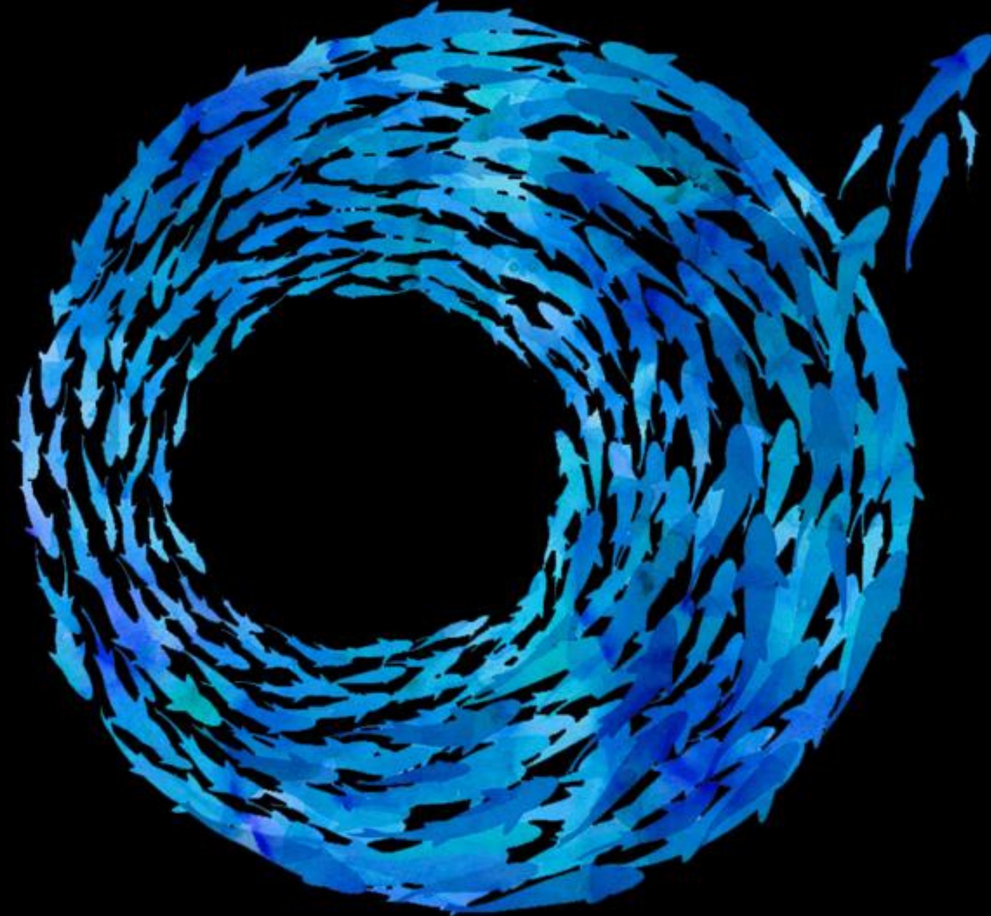
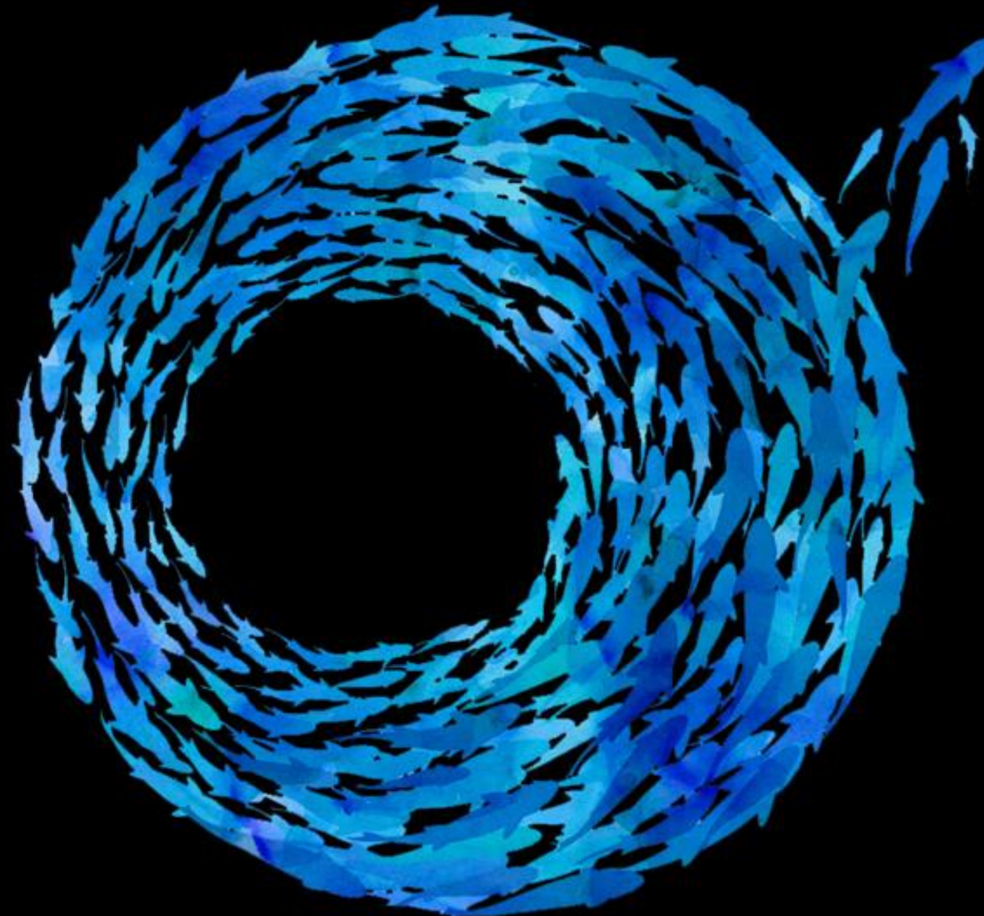
Deloitte.



The 2018 National Multistate Tax Symposium

Take the lead—Tax reform and fortifying state positions

February 7-9, 2018



Accounting for state taxes

Chris Barton, Deloitte Tax LLP
Kent Clay, Deloitte Tax LLP
Shanna Steed, The Walt Disney Company

February 7-9, 2018

Agenda

- Tax reform and state tax considerations
- Taxes and credits within the scope of ASC 740
- Identifying and measuring deferred taxes
- Other considerations
- What to remember

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Tax reform and state tax considerations

Tax reform and ASC 740—State tax considerations

Provision	"To-Do"
Federal corporate rate reduction	• Determine federal impact of state items (re-measure deferred taxes)
Transition tax on deemed repatriation/actual repatriation	• Determine whether transition tax should be treated in same manner that states treat Subpart F income (many states do not provide full exclusion and/or require netting expenses and do not provide 8 years to pay) • Analyze impact on valuation allowance and deferred taxes • Evaluate state treatment of actual repatriations • Consider impact on apportionment (i.e., receipts factor)

NOL modifications	• Analyze impact on valuation allowance analysis, including:
	  • Impact on federal and state NOLs
	  • Impact on ability to utilize state credits

Interest expense limitation	• Evaluate impact of any additional limitations on interest expense for state purposes (related to third party and affiliated indebtedness) • Analyze impact on valuation allowance analysis • Analyze state definition of "taxpayer" for purposes of limitation
Immediate federal expensing	• Evaluate state conformity to IRC section 168(k)(1)(A) • Determine whether any state ITC/R&D credits use federal basis which will need to be valued or eliminated • Analyze impact on valuation allowance analysis
Base erosion and anti-abuse tax ("BEAT")	• Determine state conformity
Global intangible low-taxed income ("GILTI")	• Determine whether GILTI should be treated in same manner that states treat Subpart F income (see transition tax above) • Analyze impact on valuation allowance analysis
Lost or modified federal deductions and/or credits	• Evaluate impact of lost or modified federal deductions • Evaluate impact of modified credits • Analyze impact on valuation allowance analysis

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

State tax conformity to IRC—as of January 1, 2018

Rolling conformity to IRC currently in effect

Conforms to IRC as of a specific date (as noted for each affected state)

Selectively conforms (as noted for each affected state to 'IRC currently in effect', or to 'IRC as of a specific date.')

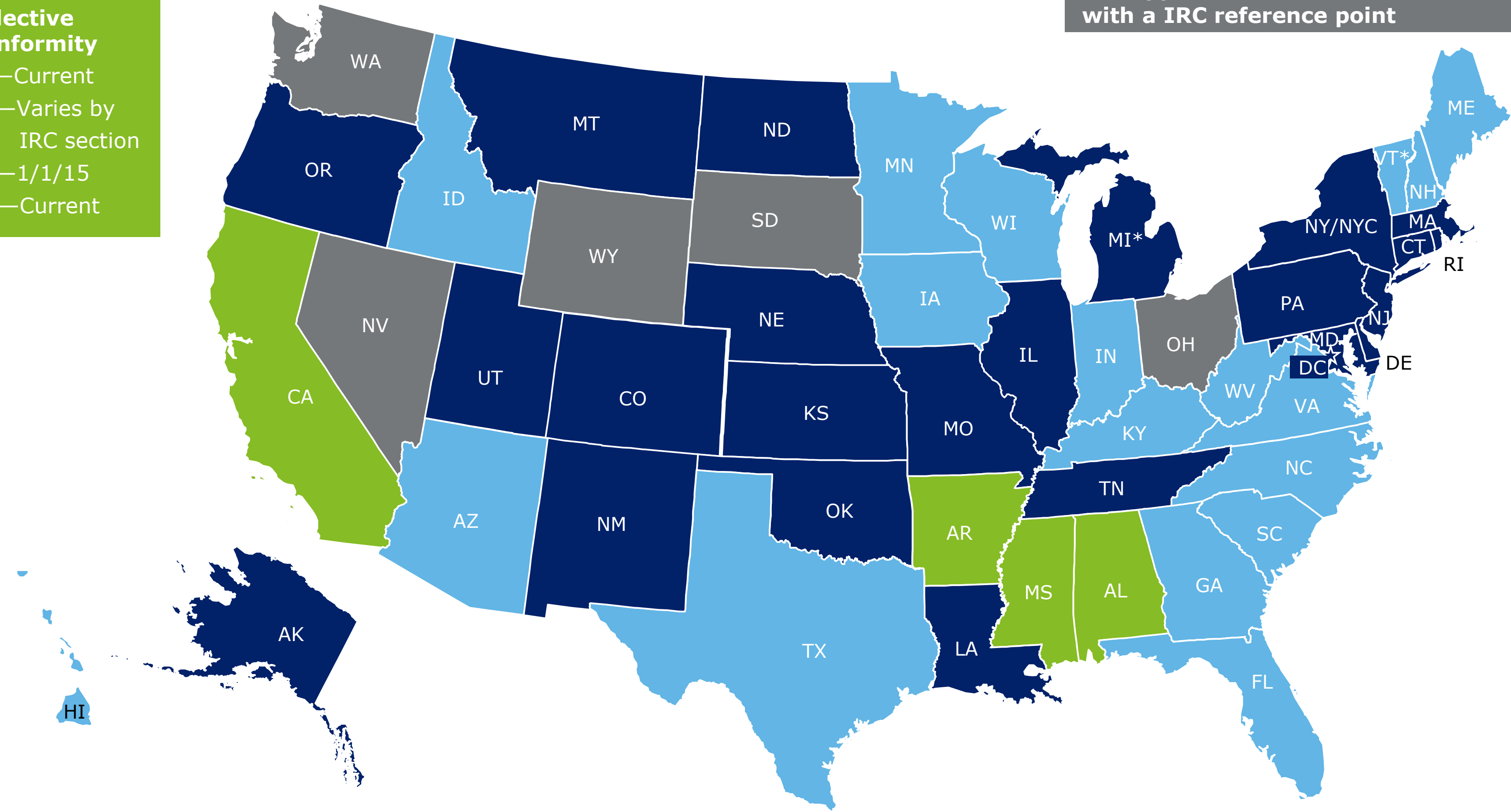
Not applicable b/c state does not levy an entity level tax with a IRC reference point

Specific Date Conformity

AZ—1/1/17
FL—1/1/17
GA—1/1/17
HI—12/31/16
ID—1/1/17
IN—1/1/16
IA—1/1/15
KY—12/31/15
ME—12/31/16
MI*—Current or 1/1/12
MN—12/16/16
NH—12/31/16
NC—1/1/17
SC—12/31/16
TX—1/1/07
VT*—IRC in effect for 2016 TY
VA—12/31/16
WV—12/31/16
WI—12/31/16

Selective Conformity

AL—Current
AR—Varies by IRC section
CA—1/1/15
MS—Current



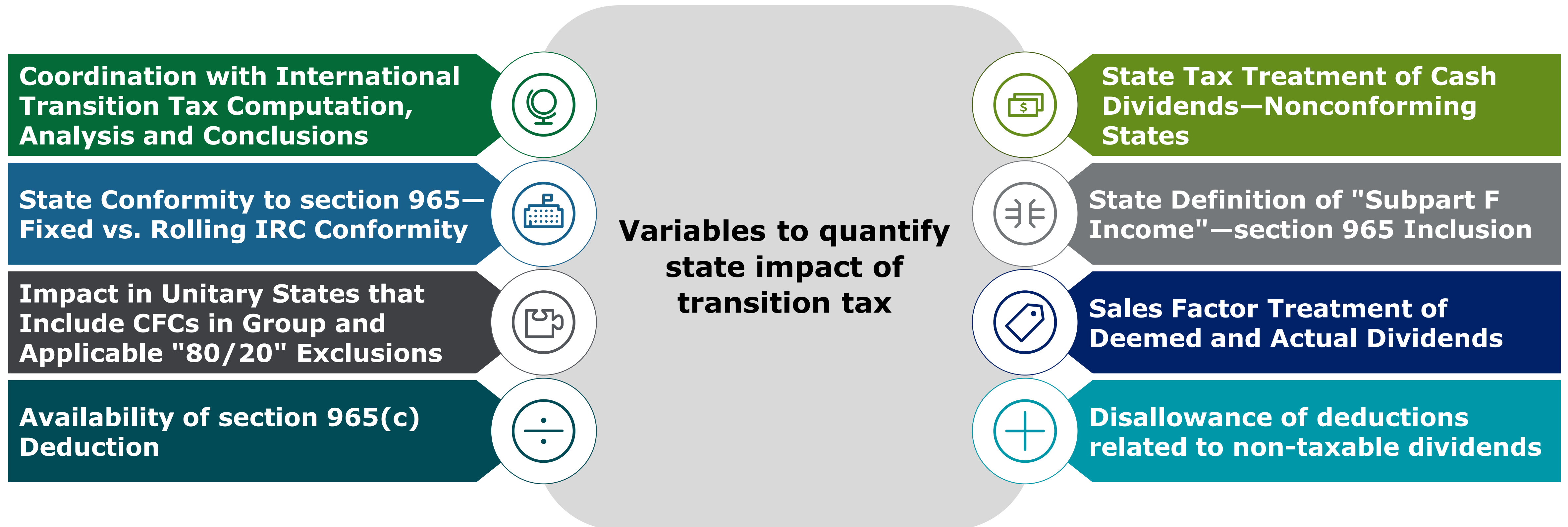
Slide to be used for illustrative purposes only. Not to be used as a substitute for research into application of rules.

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

State transition tax computation and analysis

Significant variables require analysis and integrated modeling



Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

State treatment of dividends received deduction (DRD)

For dividends paid by foreign corporations **greater than 80% owned** to a member of a water's edge group, the following are states where income would NOT be eligible for a 100% DRD or exclusion:

- AK
- CA
- CO
- ID
- KS
- LA (if paid or deemed paid before 6/30/18)
- NM (if filing consolidated/combined)
- ME
- MA
- MN
- MT
- NH
- ND
- OR
- UT
- VT

Of these states, **the ones in blue would currently conform to section 965** as enacted.

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Tax reform and ASC 740—State tax considerations example

- Assumptions:
  - Section 965 repatriation amount = $3B
  - Blended (aggregate) state tax rate = 5%
  - No cash dividends paid
- All deemed dividend is apportionable income
- Section 965 deemed inclusion is Subpart F income
- Single sales factor apportionment
- No state special rules regarding limitation on dividends eligible for DRD, distortion tests, etc.

- Potential conclusions:
  - If assume all DRD eligible, state tax = $0
  - If assume all taxable, state tax = $150 million (5% x $3B)
  - Based on specific state analysis below, state tax = $15.3M (before federal benefit)

	State A	**State B**	**State C**
Conformity to 12/31/2017 IRC	No	Yes	Yes
Deemed Dividend	$0	$3B	$3B
DRD%	100%	80%	80%
Dividend amount incl. in state tax base	0	$600M	$600M
Dividends Statutorily Included In Sales Factor	Yes	No	Yes
Sales Factor Numerator	$20M	$50M	$30M
Sales Factor Denominator	$100M	$100M	$3.1B
Sales %	20%	50%	1%
State tax rate (before federal benefit)	5%	5%	5%
Actual state tax (before federal benefit)	0	$15M	$300K

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Tax reform and ASC 740—State tax considerations example (cont’d)

Risk of Not Performing a GILTI Specific State Analysis – Illustrative Example

Assumptions:

- GILTI Inclusion Amount: $1B, GILTI Deduction Amount = $500M, FDII Deduction Amount = $100M
- Blended State Tax Rate: 6%
- All GILTI is apportionable income but is not included in the receipts apportionment factor
- Entity recognizing GILTI income is considered an 80/20 company that may be excludable from certain combined groups, as applicable
- States would not allow a “double benefit” for GILTI deduction, if GILTI income is not included in state taxable income

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Tax reform and ASC 740—State tax considerations example (cont'd)

Risk of Not Performing a GILTI Specific State Analysis – Illustrative Example

Potential Conclusions:

- If assume all GILTI income is DRD eligible, state tax = $0
- If assume all taxable = $24M ($400M * 6%)
- Based on specific state analysis below, state tax = $13.6M (before federal tax benefit)

	State A	State B	State C	State D
Conformity to 2018 IRC	No	Yes	Yes	Yes
§ 951A GILTI Income	$0	$1B	$1B	$1B
DRD Applicable	N/A	No	No	100%
US Shareholder Files as part of group?	Yes	Yes	No	Yes
Includable Income	$0	$1B	$0	$0
Section 250 Deduction Allowed?	N/A	No	No	Yes
Allowable Deduction	N/A	$0	$0	($100M)
Taxable Income	$0	$1B	$0	($100M)
Group Apportionment %	10%	20%	15%	30%
Tax Rate	8%	8%	8%	8%
Actual State Tax	$0	$16M	$0	($2.4M)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

Mastery glossary definitions

- Income taxes: domestic and foreign federal (national), state, and local (including franchise) taxes based on income
- “Income” is not defined but “taxable income” is defined
- Taxable income: the excess of taxable revenues over tax deductible expenses and exemptions for the year as defined by the governmental taxing authority

Application

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Scope

Distinctions between income and non-income taxes

Financial statement item	Description
Current tax expense	• Recognized 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
Disclosure	• Different disclosure requirements for income vs. non-income taxes

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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.,

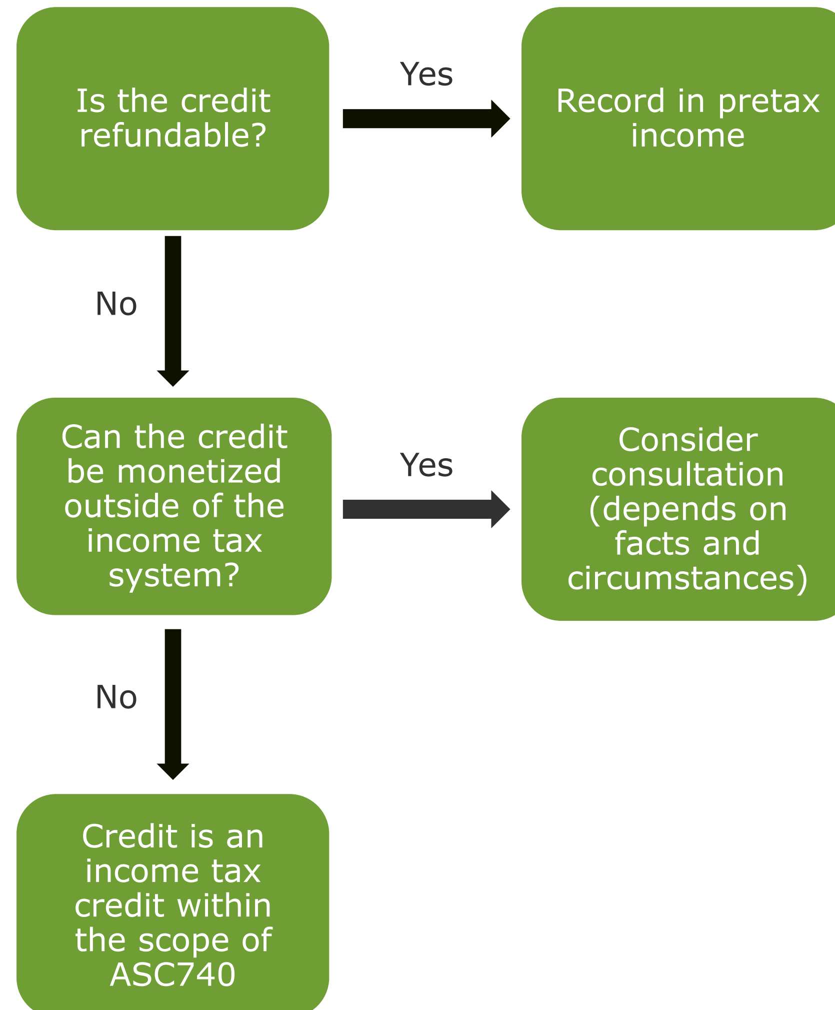
- An increasing number of jurisdictions assess taxes based on gross receipts less certain current period deductions (e.g., Texas)
- The tax law may state that the tax is not an income tax (e.g., Texas), but the tax may still be within the scope of ASC 740

Copyright © 2018 Deloitte Development LLC. All rights reserved.

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



Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Non-income based 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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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)

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Environmental tax credit
Example (cont'd)

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

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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 $3M

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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	$10.0M	
CR Deferred credit[1]		$5.53M
CR Cash		$3.0M
CR Deferred tax liability – Federal		$1.47M

[1] The deferred credit will be reversed and recognized 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)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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 21% of the state DTA, however, the actual reduction in federal taxes payable over time is 21% of $3M paid for the credit
- Assume the credit is fully utilized in Year 2

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Purchased tax benefit
Example (cont'd)

Description		State A		Federal	
Pretax income		$100		$100	
State deduction (amount paid for credit)		N/A		(3)	
Taxable income		100		97	
Tax rate		10%		21%	
Tax before credits		10		20.37	
Credits		(10)		N/A	
Payable		0		20.37	
DTA/(DTL)		10		(1.47)	
Deferred Credit		(7)		1.47	
Total Expense		**3.0**	*	**20.37**	*
		Σ* $23.37			

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Purchased tax benefit

Example (cont'd)

			$	%
"Expected" Fed & State	100 X [21% + (10% X 79%)]	=	$28.90	28.90%
Less credit in state A (net of amount paid)	(7)			
Net of Fed benefit	1.47	=	(5.53)	(5.53%)
Total Tax			$23.37	23.37%

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Identifying and measuring deferred taxes

Measuring deferred taxes
ASC 740-10-30-5

- Deferred taxes are determined separately for each tax-paying component (tax return filing group) in each taxing jurisdiction
- DTAs and DTLs for temporary differences are measured using the applicable tax rate (ATR) (Enacted tax rate* x Apportionment factor)
- Apportionment factors can significantly impact the state ATR
  - As a shortcut, entities sometimes use PY apportionment factors and CY statutory rate
  - Apportionment percentages should be adjusted for significant operational changes (e.g., acquisitions or divestitures, internal restructurings and significant changes in business operations); this method may yield a reasonable estimate

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

State Applicable Tax Rate
Overview

Generally, state ATR should be

- Calculated for each taxpaying component within the consolidated financial reporting group
- Applied to that taxpaying component's temporary differences
- A shortcut may be acceptable if it does not result in a material difference (considerations include, but are not limited to)
  - Different filing groups (e.g., worldwide, consolidated, separate entity, unitary)
  - Aggregate apportionment factors could be significantly greater than or less than 100%
  - Different inventory of temporary differences
  - Whether/how states decouple from federal (e.g., depreciation)
  - Adjusted gross receipts tax regimes (e.g., Texas)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Blended vs. separate company ATR
Example 1

Reporting entity has two entities, X and Y, which file in separate states, and have temporary differences of $900 and $100, respectively

Description	Entity X	Entity Y	Total	
Current year taxable income	100	200	300	[a]
State tax rate	3%	5%		
Tax	3	10	13	[b]
Current blended rate calculation:				
Blended state rate = [b] ÷ [a]			4.33%	
Consolidated temporary differences			1,000	
Deferred tax assets - incorrect			43	[c]
Separate Company rate calculation:				
Separate company state rates	3%	5%		
Separate company temporary differences	900	100		
Deferred tax assets	27	5	32	[d]
Difference = [c] - [d]			11	

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Blended vs. separate company ATR
Example 2

Reporting entity has two entities, X and Y, which file in separate states, and have temporary differences of $900 and $100, respectively				
Description	Entity X	Entity Y	Total	
Current year taxable income	(100)	200	100	[a]
State tax rate	3%	5%		
Tax	0	10	10	[b]
Current blended rate calculation:				
Blended state rate = [b] ÷ [a]			10.00%	
Consolidated temporary differences			1,000	
Deferred tax assets - incorrect			100	[c]
Separate Company rate calculation:				
Separate company state rates	3%	5%		
Separate company temporary differences	900	100		
Deferred tax assets	27	5	32	[d]
Difference = [c] – [d]			68	

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Effective tax rate (ETR) vs. ATR
Example

Assumptions

- Corp X apportions its income to State A that has an enacted statutory rate of 7%
  - 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 in State A and NewCo will be required to file in a new state with a statutory rate of 2%

Question

- What is the ATR and ETR 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%	

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

ETR vs. ATR
Example – Answer – ETR and ATR after planning

After planning				
Description	Corp X	NewCo	Total	
Pretax income	$ 800	$200	$1,000	[a]
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	[b]
ETR = [b] ÷ [a]			6%	
ATR to measure temps			7%	

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

ETR vs. ATR
Example continued

Additional facts and solution

- Corp X and New Co have $2,000 of consolidated 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%.

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Scheduling of ATR
Example (cont'd)

Solution

Description	Total balance sheet amount	Scheduled to reverse in				Total as scheduled
		20X1	20X2	20X3	20X4 +	
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
Net Temporary Differences						($500)
State tax effect of temps at current applicable rate - Incorrect						($45)
Fully phased in future apportionment						60%
Tax Rate						9%
"Expected" deferred without scheduling – Incorrect						($ 27)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Adjusted gross receipts tax regimes
Deferred tax computations

Some tax jurisdictions assess tax on businesses on the basis of an amount computed as gross receipts less certain current-period deductions that are specifically identified by statute ("adjusted gross receipts")

- For example, the Texas margin tax base is calculated as the lesser of
  - Receipts less cost of goods sold
  - Receipts less compensation expenses
  - 70 percent of receipts
- The relationship between current Texas margin tax expense and pretax book income is not as direct as other states' income taxes

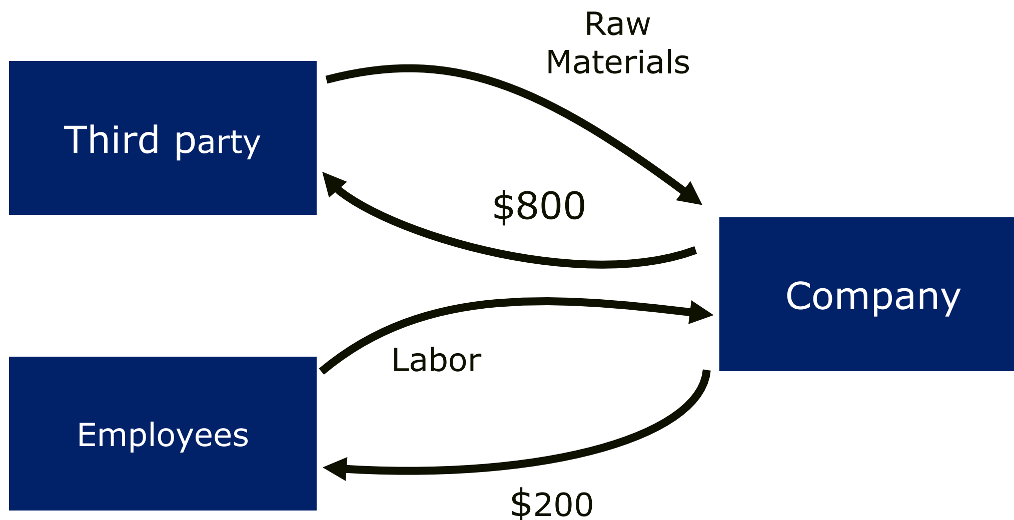
Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Adjusted gross receipts tax regimes
Example

Assumptions

- State X permits raw material purchases to be deducted from gross receipts in the period acquired, but prohibits any deduction for labor costs incurred in any period
- For ease, assume the tax rate is 1% and 100% apportionment



Inventory at End of Year

Book = $1,000
($800 raw materials + $200 labor)

Tax = $0

Current deduction = $800

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Adjusted gross receipts regimes
Example - Answer

View A (Balance Sheet Approach)

- Presumption in ASC 740 is that assets are recovered at their financial statement carrying value
- Record deferred taxes on the entire book/tax basis difference
  - Taxable temporary difference – Inventory $1,000
  - Deferred tax liability – Inventory ($1,000 x 1%) $ 10
  - Current year "permanent" difference - Labor $ 200
- Current book expense $0, Current tax deduction $800
- Difference between the $800 current deduction ($8 current benefit) and the $1,000 increase in taxable temporary differences ($10 deferred expense) results in a $200 current period rate reconciling item (yielding an additional $2 total expense)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Adjusted gross receipts regimes

Example - Answer (cont'd)

View B (Timing Approach)

- Record deferred taxes on only those items that will enter into the measure of both book and taxable income in a current or future year
  - Taxable temporary difference – Inventory $800
  - Deferred tax liability – Inventory ($800 x 1%) $ 8
  - Future year "permanent" difference – Labor $200
- Current book expense $0, Current tax deduction $800
- Future book cost recoverable/expense $1,000, Future tax deduction $0
- Future reversal of taxable temporary difference $800
- Difference between future book cost recoverable of $1,000 and future reversal of taxable temporary difference of $800 results in a $200 future "permanent" difference

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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
- Anticipated business changes should be considered
- Certain state attributes may have little to no likelihood of being utilized
  - Consider whether VA is appropriate or whether the DTA should be written off

Consultation with your attest firm is recommended

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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 and proactive restructuring techniques
- Amnesty programs
  - Increased number of states initiating programs
  - Often enhanced penalties for non-participation

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Uncertain tax positions

Administrative practice and precedent — Economic nexus

- Focal point in determining number of years for which unrecognized tax benefits 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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

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)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Other considerations

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Tax rate changes

State	Tax rate changes
Connecticut	20% surcharge in 2017, 10% in 2018; phased out after 2018
District of Columbia	9.0% for 2017, 8.25% for 2018
Illinois	5.25% + 2.5% personal property replacement tax for taxable years before July 1, 2017; 7% + 2.5% replacement tax for tax years beginning on or after July 1, 2017
Indiana	6.25% 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 Hampshire	8.5% for 2016, 8.2% for 2017; 7.7% for 2020; 7.5% for tax years ending on or after 12/31/2021
New Mexico	Reduction of highest tax rate: 6.2% for 2017, 5.9% after 2017
North Carolina	3% for 2017; 2.5% for tax years beginning on or after January 1, 2019

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

- Federal tax reform creates a litany of state considerations from an ASC740 perspective
- 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)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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 caused 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.

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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.

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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?

Copyright © 2018 Deloitte Development LLC. All rights reserved.

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.
Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

State apportionment changes
Overview

Single-sales factor weighting

- 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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Apportionment methodology changes

State	Noteworthy apportionment methodology changes
Delaware	Single Sales Factor beginning in 2019
Montana	Market based sourcing in 2018
North Carolina	Single Sales Factor beginning in 2018
North Dakota	Single Sales Factor election available for tax years after 2018
New York City	Single Sales Factor beginning in 2018
Oregon	Market based sourcing in 2018
Tennessee	Market based sourcing for tax years beginning on or after July 1, 2016

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Apportionment methodology changes
Example

Assumptions

- Corporation A, located in State X, generates subscription receipts from its website
  - For 20X1 and beyond, Corporation A is projected to generate approximately $1,000 of TI per year (pre-apportioned)
  - As of the beginning of 20X1, Corporation A has $300 of State X NOL DTAs (post-apportionment carryover), which expire pro-rata in 20X2-20X3
  - Corporation A has $3,000 of DTAs related to temporary differences expected to begin reversing after 20X3
- Enacted and effective 20X1, State X switches from cost of performance sourcing for non-tangible personal property sales to market based sourcing, resulting in a decrease to Corporation A's State X apportionment percentage from 100% to 26%
- State X's statutory tax rate is 10%

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Apportionment methodology changes

Example cont'd — Solution — Before change to market sourcing

Description	20X0 EOY	20X1	20X2	20X3
DTAs – temporary differences	$3,000	$3,000	$3,000	$3,000
DTA – State X NOL BOY	N/A	$ 300	$ 200	$ 100
DTA – State X NOL current year generation/(utilization)	N/A	($ 100)	($ 100)	($ 100)
NOLs expiring		$0	$0	$0
DTA – State X NOL EOY	$ 300	$ 200	$ 100	$0
Current tax (expense)/benefit	N/A	$0	$0	$0
Deferred tax (expense)/benefit – State X NOL DTA utilization		($ 100)	($ 100)	($ 100)

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

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Apportionment methodology changes

Example cont'd — Solution — After change to market sourcing

Description	20X2 EOY	20X3	20X4	20X5
DTAs – temporary differences	$3,000	$ 780	$ 780	$780
DTA – State X NOL BOY (before VA)	N/A	$ 300	$ 274	$150
DTA – State X NOL current year generation/(utilization)	N/A	($ 26)[1]	($ 26)	($ 26)
NOLs expiring			($ 98)	($124)
DTA – State X NOL EOY (before VA)	$ 300	$ 274	$ 150	$ 0
Current tax (expense)/benefit	N/A	$0	$0	$ 0
Deferred tax (expense)/benefit – State X NOL DTA utilization	N/A	($ 26)	($ 26)	($ 26)
Deferred tax (expense)/benefit – revaluation of DTAs – temporary differences	N/A	($2,220)[2]	$ 0	$ 0
Deferred tax (expense)/benefit – State X NOL DTA VA		($ 222)[3]	$ 0	$ 0

Notes: [1] $1,000 x 26% x 10% [2] [$3,000 x (1-26%) [3] (98) + (124)

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

What to remember

What to remember

- 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
- Deferred tax assets and liabilities for temporary differences are measured using the applicable tax rate
- 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 that impact the current and deferred state tax rates

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

Contact information

Chris Barton
Deloitte Tax LLP
cbarton@deloitte.com

Kent Clay
Deloitte Tax LLP
kclay@deloitte.com

Shanna Steed
The Walt Disney Company
Shanna.L.Steed@disney.com

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

This presentation contains general information only and the respective speakers and their firms are not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. The respective speakers and their firms shall not be responsible for any loss sustained by any person who relies on this presentation.

Copyright © 2018 Deloitte Development LLC. All rights reserved.

Copyright © 2018 The National Multistate Tax Symposium: February 7-9, 2018

About Deloitte
Deloitte refers to Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about to learn more about our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2018 Deloitte Development LLC. All rights reserved.