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Accounting for Income Taxes

Quarterly Hot Topics

December 2015

In this issue:

Accounting developments

FASB to issue final standard on improvements to employee share-based payment accounting

At its November 23, 2015, meeting, the Financial Accounting Standards Board (FASB) discussed feedback received on the proposed **Accounting Standards Update (ASU)** and directed the staff to draft a final ASU for vote by written ballot. The FASB affirmed its proposed amendments related to (1) accounting for income taxes in the income statement upon vesting or settlement of awards, (2) presentation of excess tax benefits in the statement of cash flows, (3) accounting for forfeitures, (4) minimum statutory withholding requirements, (5) presentation of employee taxes paid in the statement of cash flows when an employer withholds shares to meet minimum statutory withholding requirements, and (6) private-company practical expedients related to expected term and intrinsic value. In addition, the FASB made tentative decisions about treating tax effects of exercised or vested awards as discrete items in the reporting period in which they occur, the transition method, disclosures in the adoption period, disclosures about accounting for forfeitures, and the effective date of the final standard. For public entities, the standard will be effective for annual reporting periods beginning after December 15, 2016, and interim periods within those periods. The final ASU is expected to be issued in the first quarter of 2016. For more information, see Deloitte's June 12, 2015, **Heads Up** and **November 30, 2015, Journal Entry publication**.

FASB to issue final standard on simplifying the equity method of accounting

On June 5, 2015, the FASB issued a **proposed ASU** on equity method accounting as part of its simplification initiative. The proposal would amend the accounting for equity method investments, eliminating the requirements for an investor to (1) account for basis differences related to its equity method investees and (2) retroactively account for an investment that becomes newly qualified for use of the equity method because of an increased ownership interest as if the equity method had been applied during all previous periods in which the investment was held. At its November 19, 2015, meeting, the FASB directed its staff to draft a final standard that eliminates the requirement that an entity retrospectively adopt the equity method when an investment first qualifies for the equity method as a result of an increase in the level of ownership interest. The standard will be effective for fiscal years beginning after December 15, 2016; early adoption will be permitted. The FASB is expected to issue the final ASU in the first quarter of 2016. However, the FASB decided not to move forward at this time with a decision on whether to eliminate the requirement to account for the basis difference between the cost of an investment and the underlying net assets of the investee. The Board instructed its staff to perform further research and will continue to keep this issue on its active agenda for further deliberation. For more information, see Deloitte's **June 16, 2015, Heads Up** and **November 20, 2015, Journal Entry publication.**

Leases — FASB agrees on effective date

At its November 11, 2015, meeting, the FASB finished redeliberations related to its upcoming leases standard. The Board tentatively decided that the new leases standard would be effective for public business entities for annual periods beginning after December 15, 2018, and interim periods therein. For all other entities, the standard would be effective for annual periods beginning after December 15, 2019, and interim periods thereafter. Early adoption would be permitted for all entities. Further, an entity's ability to early adopt the leases standard would not be linked to its adoption of any of the FASB's other standards.

The FASB also tentatively decided to exempt leases that begin near the end of the underlying asset's economic life from the classification criterion under which, if the "lease term is for the major part of the remaining economic life of the underlying asset," a lessee would classify the lease as a financing lease.

The Board has directed the staff to finish drafting a final ASU for a vote by written ballot. The final standard is expected to be issued in early 2016. For more information, see Deloitte's **November 12, 2015, Journal Entry publication.**

FASB to issue final standard on classification and measurement of financial instruments

At its November 11, 2015, meeting, the Board directed the staff to draft a final standard on classification and measurement of financial instruments, which is expected to be issued in January 2016.

Further, the Board discussed the comments received on its external review draft and made tentative decisions regarding the final standard's effective date and early application provisions. For public business entities, the standard would be effective for fiscal years beginning after December 15, 2017, including interim periods therein.

In addition to changing the guidance for measuring and presenting financial instruments in the financial statements, the proposed guidance would eliminate the diversity in practice related to an entity's evaluation of the need for a valuation allowance for debt securities that are classified as available-for-sale. Under current US Generally Accepted Accounting Principles (US GAAP), entities perform this evaluation either separately from their other deferred tax assets or in combination with them. The proposed guidance would clarify that an entity is required to make "the assessment of a valuation allowance for a deferred tax asset related to an available-for-sale debt security in combination with the entity's other deferred tax assets."

For more information, see Deloitte's **February 2, 2015, Heads Up** and, **November 12, 2015, Journal Entry publication**.

FASB makes tentative decisions about various income tax disclosure requirements

At its October 21, 2015 meeting, the FASB made tentative decisions regarding income tax disclosure requirements, including disclosures related to (1) income taxes paid, (2) deferred income taxes, (3) valuation allowances, and (4) income tax rate reconciliations.

These proposed changes to disclosure requirements are in addition to the tentative decisions the FASB made on February 11, 2015 to add disclosure requirements related to undistributed foreign earnings, as well as the tentative decisions the FASB made on August 26, 2015 to make changes to disclosure requirements related to unrecognized tax benefits.

At its October 21 meeting, the FASB instructed its staff to conduct further outreach with stakeholders and to hold discussions with the Private Company Council (those discussions occurred on December 4 at a PCC meeting). In addition, the Board directed the staff to begin drafting a proposed ASU for public comment that would take into account all the tentative decisions reached to date regarding income tax disclosure requirements.

For more information, see Deloitte's **February 12, 2015, August 28, 2015,** and **October 26, 2015, Journal Entry publication.**

FASB redeliberates income tax proposals related to intra-entity asset transfers

At its meeting on October 5, 2015, the FASB redeliberated its **proposed ASU** related to the accounting for income taxes for intra-entity asset transfers. The Board discussed the different views expressed by constituents in their comment letters on the proposed guidance to eliminate the current exception in Accounting Standards Codification (ASC) 740 that requires entities to defer the income tax consequences of intra-entity asset transfers until the assets are sold to an outside party. A number of constituents asserted that both costs and complexity would increase under this proposal. Some respondents proposed that the Board permit a continuation of the exception for intra-entity transfers of inventory as a practical expedient while eliminating the exception for transfers of all other assets. The Board instructed its staff to perform additional research on these issues as well as outreach regarding the costs and benefits of providing a practical expedient for intra-entity inventory transfers. The Board will redeliberate the proposal at a future meeting and is expected to either eliminate the exception entirely (in a manner consistent with the current proposal) or establish a practical expedient, in which case the exception would be eliminated for all intra-entity asset transfers other than inventory. For more information, see Deloitte's **January 30, 2015, Heads Up**, and **October 7, 2015, Journal Entry publication.**

FASB issues ASU on balance sheet classification of deferred taxes

On November 20, 2015, the FASB issued **ASU 2015-17**, *Balance Sheet Classification of Deferred Taxes,* as part of its simplification initiative (i.e., the Board's effort to reduce the cost and complexity of certain aspects of US GAAP). The ASU requires entities to present deferred tax assets (DTAs) and deferred tax liabilities (DTLs) as noncurrent in a classified balance sheet. It thus simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current or noncurrent in a classified balance sheet. The ASU is aligned with the current guidance in IAS 12, which requires entities to present DTAs and DTLs as noncurrent in a classified balance sheet. Netting of DTAs and DTLs by tax jurisdiction is still required under the new guidance.

For public business entities, the ASU is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the ASU is effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted for all entities. For more information, see Deloitte's **November 30, 2015, Heads Up.**

FASB proposes ASU to increase transparency of accounting for government assistance arrangements

On November 12, 2015, the FASB issued a **proposed ASU** that would increase financial reporting transparency by requiring specific disclosures about government assistance received by businesses. Government assistance arrangements are legally enforceable agreements under which the government provides value to the entity (e.g., grants, loan guarantees, and tax incentives). The objective of the proposed disclosure requirements is to enable financial statement users to better assess (1) the nature of the government assistance, (2) the accounting policies for the government assistance, (3) the impact of the government assistance on the financial statements, and (4) the significant terms and conditions of the government assistance arrangements. Comments on the proposed ASU are due by February 10, 2016. For more information, see Deloitte's November 20, 2015, **November 20, 2015, Heads Up**.

FASB's proposed ASU states that omissions of immaterial disclosures are not accounting errors

On September 24, 2015, the FASB issued a **proposed ASU** that would amend the Codification to indicate that the omission of disclosures about immaterial information is not an accounting error. The proposal notes that materiality is a legal concept that should be applied to assess quantitative and qualitative disclosures individually and in the aggregate in the context of the financial statements taken as a whole. For more information, see Deloitte's **September 28, 2015, Heads Up.**

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 DTL or 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 position. Pursuant to ASC 740-10-25-15, a change in judgment that results in subsequent recognition, derecognition, 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 adoption of ASU 2015-17 (see article above), an entity that presents a classified balance sheet must classify the deferred 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.

Tax expense: For both calendar and non-calendar-year-end reporting entities, the effect of the 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 intraperiod tax allocation guidance in ASC 740-20.

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

International

For a summary of the current major international income tax developments for the current quarter please refer to the **Accounting for Income Taxes – Global Tax Developments** publication. The Global Tax Developments publication will be issued shortly after the release of this publication. The Global Tax Developments publication also includes a summary of combined tax rates applicable in several key jurisdictions and the dates of enactment of rate changes, if applicable, under US GAAP.

US Tax Court's Altera decision raises broader questions

The US Tax Court on July 27 held, in a unanimous 15-0 decision in Altera Corp. v. Commissioner, that a rule promulgated under the 2002 proposed modification to the 1995 cost sharing regulations requiring participants in a qualified cost sharing arrangement (QCSA) to share stock-based compensation costs related to the intangible development area of the QCSA (i.e., Treas. Reg. § 1.482-7(d)(2)(2003), the "all costs rule") did not satisfy the reasoned decision-making standard, and is thus invalid. Companies should consider whether the Altera decision could impact their income tax accounts. Please refer to the **Deloitte Global Transfer Pricing Alert** for further details.

Controversy

Bipartisan Budget Act of 2015 cause significant rule changes to partnership audits and adjustments

Background

On Monday, November 2, 2015, the Bipartisan Budget Act of 2015 (the "Budget Act") was enacted, which includes, among other items, significant rule changes for partnership audits and adjustments. The Budget Act completely replaces the current Tax Equity and Fiscal Responsibility Act (TEFRA) procedural rules for partnership audits and adjustments. These provisions are effective for returns filed for partnership taxable years beginning after December 31, 2017, however a partnership may elect to apply the new rules to any partnership return filed for partnership taxable years beginning after the date of enactment and before January 1, 2018. The Budget Act and Protecting Americans from Tax Hikes (PATH) Act (discussed in the Periods and methods section below) are two recent enacted laws by the U.S government that contribute to the initiative of streamlining IRS audits of large partnerships

Previous and new partnership tax rules

TEFRA established unified audit rules for partnerships with more than 10 partners, and required that the tax treatment of all partnership items be determined at the entity level for these partnerships. Partnerships with more than 100 partners (an electing large partnership or ELP) were allowed to elect into a simplified reporting regime, which included streamlined audit and adjustment procedures.

The Budget Act repeals the current TEFRA and ELP rules and replaces them with one set of partnership-level audit rules that will apply to all partnerships, subject to an election out by certain partnerships with 100 or fewer partners. Under these streamlined audit rules, the IRS will examine items of income, gain, loss, deduction, or credit for a particular year (the "reviewed year"), and any adjustments will be taken into account by the partnership at the partnership level in the year the audit or judicial review is completed (the "adjustment year").

Under the Budget Act, the partnership will pay the tax, interest, and penalties on underpayments. The tax due is calculated by multiplying the net of the adjustments by the highest statutory corporate or individual rate in place. Any adjustments not causing underpayments will then flow through to the partners in the year of the adjustment. The amount of the underpayment at the partnership level could be reduced by (i) the tax reported on the underpayment by partners filing amended returns, (ii) the tax attributable to tax-exempt partners, and (iii) the tax rate differential due to a lower corporate tax rate or lower capital gain/dividend rate.

Alternatively, partnerships may elect to issue adjusted information returns to the reviewed-year partners, who would then take the adjustments into account on their individual returns in the adjustment year through a simplified amended return process. Those partners would calculate the additional tax owed for the reviewed year and then pay the tax (and interest and penalties) from that prior year with the tax return for the year when they receive the statement of adjustments. Once this election is made, it may only be revoked with the consent of the Secretary.

Small partnerships with 100 or fewer qualifying partners are allowed to elect out of the new rules, and those partnerships and partners are subject to the general rules that apply to auditing individual taxpayers. To qualify to elect out, the partners must all be individuals, C corporations, foreign entities that would be treated as C corporations if domestic, S corporations, estates of deceased partners, or others if the Secretary prescribes in guidance. The election to opt out is made for a particular year with a timely filed return for that taxable year.

Audits will be handled by a designated partnership representative, who can be a partner or non-partner with a substantial presence in the US The partnership representative is granted broad authority to resolve any partnership audit and any such resolution would be binding on all partners.

Periods and methods

Tax extenders bill becomes law

On December 18, 2015, President Obama signed legislation that extends several business provisions retroactive to the end of 2014. It also modifies certain provisions prospectively. The legislative package (**H.R. 2029**) combines a bill to renew dozens of expired tax deductions, credits, and incentives with omnibus appropriations legislation that sets spending levels for government agencies for the remainder of fiscal year 2016.

The PATH Act – the extenders component of H.R. 2029 – makes permanent several lapsed business incentives, such as the research credit and the Subpart F exception for active financing income. It also renews a handful of provisions – such as bonus depreciation, the work opportunity and new markets credits, and production and investment tax credits for wind and solar energy – for five years. Other provisions are extended through 2016. In some cases, provisions are extended with modifications, while certain others are extended subject to a phase-out.

Below is a highlight of the major business provisions in the legislation:

Business extenders

Permanent provisions: The PATH Act permanently extends several business provisions retroactive to the end of 2014. It also modifies certain provisions prospectively. The legislation permanently extends (and in some cases modifies) the following provisions:

- The research and experimentation credit;
- Increased expensing limits under Section 179;
- The subpart F exception for active financing income;
- 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements;
- The minimum 9 percent low-income housing tax credit rate for non-federally subsidized buildings;
- The employer wage credit for employees who are active duty members of the uniformed services;
- Provisions allowing passthrough character of interest-related dividends and short-term capital gains dividends from regulated investment companies (RICs) to foreign investors;

- RIC qualified investment entity treatment under the Foreign Investment in Real Property Tax Act (FIRPTA); and
- The reduced recognition period for S corporation built-in gains tax.

Five-year extensions

A handful of other business provisions receive five-year extensions. Those made retroactive to the end of 2014 and extended through 2019 include:

- Bonus depreciation and the election to accelerate alternative minimum tax credits in lieu of first-year bonus depreciation, phased down over five years;
- The lookthrough rule for payments between related controlled foreign corporations under the foreign personal holding company rules;
- The new markets tax credit; and
- The work opportunity tax credit.

Two-year extensions

Several other business provisions are renewed through 2016, retroactive to the end of 2014, including the:

- Credit for maintenance of railroad tracks;
- Special expensing rules for certain film and television productions;
- Section 199 deduction with respect to income attributable to domestic production activities in Puerto Rico;
- Seven-year recovery period for motorsports entertainment complexes; and the
- Three-year recovery period for certain race horses.

Other provisions

- Beyond extenders, the PATH Act includes several provisions to overhaul the tax treatment of real estate investment trusts (REITs) and makes permanent several incentives to promote charitable giving by businesses; and
- Within the omnibus spending component of the package, Congress struck a deal to provide various extensions of the wind production tax credit (PTC), investment tax credit (ITC) in lieu of PTC, and the solar ITC in exchange for lifting the 40-year ban on crude oil exports.

Partnership audit provisions

The PATH Act includes several technical corrections to rules streamlining IRS audits of large partnerships that were enacted earlier this year in the Bipartisan Budget Act of 2015. (For prior coverage, see **Tax News & Views, Vol. 16, No. 37, Oct. 30, 2015,** and Controversy section herein)

Also in the legislation are provisions addressing taxpayer access to the Federal Tax Court as well as Tax Court administration.

A complete list of provisions in the agreement is available **here**.

US Multistate

Alabama: On September 14, 2015, Governor Bentley signed into law Senate Bill 20, which requires the Alabama Department of Revenue ("Department") to establish a tax amnesty program ("Program") for a period of at least two months duration in 2016, occurring prior to August 31, 2016, which will apply to most taxes administered by the Department for such eligible taxes due prior to January 1, 2015, or such eligible taxes for taxable periods that began before January 1, 2015. In exchange for participation, qualifying taxpayers potentially may receive a waiver of one-half of the interest and all of the penalties associated with the tax periods for which amnesty is applied. If, following the termination of the tax amnesty period, the Department issues a deficiency assessment for a period for which amnesty was taken, the Department has the authority to impose penalties and institute civil proceedings or criminal proceedings as authorized by state law "only with respect to the difference between the amount shown on the amnesty application and the correct amount of tax due. After the amnesty program expires, the new law also grants the Department the authority to impose via regulation an additional "cost of collection penalty" not to exceed 20% of any additional deficiency assessed for any taxable period for which amnesty was taken. For additional details on the benefits provided under the Program, the limitations to participation and the process by which taxpayers may avail themselves to the Program, see Deloitte's **October 2, 2015 issue of State Tax Matters**.

California: On September 30, 2015, Governor Brown signed into law Assembly Bill 154 contains a number of important tax-related provisions, including:

- Advances California's federal tax conformity to the IRC as of January 1, 2015.
- Resolves ambiguities surrounding the validity of Senate Bill 401.
- Provides additional exceptions to the 20 percent large corporate understatement penalty.
- Conforms to federal net operating loss carryback procedure allowing an extension of the time to pay tax.
- Conforms to various other changes made to the IRC between 2009 and 2015.

For additional details on the law changes for California, see Deloitte's **California Multistate Tax Alert**

On December 31, 2015, the California Supreme Court, in The Gillette Company, et. al., v. Franchise Tax Board, unanimously reversed the California Court of Appeal's decision and denied the taxpayers' election to change their corporation franchise tax apportionment formula to apply the provisions of the Multistate Tax Compact ("Compact") contained in California Revenue & Taxation Code (CRTC) Section 38006. The taxpayers had sought to use the equally weighted, three-factor apportionment formula (property, payroll, and sales) available under the Compact (Compact Election) in lieu of the three-factor formula with double-weighted sales provided in CRTC Section 25128. The California Supreme Court held that the Compact was not a binding reciprocal agreement among the member states and thus the California Legislature may properly eliminate the Compact's election provision. Companies should consider whether the Gillette decision could have an impact on their income tax accounts.

Connecticut: On December 29, 2015, Connecticut Governor Dannel Malloy signed Senate Bill 1601, which includes changes to Connecticut tax law in addition to those adopted earlier in the year. Changes to Connecticut's corporation business tax include:

- Modifications to the Connecticut corporation business tax laws regarding mandatory unitary taxation effective for all income years beginning on or after January 1, 2016;
- Modifications to the Connecticut corporation business tax laws regarding apportionment effective for all income years beginning on or after January 1, 2016; and
- Adjustments to Connecticut tax credits, which have various effective dates specified.

For additional details on the Connecticut tax law changes, see Deloitte's **Connecticut Multistate Tax Alert**.

District of Columbia: On July 27, 2015, District of Columbia Mayor Muriel Bowser signed the Fiscal Year 2016 Budget Support Act of 2015 in the form of emergency legislation [D.C. Act 21-127 (B21-283)] that would have expired on October 25, 2015. The Act included an enumerated list of tax haven jurisdictions for combined reporting purposes and contained provisions for market-based sourcing of sales other than sales of tangible personal property for tax years beginning after 2014. On August 11, 2015, Mayor Bowser signed a permanent version of the Fiscal Year 2016 Budget Support Act of 2015 [D.C. Act 21-148 (B21-158)], which also included the enumerated list of tax haven jurisdictions for combined reporting purposes and clarified provisions for market-based sourcing of sales other than sales of tangible personal property for tax years beginning after 2014. This permanent legislation specifically provided that the law became effective on October 1, 2015, although the legislation was subject to a congressional review period before it came into effect on October 22, 2015. For additional details on the District of Columbia's new legislation, see Deloitte's **December 11, 2015 issue of State Tax Matters**.

Michigan: The Michigan Department of Treasury ("Department") recently issued guidance, Revenue Administrative Bulletin 2015-20, on how taxpayers should determine where the recipient of services receives the benefit of those services for purposes of calculating the sales factor under Michigan's corporate income tax (CIT) apportionment provisions. Under the CIT statutes, sales from the performance of services generally must be sourced to Michigan if the recipient of the services receives the benefit of the services in Michigan. This guidance addresses issues such as:

- Whether the recipient of services may be someone other than the purchaser of the services;
- How to appropriately source service receipts when only a portion of the benefit of services is received in Michigan;
- How to handle situations where a taxpayer is unable to determine where the recipient of a service received the benefit of that service; and
- How the Department's guidelines will be applied in practice through various listed examples.

For additional details on the Department's new guidance, see Deloitte's **October 23, 2015 issue of State Tax Matters**.

New Hampshire: Pursuant to recently enacted legislation House Bill 2 that provides for an amnesty program that will run from December 1, 2015 through February 15, 2016, with respect to taxes administered and collected by the New Hampshire Department of Revenue Administration ("Department") for unpaid taxes reported and paid in full, the Department has issued related guidance on the program's implementation. During the amnesty program, taxpayers have a "one-time opportunity" to receive amnesty from all underlying penalties and one-half interest on their outstanding qualifying taxes. The guidance explains that amnesty is available regardless of whether the Department has assessed the tax due or the taxpayer has filed a return and even if the taxpayer has appealed or intends to appeal. For additional details and guidance on the program's implementation, see Deloitte's **November 20, 2015 issue of State Tax Matters**.

New York State: The New York State Department of Taxation and Finance ("Department") recently proposed regulations that would amend 20 NY Codes, Rules and Regulations Section 4-4.6 add new Section 4-4.9 These regulations address the sourcing of receipts from other services and other business activities and sales of digital products that are currently governed by the hierarchies described in Tax Law Sec. 210-A.10 (for other services and other business activities) and 210-A.4 (for digital products), respectively. These proposed regulations are part of a broader effort by the Department "to amend the Article 9-A Business Corporation Franchise Tax Regulations to incorporate the changes made by the corporate tax reform legislation contained in the 2014-2015 and 2015-2016 enacted New York State Budgets." The Department is accepting public comments on these proposed regulations until January 16, 2016. Once adopted, regulations generally are prospective in application.

The proposed regulations include numerous examples, many of which are highly fact-specific, potentially raising challenges for taxpayers seeking to apply them to other situations. Taxpayers may wish to consider whether the regulations and related examples could benefit from further clarification. Taxpayers who may have a view contrary to or not clearly expressed in the proposed regulations may wish to consider contacting the Department by January 16, 2016, either to suggest new wording to a proposed regulation or to request that a more specific example be added. For additional details on the proposed regulations for New York State, see Deloitte's **New York State Multistate Tax Alert**.

Pennsylvania: The Commonwealth Court of Pennsylvania (the "Commonwealth") recently held that the statutory cap on Pennsylvania's net operating loss (NOL) carryover deduction, as applied to Nextel Communications of the Mid-Atlantic, Inc. (Taxpayer) for Corporate Net Income Tax (CNIT) purposes, violates the Uniformity Clause of the Pennsylvania Constitution. The court's remedy would allow Taxpayer to deduct its NOLs without regard to the cap in calculating its CNIT.

As of December 22, 2015, the Commonwealth has filed exceptions with the Commonwealth Court seeking a reconsideration of the decision. Once the exceptions have been ruled upon, either party may exercise an automatic right of appeal to the Pennsylvania Supreme Court within 30 days from the date of the Commonwealth Court's decision. Accordingly, the decision is not final. However, while this case remains pending, taxpayers who were previously in an NOL carryover position with income exceeding the statutory NOL cap may wish to consider filing CNIT refund claims in order to preserve their rights to refunds for open tax periods. Upon further appeal, the Pennsylvania Supreme Court could uphold or overturn the entire decision, or uphold the finding of a Constitutional violation but prescribe a different remedy, which may thus impact the application of NOL caps in tax periods subsequent to 2007. For additional details on the Commonwealth Court of Pennsylvania's ruling, see Deloitte's **Pennsylvania Multistate Tax Alert**.

Texas: Pursuant to legislation enacted in 2013, effective January 1, 2014, which allowed taxpayers to elect to either claim a sales/use tax exemption for the purchase of tangible personal property used for research and development (R&D) activities or take an R&D credit against the franchise tax for qualifying research expenditures, the Texas Comptroller has issued a new R&D administrative rule to help implement these provisions. The new rule defines terms and concepts such as "combined group," "qualified research," and "depreciable tangible personal property used in qualified research," as well as explains that depreciable tangible personal property is directly used in qualified research if it is used in the actual performance of activities that are part of the qualified research. For additional details on the Comptroller's new guidance, see Deloitte's **December 4, 2015 issue of State Tax Matters**.

Did you know?

Presentation of deferred federal income taxes associated with deferred state income taxes

ASC 740-10-55-20 states:

State income taxes are deductible for US federal income tax purposes and therefore, a deferred state income tax liability or asset gives rise to a temporary difference for purposes of determining a deferred US federal income tax asset or liability, respectively. The pattern of deductible or taxable amounts in future years for temporary differences related to deferred state income tax liabilities or assets should be determined by estimates of the amount of those state income taxes that are expected to become payable or recoverable for particular future years and, therefore, deductible or taxable for US federal tax purposes in those particular future years.

Question

Is it appropriate to net the federal effect of a state DTL or DTA against the state deferred tax?

Answer

No. ASC 740 generally requires separate identification of temporary differences and related deferred taxes for each tax-paying component of an entity in each tax jurisdiction, including US federal, state, local, and foreign tax jurisdictions.[1] ASC 740-10-45-6 states the following regarding the offsetting of DTAs and DTLs:

[1] As described in ASC 740-10-30-5, a tax-paying component is an individual entity or group of entities that is consolidated for tax purposes.

> For a particular tax-paying component of an entity and within a particular tax jurisdiction, all current deferred tax liabilities and assets shall be offset and presented as a single amount and all noncurrent deferred tax liabilities and assets shall be offset and presented as a single amount. **However, an entity shall not offset deferred tax liabilities and assets attributable to different tax-paying components of the entity or to different tax jurisdictions**. [Emphasis added]

For example, assume that Company A has a state DTL of $100 related to a fixed asset and that this DTL represents taxes that will need to be paid when the fixed asset is recovered at its financial reporting carrying amount. The future state taxes will result in a $100 deduction on the US federal income tax return, and a DTA of $35 ($100 deduction × 35% tax rate) should be recognized for that future deduction. In this example, Company A should report a $100 state DTL and separately report a $35 federal DTA. It would not be appropriate to report a "net of federal tax benefit" state DTL of $65.

In addition to improper presentation of DTAs and DTLs in the balance sheet, improperly netting the federal effect of state deferred taxes against the state deferred taxes themselves can result in, among other things, (1) an improper assessment of whether a valuation allowance is necessary in a particular jurisdiction or (2) improper disclosures related to DTAs and DTLs.

Additional Q&A's will be incorporated in our latest edition of our **Roadmap to Accounting for Income Taxes**, which will be issued in January 2016. Refer to **Appendix A** for a list of Q&A topics that will be covered in our pending roadmap publication.

Learn more

A Roadmap to Accounting for Income Taxes is part of Deloitte's Roadmap series. 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:

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

We hope that you find our Roadmap useful and informative. 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**.

Financial Reporting for Taxes Training: *Mark your calendar!* Corporate tax and accounting professionals continue to face significant challenges in financial reporting for income taxes. Deloitte's Financial Reporting for Taxes Training seminars can help you stay informed. Our seminars will be held May 23–27 in Orlando, FL and December 5–9 in Las Vegas, NV. The seminars will feature comprehensive and specialty course offerings available as a single course or combination of courses. Invitations containing course descriptions, pricing, registration, and additional information will be coming soon.

SEC Comment Letters — Including Industry Insights: What "Edgar" Told Us: The ninth edition in Deloitte's SEC Comment Letter series includes extracts of frequently issued SEC staff comments, additional analysis, and links to resources that are relevant to SEC filers. The publication provides additional sample comments and analysis on income tax matters under ASC 740. A copy of this publication can be found **here**.

Example Disclosure: Accounting for Income Taxes: This example disclosure summarizes accounting and disclosure requirements outlined in SEC Regulation S-K, SEC Regulation S-X, and FASB ASC Topic 740, Income Taxes. The information in this example disclosure reflects pronouncements that are effective as of December 31, 2014. A copy of this publication can be found **here**.

International Core of Excellence (ICE) 2015 Country Essentials: Deloitte Tax LLP's International Core of Excellence (ICE) is a local resource designed to help US companies doing business in multiple jurisdictions.

ICE is a US-based team of highly experienced tax professionals from key jurisdictions around the world. ICE team members, who are specialists in the tax systems of their home jurisdictions, can identify and address how foreign tax considerations impact a US multinational's US business drivers and tax planning. The **ICE Country Essentials** provide information on the tax rules in ICE countries, covering direct and indirect taxes and rates, tax basis and residency rules, plus forms of business organization, accounting standards and foreign exchange controls. The ICE Country Essentials are drawn from the larger Deloitte Highlights series reviewing the tax landscape of nearly 150 jurisdictions. The Essentials serve as companion pieces to the **Deloitte Taxation and Investment Guides**, which help potential investors understand the investment climate, operating conditions and tax system of most major trading jurisdictions in greater detail.

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.**

Appendix A

This appendix summarizes a list of Q&A topics that will be included in the January 2016 **Roadmap to Accounting for Income Taxes** edition**.**

Primary Reference	Topic: Question
740-10-25-2	**Measuring Deferred Taxes in Consolidated Financial Statements When a Foreign Subsidiary Uses a Local Statutory Basis of Accounting to Prepare Its Financial Statements:** How should deferred taxes be computed for purposes of a company's consolidated financial statements prepared in accordance with US GAAP when both stat-to-GAAP and stat-to-tax differences are present?
740-10-25-2	**Accounting for the Tax Effects of Tax Positions Expected to Be Taken in an Amended Tax Return or Refund Claim or to Be Self-reported Upon Examination:** When should an entity account for the tax effects of its intent to file amended tax returns or refund claims or to report self-identified audit adjustments (i.e., affirmative adjustments) in its financial statements?
805-50-25-3	**Applicability of Pushdown Accounting to Income Taxes and Foreign Currency Translation Adjustments:** To properly account for income taxes and foreign currency translation adjustments, must an acquirer apply pushdown accounting?
740-10-45-6	**Presentation of Deferred Federal Income Taxes Associated With Deferred State Income Taxes:** Is it appropriate to net the federal effect of a state DTL or DTA against the state deferred tax?
740-10-30-8	**Deferred Tax Treatment of Hybrid Taxes:** How should an entity determine the appropriate tax rate to use for measuring DTAs and DTLs in a hybrid tax regime?
740-10-15-3	**Hybrid Taxes:** When paying taxes in a hybrid tax regime, how should an entity determine the portion of taxes paid that should be treated as "income taxes" under ASC 740?
740-30-25-18(a)	**Deductible Outside Basis Difference in a Foreign Subsidiary:** Should an entity record a DTL for unremitted earnings when there is an overall excess-of-tax-over-financial-reporting outside basis difference in a foreign subsidiary and the entity intends to remit the foreign earnings?
740-20-45	**Intraperiod Allocation of "Out of Period" Tax Effects of Uncertain Tax Benefits (UTB) That Originated in Discontinued Operations:** How should the parent allocate the out-of-period tax expense or benefit associated with adjusting the carrying amount of a UTB when the UTB was originally allocated to discontinued operations?
740-20-45-8	**Intraperiod Allocation: Treatment of Certain Out-of-Period Adjustments:** How should an entity allocate the tax effects of out-of-period adjustments for which there is no specific guidance in ASC 740?
740-30-25-5	**Accounting for Temporary Differences Related to an Investment in a Corporation:** How should an investor apply the guidance in ASC 740-30 on temporary differences related to investments in subsidiaries?
740-10-30	**"Unborn" Foreign Tax Credits (FTC):** Should a deferred tax asset be recognized for the anticipated excess FTCs that will arise in a future year when the foreign subsidiary pays the dividend

740-30-25-9 **and** 740-30-25-18	**Parent's Deferred Tax Considerations When Intercompany Loans That Are of a Long-Term-Investment Nature Are Denominated in the Subsidiary's Currency:** When a loan that is of a long-term-investment nature is denominated in the subsidiary's functional currency and the parent will have an exchange-related gain or loss, should the exception to the recognition of a deferred tax liability under ASC 740-30-25-17 (related to a taxable basis difference in a foreign subsidiary whose reversal is not foreseeable) or the exception to the recognition of a deferred tax asset under ASC 740-30-25-9 (related to a deductible temporary difference in any subsidiary that is not expected to reverse in the foreseeable future) be applied?
740-10-25-2	**Recognizing the Foreign Income Tax Effects of a US Dollar–Denominated Loan to a Foreign Subsidiary (FS) That Uses the US Dollar as Its Functional Currency:** In the circumstances described above, under which an FS determines its taxable income by using the Local Currency and will have a taxable gain or loss for foreign exchange movement related to the loan, what are the accounting implications under ASC 740?
740-10-25-2	**Deferred Tax Considerations Related to a Foreign Subsidiary When Intercompany Loans That Are of a Long-Term-Investment Nature Are Denominated in the Parent's Currency:** When an intercompany loan that is of a long-term-investment nature is denominated in the parent's functional currency, is it appropriate for the subsidiary to record deferred taxes related to the pretax foreign exchange gain or loss or is there an exception to the normal recognition principles?
740-10-25-32 (Secondary 740-20-45-11(g))	**Accounting for the Elimination of Income Taxes Allocated to a Predecessor Entity When the Successor Entity Is Nontaxable:** How should deferred income taxes that were allocated to the predecessor entity be eliminated in the successor entity's financial statements when the successor entity is nontaxable?
740-10-25-32 (Secondary 740-20-45-11(g))	**Successor Entity's Accounting for the Recognition of Income Taxes When the Predecessor Entity Is Nontaxable:** How should a C corporation recognize deferred income taxes in the circumstances described above?
740-10-30-27	**Application of the Separate Return Method in Combined or Carve-out Financial Statements of Multiple Legal Entities, Multiple Divisions, or Both:** How should an entity use the separate return method to determine the amount of income taxes to include in combined or carve-out financial statements of multiple legal entities, multiple divisions, or both?
740-10-25-3(f)	**Deferred Income Tax Effects When Functional Currency Changes From the Local Currency to the Reporting Currency:** What are the deferred tax consequences when a foreign entity changes its functional currency from the foreign currency to the reporting currency?
740-270-30	**Computing an Interim Tax Provision for an Entity Subject to Tax in Multiple Jurisdictions:** If an entity is able to recognize any benefit (even a relatively small one) attributable to the anticipated ordinary loss in a separate jurisdiction, can the entity exclude ordinary income (or loss) in that jurisdiction and the related tax expense from the overall computation of the estimated AETR?
740-10-50-12	**Evaluating Significance of Reconciling Items in the Rate Reconciliation:** What is meant by "significant" reconciling item in ASC 740-10-50-12 and 740-10-50-13?
740-10-30-7	**Initial Measurement of Tax Positions That Are Considered Binary:** If a tax position is considered binary and meets the more-likely-than-not threshold for recognition, is it appropriate to consider only two possible outcomes for measurement purposes: the position is sustained or the position is lost?

740-10-15-4	**Income Tax Indemnifications Upon Sale of a Subsidiary That Previously Filed a Separate Tax Return:** Should A apply the provisions of ASC 740 to the subsidiary's previously taken tax position after the sale of the subsidiary?
323-740-15-3	**Applicability of the Proportional Amortization Method to a Qualified Affordable Housing Project Investment (**QAHPI) **That Generates Miscellaneous Tax Credits in Addition to Affordable Housing Credits:** Is a QAHPI that generates other tax credits for the investor in addition to QAHP credits outside the scope of ASC 323-740 and therefore ineligible for the proportional amortization method?
323-740-25-1	**Recognizing Deferred Taxes When the Proportional Amortization Method Is Used to Account for an Investment in a Qualified Affordable Housing Project:** For an investment accounted for under the proportional amortization method, should an entity record deferred taxes for the temporary difference between the investment's carrying amount for financial reporting purposes and its tax basis?
740-270-30	**Impact of Zero-Tax-Rate Jurisdictions and Nontaxable Entities on an Entity's Annual Effective Tax Rate:** Can the exception in ASC 740-270-30-36 be extended to exclude nontaxable entities or entities that are operating in a zero-tax-rate jurisdiction from the overall computation of the AETR?
740-10-30-22	**Example Illustrating the Estimation of Future Taxable Income When Negative Evidence in the Form of Cumulative Losses Exists**

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