Accounting for income taxes

Quarterly hot topics

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Accounting developments

FASB simplifies accounting for the tax consequences of intra-entity asset transfers

On October 24, 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*, which removes the prohibition in ASC 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The Accounting Standards Update (ASU), which is part of the Board's simplification initiative, is intended to reduce the complexity of US GAAP and diversity in practice related to the tax consequences of certain types of intra-entity asset transfers, particularly those involving intellectual property (IP).

The Financial Accounting Standards Board (FASB) decided to exclude transfers of inventory from the new guidance because of some constituents' concerns about the costs and complexity of applying it to taxes related to intra-entity inventory transactions. The Board noted that such application would run counter to its simplification initiative. Accordingly, entities will continue to be prohibited from recognizing the current and deferred tax effects of intra-entity transfers of inventory.

Refer to Deloitte's October 25, 2016, Heads Up for additional information.

Tax law developments

Under US GAAP, the effects of new legislation are recognized upon enactment (ASC 740-10-25-47). More specifically, the effect of a change in tax laws or rates on a deferred tax liability (DTL) or deferred tax asset (DTA) is recognized as a discrete item in the interim period that includes the enactment date. The tax effects of a change in tax laws or rates on taxes currently payable or refundable for the current year are reflected in the computation of the annual effective tax rate (AETR) after the effective dates prescribed in the statutes, beginning no earlier than the first interim period that includes the enactment date of the new legislation. However, any effects of a tax law or rate change on taxes payable or refundable for a prior year, such as when the change has retroactive effects, is recognized upon enactment as a discrete item of tax expense or benefit for the current year.

Uncertain tax positions: The evaluation of new information may lead to subsequent changes in judgment as it relates to a particular tax position. Pursuant to ASC 740-10-25-15, a change in judgment that results in subsequent recognition, de-recognition, or a change in measurement of a position taken in a prior annual period, must be recognized as a discrete item in the period in which the new information becomes available. ASC 740 states that the measurement of a tax position should "be based on management's best judgment given the facts, circumstances, and information available at the reporting date." Additional analysis of existing information would not typically constitute new information for purposes of adjusting prior estimates.

Classified balance sheet: Before adopting ASU 2015-17[1], an entity that presents a classified balance sheet must classify the deferred tax balances as either current or noncurrent on the basis of the financial accounting classification of the related liability or asset for which a temporary difference exists. A deferred tax balance that is not related to an asset or liability for financial reporting purposes, such as the deferred tax consequences related to an operating loss or a tax credit carryforward, is classified in accordance with the expected reversal date of the related temporary difference or tax attribute. The effect of a change in tax law on the current or noncurrent classification of a deferred tax amount that is not related to an asset or liability for financial reporting purposes should be recognized in the financial statements of the interim or annual period that includes the enactment date.

Intra-period allocation of tax expense: The effect of a tax law change on prior-year taxes and on DTAs or DTLs existing as of the enactment date would be presented as a component of income tax expense or benefit from continuing operations. The effects of changes in tax law on items not included in income from continuing operations (e.g., discontinued operations and other comprehensive income) arising in the current year and before the enactment date should be included in the current interim period as part of income from continuing operations. The effect of the change on total tax expense or benefit (current and deferred) related to post-enactment income would be allocated between continuing operations and other financial statement components in accordance with the intra-period tax allocation guidance in ASC 740-20.

[1] *ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*

The topics below highlight what we believe are significant tax law developments with broad applicability that should be considered during the preparation of the financial statements. However, note that this is not a comprehensive list of all recent tax law changes.

International

New Section 987 Regulations

On December 7, 2016, the Internal Revenue Service (IRS) and Treasury issued a comprehensive package of regulations that provide long-awaited guidance under section 987 and amend related existing rules under sections 861, 985, 988, and 989. The package consists of final regulations, which generally have a delayed effective date (the "Final Regulations"), and temporary regulations, which in some instances have immediate application (the "Temporary Regulations").

The Final Regulations provide rules for determining income or loss with respect to a qualified business unit (QBU) operating in a functional currency that is different from that of its owner ("Section 987 QBU"). The Final Regulations also provide rules for determining the timing, amount, character, and source of section 987 gain or loss realized by the taxpayer with respect to such QBUs. The Final Regulations are similar to the proposed regulations issued in 2006, with several important distinctions, and generally apply to taxable years beginning on or after one year after the first day of the first taxable year following December 7, 2016. However, taxpayers may elect to apply the new regulations to the first taxable year beginning after December 7, 2016. The Final Regulations exclude certain taxpayers from the scope, but the preamble provides that such taxpayers must use a reasonable approach to comply with section 987.

The Temporary Regulations establish section 987 loss deferral rules for certain transactions entered into after January 6, 2017, with immediate application to tax avoidance transactions entered into after December 6, 2016. The Temporary Regulations also provide certain elections and other rules which, subject to exceptions, track the effective date of the Final Regulations as described above.

Refer to the United States Tax Alert dated December 14, 2016 for further details on the section 987 regulations. Additionally, you may listen to a replay of our Special Edition Dbriefs held on December 20, 2016, *New Section 987 regulations: What could they mean for your company*.

Final and Proposed Subpart F Regulations Addressing Section 956 and the Active Rents and Royalties Exception

On November 3, 2016, the Internal Revenue Service ("IRS") and US Department of the Treasury (the "Treasury") issued final subpart F regulations (the "Final Regulations") addressing sections 954 and 956. The regulations generally adopt, with amendments, the temporary and proposed regulations related to section 954 that were issued on September 1, 2015. Along with the Final Regulations, the IRS and Treasury issued additional proposed section 956 regulations.

The following typical transactions and structures are impacted by the Final Regulations:

- Controlled foreign corporations ("CFCs") that are partners in partnerships that acquire US property and make loans to, or guarantee debt of, related US persons
- Taxpayers relying on the outside basis limitation for purposes of determining the amount of US property held by a CFC indirectly through a partnership in accordance with Revenue Rule 90-112
- CFCs that make loans to domestic or foreign partnerships with related partners
- CFCs that engage in related party factoring transactions
- Taxpayers that rely on the activities conducted pursuant to a cost sharing agreement to meet the "developer exception" and "active marketing exception" under Treasury Regulation §1.954-2

Refer to the United States Tax Alert dated September 4, 2015 which explains the 2015 Temporary Regulations and 2015 Proposed Regulations to section 954 and the United States Tax Alert dated November 3, 2016 for a discussion of the section 956 changes.

Temporary and Proposed Regulations address covered asset acquisitions under Section 901(m)

On December 7, 2016, the Treasury and the IRS published temporary regulations (T.D. 9800, the "Temporary Regulations") and proposed regulations (REG-129128-14, the "Proposed Regulations") under section 901(m) with respect to transactions that may give rise to a basis increase under US law, but not under foreign law. The Temporary Regulations include the regulations previously announced in Notice 2014-44 and Notice 2014-45 (the "original Notices"), without significant modification (see United States Tax Alert dated July 23, 2014). In general, the Temporary Regulations have retroactive effect as of July 21, 2014. The Temporary Regulations also contain an important provision, not found in the original Notices, that excludes gross basis withholding taxes from the definition of foreign income taxes for purposes of section 901(m).

Refer to the United States Tax Alert dated December 12, 2016 for further information regarding these regulations.

Final section 367(a)/(d) regulations retroactively prevent tax-free outbound transfers of foreign goodwill and going concern value

On December 15, 2016, the US Department of the Treasury and the Internal Revenue Service (IRS) issued final regulations under section 367(a) and (d) of the Internal Revenue Code that prevent certain property, including but not limited to foreign goodwill and going concern value, from being transferred by a US person to a foreign corporation on a tax-free basis. The final regulations, which generally mirror the 2015 proposed regulations, retain the retroactive effective date contained in the proposed regulations, thus applying to outbound transfers occurring on or after September 14, 2015.

For more information refer to the International Tax Alert dated December 20, 2016.

Triangular reorganizations involving foreign corporations and inbound nonrecognition transactions

On December 2, 2016, the Treasury and the IRS issued Notice 2016-73 (the "Notice") to target transactions purportedly designed to repatriate earnings and basis of foreign corporations without incurring US tax. In particular the Notice appears to target the following transactions:

- Foreign-to-foreign triangular reorganizations relying on section 954(c)(6) and/or the "30-day rule" to avoid subpart F income
- Triangular reorganizations utilizing Nonqualified Preferred Stock ("NQPS")
- Foreign-to-foreign triangular reorganizations if the foreign issuing corporation subsequently comes inbound through a reorganization or a liquidation
- Triangular reorganizations utilizing previously-taxed income ("PTI")
- All inbound reorganizations or liquidations, even if they were not preceded by a triangular reorganization

Refer to the United States Tax Alert dated December 6, 2016 for further details regarding this Notice.

US Federal

Final and temporary regulations under Sections 385

On October 21, 2016, the United States Treasury and the IRS released final and temporary regulations under section 385 of the Internal Revenue Code (the "385 Regulations") that (i) establish threshold documentation requirements that ordinarily must be satisfied in order for certain related-party interests in a corporation to be treated as indebtedness for US federal income tax purposes; and (ii) treat as stock certain related-party interests that otherwise would be treated as indebtedness for US federal income tax purposes.

Refer to Deloitte's United States Tax Alert dated October 14, 2016 for additional details.

For multistate considerations, please refer to the External Multistate Tax Alert dated December 20, 2016.

Treasury and IRS publish final, temporary, and proposed regulations modifying the rules of disguised sales and allocation of partnership liabilities

On October 5, 2016, the Treasury Department ("Treasury") and the IRS published the following:

- Final regulations (T.D. 9787, the "Final Disguised Sale Regulations") providing guidance under section 707 relating to the disguised sales of property to or by a partnership and guidance under section 752 relating to allocations of liabilities of a partnership to partners for disguised sale purposes. The Final Disguised Sale Regulations generally adopt the provisions of the proposed regulations issued on January 30, 2014 (REG-119305-11, the "2014 Proposed Regulations") with some modifications.
- Temporary regulations (T.D. 9788) for both section 707 (the "707 Temporary Regulations") and section 752 (the "752 Temporary Regulations"). These temporary regulations together impact how liabilities are taken into account for purposes of the disguised sale rules and include rules on the treatment of "bottom dollar payment obligations."

  Note: On November 17, 2016, Treasury and the IRS published corrections to T.D. 9788 to clarify that a partner's share of a partnership liability for purposes of the disguised sale rules cannot exceed a partner's share of a partnership liability under the general liability allocation rules of section 752 (with certain modifications).

- Proposed regulations (REG-122855-15, the "752 Proposed Regulations") incorporate the 752 Temporary Regulations and withdraw a portion of the 2014 Proposed Regulations to the extent not adopted by the Final Disguised Sale Regulations. The 752 Proposed Regulations also contain rules addressing when certain obligations to restore a deficit balance in a partner's capital account are disregarded under section 704 and when partnership liabilities are treated as recourse liabilities under section 752.

US Multistate

California: On October 11, 2016, the US Supreme Court, in The Gillette Company, et al., v. California Franchise Tax Board, denied review of the California Supreme Court's 2015 ruling [see previously issued Multistate Tax Alert for more details on this 2015 ruling], which had unanimously reversed the California Court of Appeal's 2012 decision and denied the taxpayers' election to change their state corporation franchise tax apportionment formula to apply the provisions of the Multistate Tax Compact contained in California Revenue & Taxation Code (CRTC) Section 38006. The taxpayers in this case had sought to use the equally weighted, three-factor apportionment formula (property, payroll, and sales) available under the Multistate Tax Compact in lieu of the three-factor formula with double-weighted sales provided in CRTC Section 25128. For additional details on this denied review, as well as related considerations, see Deloitte's California Multistate Tax Alert dated October 14, 2016.

On November 1, 2016, the California Franchise Tax Board (FTB) issued Notice 2016-03, providing guidance on how it will process cases before the FTB and the California State Board of Equalization following the US Supreme Court's decision to deny review of the California Supreme Court's 2015 ruling. For additional details on the FTB guidance set forth in the Notice, see Deloitte's California Multistate Tax Alert dated November 21, 2016.

Note: On December 12, 2016 the US Supreme Court also denied a similar review of a 2016 Minnesota Supreme Court decision that denied the taxpayer's election of the Multistate Tax Compact.

Mississippi: On October 27, 2016, the Mississippi Supreme Court affirmed a Mississippi Chancery Court's 2015 ruling, which had held that the state's dividend exclusion statute violates the US Constitution's Commerce Clause because it "clearly favors domestic corporations over foreign competitors and discourages corporations from choosing to locate their operations outside Mississippi." The Mississippi statute allows an exclusion from a taxpayer's gross income for intercompany dividends received from domestic affiliates doing business and filing income tax returns in Mississippi. In doing so, the Mississippi Supreme Court determined that the geographical limitation in the statute at issue (i.e., Miss. Code Ann. Section 27-7-15(4)(i)) offends the negative aspect of the Commerce Clause and thus held that portion of the statute to be unconstitutional and invalid.

New York: The New York City Department of Finance (Department) recently released an “Update on Audit Issues” (Update) addressing issues of income allocation relevant to certain New York City business income taxes. More specifically, the Update addresses two issues:

1. Whether an entity may invoke the receipts allocation provisions (collectively referred to herein as the Broker-Dealer Provisions) of N.Y.C. Admin. Code Secs. 11-508(e-3) (i.e., under the Unincorporated Business Tax (UBT)), 11-654.2(5)(b) (i.e., under the Corporate Tax of 2015), or 11-604(3)(a)(10) (i.e., under the General Corporation Tax (GCT), as applicable to federal S corporations) if it is not a registered securities or commodities broker or dealer (Registered); and
2. Whether an entity may invoke the registration status of a Registered single-member limited liability company, which it owns and treats as a “disregarded entity” for federal income tax purposes (SMLLC), in order to apply the Broker-Dealer Provisions to receipts from activities the SMLLC does not conduct.

The Update states that the Department has observed that some taxpayers have interpreted the terms “registered securities or commodities broker or dealer” and “registered securities broker or dealer” broadly, apparently on the basis of two Finance Letter Rulings under which the Department permitted unregistered limited partnerships to characterize themselves as Registered. See, Finance Letter Rulings #12-4934/UBT (August 19, 2013) and #13-4950/UBT (March 28, 2014, together, referred to herein as the Broker-Dealer Rulings). However, the Update notes that the Broker-Dealer Rulings relied on representations that the taxpayers were entitled to, and did, function as securities or commodities brokers or dealers under an exemption from Securities and Exchange Commission registration requirements and pursuant to specific Commodities Future Trading Commission registrations.

Also note that, apparently, a Department representative informally has indicated that this Notice was issued as a clarification and thus applies to all open tax years. For additional details on the Department’s Update, see Deloitte’s December 9, 2016 issue of State Tax Matters.

Texas: On December 2, 2016, the Texas Comptroller of Public Accounts (Comptroller) adopted amendments to Tex. Admin. Code § 3.584 (Rule 3.584), including changes to the application of the reduced franchise tax rate available for certain entities primarily engaged in retail or wholesale trade; however, note that elements of the originally proposed amendments affecting the Self-Production Test were not formally adopted. Nonetheless, the Comptroller has indicated the policy surrounding the proposed amendments to the Self-Production Test continues to apply and that additional amendments will be proposed in the future related to Rule 3.584.

For additional details on the provisions of the proposed amendments along with the amended regulation adopted, see Deloitte’s Multistate Tax Alert dated December 13, 2016.

Did you know?

2016 AICPA Conference on Current SEC and PCAOB Developments

At this year’s conference, the SEC staff reiterated the importance of coordination among an entity’s global business functions (e.g., treasury, accounting, and business functions) with respect to the accounting for deferred taxes on undistributed earnings of a foreign subsidiary under ASC 740. In addition, SEC Division of Corporation Finance Deputy Chief Accountant Nili Shah indicated that the SEC staff expects to issue more comments in the coming year if income tax disclosures contained in the MD&A do not improve. The staff is focused on disclosures that will help the reader of the financial statements understand the trends and uncertainties associated with:

- The historical effective tax rate (ETR) and the extent to which it is expected to be indicative of the future ETR
- Income tax expense
- Cash tax obligations and how they affect liquidity
- Unrecognized tax benefits and changes related to those benefits.
- Cash held in foreign jurisdictions that the company has asserted will be indefinitely reinvested.

Ms. Shah added that when describing the reason for a reversal of a valuation allowance, the staff would consider a discussion of the sources of future taxable income and the associated uncertainties more useful for investors than the boilerplate language that the staff sometimes sees, such as "It is no longer more likely than not that a deferred tax asset will not be realized, so we have reversed our valuation allowance."

For more information, see Deloitte's December 12, 2016, Heads Up.

Learn more

A Roadmap to Accounting for Income Taxes

The 2016 edition of *A Roadmap to Accounting for Income Taxes* was released on December 16, 2016. This Roadmap includes all of Deloitte's interpretive guidance on the accounting for income taxes, combining the income tax accounting requirements and implementation guidance from ASC 740 with Deloitte's interpretations and examples in a comprehensive, reader-friendly format. The Roadmap also contains appendixes that provide:

- Specific disclosure examples.
- Samples of recent SEC comments on income tax matters.
- A broad-based discussion of the income tax accounting guidance under International Financial Reporting Standards.

We hope that you find our Roadmap useful and informative.

Financial Reporting for Taxes Training

To help corporate tax and accounting professionals enhance their skills and stay informed of issues related to financial reporting for income taxes, Deloitte is offering Financial Reporting for Taxes Training featuring comprehensive and specialized course offerings May 22-26, 2017 in Orlando, FL and December 4-8, 2017 in Las Vegas, NV.

Further information regarding these courses and registration will be forthcoming.

Additional resources that you may find helpful:

- Deloitte Financial Accounting & Reporting - Income Taxes Home Page
- Deloitte Dbriefs Webcasts Archive
- Deloitte Heads Up Newsletter Archive

As always, we're 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: USNationalWNTActIncomeTaxesGrp@deloitte.com.

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