NAVIGATING STATE TAXATION IN A GLOBAL BUSINESS ENVIRONMENT

Accounting for State Taxes

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Agenda

Identifying and measuring deferred taxes

Taxes and credits within the scope of ASC 740

State tax hot topics

Uncertain tax positions

What to remember

Questions

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Identifying and measuring deferred taxes

Measuring deferred taxes
ASC 740-10-30-5

Deferred taxes determined separately for each tax-paying component (an individual entity or group of entities that is consolidated for tax purposes) in each taxing jurisdiction

DTAs and DTLs for temporary differences are measured using the applicable tax rate (ATR)

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State ATR

Deferred tax computations

State ATR is the product of the enacted tax rate and the business apportionment factor (federal ATR simply uses the enacted tax rate)

Tax rate expected to apply when temporary differences reverse (generally marginal rates unless graduated rates have material impact)

Apportionment factors can significantly impact the state ATR

- As a shortcut, entities sometimes use prior year apportionment factors and current year statutory rates
- Apportionment percentages should be adjusted for significant current year changes, such as recent changes in business activities (certain expected changes, such as acquisitions or divestitures and internal restructurings, should not be included until they are reflected in the financial statements)

Note: Consultation with your attest firm is recommended

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State ATR

Deferred tax computations (cont'd)

Blended State Rate

- As a shortcut, companies sometimes use an average of the state ATR for multiple taxpaying components then apply it to the cumulative temporary differences of the consolidated financial reporting group

Generally, state ATR should be:

- Calculated for each taxpaying component (an individual entity or group of entities) within the consolidated financial reporting group
- Applied to that taxpaying component's cumulative temporary differences

Note: Consultation with your attest firm is recommended

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Blended vs. separate company ATR

Example

Description	Entity X	Entity Y	Total	
Temporary differences	900	100	1,000	
Current year taxable income	100	200	300	
State tax rate	3%	5%		
Tax	**3**	**10**	**13**	
Blended				
Blended state rate ($13 divided by $300)			4.33%	
Consolidated temporary differences			1,000	
Deferred tax assets			**43**	**[a]**
Separate Company				
Separate company state rates	3%	5%		
Separate company temporary differences	900	100		
Deferred tax assets	**27**	**5**	**32**	**[b]**
Difference		**= [a]–[b]**	**11**	

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Effective tax rate (ETR) vs. ATR

Example

Facts

- Corp X apportions its income to 2 states (statutory rate of 7% each)
  - Current pretax income is $1,000 and unfavorable temporary differences are $800
- Corp X is implementing an approach that will shift its third-party licensing function to a NewCo and, with it, $200 of book and taxable income
  - Corp X will continue to file returns in the original 2 states and NewCo will be required to file in a new state with a statutory rate of 2%

Before Planning		
Description	**Corp X**	
Pretax income	**$1,000**	**[a]**
Temp differences	800	
State taxable income	**$1,800**	
State tax rate	7%	
Current tax expense – State	**$ 126**	
Deferred tax expense – State	**($ 56)**	
Total income tax expense – State	**$ 70**	**[b]**
ETR = [b] ÷ [a]	**7%**	
ATR to measure temps	**7%**	

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ETR vs. ATR

Example (cont'd)

ETR and ATR before and after planning

Before Planning		
Description	**Corp X**	
Pretax income	**$1,000**	**[a]**
Temp differences	800	
State taxable income	**$1,800**	
State tax rate	7%	
Current tax expense – State	**$ 126**	
Deferred tax expense – State	**($ 56)**	
Total income tax expense – State	**$ 70**	**[b]**
ETR = [b] ÷ [a]	**7%**	
ATR to measure temps	**7%**	

After Planning				
Description	**Corp X**	**NewCo**	**Total**	
Pretax income	**$ 800**	**$200**	**$1,000**	**[c]**
Temp differences	800	0		
State taxable income	**$1,600**	**$200**		
State tax rate	7%	2%		
Current tax expense – State	**$ 112**	**$ 4**	**$ 116**	
Deferred tax expense – State	**($ 56)**	**$ 0**	**($ 56)**	
Total income tax expense – State	**$ 56**	**$ 4**	**$ 60**	**[d]**
ETR = [d] ÷ [c]			**6%**	
ATR to measure temps			**7%**	

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ETR vs. ATR

Example (cont'd)

Observations

- After planning, Corp X must use its ATR of 7% not its new ETR of 6% to measure temporary differences
- Planning has no effect on Corp X's ATR (statutory rate x apportionment percentage)
- If Corp X were to measure its temporary differences at the new ETR of 6%, it could understate the impact temporary differences have on income taxes payable in the year of reversal (see continuation of example)

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ETR vs. ATR

Example (cont'd)

Additional facts and solution

- Corp X has $2,000 of pretax income in Year 2 when temporary difference reverses, as follows

Description	Corp X	New Co	Total
Book income	**$1,800**	**$200**	**$2,000**
Temporary difference	(800)	0	(800)
Taxable income	**$1,000**	**$200**	**$1,200**
State tax rate	7%	2%	
Current tax expense – State	**$ 70**	**$ 4**	**$ 74**
Deferred tax expense – State*	**$ 56**	**$ 0**	**$ 56**
Income tax expense – State	**$ 126**	**$ 4**	**$ 130**
State ETR	**7%**	**2%**	**6.5%**

* Temporary difference results in a tax savings at the rate of 7% in Year 2. If the DTA had been incorrectly recorded at the ETR of 6% in Year 1, the ETR in Year 2 would have been 6.1%.

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Scheduling of ATR

Example

Facts

- A single entity company files tax returns in Jurisdiction A that has an enacted statutory tax rate of 9%
- In 20X0, the company apportioned 100% of its income to Jurisdiction A
- At the end of 20X0, the company had net taxable temporary differences of $500 expected to reverse at various times over the next 5 years
- During 20X0, Jurisdiction A enacts a phased-in triple weighted apportionment sales factor that will decrease the company's total apportionment factor in Jurisdiction A to 60% over the next 5 years

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Scheduling of ATR

Example (cont'd)

Solution

Description	Total Balance Sheet Amount	Scheduled to Reverse in				Total as Scheduled
		20X1	20X2	20X3	20X4 & Later	
Deductible temporary differences	$4,500	$4,250	$ 250	$ 0	$ 0	$4,500
Taxable temporary differences	(5,000)	(250)	(250)	(500)	(4,000)	(5,000)
Net temporary differences	**($ 500)**	**$4,000**	**$ 0**	**($500)**	**($4,000)**	**($ 500)**
Apportionment	100%	90%	80%	60%	60%	
Tax rate	9%	9%	9%	9%	9%	
State tax effect – correct		**$ 324**	**$ 0**	**($ 27)**	**($ 216)**	**$ 81**

State tax effect – incorrect	**($ 45)**	**Current applicable rate (incorrect)**
Net temporary differences	**($ 500)**	
Expected apportionment	60%	
Tax rate	9%	
"Expected" deferred – incorrect	**($ 27)**	**Without scheduling (incorrect)**

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Valuation allowances

- Jurisdiction-specific laws have to be considered when assessing the need for a valuation allowance which can lead to a different conclusion than federal
  - Different number of years for carryforward/carryback periods
  - Annual limitations on the amount and type of income that can be carried back or carried forward
- Forecasts related to future income should be consistent with estimates used for other purposes
- Business changes should be considered to determine which should be anticipated and which should not
- Certain state attributes may have little to no likelihood of being utilized
  - For example, taxpayers may have NJ AMA nexus but not income tax nexus (taxpayer never able to utilize credit since not subject to income tax)
  - Consider whether VA is appropriate or whether the DTA should be written off

Note: Consultation with your attest firm is recommended

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Taxes and credits within the scope of ASC 740

Scope

Overview

ASC 740-10-05-1

- The Income Taxes Topic addresses financial accounting and reporting for effects of income taxes that result from an entity's activities during current and preceding years
- "Income" is not defined but "taxable income" is defined

Definitions

- Income taxes — domestic and foreign federal (national), state, and local (including franchise) taxes based on income
- Taxable income — the excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority

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Scope

Distinctions between income and non-income taxes

Financial Statement Item	Description
Current tax payable or receivable	• Accrued for both income and non-income taxes
Deferred tax assets and deferred tax liabilities	• Recorded for income taxes only
Uncertainties	• UTBs related to income taxes (ASC 740) • Contingent liabilities related to non-income taxes (ASC 450)
Presentation	• Income taxes reported below the line • Non-income taxes reported above the line (impacts financial ratios differently)
Disclosure	• Income tax-related (numerous and specific) • Non-income tax-related (different requirements)

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Scope

Distinctions between income and non-income taxes (cont'd)

Examples of taxes not within the scope of ASC 740

- Gross receipts taxes
- Capital taxes
- Taxes withheld on behalf of and for the benefit of the recipient of the payment or distribution (i.e., dividends, interest, royalties, services, etc.), assuming the recipient is not a member of the consolidated financial group

Whether a tax is an "income tax" may not be obvious, e.g.,

- An increasing number of jurisdictions assess taxes based on gross receipts less certain current period deductions (e.g., Texas)
- The tax law may state that the tax is not an income tax (e.g., Texas), but the tax may still be within the scope of ASC 740

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Taxes within scope of ASC 740

Example — Texas margin tax

Assessed on Texas-sourced taxable margin computed as lesser of:

- 70 percent of total revenue
- Total revenue less cost of goods sold
- Total revenue less compensation

Consider magnitude of deductions/adjustments to tax base

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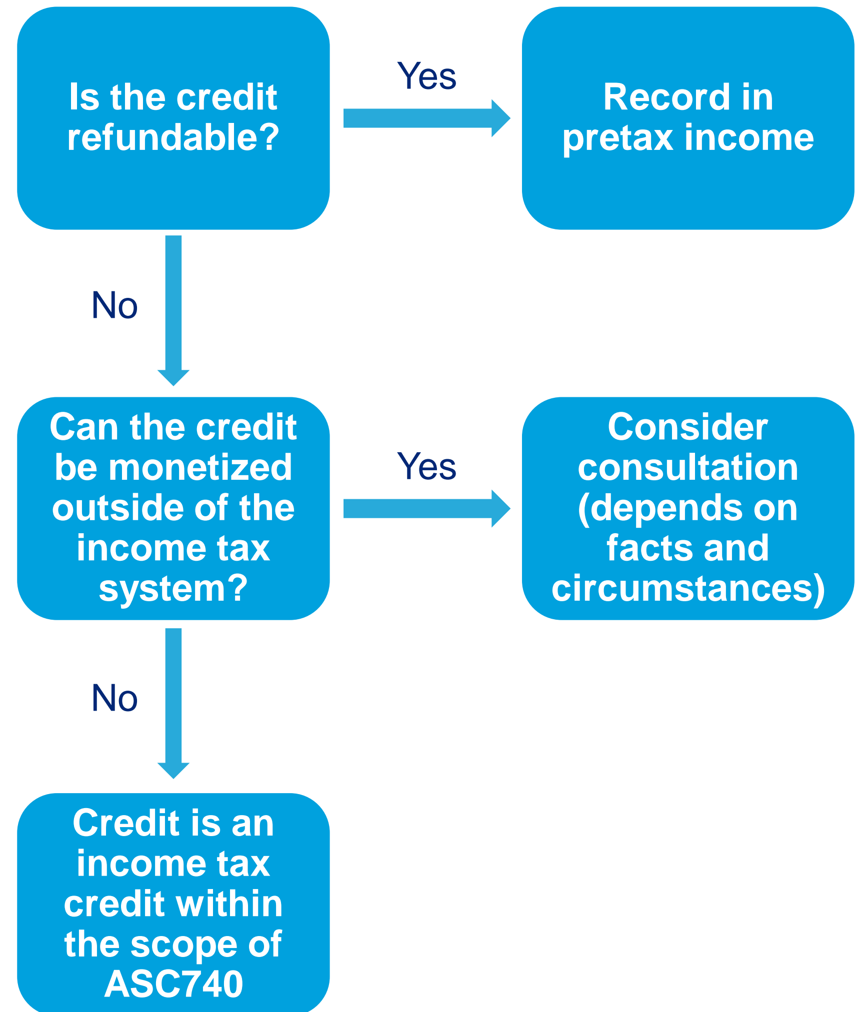
Is a credit an income tax item?

Overview

- Determining whether credits are within the scope of ASC 740 may not always be clear; generally, refundable credits are accounted for outside the scope of ASC 740 since monetizing the credits is not dependent upon taxable income, whereas nonrefundable credits are in the scope of ASC 740
- Should consider
  - Purpose of the credit
  - Impact on tax basis
  - How the credit is computed
  - How and when the credit is refunded or monetized



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Refundable tax credits

Example

Question

- Are “refundable” tax credits within scope of ASC 740 and accordingly classified within income tax expense in the financial statements?

Solution

- If realization of the tax credit does not depend on the entity's generation of future taxable income or entity's ongoing tax status or tax position, the credit is not considered an element of income tax accounting under ASC 740
- If a new tax law changes the way a tax credit previously in the scope of ASC 740 is realized, an entity could continue to apply ASC 740 to the credits recognized at the time of the law change
  - Any new credits earned after the tax law change might be accounted for differently

Note: Consultation with your attest firm is recommended

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Non-income based credit

Example — Business enterprise zone equipment sales tax credit

Facts

- Credit for sales taxes paid on purchase of certain business property used exclusively in an enterprise zone for at least 3 years
- Certain limitations apply to maximum amount of credit and minimum sales price

Question

- Is the credit in the scope of ASC 740?

Solution

- Since the credit is unrelated to any measure of taxable income, it is not an income based tax credit within the scope of ASC 740

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Investment tax credits

Accounting methods

ASC 740-10-25-46

- Identifies the deferral method and the flow-through method as acceptable methods of accounting for investment tax credits
  - Preferred: Allowable investment tax credit reflected in net income over the productive life of acquired property (deferral method)
  - Acceptable: Allowable investment tax credit as a reduction of federal income taxes in the year the credit arises (flow-through method)

ASC 740-10-50-20

- Whichever method of accounting for the investment tax credit is adopted, full disclosure must be made of the method followed and amounts involved (when material)

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Environmental tax credit

Example

Facts

- Jurisdiction X provides an income tax credit to manufacturers based on cost of constructing or improving facilities where products are made of recycled materials or products are powered by solar energy or other forms of renewable energy
- Non-refundable credit against income tax equal to 10% of qualifying construction cost
- No carryback,15-year carry forward
- No reduction in tax basis is required for credit received
- Jurisdiction X has a 7% statutory tax rate
- Company A constructs an energy efficient building for $100M that qualifies for the 10% tax credit (assume 100% of cost qualifies)

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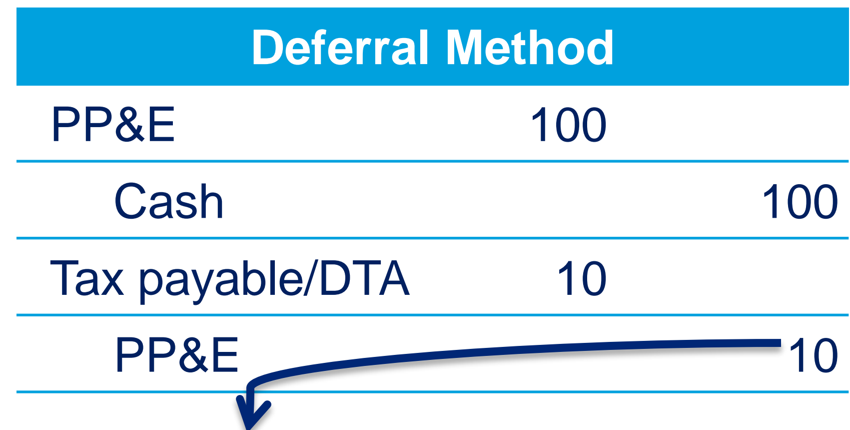
Environmental tax credit

Example (cont'd)

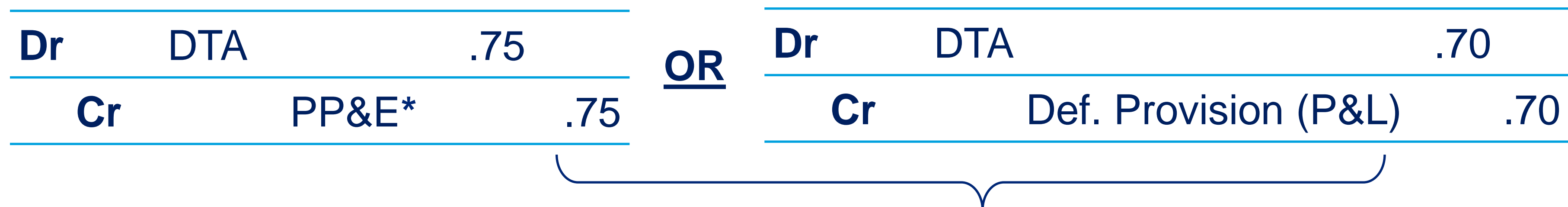
Solution

Flow-through Method		
PP&E	100	
Cash		100
Tax payable/DTA	10	
P & L		10



Deferral Method		
PP&E	100	
Cash		100
Tax payable/DTA	10	
PP&E		10

Deferred taxes for book/tax basis difference in PPE under deferral method



Dr	DTA	.75	
Cr	PP&E*		.75

OR

Dr	DTA	.70	
Cr	Def. Provision (P&L)		.70

$**0.05** difference in deferred provision when ***DTA*** reverses is offset by lower depreciation expense

* (7%/(1-7%)) x $10 = $ .75

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Purchased tax benefits

Credits and other attributes

From a third party (ASC 740-10-25-52)

- Record DTA for future tax benefits purchased from a third party
- No immediate tax benefit
- Record deferred credit for difference between amount paid for future tax benefit and DTA (deferred credit is not a DTL)
- Applies to purchases from a third party which is not a government acting in its capacity as a taxing authority

From the government (ASC 740-10-25-53)

- Record DTA for future tax benefits purchased from the government
- Generally results in immediate tax benefit
- Record tax benefit for difference between amount paid for future tax benefit and DTA
- Applies to transactions between a taxpayer and government only if government is acting in its capacity as a taxing authority

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Purchased tax benefit

Example

Facts

- State A provides a non-refundable income tax credit for up to 50% of qualified investments in green infrastructure ranging from energy efficient buildings to renewable energy (e.g., wind farms)
  - Annual limitations apply
  - Project owner may choose to transfer the credit to one or more third parties ("pass-through" partner(s)") in exchange for a lump-sum cash payment
  - Project owner may choose to transfer the credit because it is a non-profit organization, school, governmental agency, tribe, other public entity or business without a tax liability to use the energy tax credit
  - State A Department of Energy reviews and sets the pass-through rate but does not directly sell the credit to the pass-through partner
- Company A constructs an energy efficient building in State A
  - Construction of the building qualifies for a business energy tax credit of $10M
- Company A is a loss company and enters into an agreement to transfer the credit to Company B for the reviewed and set rate of $3M

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Purchased tax benefit

Example (cont'd)

Solution

- Based on the guidance in ASC 740-10-25-52, Company B will record

Journal Entries			
DR	Deferred tax asset	$10M	
CR	Deferred credit[1]		$7M
CR	Cash		$3M
DR	Deferred credit [($10M-3M) x 35%][2]	$2.45	
CR	Deferred tax liability – Federal		$2.45

[1] The deferred credit will be amortized as an income tax benefit in proportion to realization of the tax benefit of the DTA (i.e., as the credits are utilized on the tax returns filed in Jurisdiction X)
[2] Assumes satisfaction of $10M state liability with acquired credit doesn't cause state taxable income

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Purchased tax benefit

Example (cont'd)

Facts — Year 2

- Company B has $100M of pre-tax book income, State A taxable income and federal taxable income (before state tax deduction)
- Assume State A has a 10% tax rate
- Deferred credit is a balance sheet account but not a deferred tax liability
- At purchase, federal DTL for federal detriment of state credits equals 35% of the state DTA, however, the actual reduction in federal taxes payable over time is 35% of $3M paid for the credit
- Assume the credit is fully utilized in Year 2

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Purchased tax benefit

Example (cont'd)

Solution

Description	State A	Federal
Pretax income	$100	100
State deduction (amount paid for credit)	N/A	(3)
Taxable income	100	97
Tax rate	10%	35%
Tax before credits	10	33.95
Credits	(10)	N/A
Payable	0	33.95
Journal Entries (DR/CR)	**State A**	**Federal**
1) Current tax expense	0	$33.95 *
Current tax payable		(33.95)
2) Deferred tax expense	10 *	(3.5) *
DTA/DTL	(10)	3.5
3) Deferred tax expense	(3.5) *	
Deferred credit	3.5	
Total expense	**Σ* $36.95**	

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Purchased tax benefit

Example (cont'd)

Rate reconciliation

					$	%
PBT	100	X	35%	=	$35	35%
"Expected" state		100 X 10% = 10				
Less credit in state A (net of amount paid)			(7)			
Gross state tax expense			3			
Net of Fed benefit			(1.05)		1.95	1.95
Total Tax					**$36.95**	**36.95%**

Summary

DR/CR	DTA / (DTL)		Deferred (credit)	Cash	Federal payable	Current expense	Deferred expense
	State A	Federal					
Y1 – purchase credit	$10	($3.5)	($3.5)	($3)			
Y2 – current payable					($33.95)	$33.95(a)	
Y2 – utilize credits	($10)	$3.5	$3.5				$3(a)
Ending balance	$0	$0	$0	($3)	($33.95)	n/a	n/a

Total provision (sum(a)) = $36.95

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Purchased tax benefit

Example (cont'd)

Question

What about Company A's (seller) accounting?

Solution

- Less clear
- Factors to be considered:
  - Company's history with respect to the utilization of the credit
  - Company's intent

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State tax hot topics

State tax law changes

Impact to current and deferred income taxes

Current income taxes

- Local tax jurisdiction legislative changes and updates are reflected in the estimated annual effective tax rate calculation beginning no earlier than the first interim period that includes the enactment date of the new legislation
- Effect of a change in tax laws or rates on taxes currently payable or refundable for the current year shall be recorded after the effective dates

Deferred income taxes

- Effects of tax law changes are recorded or taken into account in the period that includes the enactment date
  - Deferred tax balances are adjusted accordingly

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Tax rate changes

State	Tax rate changes
Alaska	Changes to graduated tax rates, highest marginal rate remains at 9.4%
Arizona	6.5% for 2014, 6.0% for 2015, 5.5% for 2016, 4.9% after 2016
Connecticut	Extension of 20% surcharge through the end of tax year 2015
Indiana	Effective July 1, 2014, new law phases in revised state corporate tax rate reductions (beyond 6.5%) eventually lowering the corporate tax rate to 4.9% after June 30, 2021. Reduction as follows: 7% after June 30, 2014, 6.5% after June 30, 2016, 6.0% after June 30, 2017, 5.75% after June 30, 2018, 5.5% after June 30, 2019, 5.25% after June 30, 2020, and 4.9% after June 30, 2021.
New Mexico	Reduction of highest tax rate: 7.3% for 2014, 6.9% for 2015, 6.6% for 2016, 6.2% for 2017, 5.9% after 2017
New York	Corporate franchise tax rate on entire income reduced from 7.1% to 6.5%, effective for taxable years beginning on or after January 1, 2006. Income Tax for “qualified New York manufacturers” is eliminated effective for taxable years beginning after January 1, 2014.

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Tax rate changes (cont'd)

State	Tax rate changes
North Carolina	Lowered from 6.9% to 6% for 2014, 5% for 2015, and if certain net revenue targets are met 4% for 2016 and 3% for 2017
North Dakota	Tax rates for each bracket reduced, with the highest marginal rate decreasing from 5.15% to 4.53%
Rhode Island	NOTE: On 6/19/14, new legislation (effective for tax years beginning on or after January 1, 2015), was enacted which makes significant changes to Rhode Island corporate tax rules, including but not limited to: i) Mandatory unitary combined reporting; ii) Reduced the state corporate income tax rate from 9% to 7% of net income iii) Adopting single-sales factor apportionment, with market-based sourcing for sales of other than tangible personal property; iv) repealing Rhode Island's current intercompany intangible/interest expense "addback" statute
Texas	Reports originally due during calendar 2014 – reduced from 1% to .975% and from 0.5% to 0.4875% for qualified wholesalers Due during calendar 2015 – 0.95% or 0.475% if certain revenue targets are met

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Tax law changes

Enactment dates

Enactment date

- Often more difficult to determine for state and foreign jurisdictions than for federal (federal generally when President signs bill into law), for example:
  - Oregon tax law change – some legislative changes considered enacted upon voters approval and some when signed by Governor

State tax observations

- Recently, tax law changes have been related to sourcing of the sales factor and other apportionment factor changes
- In prior years, tax law changes focused more on tax base changes (MI, TX, OH)

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Contingent state tax law changes

Introduction

Certain jurisdictions may make a change in tax law or rate contingent on an event outside the control of the entity

Texas

- H.B. 500, which passed in May 2013, provides franchise tax rates would be reduced if probable revenue estimates, as certified by the Comptroller, exceed previous estimates so that any revenue loss cause by the rate reduction would be offset.
- Under H.B. 500, the rates would be temporarily reduced as follows:
  - For reports due in 2014, the rate could be 0.4875 percent for retailers or wholesalers and 0.975% for other taxpayers
  - For reports due in 2015, the rate could be 0.475% for retailers or wholesalers and 0.95% for other taxpayers.

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Contingent state tax law changes

Example — Measurement

Question

- If a phased-in change in tax rates is enacted and the applicable future tax rate is contingent on an event outside the control of the entity, what are the acceptable methods under ASC 740 to determine the applicable tax rate to be used in measuring the tax consequences of existing temporary differences and carryforwards?

Solution

- ASC 740 does not specifically address this matter; entities will need to establish a policy regarding the determination of the rate to be used in measuring DTAs and DTLs
- An entity should be consistent in applying whatever policy it ultimately chooses and ensure that it provides proper documentation regarding scheduling of DTAs and DTLs, the basis for judgments applied, and the conclusions reached

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Contingent state tax law changes

Example — Measurement

Solution (cont'd)

- Approach 1 – determine if the difference in measurement between the two rates is material by scheduling future reversals and if material, make an assessment regarding whether the contingency will be met in order to determine the future rate by period
  - Similar to the application of graduated tax rates
  - Entities using this approach should have sufficient documentation regarding its assessment of whether the contingency will be met
- Approach 2 – establish an accounting policy to always use the highest of the enacted rates until the contingency is resolved and confirmation of the period being eligible for a lower rate is available
  - The lower rate would only be applied to those DTAs and DTLs for which the associated liability is expected to be settled or asset recovered in that one period for which the contingency is resolved

Note: Consultation with your attest firm is recommended

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Contingent tax rate change

Example

Facts

- Company A has 50% apportionment in State 1 and 50% in State 2
- Company A has several DTAs and several DTLs that are expected to reverse over the next 10 years
- State 1 enacts a tax law that includes modification to the income tax rates to be phased-in over the next 5 years subject to certain contingencies, as follows

Tax rate before change	5.0%
Year 1	5.5%
Year 2	6.0%
Year 3	6.5%
Year 4	7.0%
Year 5 and subsequent	7.5%

  - Rate increases in years 2 through 5 may be suspended if state spending limits are exceeded and the Governor approves the suspension
- Company A determines that it must remeasure its DTA and DTL pursuant to ASC 740 for the enacted law change

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Contingent tax rate change

Example (cont'd)

Question

- What tax rate should Company A apply when measuring its DTAs and DTLs that are scheduled to reverse in years 2 and beyond?

Solution

- ASC 740 does not provide specific guidance in determining what rate to apply when contingent on events that are outside the control of the entity. Two Alternative approaches for State 1:
  - Determine if the use of the higher rate would cause a significant difference compared to the use of the lower rate. If not applying the higher rate, Company A should have adequate documentation supporting its position. Must consider how objectively verifiable the contingency is and the likelihood of occurrence.
  - Company could adopt a policy to always apply the highest enacted rate until the event causing the contingency is resolved. If the contingency is resolved and the lower rate is applicable, measurement for the single year affected is appropriate.

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NOL suspension

Overview

Several states have adopted laws that will suspend the use of NOL carryforwards for a specified number of years

The NOL suspension could impact both the current and deferred income tax provisions for an entity expected to utilize NOLs

NOL suspension could result in a change in judgment about an entity's ability to realize a deferred tax asset associated with the state NOL in future years

- Any related change to the valuation allowance should be recorded in the period of enactment through continuing operations pursuant to ASC 740-10-45

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NOL suspension

Example

Facts

- Company A has an NOL carryforward of $100,000 that will expire in 20X4
  - DTA recorded is $9,000 as of 20X0
- Company A has two DTLs as of 20X0 totaling $9,000 that are expected to reverse pro-rata over the next two years, 20X1 and 20X2
  - Company A considers the DTL reversal as a source of taxable income for purposes of its VA analysis
- Assume that in 20X1 the state enacts a tax law that will suspend the use of NOLs for years 20X1 and 20X2, but will allow Company A to tack the suspended two years onto the NOL carryforward period

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NOL suspension

Example (cont'd)

Solution — Before NOL suspension

Description	20X0 Amount	20X1	20X2
		Expected reversal	
DTA	$9,000	($4,500)	($4,500)
DTL 1	($5,000)	$2,500	$2,500
DTL 2	($4,000)	$2,000	$2,000
Current tax expense (benefit)		$ 0	$ 0
Deferred tax expense (benefit)		$ 0	$ 0

- Company A expects that the reversing deferred tax liabilities will be an available source of taxable income and therefore has concluded that its deferred tax asset recorded is more likely than not to be realized and no valuation allowance is needed

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NOL suspension

Example (cont'd)

Solution — After NOL suspension

Description	20X0 Amount	20X1	20X2
		Expected reversal	
DTA	$9,000	$ 0	$ 0
DTL 1	($5,000)	$2,500	$2,500
DTL 2	($4,000)	$2,000	$2,000
Current tax expense (benefit)		$4,500	$4,500
Deferred tax expense (benefit)		($4,500)	($4,500)
Deferred tax expense – VA		$9,000*	

- Since the DTLs will reverse in a year outside of the NOL utilization period, Company A can no longer consider the DTLs a source of taxable income for utilizing the DTA and should consider the need for a VA

* Company A determined in 20X1 that a full valuation allowance was required

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Scheduling NOL DTA utilization

Example

Facts

- Company B has a state NOL carryover of $800 resulting in a NOL DTA of $80 ($800 @ 10%)
- There is a 10 year carryforward period and an annual NOL utilization is capped at 60% of taxable income each year
- Company B recorded a DTL of $100 that is expected to reverse evenly over the next 4 years
- Company B has cumulative losses and no tax planning strategies
  - Thus, the NOL DTA realization is dependent on DTL(s)

Question

- Should Company B record a valuation allowance against its NOL DTA under the NOL carryforward rules outlined above?

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Scheduling NOL DTA utilization

Example (cont'd)

Solution

Though this might initially appear to be correct in total …	
Total DTL available	($100)
Total NOL DTA	80
Net DTA/(DTL)	($ 20)
NOL DTA not realized by reversal of DTL – VA required	**0**

…consider 60% limitation on NOL	
Total DTL available	($100)
DTL available as a source of income (NOL utilization capped at 60%)	(60)
Total NOL DTA available	80
NOL DTA not realized by reversal of DTL – VA required	**$20**

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State apportionment changes

ASC 740 implications

Deferred tax provision

- May cause remeasurement of recorded DTAs and DTLs, which should be included as a discrete item in the period the law change is enacted as prescribed by ASC 740-270-25-5
- The effect of remeasuring DTAs and DTLs should be presented as an item of income from continuing operations even if the DTA or DTL was originally established through an item other than continuing operations, e.g., OCI, discontinued operations, pursuant to ASC 740-20-45-8

Current tax provision

- The effect of the law change in the current year should be recorded after the effective date and reflected in the entity's annualized ETR pursuant to ASC 740-270-25-5

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State apportionment changes

Overview

Single-sales factor weighting

- Recently, several states have adopted laws that provide for a mandatory or elective single-sales factor weighting of apportionment
- The increase to the weight of the sales factor and elimination of the property and payroll factors in the apportionment of taxable income may cause an entity's state ATR and ETR to change significantly

Market-based sales sourcing

- Several states have also adopted laws requiring market-based sales sourcing for determining the sales apportionment factor
- The premise behind market-based sourcing is that sales should be sourced to the "marketplace" (i.e. the state) that ultimately contributes to a taxpayer's income
- Similar to single-sales factor apportionment, market-based sales sourcing could have a significant impact on an entity's ATR and ETR

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Apportionment methodology changes

State	Noteworthy apportionment methodology changes
Arizona	Market based sourcing election in 2014, 3 year phase-in
Massachusetts	Market based sourcing in 2014
Minnesota	Single sales factor in 2014; already has market based sourcing
New York	Market based sourcing in 2015
Pennsylvania	Market based sourcing in 2014
Rhode Island	Market based sourcing in 2015

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Apportionment methodology changes

Example

Facts

- Corporation A, located in New York, generates subscription receipts from its website.
  - For 20X1 and beyond, Corporation A is projected to generate approximately $20 million of taxable income.
  - Beginning 20X1, Corporation A has $5 million of New York NOL DTAs, which expire pro-rata over 20X2-20X3.
  - Corporation A has $30 million of non-NOL DTAs related to federal timing differences expected to begin reversing in 20Y0
- Enacted and effective 20X1, New York switches from cost of performance sourcing for non-TPP sales to market based sourcing, resulting in a decrease to Corporation A's New York apportionment percentage from 100% to 13%
- New York's statutory tax rate is assumed to be 10% for simplicity purposes

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Apportionment methodology changes

Example — Solution — Before change to market sourcing

Description	20X0 EOY	20X1	20X2	20X3
State DTAs – federal timing	$30,000,000	$30,000,000	$30,000,000	30,000,000
DTA – New York NOL BOY	N/A	$5,000,000	$3,000,000	$1,000,000
DTA – New York NOL current year generation/(utilization)	N/A	($2,000,000)	($2,000,000)	($1,000,000)
DTA – New York NOL EOY	$5,000,000	$3,000,000	$1,000,000	$0
Current tax (expense)/benefit	N/A	$0	$0	($1,000,000)
Deferred tax (expense)/benefit – CA NOL DTA utilization		($2,000,000)	($2,000,000)	($1,000,000)

Note: Since NOLs are expected to be utilized before expiration, no valuation allowance is necessary

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Apportionment methodology changes

Example — Solution — After change to market sourcing

Description	20X2 EOY	20X3	20X4	20X5
State DTAs – federal timing	$30,000,000	$3,900,000	$3,900,000	3,900,000
DTA – New York NOL BOY	N/A	$5,000,000	$4,740,000	$0
DTA – New York NOL current year generation/(utilization)	N/A	($260,000)	($260,000)	(260,000)
DTA – New York NOL EOY	$5,000,000	$4,740,000	$4,480,000	$4,220,000
Current tax (expense)/benefit	N/A	$0	$0	$0
Deferred tax (expense)/benefit – NY NOL DTA utilization	N/A	($260,000)	($260,000)	($260,000)
Deferred tax expense (expense)/benefit – federal timing DTAs revaluation	N/A	($26,100,000) [$30M x 13%]	$0	$0
Deferred tax (expense)/benefit – NY NOL DTA valuation allowance		($4,220,000)	$0	$0

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Uncertain Tax Positions

Uncertain tax positions

State considerations

- Understand tax law in local jurisdictions
- Nexus issues (physical presence and economic nexus)
- Opportunity to remediate nexus issues through voluntary disclosure agreements (VDAs) and proactive restructuring techniques
- Amnesty programs
  - Increased number of states initiating programs
  - Often enhanced penalties for non-participation

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Uncertain tax positions

Administrative practice and precedent — Economic nexus

- Focal point in determining number of years for which unrecognized tax benefits (UTBs) are recognized when returns have not been filed but are MLTN required
- Unless an administrative practice or precedent limits the look-back period, UTBs are recorded for all "nexus" years when the recognition standard is not satisfied
- Deferred taxes must also be recognized if nexus is ongoing
- Administrative practices and precedents need to be widely understood
- Approximately twelve states have been identified with an administrative practice or precedent
- Applicable even where fact of non-filing is discovered by the taxing jurisdiction (i.e., outside of a VDA process)

Note: Whether a UTP meets recognition by application of an administrative practice and precedent is generally a tax technical determination and not an accounting determination

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Uncertain tax positions

Court of last resort

- Informal FASB staff guidance provides that, with respect to the constitutionality of state statutes, the U.S. Supreme Court is the "Court of Last Resort"
- No need to assess probability that U.S. Supreme Court would actually hear the case
- Recognition standard is satisfied if entity can document that, based on its specific facts and circumstances, the U.S. Supreme Court would "more likely than not" rule in its favor if the Court heard the case (if so, it becomes a question of measurement)

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What to remember

What to remember

Deferred tax assets and liabilities for temporary differences are measured using the applicable tax rate

The variety of tax regimes, credits, and incentives as well as lack of specific accounting guidance often make it difficult to determine whether a tax or credit is within scope of ASC 740

ASC 740 is applied for a particular tax-paying component of an entity and within a particular jurisdiction

Many states are implementing changes to filing methods, apportionment, attribute utilization, and tax rates

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