Accounting for Income Taxes
Q1 2017 Hot Topics

Accounting developments

FASB amends guidance on derecognition and partial sales of nonfinancial assets
On February 22, 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-05, which clarifies the scope of the Board's recently established guidance on nonfinancial asset derecognition (ASC 610-20) as well as the accounting for partial sales of nonfinancial assets. The Accounting Standards Update (ASU) conforms the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue standard (ASC 606, as amended).

The FASB issued the ASU in response to stakeholder feedback indicating that (1) the meaning of the term "in-substance nonfinancial asset" is unclear because the Board's new revenue standard does not define it and (2) the scope of the guidance on nonfinancial assets is confusing and complex and does not specify how a partial sales transaction should be accounted for or which model entities should apply.

The amended guidance is expected to impact, among other things, (1) the timing of recognition of gains and losses on transactions previously accounted for under the real estate sales guidance and (2) the accounting basis for assets that meet the criteria to be accounted for as a partial sale.

See Deloitte's February 28, 2017, Heads Up for additional information.

FASB continues discussions on updates to income tax disclosure requirements
The FASB met on January 25, 2017, and March 17, 2017, to continue discussions on the Board's proposed ASU that would modify or eliminate certain disclosure requirements related to income taxes as well as establish new requirements. No tentative decisions have been reached at this time. However, the Board has directed the staff to conduct additional outreach regarding the proposed disclosure requirements for income taxes.

See Deloitte's July 29, 2016, Heads Up for additional information on the proposed ASU.

Tax law developments

Under US GAAP, 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.

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 should 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 should be allocated between continuing operations and other financial statement components in accordance with the intraperiod tax allocation guidance in ASC 740-20.

Uncertain tax positions: The evaluation of new information may lead to 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 change occurs. 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.

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.

US Federal

Notice 2017-06: Extension of eligibility waiver for certain method changes to comply with the final tangible property regulations

Rev. Proc. 2016-29 (issued May 5, 2016[2]) provided a waiver for a limited time of the five-year prior change eligibility rule in Rev. Proc. 2015-13 for making certain automatic method changes to comply with the final tangible property regulations. Notice 2017-06 waives the eligibility rule for one more year (to any taxable year beginning before January 1, 2017) for taxpayers making certain automatic changes under the final tangible property regulations.

Tax Court rejects capital gain treatment on forfeited deposit from cancelled sale of property

In CRI-Leslie, LLC vs. Comm., 147 TC 8, the Tax Court rejected Taxpayer's argument that section 1234A extends to section 1231 property. Taxpayer, a partnership in the business of hotel and restaurant operations, entered into an agreement to sell a hotel property, a section 1231 property. The sale did not take place and Taxpayer retained the deposit and reported the amount as long-term capital gain on its return. The Internal Revenue Service (IRS) recharacterized the gain as ordinary income. On appeal, the Tax Court explained that section 1234A expressly refers to property that is "a capital asset in the hands of the taxpayer" and property described in section 1231 is explicitly excluded from the definition of capital asset in section 1221. The Tax Court concluded that the "plain meaning of capital asset" as used in section 1234A does not extend to section 1231 property.

Temporary regulations under section 721(c); Limitations on tax-free contributions of appreciated property to a partnership

On January 19, 2017, the US Department of the Treasury and the IRS published temporary regulations under section 721(c) (the "Temporary Regulations") with respect to the contribution of built-in gain property by a US person to certain partnerships having one or more direct or indirect related foreign partners (a "Related Foreign Person").

[1] ASU 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*
[2] See Deloitte's June 2016 *Accounting for income taxes – quarterly hot topics* newsletter for additional information.

The Temporary Regulations adopt the rules announced in Notice 2015-54 with respect to section 721(c) with certain substantive modifications and additions. Specifically, if (i) a US person contributes certain property with a built-in gain of greater than $1 million to a partnership during its taxable year, (ii) a Related Foreign Person with respect to the US person is a direct or indirect partner in the partnership, and (iii) the US person and Related Foreign Persons own 80 percent or more of the interests in partnership capital, profit, deductions, or losses, then the US person must recognize any built-in gain with respect to the contributed property unless the requirements of the "Gain Deferral Method" are satisfied.

Regulations under sections 482 and 6662 ensuring the appropriate valuation of controlled transactions involving partnerships are not contained in the Temporary Regulations but are anticipated in future regulations.

The Temporary Regulations generally apply to all contributions occurring on or after August 6, 2015. However, new rules, including any substantive changes to the rules described in the Notice, apply to contributions occurring on or after January 18, 2017. More information may be found in the US Inbound Corner issued February 2017.

On the Horizon

Tax policy decisions ahead

President Donald Trump's address to a joint session of Congress on February 28 laid out tenets of tax reform that broadly comport with plans currently being advanced by House Republican leaders, but the speech did not provide specific policy directives in some key areas where GOP lawmakers are struggling to reach consensus.

President Trump clearly echoed calls from the congressional Republican playbook when he stated that his administration is developing "historic tax reform that will reduce the tax rate on our companies so they can compete and thrive anywhere and with anyone" as well as "provide massive tax relief for the middle class." Less clear, however, was his position on the issue of the border-adjustment tax proposed by House Speaker Paul Ryan, R-Wis., and Ways and Means Committee Chairman Kevin Brady, R-Texas, in the tax reform blueprint they released last June.

In his address to Congress, President Trump touched only broadly on border tax issues, calling for "a level playing field for American companies and workers" and noting that "when we ship products out of America, many other countries make us pay very high tariffs and taxes—but when foreign companies ship their products into America, we charge them almost nothing." For now, House Republican leaders continue to make the case for their proposal, and many others wait on legislative language to more fully assess the impact such a tax would have.

For more information on President Trump's February 28 speech, see Deloitte's Tax News and Views, March 3, 2017.

International

UK's Written Notification to Leave the EU

On March 29, 2017, United Kingdom (UK) Prime Minister Theresa May provided written notification to the European Council of the UK's intention to withdraw from the European Union (EU) under Article 50 of the Lisbon Treaty. Written notification marks the opening of withdrawal negotiations between the UK and the EU, with withdrawal itself scheduled to take effect the earlier of either (1) the date a withdrawal agreement enters into force or (2) two years after the UK's notification under Article 50 (unless the negotiations are extended). However, because there is no precedent for the departure of an EU-member state from the EU, other significant aspects of the Article 50 process are less clear, including:

- Whether and, if so, how a notification of intention to withdraw from the EU could be revoked.
- The precise steps (at both the EU and the individual-member-state level) to be followed before withdrawal of the UK from the EU would take effect.
- What the outcome of the negotiations will be in terms of the prospective agreements and relationship between the UK and EU.
- What transitional provisions or transitional periods might be agreed to.

In the meantime, EU laws will continue to apply to UK entities exactly as they do today. Along with the many other aspects of European law that would presumably cease to apply to the UK upon its withdrawal from the EU, unless other agreements are reached, various tax exemptions and reliefs related to intra-Europe undertakings would presumably also no longer apply to dealings between UK entities and entities domiciled in EU-member states.

ASC 740 (FASB Accounting Standards Codification Topic 740, Income Taxes) requires entities to measure deferred tax assets and liabilities by using enacted tax rates and provisions of the enacted tax law (ASC 740-10-05-7 and ASC 740-10-30-2(a)). It also requires entities to recognize, as of the date of enactment, the effect on deferred taxes of a change in tax law or rates (ASC 740-10-25-47) and a change in tax status that results from a change in tax law (ASC 740-10-25-33.). If a foreign private issuer uses IFRSs, IAS 12 (Paragraph 47 of IAS 12, Income Taxes) requires it to measure deferred taxes by using the tax rates and tax laws that have been enacted or substantively enacted.

We believe that, given the level of uncertainty and unknowns about the Article 50 process, the UK's notification under Article 50 would *not*, in itself, result in recognition of potential income tax effects of the UK withdrawal in the period of notification.

This accounting conclusion has been discussed with the SEC staff, and we understand that the staff will not object to an SEC registrant's reporting under U.S. GAAP, or a foreign private issuer's reporting under IFRSs:

- Disclosing the uncertainties and potential income tax accounting effects in the reporting period in which the UK submits its written notice of withdrawal under Article 50. The disclosure should include, at a minimum:
    - A description of the UK withdrawal from the EU.
    - The nature of the entity's activities that could be affected by the UK withdrawal.
    - The potential income tax accounting effects of the UK withdrawal on an entity's financial statements.
- Accounting for the income tax effects of the UK withdrawal as of the earlier of (1) the date of enacted (or substantively enacted for foreign private issuers reporting under IFRSs) changes in the tax laws throughout the negotiation period between the UK and individual EU member states/EU or (2) the date on which the UK actually withdraws from the EU.

    For additional details, see Deloitte Financial Reporting Alert 17-4, dated March 31, 2017, and see the June 24, 2016 (updated March 31, 2017), *Financial Reporting Alert* (16-1).

US multistate

California: The California Court of Appeal (Court) has affirmed a 2014 trial court ruling that a cable service company did not operate as a unitary business with its commonly owned cable television home shopping channel in 1998 and 1999, and thus the latter did not have to be included in the cable service company's California combined report. In dispute were the nature, extent, and significance of the intercompany transactions occurring between the two companies, as well as whether and/or to what degree the cable service company exercised control over or influenced the cable television home shopping channel. The Court agreed with the cable service company's claims on the unitary issue that the two companies were not vertically integrated, lacked a centralized management, generated no economies of scale, and produced no other flow of values that justified the California Franchise Tax Board's unitary business treatment. Moreover, the Court found that the two companies were not dependent upon or contributed to the other within the meaning of the legal standards for determining a unitary business. The Court additionally upheld that a $1.5 billion payment received by the cable service company from a third-party cable television system operator as a "termination fee" in connection with an agreement/merger plan between the two parties in 1999 constituted apportionable business income for state corporation franchise tax purposes. For additional details, including access to the ruling, see Deloitte's January 6, 2017 issue of State Tax Matters.

Massachusetts: The Massachusetts Department of Revenue has issued a technical information release that explains application of the Massachusetts corporation excise tax to offshore investment companies described in IRC Sec. 864(b)(2)(A)(ii) that conduct certain activities in Massachusetts—including "safe harbor" rules under which certain offshore investment companies will not be subject to the Massachusetts corporation excise tax. The new release also describes potential security corporation treatment for offshore investment companies that are subject to the corporation excise tax. For additional details on the Department's Update, see Deloitte's February 24, 2017 issue of State Tax Matters.

Michigan: On January 24, 2017, the Michigan Supreme Court issued an Order refusing to hear the Michigan Department of Treasury's appeal request of the Michigan Court of Appeal's published 2016 decision in LaBelle Management, Inc. v. Michigan Department of Treasury. As a result, the ownership test for purposes of determining if a unitary business group exists—for both the Michigan Business Tax and Michigan Corporate Income Tax—and specifically the interpretation of the term "indirectly," does not extend to "constructive" ownership situations, such as those that exist under IRC § 318 attribution rules. Further, on February 28, 2017, the Michigan Department of Treasury issued a "Notice to Taxpayers" stating that the Michigan Court of Appeal's decision in Labelle Management is now "binding precedent" and rescinding elements of administrative guidance which had previously stated that the requisite ownership/control existed between brother-sister affiliated companies. In this Notice, Treasury also states that the Labelle Management decision will be given "full retroactive effect and Treasury will apply it to all open years." For additional details and information set forth in the Notice, see Deloitte's Michigan Multistate Tax Alert.

New York: An administrative law judge recently held that a taxpayer's receipts from its electronic bill payment and presentment transactions constituted receipts from services rather than "other business receipts," and were properly sourced outside New York to the location where the underlying services were performed by the taxpayer for purposes of calculating the receipts factor under the Article 9-A state business corporation franchise tax for the prior tax years at issue. In doing so, the judge rejected the contention of the New York State Department of Taxation and Finance (Department) that there must be human involvement for the receipts to have resulted from services performed, explaining that employing technology in the performance of services "does not, per se, remove the resulting receipts from the realm of receipts derived from the performance of services." The judge additionally explained that even if such receipts had in fact constituted "other business receipts," they must be sourced outside New York in this case—i.e., to the location where the work that generated the income was performed. Lastly, the judge explained that legislation enacted subsequent to the tax periods at issue in this case changed the allocation of service receipts to a customer sourcing approach for Article 9-A state business corporation franchise tax purposes, applicable for tax years beginning on and after January 1, 2015. The judge reasoned that such change would have been unnecessary if the allocation of service receipts was interpreted as the Department had asserted.

For additional details, including access to the ruling, see Deloitte's January 20, 2017 issue of State Tax Matters.

Pennsylvania: Pursuant to legislation enacted in 2016, the Pennsylvania Department of Revenue recently issued a "Fact Sheet" on the 60-day tax amnesty program that will run from April 21, 2017 through June 19, 2017, and will generally apply to all taxes administered by the Department that are delinquent as of December 31, 2015. Individuals, businesses and other entities that participated in Pennsylvania's 2010 tax amnesty program are ineligible to participate in this upcoming 2017 tax amnesty program. For additional details on the benefits provided under the program, the limitations to participation and the process by which taxpayers may avail themselves of the Program, see Deloitte's January 6, 2017 issue of State Tax Matters.

Texas: On February 24, 2017, the Court of Appeals, 3rd District of Texas, reversed an earlier decision by the 419th Travis County District Court, and held that Autohaus LP, LLP was not entitled to include certain costs associated with installing the automotive parts it sold for purposes of calculating the Texas franchise tax cost of goods sold (COGS) subtraction. For additional details, including a summary of the Court of Appeal's decision (plus access to the ruling) and some taxpayer considerations, see Deloitte's Texas Multistate Tax Alert.

Virginia: Effective July 1, 2017, a new law requires the Virginia Department of Taxation (Department) to administer a tax amnesty program at some point during its 2017-2018 fiscal year (i.e., at some point during July 1, 2017 through June 30, 2018) for at least 60 days, but no more than 75 days, which generally will be open to any taxpayer that is required to but has failed to file a return or pay any tax administered by the Department. The program provides for a potential 50% interest waiver and 100% penalty waiver; however, additional post-amnesty penalties may apply. For additional details on the benefits provided under the program, the limitations to participation and the process by which taxpayers may avail themselves of the program, see Deloitte's March 3, 2017 issue of State Tax Matters.

District of Colombia: On February 28, 2017, the District of Columbia (District) CFO released the February 2017 Revenue Estimate FY2017-2021. This report certified that projected revenues were sufficient to implement the remaining tax cuts outlined in DC. Code Ann. Section 47-181. This includes a further reduction of the unincorporated business and incorporated business franchise tax rate from 9.0 percent to the maximum afforded reduction of 8.25 percent for tax years beginning on or after December 31, 2017. For additional details on District developments and the current status of corporate tax rate reductions, including the impact of the February 2017 Revenue Estimate FY2017-2021, see Deloitte's March 17, 2017 issue of State Tax Matters.

See our Did You Know? section for additional technical discussion on a contingent change in tax rates and the impact on the financial statements.

IRC Conformity: Recently, the following states passed legislation to update their conformity to the current federal Internal Revenue Code (IRC). For additional details on each state's tax law change, including the effective dates and instances where the state decouples from certain federal provisions, see Deloitte's issue of State Tax Matters provided below.

- Arizona—March 10, 2017 issue of State Tax Matters
- Arkansas—March 3, 2017 issue of State Tax Matters
- Florida—January 13, 2017 issue of State Tax Matters
- Idaho—February 24, 2017, issue of State Tax Matters
- Minnesota—January 20, 2017 issue of State Tax Matters
- South Dakota—February 10, 2017 issue of State Tax Matters
- Virginia—February 10, 2017 issue of State Tax Matters

Did you know?

Measurement when contingent phased-in changes in tax rates are enacted
A phased-in change in tax rates occurs when an enacted law specifies that the tax rate applied to taxable income will change in future periods. In certain jurisdictions, the change in tax rates may be contingent on an event outside an entity's control.

In accordance with ASC 740, the tax rate used to measure DTLs and DTAs are the enacted tax rate expected to apply to taxable income in the years that the liability is expected to be settled or the asset recovered. ASC 740 does not provide guidance on determining what rate to use when there is more than one possible rate and this determination is contingent on events that are outside an entity's control.

Therefore, entities in jurisdictions in which a phased-in change in tax rates is enacted will need to establish a policy (see alternative approaches below) for determining the rate to be used in measuring DTAs and DTLs. This policy should be consistently applied and contain proper documentation of the scheduling of DTAs and DTLs, the basis for judgments applied, and the conclusions reached.

Example
In March 20X1, the State X passed legislation to provide business tax relief over future years in the form of phased-in reductions in the corporation net income tax (CNIT) rate. The rate reduction schedule is as follows:

Schedule — CNIT	
Tax years beginning on or after January 1, 20X2	8.50%
Tax years beginning on or after January 1, 20X5	7.75%
Tax years beginning on or after January 1, 20X6	7.00%
Tax years beginning on or after January 1, 20X7	6.50%

Alternative 1
An entity might view the phased-in rate reduction as being similar to a graduated tax rate or, alternatively, as an exemption from a graduated tax rate. (For examples illustrating graduated tax rates, see ASC 740-10-55- 136 through 55-138.) Under ASC 740, when a tax jurisdiction has a two-rate schedule, an entity should determine whether the graduated rates have a material effect and, if so, should forecast its future income to determine which rate to apply to its taxable temporary differences. In the above example, the entity would need to assess whether the 10 percent test will be passed to determine its future rate by period.

An entity should have sufficient documentation regarding its assessment of whether the 10 percent test will be met in future periods (e.g., consideration of the state's budget forecasts, spending levels, anticipated needs for rainy day funds), since this is the basis under law for applying the lower of two applicable tax rates in any given year.

Alternative 2
An entity might establish a policy to use the highest enacted rate potentially applicable for a future period as the applicable rate until the contingency is resolved (i.e., the 10 percent test is passed). The lower rate would only be applied to DTAs and DTLs for which the associated liability is expected to be settled or asset recovered in that one period, because an assumption that subsequent 10 percent tests will be passed for those future periods would be inappropriate.

For more information about measurement when phased-in changes in tax rates are enacted, see *Deloitte's A Roadmap to Accounting for Income Taxes* (Fourth Edition) Section 4.13. Please see below for additional information.

Learn more

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. Take advantage of registration discounts. Register today.

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.

Additional resources that you may find helpful:

- Deloitte Financial Accounting & Reporting - Income Taxes Home Page
- Deloitte Tax Accounting & Provision Services Home Page
- Deloitte Tax Accounting & Provisions Dbriefs Webcasts Series
- 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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