SEC's Division of Corporation Finance, reiterated comments made at last year's AICPA conference about assessing the realizability of DTAs. The SEC staff had noted that it would have difficulty agreeing with a registrant's assertion that losses incurred during the economic downturn are aberrations but that it would base its conclusions on a registrant's specific facts and circumstances. Mr. Shannon also reminded registrants that in assessing the realizability of DTAs, they should consider cumulative losses in recent years to be significant negative evidence and that to avoid recognizing a valuation allowance, they would need to overcome such evidence with significant objective and verifiable positive evidence. He explained that although it is difficult under U.S. GAAP to overcome negative evidence related to cumulative losses, it is theoretically possible to do so.

Mr. Shannon also noted that because many registrants have begun returning to profitability, they are considering whether they should reverse a previously recognized valuation allowance. He indicated that factors for registrants to consider in making this determination would include:

- The magnitude and duration of past losses.
- The magnitude and duration of current profitability.
- Changes in the above two factors that drove losses in the past and those currently driving profitability.

Further, he noted that registrants should bear in mind that the goal of the assessment is to determine whether sufficient positive evidence outweighs existing negative evidence. He emphasized the importance of objectively verifiable evidence and noted that it carries more weight than evidence that is not objectively verifiable. In addition, Nili Shah, deputy chief accountant in the SEC's Division of Corporation Finance, explained that in performing their analysis, registrants should (1) assess the sustainability of profits in the current economic environment and (2) consider their track record of accurately forecasting future financial results. She noted that any doubt about sustainability of profitability in a period of economic uncertainty may give rise to evidence that is less objectively verifiable. Likewise, an entity's poor track record of accurately forecasting future results would also result in future profit projections that are less objectively verifiable. Thus, such evidence would carry less weight in a valuation allowance assessment.

Ms. Shah also pointed out that registrants' disclosures should include a discussion of the factors or reasons that led to a reversal of a valuation allowance; this discussion should effectively answer the question "why now." Such disclosures would include a comprehensive analysis of all available positive and negative evidence and how the entity weighed each piece of evidence in its assessment. She also reminded registrants that the same disclosures would be expected when there is significant negative evidence and a registrant concludes that a valuation allowance is necessary.

Other Resources: For more information about the 2012 AICPA National Conference on Current SEC and PCAOB Developments, see Deloitte's December 11, 2012, [Heads Up](#). ●

Tax-Related Themes of Recent SEC Staff Comments to Domestic Registrants and Foreign Private Issuers

Affects: Domestic SEC registrants and foreign private issuers.

Summary: Domestic Registrants

The SEC staff's income-tax-related comments to domestic registrants, from both a recognition and a disclosure perspective, have focused on repatriation of foreign earnings and liquidity ramifications, valuation allowances, disclosures about the rate reconciliation, and unrecognized tax benefits. The staff often asks registrants to provide early-warning disclosures to help users understand these items and how they potentially affect the financial statements. The following bullets provide additional insight into the SEC staff's comments on these disclosures:

- *Repatriation of foreign earnings and liquidity ramifications* — Under U.S. GAAP, an entity must disclose when a DTL is not recognized for an investment in a foreign subsidiary because the earnings of that subsidiary are indefinitely reinvested, as well as the gross amount of the temporary difference for which deferred taxes have not been provided. In addition, when a registrant believes that it is not practicable to determine the DTL, the registrant should state that belief in its disclosures.

The SEC staff has indicated that when a registrant with significant amounts of cash and short-term investments overseas has asserted that such amounts are indefinitely reinvested in its foreign operations, the SEC staff expects the registrant to provide the following disclosures in an MD&A liquidity analysis:

- The amount of cash and short-term investments held by foreign subsidiaries that would not be available to fund domestic operations unless the funds were repatriated.
- A statement that the registrant would need to accrue and pay taxes if the funds were repatriated.
- If true, a statement that the registrant does not intend to repatriate those funds.
- *Rate reconciliation* — The SEC staff has requested registrants to provide additional disclosures about the components of the rate reconciliation in the notes to the financial statements and in MD&A. In certain situations, a further breakdown of the portion attributable to foreign operations (on a country-specific basis) may be necessary. Registrants should also consider whether the sustainability of historical effective tax rates is uncertain and should provide adequate disclosure (e.g., amount of pretax income and country-specific effective tax rates) if the impact on the registrant could be material.
- *Valuation allowances* — The SEC staff continues to focus on valuation risks related to DTAs. In response to the past economic downturn and current economic environment, the staff has focused on the realizability of DTAs. However, because of improvement in the economy and the resumption of profitability by some entities, the staff has begun to ask registrants about reversals of, or other changes in, their valuation allowances. The staff has advised registrants that adjust a valuation allowance for a DTA to disclose (1) the triggering event or new evidence leading to the adjustment and (2) the effect on current and future results. Registrants should consider providing early-warning disclosures in MD&A and in the notes to the financial statements if an increase in the valuation allowance is reasonably likely in the near future. The staff has also commented when a registrant's disclosures about its valuation allowance seem inconsistent with other disclosures in the filing.
- *Unrecognized tax benefits* — The SEC staff continues to comment when registrants have failed to provide the required disclosures about unrecognized tax benefits, which include a tabular reconciliation of such benefits. Registrants that have no unrecognized tax benefits (or for which such benefits are immaterial) should consider disclosing those facts. In addition, the SEC staff expects registrants to provide more transparent disclosures about reasonably possible changes in unrecognized tax benefits. Because the guidance on the acceptable level of aggregation of information for these disclosures is not prescriptive and permits judgment, the SEC staff evaluates a registrant's level of disclosure on a case-by-case basis.

Foreign Private Issuers

In its comments to foreign private issuers, the SEC staff has primarily focused on rate reconciliations and the nature of the items disclosed as well as on the completeness and adequacy of disclosures required by IFRSs. More specifically, the staff has focused on the following items:

- The nature of adjustments and reconciling items.
- Specific facts and circumstances related to the timing of adjustments.
- Explanation of changes in applicable tax rates.
- Recognized amounts for each type of temporary difference.
- The amount of DTAs that was not recognized.
- Income tax consequences of dividends declared.

Implications and

Next Steps: An entity should confirm that its financial statements include the required disclosures and that these disclosures enable users to understand the current and future tax consequences of the entity's transactions and related events. The entity should determine that recognition of tax consequences of business transactions is consistent with the accounting requirements and that its disclosures about the tax consequences are transparent to financial statement users.

Other Resources: See the following Deloitte publications for additional guidance on the SEC staff's comments on income taxes:

- [September 2012 SEC Comment Letter Examples: Income Taxes](#).
- [SEC Comment Letters — Including Industry Insights: Highlighting Risks](#) (updated November 2012).
- [SEC Comment Letters on Foreign Private Issuers Using IFRSs](#) (updated March 2012). ●

Standard-Setting Developments

FASB's and IASB's Joint Projects: Impact on Accounting for Income Taxes

Affects: All entities.

Summary: The FASB and IASB are currently working on five joint projects: leases, revenue recognition, financial instruments, insurance contracts, and investment companies. Below is a brief summary of each project, including tax implications.

Implications and

Next Steps: Lease Accounting

In the nearly two years the FASB and IASB (the “boards”) have spent addressing comments received on their August 2010 leases exposure draft (ED), released by the FASB as a [proposed ASU](#),⁸ the boards have made a number of significant changes to their proposed guidance on leases. However, the right-of-use (ROU) model remains and would require lessees to recognize an ROU asset and a liability for all lease contracts (other than short-term leases). The boards are expected to expose a revised leases ED for a 120-day comment period in the first quarter of 2013. On the basis of this timeline, a final standard is likely to be issued in late 2013 and is expected to be effective no earlier than annual reporting periods beginning on January 1, 2016.

Many entities have accounted for leases as operating leases for tax purposes. Therefore, under current accounting guidance, an entity may have had operating leases for both book and tax purposes, in which case there would be no existing temporary difference related to lease classification. The ED's proposed changes would most likely give rise to new temporary differences for many entities involved in leasing transactions. Because the ED affects all outstanding leases as of the date of initial application, entities will need to be mindful of the significant temporary differences that may arise upon initial application of the final ASU; entities may need to account for such temporary differences on a lease-by-lease basis. Entities also need to consider the potential state tax issues that may arise, including how the classification of the

⁸ FASB Proposed Accounting Standards Update, *Leases*.

ROU asset (tangible vs. intangible) may affect the apportionment formula in the determination of state taxable income and how the significant increase in recorded lease assets could affect the determination of franchise tax payable.

Revenue Recognition

In November 2011, the FASB and IASB jointly issued a revised ED on revenue recognition for a 120-day comment period that ended in March 2012. The revised ED, issued by the FASB as a [proposed ASU](#),⁹ outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and would supersede substantially all current revenue recognition guidance. Although the feedback from entities in most industries was similar and generally indicated support for the boards' efforts to develop a single comprehensive revenue recognition standard, respondents expressed concerns about several aspects of the revised ED. The boards are expected to issue a final standard in the first half of 2013. Under the revised ED, a final standard would be adopted retrospectively (with certain optional practical expedients) and would not be effective before annual periods beginning on or after January 1, 2015, for public entities, with a minimum of a one-year deferral for nonpublic entities.

Tax departments need to assess changes in book revenue recognition methods to prepare for the tax effects of the new standard. Federal income tax law contains specific rules on certain types of revenue, such as income from long-term contracts and advance payments for goods and services. Those rules often overlap with a taxpayer's financial reporting policies, in which case the taxpayer often applies, as its tax method, the revenue recognition method it uses in maintaining its books and records. Because the proposed guidance may change the amount and timing of revenue recognition for entities that maintain their books and records under U.S. GAAP or IFRSs, the accounting proposed in the revised ED may have cash tax implications or give rise to new book-tax differences that will need to be captured, calculated, and tracked through tax accounting processes and systems.

If a change in a tax accounting method is advantageous or expedient, including circumstances in which the book method has historically been used, the taxpayer will most likely be required to obtain approval from the tax authorities. Similar issues may arise in foreign jurisdictions that maintain statutory accounting records under U.S. GAAP or IFRSs.

Financial Instruments

The FASB's and IASB's project on accounting for financial instruments (AFI) addresses the accounting for a broad range of financial instruments, including investments in debt and equity securities, investments in nonmarketable equity securities, loans, loan commitments, deposit liabilities, trade payables, trade receivables, derivatives, and debt liabilities. In a marked contrast to the other priority convergence projects addressed in this publication (revenue recognition and leases), the boards have struggled to develop converged AFI requirements. The AFI project is divided into three major components: classification and measurement (C&M), impairment, and hedge accounting. Although the boards converged key elements of their C&M models in 2012, their views on impairment appear to diverge and they have not worked together on hedge accounting from the beginning. The FASB released a [proposed ASU](#)¹⁰ on impairment in December 2012 and intends to issue a proposed ASU on the C&M component of the AFI project during the first quarter of 2013. At this time, there is no clear timeline for the FASB's hedge accounting component.

For tax purposes, AFI can be quite complex, involving differences in character (capital vs. ordinary) and timing (e.g., mark to market vs. cost). The following factors must also be considered:

- Gains are taxed as ordinary income or as capital gains depending on the tax classification (again, differences in character).
- The classification or measurement attribute applied to the accounting for financial instruments for book purposes may be indicative, but is not determinative, of the tax treatment; differences are common.
- Fair market value measurement requirements under the IRC (e.g., IRC Sections 475 and 1256) differ from the fair value measurement requirements under ASC 820.

⁹ FASB Proposed Accounting Standards Update, *Revenue From Contracts With Customers*.

¹⁰ FASB Proposed Accounting Standards Update, *Financial Instruments — Credit Losses*.

Insurance Contracts

Since the 2010 issuance of the FASB's [discussion paper](#) (DP)¹¹ and IASB's [ED](#)¹² on insurance contracts, several key issues related to this project have emerged as a result of the comment letter process, an extensive outreach program, and countless redeliberations. While the boards have made some progress in reconciling their differing views on these issues, it has become increasingly clear that their new standards on insurance contracts will be similar but not fully converged. Nevertheless, the boards remain committed to convergence whenever possible and will continue to jointly redeliberate this project.

The IASB recently confirmed its decision to reexpose the insurance contracts ED in the first half of 2013. The reexposed ED's questions for respondents will be limited to aspects of the ED that have significantly changed as a result of the IASB's redeliberations. The decision to reexpose, rather than issue a review draft, was made despite some board members' concerns that such a decision would further delay the issuance of a final standard, which is now targeted for 2014. The IASB also recently noted that it would allow approximately three years for implementation; thus, the mandatory effective date would be no earlier than January 1, 2017, and possibly as late as January 1, 2018.

The FASB recently published a revised timetable for its ED, which has been delayed until the first half of 2013 to coincide with the issuance of the IASB's ED. Although the effective date for the FASB's standard on insurance contracts remains uncertain, it is expected to be no earlier than the IASB's effective date (i.e., January 1, 2017, at the earliest).

Several aspects of the new insurance contracts standard will affect the accounting for income taxes. For example, the new standard will change the accounting for deferred acquisition costs, which may result in substantial changes to the corresponding deferred taxes. In addition, entities need to consider the income tax effects of the "other comprehensive income (OCI) solution." Under the OCI solution, changes in the insurance liability resulting from the remeasurement of the discount rate as of each reporting period will be recognized in OCI in an effort to limit profit-and-loss volatility.

Some aspects of the new insurance contracts standard will be closely related to the changes made by the revenue recognition and financial instruments standards. Tax departments should consider the income tax accounting effects related to those standards in evaluating the insurance contracts standard, since the timing of the new standards is expected to be similar. See the [Revenue Recognition](#) and [Financial Instruments](#) sections above for further discussion of these projects.

Investment Companies

In October 2011, the FASB and IASB issued an ED (released by the FASB as a [proposed ASU](#)¹³) on identifying when an entity qualifies as an investment company. In response to feedback, the boards have subsequently agreed that to qualify as an investment company, an entity would only have to meet certain of the original six criteria outlined in the ED. The remaining criteria would still be included in the definition, but only as characteristics typical of investment companies; an entity would consider these characteristics in determining whether it meets the revised definition of an investment company. The boards have tentatively decided not to provide any guidance on how an investment company should account for its controlling financial interests in another investment company. This is a significant departure from the guidance in the FASB's ED, which would have required an investment company to consolidate a controlling financial interest in another investment company. In another difference from the ED, the FASB has tentatively agreed that all real estate investment trusts (REITs) would be outside the scope of the investment company requirements. The final guidance would be effective for interim and annual periods in fiscal years that begin on or after December 15, 2013, for both public and nonpublic entities. Early adoption would be prohibited.

Entities should monitor any changes to the definition of an investment company as the new standard is finalized, since these changes could affect whether an entity qualifies for investment company accounting. Note that investment companies may be considered pass-through entities that are not considered taxable because the applicable tax laws and regulations attribute the income tax to the owners of the pass-through entity rather than to the pass-through entity itself. Certain entities that function similarly to a pass-through entity, such as REITs and regulated investment companies (RICs), are also considered tax-exempt in substance. DTAs and DTLs on taxable and deductible temporary differences

¹¹ FASB Discussion Paper, *Preliminary Views on Insurance Contracts*.

¹² IASB Exposure Draft, *Insurance Contracts*.

¹³ FASB Proposed Accounting Standards Update, *Financial Services — Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*.

that are attributable to an investment in a pass-through entity (i.e., “outside basis differences”) may need to be recorded for entities that qualify as investment companies under the new guidance. Outside basis differences result from differences between the carrying amount of the investment company on the parent level for financial reporting purposes and the underlying tax basis in that investment.

Other Resources: See the following Deloitte publications for additional guidance on the FASB’s and IASB’s joint projects:

- [December 21, 2012, *Heads Up*, “FASB Settles on Single Impairment Model for Financial Assets.”](#)
- [October 16, 2012, *Heads Up*, “IASB Issues Draft of Hedge Accounting Model.”](#)
- [September 27, 2012, *Heads Up*, “Overview of Board Decisions on the Leases Project.”](#)
- [September 24, 2012, *Heads Up*, “Update on FASB’s Project on Classifying and Measuring Financial Instruments.”](#)
- [April 13, 2012, *Heads Up*, “Comments on the Revised Exposure Draft on Revenue Recognition.”](#)
- [Insurance: Accounting and Financial Reporting Update](#) (December 2012).
- [Real Estate: Accounting and Financial Reporting Update](#) (December 2012).
- [Banking & Securities: Accounting and Financial Reporting Update](#) (December 2012).
- [Asset Management: Accounting and Financial Reporting Update](#) (December 2012).
- [Power & Utilities: Accounting, Financial Reporting, and Tax Update](#) (January 2013). ●

Proposed New Disclosures for Reclassification Adjustments Out of AOCI

Affects: All entities.

Summary: On August 16, 2012, the FASB issued a [proposed ASU](#)¹⁴ that would expand the disclosure requirements for items reclassified out of accumulated other comprehensive income (AOCI) for both interim and annual periods. The proposal focuses on new disclosures and would not otherwise modify the current requirements for the reporting of net income or OCI in the financial statements. OCI includes gains and losses that are initially excluded from net income. Those gains and losses are later reclassified out of AOCI. The proposed ASU would require entities to use two separate tables to disclose the activity within AOCI: one reflecting changes in AOCI and the other reflecting items reclassified out of AOCI. The table disclosing reclassifications out of AOCI (including the income tax effects) would need to contain information about the affected net income line item for each reclassified component, except for those components of AOCI that are not reclassified into net income in their entirety. For those reclassifications, entities should include cross-references (when applicable) to other disclosures that discuss such items (e.g., the defined benefit plan note disclosures).

Implications and

Next Steps: Tax effects related to reclassification adjustments are computed under ASC 740-20. Under the general intraperiod tax allocation rules, an entity is generally required to calculate the tax expense or benefit from items reported in continuing operations without considering the tax effects of items other than continuing operations. When an amount is reclassified (e.g., moved from AOCI to continuing operations) there is often no identifiable tax effect related to the amount now included in continuing operations (i.e., there is no associated current tax effect or change in deferred taxes). For example, this phenomenon occurs regularly in the accounting for defined benefit plans as actuarial gains or losses are initially recorded in AOCI and then allocated over time to net periodic benefit cost.

One approach to addressing the reclassification issue is to associate pretax reclassified amounts with hypothetical movements in the related balance sheet account to “create” related tax effects under the intraperiod tax allocation rules (this approach would comply with the requirement to determine the tax consequences of items in continuing operations without considering the tax effects of items other than continuing operations).

¹⁴ FASB Proposed Accounting Standards Update, *Presentation of Items Reclassified Out of Accumulated Other Comprehensive Income*.

In addition, it is not uncommon for residual tax effects or rate anomalies to remain in AOCI when entities apply the intraperiod tax allocation rules. Any such residual tax effects in AOCI should be released to income from continuing operations on the basis of an entity's separate accounting policy for releasing residual tax effects related to each AOCI component.

Other Resources: For more information, see Deloitte's [September 2012 Accounting for Income Taxes: Quarterly Hot Topics](#).

Two Income Tax Accounting Topics Added to the EITF's Agenda

Affects: Certain entities with liabilities for unrecognized tax benefits (Issue 13-C) and entities that invest in certain affordable housing projects (Issue 13-B).

Summary: In November 2012, the FASB chairman added the following two topics to the EITF's agenda:

- Presentation of a liability for an unrecognized tax benefit when an NOL or tax credit carryforward exists (Issue 13-C).
- Accounting for investments in tax credits (Issue 13-B).

Presentation of a Liability for an Unrecognized Tax Benefit When an NOL or Tax Credit Carryforward Exists

A liability for an unrecognized tax benefit sometimes does not result in a cash payment when an NOL or tax credit carryforward is used to settle that liability. Under U.S. GAAP, there is no explicit guidance on presentation of such a liability in the financial statements, which has led to diversity in practice. Many entities apply an approach that the FASB has proposed in its responses to technical inquiries about this topic. Under this approach, an unrecognized tax benefit should be presented as a separate liability (i.e., on a gross basis) in the statement of financial position unless the unrecognized tax benefit "is directly associated with a tax position taken in a tax year . . . that resulted in the recognition of an NOL carryforward for that year,"¹⁵ in which case the liability would be presented on a net basis. However, some entities believe that an unrecognized tax benefit should be presented net of a DTA for an NOL or tax credit carryforward "when the uncertain tax position would, or is available to, reduce the NOL or tax credit carryforward under the provisions of the tax law." In addressing the diversity in practice related to net presentation of a liability for an unrecognized tax benefit, the Task Force is considering both of these approaches as well as a third alternative under which entities may choose either approach as an accounting policy election.

Accounting for Investments in Tax Credits

The Low-Income Housing Tax Credit (LIHTC) program is a federal government program designed to stimulate investment in the construction and rehabilitation of low-income housing. The program provides tax credit benefits to the owners of an entity that owns qualifying property. Generally, these investments (and investments in programs similar to LIHTC) are accounted for under the equity method.¹⁶ Under the equity method, the pretax investment performance and tax benefits are presented separately in the statement of financial performance (and the tax benefits are included in the tax provision). Some entities use an alternative method, known as the "effective yield" method, to account for these investments. Under the effective yield method, an investment's performance is presented in the statement of financial performance on a net basis along with the tax benefits within an entity's tax provision. However, this method can only be used when an entity meets certain U.S. GAAP¹⁷ criteria related to LIHTC investments (most entities are not able to meet these criteria). Some believe that the financial statement presentation under the equity method makes an investment's total performance difficult to understand since LIHTC investments generally result in pretax losses but are profitable with respect to the tax benefits.

This Issue was added to the EITF's agenda to consider potential accounting and disclosure alternatives to the current U.S. GAAP requirements for these investments. The FASB chairman limited the scope of this

¹⁵ That is, an NOL carryforward has not yet been used.

¹⁶ Some entities might also account for these investments under the cost method or at fair value when the fair value option has been elected.

¹⁷ EITF Issue No. 94-1, "Accounting for Tax Benefits Resulting From Investments in Affordable Housing Projects" (codified in ASC 323-740).

¹⁸ See footnote 16.

Issue to the current U.S. GAAP¹⁸ guidance on LIHTC investments.

Implications and

Next Steps: At the EITF's January 17, 2013, meeting, the Task Force reached a consensus-for-exposure on Issue 13-C that an unrecognized tax benefit should be presented as a reduction of a DTA for an NOL or tax credit carryforward (rather than as a liability) when the uncertain tax position would, or is available to, reduce the NOL or tax credit carryforward under the provisions of the tax law. The EITF plans to discuss Issue 13-B during its March 14, 2013, meeting. After the EITF reaches a consensus, a "consensus-for-exposure" will be published for a comment period upon ratification by the FASB. After the comment period, the Task Force will consider comments received and, as warranted, affirm the consensus-for-exposure as a final consensus. The final consensus will then be provided to the FASB for ratification.

Other Resources: For more information about EITF developments, watch for our future *EITF Snapshot* publications that summarize the decisions reached during each EITF meeting. See Deloitte's January 18, 2013, *EITF Snapshot* for a summary of the decisions reached on Issue 13-C during January's EITF meeting. ●

FASB Moves Forward With Private-Company Accounting Standards

Affects: Private entities.

Summary: On May 23, 2012, the board of trustees of the Financial Accounting Foundation (FAF), the FASB's parent organization, approved the formation of the Private Company Council (PCC), which is tasked with improving the accounting standard-setting process for private companies. Shortly thereafter, the FAF released a *final report* discussing the establishment of the PCC and highlighting its two main responsibilities: (1) to determine whether exceptions or modifications to existing nongovernmental U.S. GAAP would benefit end users of private-company financial statements and (2) to advise the FASB on how private companies should treat items on the FASB's technical agenda. Any modifications or exceptions to U.S. GAAP developed by the PCC will become final if endorsed by the FASB.

Further, on July 31, 2012, the FASB staff released a *DP*¹⁹ requesting comments on a proposed framework that the FASB and PCC would use to determine whether modifications or exceptions to existing and proposed U.S. GAAP are warranted for private companies. The draft framework addresses the following areas in which exceptions or modifications might be considered: recognition and measurement, disclosure, presentation, effective date, and transition guidance.

Implications and

Next Steps: During the PCC's first meeting (held on December 6, 2012), the FASB staff presented several issues raised by constituents over the past few years of public outreach. The PCC identified four areas to research for agenda consideration, including the accounting for uncertain tax positions. Private entities should be sure to keep informed about future private-company standard-setting projects, since the potential changes resulting from these projects could affect the accounting for income taxes.

Other Resources: For more information about the developments in private-company standard setting, see Deloitte's *June 5, 2012*, and *August 7, 2012*, *Heads Up* newsletters. ●

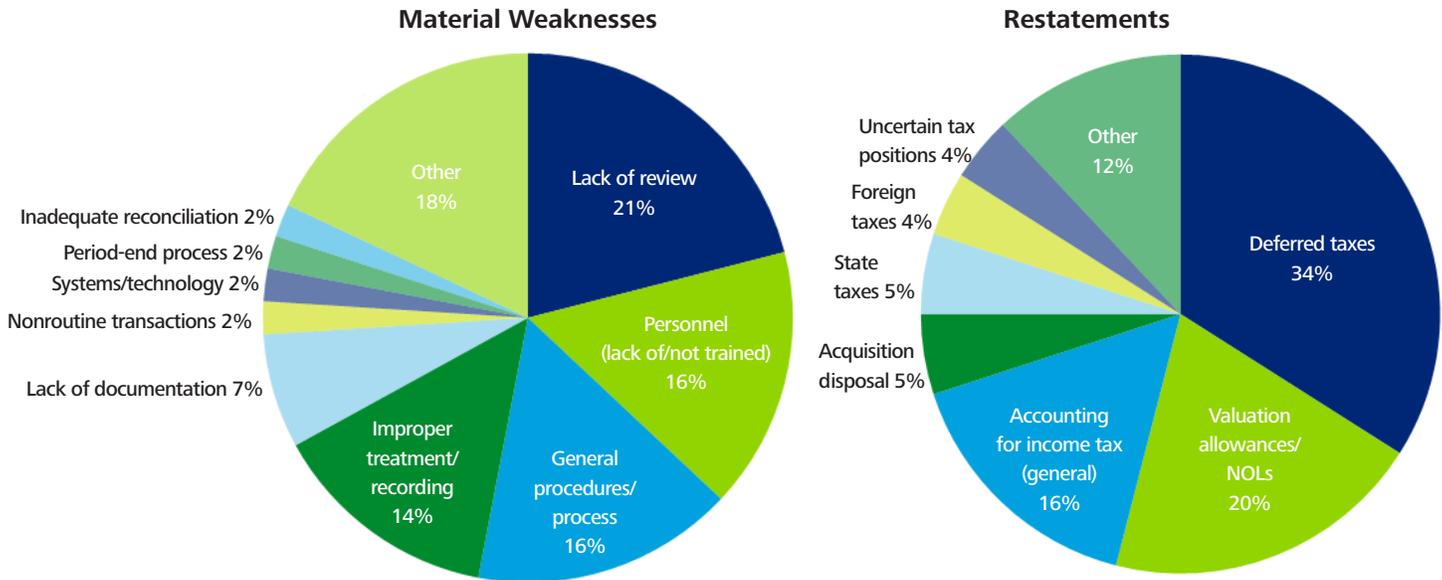
Other Developments

Internal Controls and Oversight of the Financial Reporting Process

Affects: All entities.

Summary: Corporate tax departments continue to find it challenging to account for income taxes, sometimes resulting in internal control deficiencies and restatements. As shown in the chart below, the leading causes of tax-related material weaknesses in internal controls in SEC filings during 2011 continued to be insufficient review by management, personnel issues (either a lack of sufficiently trained personnel or an insufficient number of personnel), improper treatment and recording of items under U.S. GAAP, and problems with general procedures and processes. Moreover, tax-related matters remained one of the top 10 causes of restatements in 2011. The most commonly affected tax-related areas were deferred taxes, valuation allowances, and general accounting for income taxes. Multijurisdictional tax reporting

¹⁹ FASB Discussion Paper, *Invitation to Comment — Private Company Decision-Making Framework: A Framework for Evaluating Financial Accounting and Reporting Guidance for Private Companies*.



requirements could also increase the complexity of income tax accounting, thereby increasing the risk of error and, ultimately, restatement.

It continues to be important for entities to focus on the effectiveness of internal controls, particularly for foreign operations, when considering risks associated with the accounting and financial reporting for income taxes. In a speech at the 2011 AICPA National Conference on Current SEC and PCAOB Developments, Kyle Moffatt, associate chief accountant in the SEC’s Division of Corporation Finance, indicated that controls for foreign operations continue to be among the leading causes of material weaknesses and restatements. In evaluating assertions of whether internal controls are effective, the SEC focuses on assessing whether the management teams of foreign operations have the appropriate knowledge and skills to prepare financial statements in accordance with U.S. GAAP.

There are a number of challenges associated with the monitoring of tax issues for foreign operations; common examples are listed in the following table:

Risk Management	Cost Containment
<ul style="list-style-type: none"> • Keeping up to date with legal and regulatory changes. • Coordinated management of global audit activities. • Demand for transparency by investors and shareholders. • Increased focus on financial reporting. • Access to proper knowledge and skills to comply with tax requirements in each jurisdiction, including adjustments from U.S. GAAP to local GAAP. 	<ul style="list-style-type: none"> • Inability to increase headcount to cover increased workload. • Expectation for tax executives to manage the global cost of tax services, even when costs are not in the tax budget. • Insufficient information on internal and external activities. • Lack of information on the scope of services provided for specific fees. • Lack of visibility regarding the fees charged for tax services.

Implications and

Next Steps: Some internal auditors are reevaluating their audit plan for taxes or including it for the first time. This plan may include undertaking a tax risk assessment, evaluating the appropriateness of controls, and assessing the validity of mitigation factors.

Among multinational corporations, increased visibility and transparency are needed with respect to global tax compliance and reporting. An entity may consider engaging its tax department and internal auditors to confirm that the appropriate actions are being taken to respond to developments and that risk oversight and mitigation activities are properly coordinated. Entities are looking to address these

and other operational risks by considering the transparency, costs, and risks associated with foreign jurisdictions; the recent trend has been to use a centralized model to mitigate these risks.

Another practice that has emerged in recent years to manage financial reporting risk is the preparation of a tax basis balance sheet. A balance-sheet-focused analysis of deferred tax items, when properly implemented and maintained, can enhance the efficiency and accuracy of tax accounting processes. When incorporated into ongoing tax processes by using a tax technology tool, a tax basis balance sheet approach can help entities perform tax accounting calculations and manage financial reporting risks.

Other Resources: The following Deloitte resources provide additional guidance on internal controls and oversight of the financial reporting process:

- November/December 2012 *Audit Committee Brief*, “Top Issues for Audit Committees in 2013.”
- October 2012 *Audit Committee Brief*, “Tax Risks for U.S.-Based Multinationals.”
- *Tax Basis Balance Sheet Analysis: An Approach for Continuous Improvement in Financial Reporting for Income Taxes*.
- *Tax and Internal Auditing: Augment Your Internal Audit Resources to Enhance Performance*.
- *Effective Integration, Enhanced Decision Making: The Risk Intelligent Tax Executive*. ●

Income Tax Reporting Implications of Hurricane Sandy

Affects: All entities.

Summary: Hurricane Sandy made landfall as a “superstorm” in the northeastern United States in late October 2012. In addition to tragic loss of life, Sandy caused widespread damage and destruction of property, disruption of power supplies, and disruption of business activity to varying degrees in regions of the United States and parts of the rest of the world. Affected entities reporting under U.S. GAAP should consider the tax implications of this natural disaster. Such entities may include those with principal operations in the affected area of the United States or those with ancillary operations, business interests, or major suppliers in the affected region.

Implications and

Next Steps: In light of a significant event, such as a disaster, an entity may need to reassess its need for a valuation allowance against DTAs. When affected by a significant disaster, an entity may conclude that it will not be able to generate sufficient results in the future to realize its existing DTAs and, therefore, to determine that a valuation allowance and related disclosures are required. Further, asset impairments or write-offs may result in a loss of DTLs, which previously would have been considered a source of future taxable income upon reversal. For an entity that uses foreign tax credits, management may need to revisit the entity’s state or global apportionment as income shifts from affected to nonaffected operations. Foreign earnings that were previously indefinitely reinvested may need to be repatriated to the United States in the future, in which case an entity would be required to establish a DTL related to future U.S. taxation of such income.

In addition, all of the above items may affect an entity’s interim accounting for income taxes. An entity should consider the potential impact of these items on the entity’s annual effective tax rate.

Other Resources: For more information about the income tax implications of Hurricane Sandy and other disasters, see

Deloitte's November 2012 [practice guide](#). ●

Income Tax Reporting Implications Related to the Eurozone's Economic Struggles

Affects: Entities with operations or other interests that may be affected by current events in the eurozone.

Summary: Economic conditions, particularly in Europe, continue to be volatile. Greece's election and formation of a new government in 2012, as well as other actions this year by eurozone leaders, may have alleviated some fears and mitigated the risk that Greece or other countries will exit the eurozone (i.e., discontinue the use of the euro²⁰ as their currency). However, for the time being, the situation remains uncertain — as does the general economic outlook for Europe and other regions.

Entities should carefully consider their distinct circumstances and risk exposures when analyzing how eurozone events may affect their financial reporting. Most importantly, they should confirm that their financial reporting and disclosures convey all material effects that have resulted, or could result, from events in the eurozone. This may necessitate disclosures (both within the financial statements and MD&A or other sections of SEC filings) beyond those specifically required by U.S. GAAP or SEC regulations.

Implications and

Next Steps: Entities should consider how potential liquidity and impairment concerns associated with the current eurozone environment might affect their income tax accounting. For instance, under U.S. GAAP, a DTA must be reduced by a valuation allowance to the extent that an entity determines that it is more likely than not that some or all of the DTA will not be realized. When such a determination is made, a reduction in forecasted performance may lead to a reassessment of the extent to which DTAs are not expected to be realized. To the extent that declining valuations or impairments generate NOLs, an entity will need to consider the character (i.e., capital or operating) and carryforward period of the associated NOL and evaluate whether a sufficient amount of income of appropriate character and timing exists to fully realize the related DTA.

Entities may also need to reconsider assertions made regarding the indefinite reinvestment of undistributed subsidiary earnings. Under U.S. GAAP, parent entities that assert the indefinite reinvestment of undistributed subsidiary earnings must substantiate and support the plan for reinvestment on a subsidiary-by-subsidary basis. Accordingly, liquidity or other issues resulting from the eurozone environment may affect or change a parent entity's plans or ability to assert indefinite reinvestment.

Other Resources: For more information about the financial reporting implications of the eurozone's economic struggles, see Deloitte's July 6, 2012, [Heads Up](#). ●

Tax Considerations Related to Carve-Out Financial Statements

Affects: All entities.

Summary: As entities refocus on their core strategies to sustain future growth, many are finding that divestitures of parts of their businesses, including spin transactions, have become larger and more complex. Entities will often need to prepare carve-out financial statements in conjunction with a divestiture. Determining the information related to tax provisions (e.g., balance sheets, expenses and benefits) is typically one of the most complex aspects of preparing such financial statements.

Implications and

Next Steps: Up-front planning can ease the burden on entities and increase the likelihood of a successful divestiture transaction. For entities that will prepare carve-out financial statements, such planning should include the involvement of tax professionals and advisers in the earliest stages so that tax matters can be appropriately addressed before the substantive work begins. Some of the more complex aspects of carve-out financial statements include:

- Deciding the most appropriate approach for determining deferred taxes (i.e., a top-down or bottom-up approach).
- Determining the tax effect of certain accounting carve-out adjustments (e.g., corporate overhead and reserves).
- Developing an acceptable systematic and rational method, such as the separate-return method, to

²⁰ The euro is the currency of the following 17 member states of the European Union: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain.

recalculate certain consolidated tax adjustments on a carve-out basis.

- Assessing certain tax-specific carve-out adjustments, including the build-up and use of tax attributes, tax reserve computations, and the need for a valuation allowance.
- Calculating the amount of federal and state taxes payable in the carve-out financial statements, since this is likely to be different from the amount previously booked and paid by the entities that are part of the carve-out operations.
- Recalculating the apportionment for the carve-out operations on a stand-alone basis to determine a reasonable blended state statutory tax rate.
- Considering international tax implications, including, but not limited to, the following: (1) the need to extract carve-out operations from an existing foreign consolidated group or single legal entity, (2) identification and use of foreign-specific tax attributes and NOLs, and (3) intercompany transactions that may be eliminated on a carve-out basis.
- Preparing a comprehensive tax footnote as part of the carve-out financial statements.

Other Resources: For more information, see Deloitte's [Carve-Out Financial Statements: Tax Considerations and Complexities](#). ●

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Further information about the standard setters can be found on their respective Web sites as follows: www.fasb.org (FASB); www.fasb.org/eitf/agenda.shtml (EITF); www.aicpa.org (AICPA); www.sec.gov (SEC); www.pcaob.org (PCAOB); www.fasab.gov (FASAB); www.gasb.org (GASB); and www.ifrs.org — or on www.iasplus.com/en (IASB and IFRS Interpretations Committee).

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