Accounting for Income Taxes
Quarterly Hot Topics

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Tax Reform Update

On December 22, 2017, President Trump signed the Tax Cuts and Jobs Act (the "Act") into law. Under ASC 740, entities are required to recognize the financial statement effects of new tax legislation upon enactment, which in the U.S. federal jurisdiction is the date the President signs the Bill into law. Accordingly, the enactment requires the recognition of the financial statement impacts of the new federal income tax law in the period that includes December 22, 2017. The Act reduces the prospective federal corporate income tax rate and introduces significant changes to the U.S. federal taxation of income generated by foreign subsidiaries of domestic multi-national corporations. The Act also includes provisions that scale back or eliminate many long-standing federal income tax deductions, credits, and incentives for corporations.

Please refer to the Deloitte Financial Reporting Alert 18-1 dated January 3, 2018 for further detail as to frequently asked questions (FAQ) concerning how entities should consider the financial statement effects of the new federal tax law in accordance with ASC 740.

US Multistate

New Jersey

On November 28, 2017, the New Jersey Tax Court (Court) held that the New Jersey Division of Taxation (Division) could *not* impose state corporation business tax (CBT) on an international technology company's foreign source income that is not taxable for US federal income tax purposes, pursuant to state statutes and 2011 case law that generally require the CBT base to match federal taxable income as indicated on Line 29 of federal Form 1120-F. The Division had unsuccessfully argued that pursuant to the Court's 2014 decision addressing whether a taxpayer may for CBT purposes adjust the federal basis in its property to account for depreciation deductions for which it received no CBT benefit, such taxation is warranted because state law now permits the Division to increase a taxpayer's state tax base to include certain federally excluded income (in this case, the taxpayer's entire worldwide income).

The Court concluded that prior state case law from 2011 and the Court's 2014 decision "represent two separate and distinct legislative intents as expressed in the language of the statute." In the 2011 case, the Court explained, the focus was on the language stating that New Jersey entire net income "shall be" deemed prima facie to be equal to federal taxable income, while the 2014 case did not focus on the federal taxable income language but rather on the more narrow language regarding the taxation of "profit" from the sale of assets. Distinguishing the 2014 case which concerned "phantom income," the Court reasoned that the case at hand (much like the 2011 case) concerned computation of the tax base. For additional details, see Deloitte's December 8, 2017 issue of State Tax Matters.

Pennsylvania

On October 30, 2017, a new law was enacted in Pennsylvania that increases the current percentage utilization cap of 30% of annual taxable income for Pennsylvania's net operating loss (NOL) carryover deduction for state corporate net income tax purposes to 35% of taxable income in 2018, and then to 40% of taxable income in 2019 and thereafter. Additionally, this new law removes the fixed-dollar statutory annual utilization cap of $5 million on Pennsylvania's NOL carryover deduction. The legislation also includes modifications to a number of state incentive programs, including a new deduction for certain manufacturing-related investments. See Deloitte's November 3, 2017 issue of State Tax Matters for additional information.

For additional detail on the PA Supreme Court's decision that the new law is based on, see Deloitte's Multistate Tax Alert dated October 23, 2017. Also, see Deloitte's November 24, 2017 issue of State Tax Matters for the bulletin issued by the PA Department of Revenue that discusses the Court's ruling.

Wisconsin

On September 21, 2017, Wisconsin enacted budget legislation that contains various tax-law related changes, including:

- Updating the Wisconsin income tax code to conform to the Internal Revenue Code (IRC) as amended through December 31, 2016
- Introducing special sourcing rules for broadcasters for apportionment purposes, effective for taxable years beginning after December 31, 2018
- Creating a partially refundable research and development tax credit for taxable years beginning after December 31, 2017
- Aligning the "look-back" period for credits and net business losses which limits the number of years that taxpayers may retroactively re-compute their net operating losses to no more than four years following the unextended filing due date of the return for the taxable year in which the loss occurred. This is effective beginning with losses claimed on or after September 23, 2017

For additional details, see the September 29, 2017 issue of State Tax Matters and Deloitte's Multistate Tax Alert issued on October 26, 2017.

Amnesty/Voluntary Disclosure

Connecticut

On October 31, 2017, a new law was enacted that authorizes Connecticut Department of Revenue Services to implement a "fresh start program" for eligible taxpayers through November 30, 2018. The program would apply to most taxes, including the full amount of tax due on a previously filed return and unpaid taxes on tax returns not filed that were due on or before December 31, 2016. "Fresh start" provides for a potential waiver of most underlying penalties, as well as 50% of the interest related to a failure to pay any amount due. For additional details, see Deloitte's November 3, 2017 issue and December 15, 2017 issue of State Tax Matters.

Did You Know?

2017 State Corporate Income Tax Update

The state legislative process is often lengthy, intricate, and complicated, with competing interests and varying influences from multiple directions. The 2017 legislative season has been no exception—especially considering the uncertainty over and anticipation of federal tax reform, coupled with growing state budgetary pressures to fund such areas as health care, education, transportation, and infrastructure. Continuing a trend seen last year, overall revenue growth among the states has been slow.

As a result, numerous corporate income-tax-related bills were considered in the states, addressing a wide range of issues, including nexus, tax base, business income, apportionment and market-sourcing; filing methods, unitary combination, and water's-edge elimination; tax havens; tax rates; and tax administration and amnesty. Some of the bills were enacted into law, while others were tabled for possible reconsideration next year. In 2017, states have continued to pass legislation regarding the due dates of the corporate income tax returns in response to the passage of the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, which revised the due dates for the federal partnership and corporate income tax returns. That federal law, which was signed by President Obama on July 31, 2015, had pressed state taxing authorities to clarify whether there was an effect on their tax return due dates. With most state legislative sessions having ended for 2017, the November 2017 edition of Inside Deloitte highlights, jurisdiction by jurisdiction, some of the corporate income tax legislative changes that have been enacted to date.

California

The October edition of "Inside Deloitte" discusses the recent California chief counsel ruling regarding the application of market-based sourcing rules for services provided to service providers. In Chief Counsel Ruling (CCR) 2017-01, the California Franchise Tax Board issued guidance interpreting its market-based sourcing rules for services, stating that where a taxpayer/service provider is performing services for another service provider (client service provider), the benefit received is the client service provider being relieved of having to perform some of its contractual obligations for its own customers. This generally results in the service fees being sourced to the principal location of the client service provider and not to the location of its ultimate customers. For additional information on the Chief Counsel Ruling, see the October 2017 edition of Inside Deloitte.

In the November edition of "Credits & Incentives Talk with Deloitte", the enactment of the original federal R&D credit under Internal Revenue Code (IRC) section 41, and the recent federal regulatory developments related to internal use software are discussed. Over the course of the last several decades, software development has become a common activity, from both a federal and state perspective, for which the underlying labor and consulting expenses have become part of taxpayers' research credit calculations. Because state tax authorities typically consider the analysis made by the Internal Revenue Service (IRS) as they scrutinize state research incentive calculations, recent federal regulatory developments related to software are relevant for taxpayers with state-based research tax incentives. For additional details, see the November 2017 edition of Credits and Incentives Talk with Deloitte.

Controversy

District court concludes that taxpayer's refund suit, relating to the carryback of a deduction for foreign taxes, was untimely

In *Trusted Media Brands Inc. v. United States*, [1] Trusted Media Brands, Inc. ("TMB") brought a refund suit seeking a refund in excess of $2.1 million. For the tax years ending June 30, 1995 ("1995"), June 30, 1997 ("1997"), and June 30, 2002 ("2002"), TMB paid taxes to foreign countries and claimed a foreign tax credit on its original 1995, 1997, and 2002 income tax returns. TMB reported a net operating loss ("NOL") for 2002, and carried the NOL back to its 1997 tax year. On December 14, 2011, TMB filed Form 1120X, *Amended US Corporation Income Tax Return*, thereby changing its election from claiming a foreign tax credit to taking a deduction for its foreign taxes paid or accrued in 2002, pursuant to IRC section 164(a)(3).

As a consequence of TMB flipping from crediting to deducting for tax year 2002, TMB's 2002 NOL increased, and TMB carried the 2002 NOL back to 1997 pursuant to IRC section 172(b)(1)(H) and filed an amended return for 1997 to reflect the NOL carryback from 2002. As a result of the carryback from 2002, TMB's 1997 taxable income decreased and its foreign tax credit limitation under IRC section 904 decreased. Consequently, TMB took the position that the excess foreign tax credits, which resulted from the decrease in the foreign tax credit limitation, could be carried back under the then-applicable version of IRC section 904(c).

The district court in *Trusted Media Brands* ultimately agreed with the United States and concluded that TMB's $2.1 million refund claim was untimely. The court reasoned that, because TMB chose to change its election to deduct foreign taxes paid or accrued in 2002, no credit for foreign taxes is allowed, and the applicable limitations period for TMB's 2002 refund claim is three years after the time prescribed by law for filing the return, under IRC section 6511(d)(2)(A). In addition, the court concluded, even if the special ten-year rule under IRC section 6511(d)(3) were to held applicable, that the refund that TMB seeks is time barred as it is attributable to TMB's carryback of foreign tax credits from 1997, and is not attributable to its 2002 change in election.

For additional details, please refer to our November 2017 issue of IRS Insights.

International

Notice 2017-57 defers applicability date of section 987 regulations

On October 2, 2017, Treasury and the IRS issued noticed 2017-57 (the "Notice"), announcing their intent to defer the applicability date of the final section 987 regulations (and certain temporary section 987 regulations) by one year. The Notice effectively established an administrative practice pursuant to which companies are not required to adopt the final regulations (and related temporary regulations) until "taxable years beginning on or after two years after the first date of the first taxable year following December 7, 2016." The Notice also provides that taxpayers may early-adopt the final section 987 regulations, provided that they apply the regulation consistently to all qualified business units owned directly or indirectly on the transition date. Finally, the Notice provides that the government is considering changes to the final section 987 regulations to allow taxpayers to elect alternative rules to (i) transition to the new regulations and (ii) determine section 987 gain or loss.

Please see United States Tax Alert dated October 6, 2017 for more details.

Germany federal court rules that capital gains from sale of shares by non-treaty-protected shareholder are fully tax-exempt

Germany's federal tax court (BFH) issued a decision on May 31, 2017 (published on October 25, 2017), in which it held that capital gains from the sale of shares by a foreign corporate shareholder with limited German tax liability are 100% exempt from German tax, regardless of the existence of (or provisions in) a tax treaty. In other words, the normal add-back of 5% deemed non-deductible business expenses does not apply to a limited liability taxpayer/non-treaty protected foreign shareholder. In reaching its decision, the BFH overruled the decision of the lower tax court of Hesse, which had ruled for the tax authorities. The BFH decision brings an end to a long-running dispute between tax practitioners and the tax authorities.

Under Germany's participation exemption and section 8b of the corporate income tax code, capital gains from the sale of shares generally are 100% tax exempt for corporate shareholders. However, 5% of the gains are deemed to be non-deductible business expenses and are added back to taxable income, which effectively limits the benefit of the participation exemption to 95%. Foreign shareholders are subject to limited German tax liability if they owned, directly or indirectly, at least 1% of the capital of a German corporation within the five-year period before the sale.

Please see the Deloitte World Tax Advisor article dated November 24, 2017 for more detail.

French constitutional court rules 3% surtax on dividends is unconstitutional

On October 6, 2017, the French constitutional court published a decision concluding that the 3% surtax on profit distributions, in its entirely, violates the constitution. The 3% surtax was imposed on French entities subject to corporate income tax, including French permanent establishments of foreign companies, levied on most dividend distributions (including deemed dividends) at the level of the French payer. The constitutional court decision applies as from the date of the publication. Taxpayers may file claims for reimbursement of the surtax paid in the past provided the claim has not been settled and the statute of limitations has not expired.

Please see the Deloitte World Tax Advisor article dated October 13, 2017 for more details.

Accounting Developments

SEC issues SAB 118

On December 22, 2017, the SEC issued Staff Accounting Bulletin ("SAB") 118. This SAB expresses the views of the SEC staff regarding application of ASC 740, *Income Taxes*, in the reporting period that includes December 22, 2017, the date on which the Tax Cuts and Jobs Act (the "Act") was signed into law. Specifically, the SAB addresses (i) situations where the financial statement accounting under ASC 740 is not complete for certain income tax effects of the Act upon issuance of an entity's financial statements for the reporting period in which the Act was enacted and (ii) financial statement disclosures regarding the material financial reporting impacts of the Act for which the accounting under ASC 740 is not complete.

For additional detail, please refer to the SAB issued on December 22, 2017.

REMINDER!
FASB eliminates step 2 from the goodwill impairment test

On January 26, 2017, the FASB issued Accounting Standards Update "ASU" 2017-04, which simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test[1]. Instead, "if the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit…"

For public business entities that are SEC filers, the ASU is effective for annual and any interim impairment tests for periods beginning after December 15, 2019. Early adoption is permitted.

See our February 1, 2017, Heads Up publication for additional information on the ASU's provisions.

On the Horizon

Multistate tax considerations of federal tax reform

Many of the changes included in federal tax reform will be of critical importance to state governments across the country. Certain changes may encourage taxpayers to make federal tax accounting elections in order to capitalize on the impact of the proposed federal corporate rate decrease on domestic deferred income taxes, for which the state tax consequences should be considered. Many of these changes can be expected to affect the calculation of federal taxable income, which is used by numerous states as the starting point for calculating state taxable income. In addition, several of the provisions are designed to stimulate investment in the US economy, which can also have a significant impact on the states. For additional details on potential multistate tax considerations of tax reform, see Deloitte's Multistate Tax Alert issued on December 13, 2017.

Argentina proposed tax reform would introduce most significant changes in decades

The executive branch of Argentina's federal government submitted a bill to Congress on 15 November 2017 that would significantly reform the country's tax system. The bill includes changes that would affect the taxation of both residents and nonresidents, and would lower the corporate tax rate on undistributed profits from 35% to 25% by 2020. The reform has a number of goals, including encouraging investment, promoting the development of the economy, making Argentina globally competitive, facilitating quality employment, increasing fairness in the tax system and reducing tax evasion.

While the bill is still a work in progress and the effective date is uncertain until the law is approved, the following main changes are relevant to corporations:

- The current 35% corporate income tax rate would be reduced to 30%, and then to 25% by 2020.

[1] Under the current guidance in ASC 350, impairment of goodwill "is the condition that exists when the carrying amount of goodwill exceeds its implied fair value." The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination. The process of measuring the implied fair value of goodwill is currently referred to as step 2 of the goodwill impairment test. To perform step 2, an entity must "assign the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination." Accordingly, performing step 2 can sometimes result in significant cost and complexity since the "fair value of goodwill can be measured only as a residual and cannot be measured directly.

- A withholding tax on dividends paid by an Argentine entity to a nonresident or a resident individual would be imposed at a rate of 7% for 2018 and 2019, increasing to 13% as from 2020, so that the overall income tax burden on distributed profits would reach about 35%.

- The thin capitalization rules would be replaced by rules limiting the deductibility of interest on loans with related companies to 30% of taxable EBITDA (earnings before interest, taxes, depreciation and amortization). Currently, only certain related-party interest is subject to the thin capitalization rules, based on a 2:1 debt-to-equity ratio. Certain exceptions would apply in the case of highly leveraged economic groups. The deductibility of foreign exchange losses also would be limited by the new rules.

Please see the Deloitte World Tax Advisor article dated December 15, 2017 for more detail.

Learn More

A Roadmap to Accounting for Income Taxes

The 2017 edition of A Roadmap to Accounting for Income Taxes was released on December 18, 2017. This Roadmap provides Deloitte's insights into and interpretations of the income tax accounting guidance in ASC 740 and IFRSs. Throughout the Roadmap, new guidance has been added, examples related to some of the guidance included in the previous edition have been added or substantively revised, and minor edits have been made to existing guidance to improve its clarity. This edition does not include updates related to tax reform legislation. We hope that you find our Roadmap useful and informative.

Financial Reporting for Taxes Training

Deloitte's Financial Reporting for Taxes Training features interactive courses taught by experienced professionals who will explain applicable guidance as well as share real-world experiences and leading practices. Mark you calendar for the upcoming sessions:

- May 21-25, 2018 in Orlando, Florida
- December 10-14, 2018 in Las Vegas, Nevada

Additional resources that you may find helpful

- Accounting for Income Taxes – Quarterly Hot Topics Archive
- Tax Reform Insights
- Deloitte Tax Accounting & Provision Services Home Page
- Deloitte Tax Accounting & Provisions Dbriefs Webcasts Series
- Deloitte Heads Up Newsletter Archive

As always, we are interested in your comments on our publications. Please take a moment to tell us what you think by sending us an e-mail.

Talk to Us

If you have any questions or comments about the ASC 740 implications described above or other content of Accounting for Income Taxes Quarterly Hot Topics, contact the Deloitte Washington National Tax Accounting for Income Taxes Group at:
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