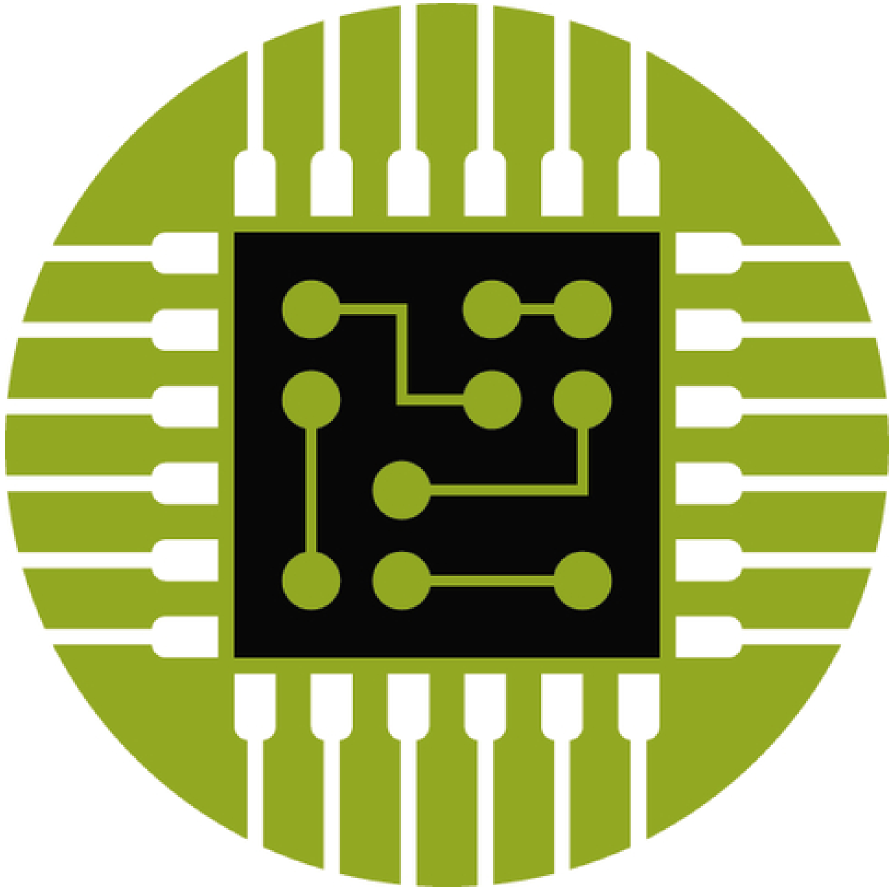
Deloitte.



2017 Corporate Tax Spring Training

Accounting for Income Taxes

May 24, 2017

FASB and SEC Update

ASU 2016-01 – Financial Instruments

ASU 2016-01 – Financial Instruments

Current	New
Marketable equity securities are classified as either held for trading at FV through net income or available for sale (AFS) except for equity method investments or consolidated investees.	Requirement for entities to carry all investments in equity securities at FV through net income, except for equity method investments or consolidation of the investee
For AFS equity securities, any amounts in accumulated OCI are cycled to net income upon sale or when the security becomes other than temporarily impaired.	For equity investments that do not have a readily determinable FV, entities are permitted to elect a practicability exception and measure the investment at cost less impairment plus or minus observable price changes.
Investments in nonmarketable equity securities other than equity method investments are measured at cost (less impairment) unless the fair value option has been elected.	

ASU 2016-01 – Financial Instruments

Effective date

- Public entities – annual periods, including interim periods within those annual periods, beginning after December 15, 2017
- Non-public entities – one year later
- Early adoption is permitted for financial statements that have not been issued or made available for issuance for the following changes:
  - Recording in other comprehensive income (OCI) of fair value (FV) changes resulting from a change in instrument-specific credit risk for financial liabilities for which a fair value option (FVO) has been elected. Elimination of FV disclosure requirements for financial instruments not recognized at FV for non-public entities.
- Early adoption NOT permitted for any other changes contained in the ASU

ASU 2016-01 – Financial Instruments

Valuation Allowance on AFS Debt Securities

Question: How should an entity evaluate a DTA (for realizability) when it relates to an AFS debt security that the entity has the intent and ability to hold to recovery, which may be maturity?

Current	New
Approach 1 — The assessment of the need for a VA for a DTA related to debt securities classified as AFS should be done in combination with other DTAs of the entity.	Approach 1 – Retained
Approach 2 — An entity would exclude the AFS debt security DTA from its other DTAs when evaluating the need for a VA because the DTA does not require future taxable income for realization since no deduction is expected based on the financial statement assertions. To apply Approach 1, an entity must still demonstrate its intent and ability to hold the debt security until recovery.	Approach 2 — Eliminated

OCI Cycling Effect – No VA
Reclassifying items

- Policy for “cycling” (reclassifying) items from OCI to continuing operations that have no associated tax effect
- An example of this is amortization of a defined benefit plan actuarial gain or loss from OCI into continuing operations (see illustration of pretax accounting below)

Description	Investment	DTA	Current Tax Payable	Income Tax Expense	P&L	OCI
Unrealized loss	($1,000)					$1,000
Recognize DTA		$400				(400)
End year 1	**($1,000)**	**$400**	**0**	**0**	**0**	**$ 600**
Activity year 2					$1,000	(1,000)
End year 2	**($1,000)**	**$400**	**0**	**0**	**$1,000**	**($ 400)**

Incremental approach

“With and without” approach

Income / (loss)	With	Without
Retained earnings	(1,000)	(1,000)
OCI	1,000	
	-	(1,000)
Tax rate	40%	40%
	-	(400)

Upon adoption, $400 of tax effect will be reclassified from OCI to P&L.

OCI Cycling Effect – VA

Reclassifying items

Description	Investment	DTA	Current Tax Payable	Income Tax Expense	P&L	OCI
Unrealized loss	($1,000)					$1,000
Recognize DTA		$0				(0)
End year 1	**($1,000)**	**$0**	**0**	**0**	**0**	**$ 1,000**
Activity year 2					$1,000	(1,000)
End year 2	**($1,000)**	**$0**	**0**	**0**	**$1,000**	**$ 0**

This appears to be a gain

ASC 740-20-45-7 (in part) / Par. 140 Exception

- The tax effect of pretax income from continuing operations generally should be determined by a computation that does not consider tax effects of items that are not included in continuing operations. The exception to that incremental approach is that all items … be considered in determining the amount of tax benefit that results from a loss from continuing operations and that shall be allocated to continuing operations.

Intraperiod tax allocation exception
Cycling or reclassifying items - Application of the exception

Question:

Should an entity consider credit entries for cycling (or reclassification) adjustments that are recorded in other comprehensive income (OCI) during the reporting period to be a potential source of future income when applying the intraperiod allocation exception in ASC 740-20-45-7?

Answer:

View A: No, an entity should generally exclude credit entries for cycling adjustments in determining income from OCI. The credit in OCI resulting from such cycling adjustments do not represent a future source of taxable income.

View B: Yes, an entity should not distinguish between credits resulting from cycling adjustments and other gains in OCI. The entity should look to the total amount of gain (including the cycling adjustment) recorded in OCI during the period to determine the amount of the future source of taxable income.

Note: Consultation with your attest firm is recommended

Clearing anomalies

How to address anomalies in Accumulated OCI

- Anomalies refers to the situation in which the tax in AOCI is not at the current statutory rate relative to the pretax amount
- This can arise on account of
  - Changes in tax rates subsequent to when the pretax amount was included in OCI
  - Pretax amounts not being tax effected on account of a VA being present and ASC 740-20-45-7 not being applicable
  - ASC 740-20-45-7 exception being applicable in one annual accounting period, but the pretax amount in OCI reversing in a subsequent annual period
  - Circumstances similar to the above

Approaches		
AFS	→	By security or by portfolio
Hedging OCI	→	Similar to AFS (by “position” or by “portfolio”)
ASC 715 OCI (i.e., by plan)	→	Portfolio only

ASU 2016-16 – Intra-Entity Transfers of Assets Other Than Inventory

ASU 2016-16 - Intra-entity asset transfers other than Inventory

Accounting guidance

Entity	Current	New
Seller	ASC 810-10-45-8 provides "If income taxes have been paid on intra-entity profits on assets remaining within the consolidated group, those taxes shall be **deferred** or the intra-entity profits to be **eliminated** in consolidation shall be appropriately reduced"	The final ASU removes the prohibition on recognition of income tax expense for taxes paid for intra-entity transactions except for transfers of inventory
Buyer	ASC 740-10-25-3(e) **prohibits** recognition of a deferred tax asset for the intra-entity difference between the tax basis of the assets in the buyer's tax jurisdiction and their cost as reported in the consolidated financial statements	The final ASU removes the prohibition on recognition of deferred tax assets on intra-entity differences between the tax basis of the assets in a buyer's tax jurisdiction and their cost as reported in the consolidated financial statements except for transfers of inventory

ASU 2016-16 - Intra-entity asset transfers

Transition guidance

- Modified retrospective with a cumulative catch-up adjustment to opening retained earnings as of the beginning of the period of adoption

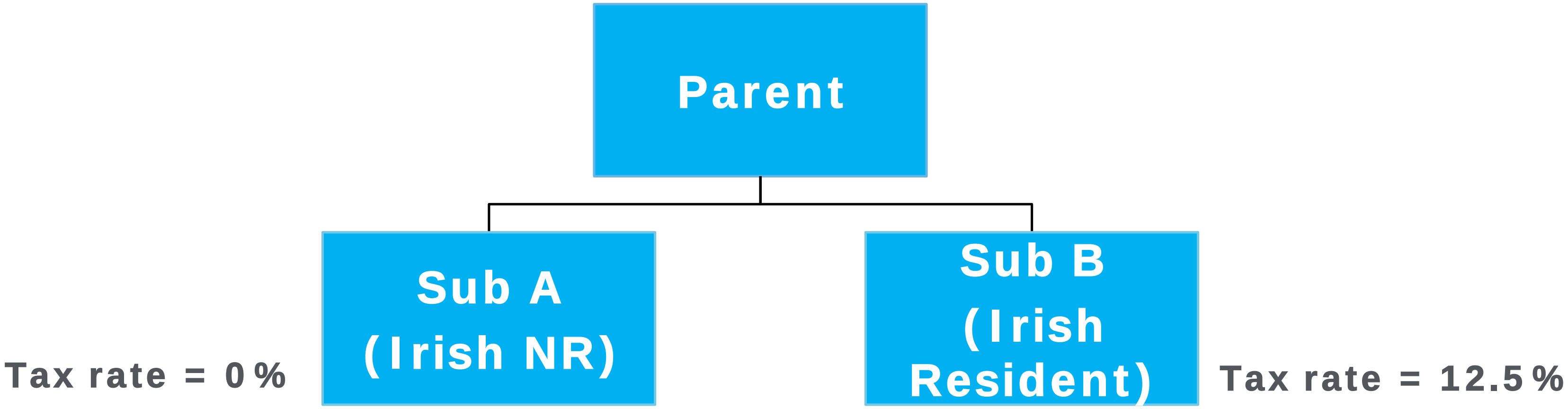
Effective date

- Public business entities – annual periods, including interim periods within those annual periods, beginning after December 15, 2017 (for non-public entities: one year later for annual periods, 2 years later for interim periods – i.e. FYs beginning after 12/15/19)

- Early adoption is permitted for all entities as of the beginning of an annual period

On-shoring intellectual property

Example – Facts (internally developed software)



Selling Price	$ 100
Cost	0
Margin	$ 100
Tax rate	0%
Tax paid	$0

Tax basis	$ 100
Book basis	$ 0
Difference	$ 100

Assumptions:

- The intellectual property is transferred in Year 1, tax amortization begins at Sub B in Year 2
- The tax life of the transferred intellectual property is 10 years

On-shoring intellectual property

Example – Current rules (internally developed software)

Parent

Sub A (Irish NR) — **Tax rate = 0%**

Sub B (Irish Resident) — **Tax rate = 12.5%**

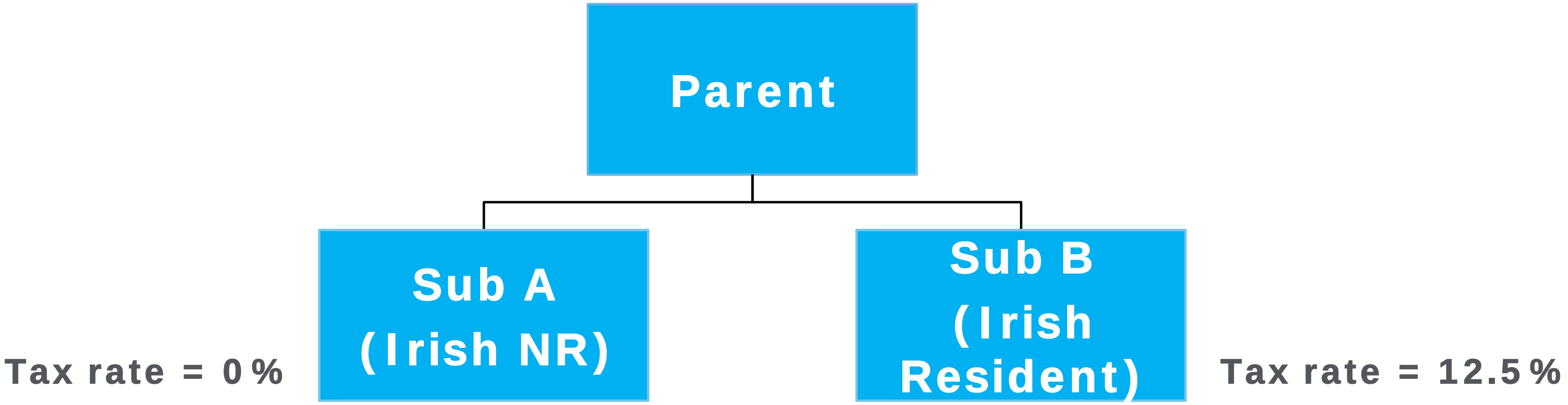
Selling Price	$ 100
Cost	0
Margin	$ 100
Tax rate	0%
Tax paid	$0

Tax basis	$ 100
Book basis	$ 0
Difference – no DTA	$ 100

Consolidated F/S		
	Year 1	Year 2
Prepaid taxes	$ 0	$ 0
DTA	$ 0	$ 0
Taxes payable	$ 0	$1.2
Tax expense	$ 0	($1.2)

On-shoring intellectual property

Example – New ASU (internally developed software)



Selling Price	$ 100
Cost	0
Margin	$ 100
Tax rate	0%
Tax paid	$0

Tax basis	$ 100
Book basis	$ 0
Difference – DTA	$ 100

Consolidated F/S		
	Year 1	Year 2
Prepaid taxes	$ 0	$ 0
DTA	$ 12.5	($1.25)
Taxes payable	$ 0	$1.25
Tax expense	($ 12.5)	$ 0

Intra-entity asset transfers — IP transfer
Disclosure

Disclosure requirement (SAB 74)

ASU 2016-16 is effective for fiscal years beginning after December 15, 2017, including interim periods within the year of adoption. Early adoption is allowed only in the first quarter of 2018. Modified retrospective adoption is required with any cumulative-effect adjustment recorded to retained earnings as of the beginning of the period of adoption. The cumulative-effect adjustment, if any, would consist of the net impact from (1) the write-off of any unamortized tax expense previously deferred and (2) recognition of any previously unrecognized deferred tax assets, net of any necessary valuation allowances. ***Company X is currently assessing the impact this guidance may have on its Consolidated Financial Statements.***

Note: Consultation with your attest firm is recommended

Intra-entity asset transfers — IP transfer
Things to consider

- Private company adoption
- Adoption timing considerations
  - Transfer to low tax jurisdiction
  - Transfer to high tax jurisdiction
- Other considerations

ASU 2014-09 – Revenue from Contracts with Customers

Introduction
Key points—adoption of ASC 606 / IFRS 15

Effective Date

Annual reporting periods beginning after December 15, 2017 and December 15, 2018 for public entities and nonpublic entities, respectively

GAAP Analysis

Will require companies to perform an in depth analysis of each type of revenue stream for financial statement purposes. Tax departments should be involved throughout this analysis to assess the areas of tax compliance and planning, as well as the associated magnitudes.

System Impacts

May impact the way data is captured, as well as additional information that may be required

Overall Tax Impacts

Will result in numerous tax impacts from both a technical and systems standpoint

IRS Expectations

The Internal Revenue Service understands that the adoption of the new revenue recognition standards will have federal income tax implications and expects companies to perform the requisite procedures in order to address these implications

Cash Tax Impact

The new revenue recognition standards may result in accelerated revenue recognition for tax purposes and associated cash outlays to taxing authorities

New revenue guidance
Transition options

Full retrospective approach

- Restate prior periods in compliance with ASC 250
- Optional practical expedients

Modified retrospective approach

- Apply revenue standard to contracts not completed as of effective date and record cumulative catch-up
- Required disclosures:
  - Amount of each F/S line item affected in current period
  - Explanation of significant changes

cumulative catch-up

January 1, 2018 Initial Application Year	2018 Current Year	2017 Prior Year 1	2016 Prior Year 2
New contracts	New ASU		
Existing contracts	New ASU + cumulative catch-up	Legacy GAAP	Legacy GAAP
Completed contracts		Legacy GAAP	Legacy GAAP

Direct and indirect effects of a change in accounting principle
Accounting guidance

ASC 250-10-45-8

- Retrospective application shall include only the direct effects of a change in accounting principle, including any related income tax effects. Indirect effects that would have been recognized if the newly adopted accounting principle had been followed in prior periods shall not be included in the retrospective application. If indirect effects are actually incurred and recognized, they shall be reported in the period in which the accounting change is made.

Direct Effects of a Change in Accounting Principle (Accounting Standards Codification Master Glossary)

- Those recognized changes in assets or liabilities necessary to effect a change in accounting principle. An example of a direct effect is an adjustment to an inventory balance to effect a change in inventory valuation method. Related changes, such as an effect on deferred income tax assets or liabilities or an impairment adjustment resulting from applying the subsequent measurement guidance in Subtopic 330-10 to the adjusted inventory balance, also are examples of direct effects of a change in accounting principle.

Indirect Effects of a Change in Accounting Principle (Accounting Standards Codification Master Glossary)

- Any changes to current or future cash flows of an entity that result from making a change in accounting principle that is applied retrospectively. An example of an indirect effect is a change in a nondiscretionary profit sharing or royalty payment that is based on a reported amount such as revenue or net income

Direct and indirect effects of a change in accounting principle

Potential direct and indirect effects

Direct Effects

- Change in timing of recognition of deferred revenue generally
- Change in deferred revenue deferred tax asset
- Change in the timing of the recognition of commissions

Indirect Effects

- Section 199 deduction
- State apportionment
- Transfer pricing
  - RAB Share
  - Reseller Arrangement
- Change in outside basis difference

New Revenue Guidance
Example – Section 199 Deduction

Assumptions

- On 1/1/2018, ABC, Inc. adopted ASU 2014-09 on a full retrospective basis which resulted in additional revenue being recognized related to 2017 and earlier periods (with a corresponding adjustment to the deferred revenue balance for all periods presented).
- On ABC, Inc.'s federal income tax return for 2017 (and earlier), it claimed a Section 199 deduction equal to 9% of its QPAI
- ABC, Inc. determined that the adoption of ASU 2014-09 will not result in the need to amend any federal income tax returns for 2017 or earlier.

Questions

- How should ABC, Inc. account for the impact to its deferred taxes as a result of adopting ASU 2014-09?
- Should ABC, Inc. account for the hypothetical impact to the Section 199 deduction as a result of adopting ASU 2014-09?

Recent SEC Comment Letters

Recent SEC Comment Letters

Example 1

We note from your prior response to our letter dated XXXX that you reflect the unrecognized tax benefits associated with your intercompany licensing arrangements in domestic tax expense, presumably under the view that the uncertain intercompany tax positions will not be sustained.

However, it appears that the split between domestic and foreign pre-tax income assumes that the uncertain tax positions are sustained, as the income from the intercompany licensing arrangements appears to be reflected as foreign.

Moreover, we understand that the unrecognized tax benefits associated with your intercompany licensing arrangements are reflected in the "effects of non-U.S. operations" in your income tax rate reconciliation. ***Please explain to us how you determined the presentation of pre-tax income and tax expense as domestic or foreign and how your presentations of activity between domestic and foreign are internally consistent.***

Recent SEC Comment Letters

Example 2

Please revise to clearly explain how you calculated the tax effects of your non-GAAP Net Income (Loss) adjustments and ***tell us how you determined that such calculations are consistent with the guidance in Question 102.11 of the Non-GAAP C&DIs. In this regard, your tax adjustment should include current and deferred income tax expense commensurate with your non-GAAP measure of profitability.*** *We note a similar presentation in your Form 8-K furnished on [XX date] and the fourth quarter Selected Company Metrics and Financials posted on your website.*

Recent SEC Comment Letters
Example 3

We note from your tax rate reconciliation on page XX that the impact of your foreign income taxed at lower than the federal rate was a benefit of $XXX million in 2016 which was more than your computed expected income tax provision of $XXX million. ***Please tell us the amount and nature of each significant reconciling item included in the benefit*** *and briefly describe the factual circumstances of your tax holiday, the per share effects of the tax holiday, and the date upon which the special tax status terminates. Revise future filings to include all of the disclosures required by ASC 740-10-50-12 and SAB Topic 11C.*

Recent SEC Comment Letters

Example 4

We note your response to comment X. Considering the significance of the $XXX million tax benefit you received due to the US tax election for years 2009, 2010 and 2012, please expand your disclosures to provide investors with a better understanding of the facts and circumstances that led to the decision. ***Please also expand your critical accounting policy disclosures you provide in MD&A in your Form 10-K that discusses the positive and negative evidence you considered in determining that your foreign tax credits deferred tax asset is realizable prior to expiration.*** *This discussion should include an explanation of the transactions that generate the foreign tax credits and how you generated foreign source income without repatriation of foreign subsidiary earnings along with the risks associated with being able to generate sufficient amount to realize the deferred tax assets.*

Changes in Tax Law

Tax Reform

Tax Reforms – What is the trend?

Domestic:

- Timing change in the recognition of income and deduction

Foreign:

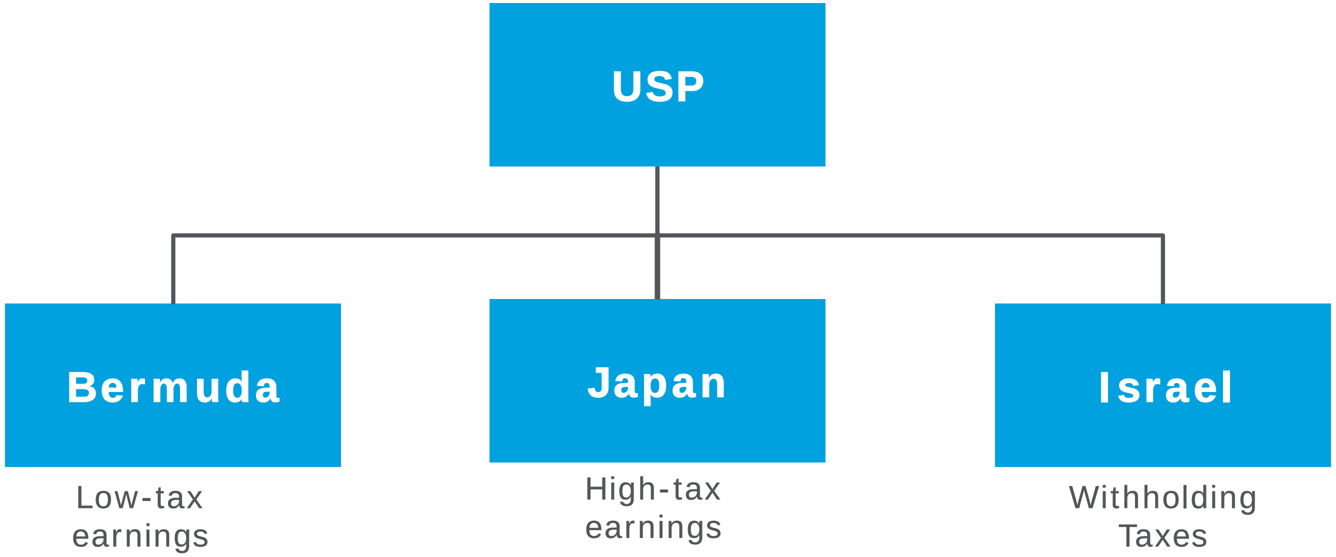
- Accelerating the recognition of foreign tax credits
- Reduction in the amount of E&P

Change in Accounting Method

When to account for the change

Method Change	Accounting Timing
Manual Change Permissible to permissible	Generally when approval has been received
Manual Change Impermissible to permissible	Generally when Form 3115 has been filed
Automatic Change Permissible to permissible	Generally when entity has the intent and ability to file the Form 3115
Automatic Change Impermissible to permissible	Generally when Form 3115 has been filed

Example - Indefinite reinvestment assertion

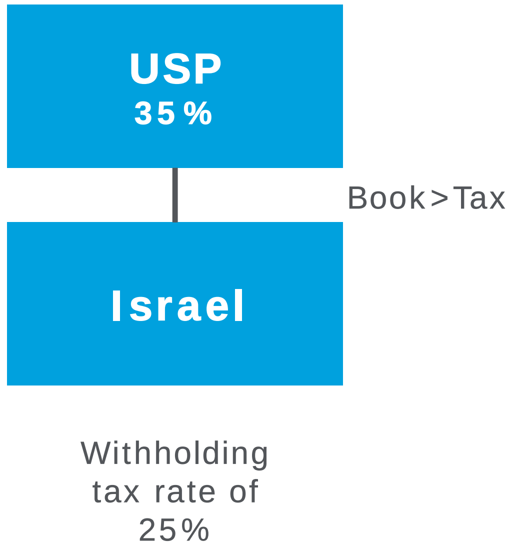


Repatriation of unremitted earnings

Example 1 – Withholding taxes

Assumptions

- USP, a US corporation, is the sole shareholder of Israel
- The book over tax outside basis difference in Israel is \$1,500. Israel has E&P of \$1,500 and a tax pool of \$0



Question

If Israel plans to remit the \$1,500 to USP in the foreseeable future, what is the DTL that USP should record?

Answer

USP should record a DTL of \$525 (\$1,500 remittance multiplied by 35% tax rate). The DTL should also include the withholding taxes that will be imposed, as well as the FTC that will be generated by USP for such withholding taxes.

Repatriation of unremitted earnings

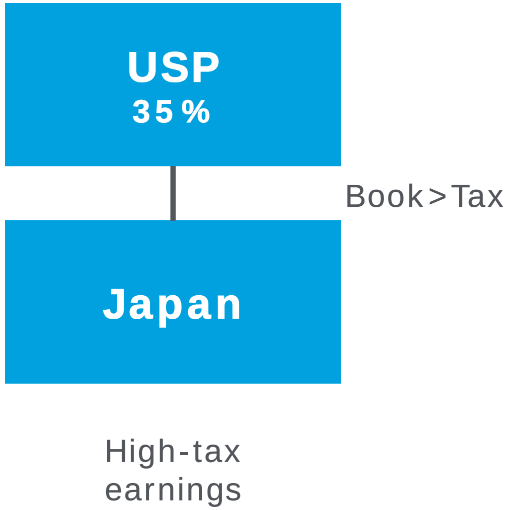
Example 2 – Excess foreign tax credits

Assumptions

- USP, a US corporation, is the sole shareholder of Japan
- The book over tax outside basis difference in Japan is $1,000. Japan has E&P of $1,000 and a tax pool of $600

Question

If Japan plans to remit the $1,000 to USP in the foreseeable future, what is the DTL that USP should record?



Answer

View A: No DTL should be record as the “unborn” FTC can only reduce the DTL to zero

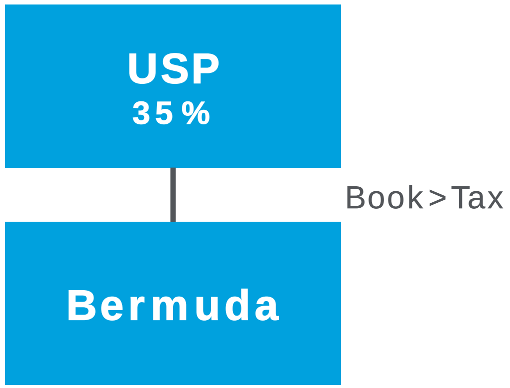
View B: No DTL should be record. Rather, a DTA of $40 (($1000 + $600) x 35% - $600) should be recognized as excess foreign tax credits will be generated in the foreseeable future which will be available to offset the tax of other foreign source taxable income.

Note: Consultation with your attest firm is recommended

Repatriation of unremitted earnings
Example 3 – Tax disclosure

Assumptions

- USP, a US corporation, is the sole shareholder of Bermuda
- The book over tax outside basis difference in Bermuda is $5,000. Bermuda has E&P of $5,000 and a tax pool of $0



Question

If the US passes the one time repatriation holiday and Bermuda plans to remit the $5,000 to USP to take advantage of the holiday, what should be disclosed?

Excess foreign tax credits

Example 3 – Potential tax disclosure

Disclosure example

On October 22, 2004, the American Jobs Creation Act of 2004 (“AJCA”) was signed into law. The AJCA included a provision for the deduction of 85% of certain foreign earnings that were repatriated, as defined in the AJCA, within a specified time frame. Among other requirements, dividends qualifying for the 85% deduction must be reinvested in the United States in certain qualified investments pursuant to a domestic reinvestment plan approved by Management. During 20X6, the Company repatriated approximately $XX billion of foreign earnings. Of the earnings repatriated, $XXX million is eligible for the reduced tax rate provided by the AJCA. Accordingly, the Company recorded a tax charge of $XX million related to the repatriation of foreign earnings under the provisions of the AJCA. In addition, the Company recorded a tax benefit of $XX million resulting from the implementation of tax planning strategies to recognize deferred tax assets that were previously not recognizable within certain foreign subsidiaries.

California Technical Advice Memorandum 2017-03

California TAM 2017-03

Timeline

- Released on April 6, 2017

Issue in question

- Whether the IRC Section 382, 383, and 384 limitations be determined on a “pre” or “post” apportionment basis
- Whether net unrealized built-in gains (“NUBIGs”) and net unrealized built-in losses (“NUBILs”) should be determined on a “pre” or “post” apportionment basis
- Whether recognized built-in gains (“RBIGs”) and recognized built-in losses (“RBILs”) should be determined on a “pre” or “post” apportionment basis

Conclusions

- Section 382, 383, and 384 limitations should be determined on a pre-apportionment basis
- NUBIGs, NUBILs, RBIGs, and RBILs should all be determined on a post-apportionment basis

California TAM 2017-03
Considerations

As a result of the TAM 2017-03, reporting entities must consider the impact on:

- Existing recognized NOL DTAs
- Valuation allowance determinations
- Realizability of non-NOL attributes

California TAM 2017-03

Example 1 – Additional NOLs recognized

Assumptions

- In 2016, ABC, Inc., a calendar year-end company, computed an annual federal Section 382 limitation of $5 million.
- ABC, Inc. further determined that it had a NUBIG which, pursuant to Notice 2003-65 results in an enhanced limitation of an additional $2 million for 5 years.
- For California purposes, ABC, Inc. applied **both** the Section 382 and the enhanced limitation on a **post-**apportionment basis and concluded that $11.5 million of its California NOLs will expire unused.
  - ABC, Inc. determined such NOLs are worthless and no DTA was recognized for the NOLs that will expire unused.
- As a result of TAM 2017-03, none of its California NOLs will expire unused as a result of Section 382.

Question

How should ABC, Inc. account for the tax impact of California TAM 2017-03?

California TAM 2017-03

Example 1 – Conclusion

Conclusion

- California TAM 2017-03 will result in ABC, Inc. recognizing approximately $1 million of additional NOL DTA with a corresponding deferred tax benefit
- ABC, Inc. will recognize such benefit in Q2 2017, the quarter in which the TAM was published
  - Such tax benefit will be recognized discretely in the quarter

California TAM 2017-03

Example 2 – Additional NOLs de-recognized

Assumptions

- In 2016, ABC, Inc., a calendar year-end company, computed an annual federal Section 382 limitation of $5 million.
- ABC, Inc. further determined that it had a NUBIG which, pursuant to Notice 2003-65 results in an enhanced limitation of an additional $2 million for 5 years.
- For California purposes, ABC, Inc. applied **both** the Section 382 and the enhanced limitation on a **pre**-apportionment basis and concluded that none of its California NOLs will expire unused.
- As a result of TAM 2017-03, $8 million of its California NOLs will expire unused as a result of Section 382.

Question

How should ABC, Inc. account for the tax impact of California TAM 2017-03?

California TAM 2017-03

Example 2 – Conclusion

Conclusion

- As a result of California TAM 2017-03, ABC, Inc. concludes that $8 million of its NOLs are now worthless and it will de-recognizing approximately $0.7 million of its NOL DTA with a corresponding deferred tax expense
- ABC, Inc. will recognize such expense in Q2 2017, the quarter in which the TAM was published
    - Such tax expense will be recognized discretely in the quarter

California TAM 2017-03

Example 3 – Valuation allowance and non-NOL attributes

Assumptions

- In 2016, ABC, Inc., a calendar year-end company, computed an annual federal Section 382 limitation of $5 million.
- ABC, Inc. further determined that it had a NUBIG which, pursuant to Notice 2003-65 results in an enhanced limitation of an additional $2 million for 5 years.
- For California purposes, ABC, Inc. applied **both** the Section 382 and the enhanced limitation on a **post**-apportionment basis and concluded that none of its California NOLs will expire unused.
- For California purposes, ABC, Inc. determined that a partial valuation allowance was required for its R&D credit carryforwards as there would not have sufficient future income to realize the benefit of all of its R&D credits

Question

How should ABC, Inc. account for the tax impact of California TAM 2017-03?

California TAM 2017-03

Example 3 – Conclusion

Conclusion

- California TAM 2017-03 will result in ABC, Inc. recognizing approximately $1 million of additional NOL DTA with a corresponding deferred tax benefit
- ABC, Inc. will recognize such benefit in Q2 2017, the quarter in which the TAM was published
  - Such tax expense will be recognized discretely
- Because more NOLs that can be utilized in the future, ABC, Inc. will need to re-evaluation the partial valuation allowance for its R&D credit carryforwards
  - Additional valuation allowance of approximately $1 million will be required as additional NOLs will be available to be utilized in lieu of R&D credits
    - The additional NOL will be recognized in Q2, the period in which it which a change in judgement as the realizability of the DTA occurred

Provision Software

Tax provision software

Applications

Products	Offered by
Corptax® Provision and US Compliance	Corptax, Inc.
Longview® Tax Provision product	Longview Solutions
Oracle® Hyperion Tax Provision	Oracle
Thomson Reuters ONESOURCE® Provision and Compliance	Thomson Reuters
Vertex® Vertex Tax Performance Engine	Vertex, Inc.

Note: Deloitte Tax LLP does not make software selections for clients and is neutral on the capabilities of each tax provision software tool presented herein

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