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Accounting for Income Taxes

Quarterly Hot Topics

June 2015

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Accounting developments

FASB proposes to simplify equity method accounting

On June 5, 2015, the Financial Accounting Standards Board (FASB) issued a **proposed Accounting Standards Update (ASU)** that would modify the accounting for equity method investments, eliminating the requirements for an investor to (1) account for basis differences related to its equity method investees (i.e., differences between the purchase price of its equity method investee and its share of the underlying net assets of the investee) 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.

For more on this proposed ASU, see Deloitte's June 16, 2015, **Heads Up**.

FASB proposes to simplify the accounting for measurement-period adjustments

On May 21, 2015, the FASB issued a **proposed ASU** that would eliminate an entity's requirement to retrospectively reflect adjustments to provisional amounts resulting from a business combination during the measurement period as if they were recognized as of the acquisition date. Since under current guidance adjustments during the measurement period are treated as if recognized as of the acquisition date, the earnings in prior quarters must be retrospectively adjusted to reflect the income statement effects of the adjustments made. Under the proposed ASU, the acquirer would record the effect of the change to the provisional amounts during the measurement period in the financial reporting period in which the adjustment is identified.

For more on this proposed ASU, see Deloitte's May 26, 2015, **Heads Up**.

FASB proposes to defer the new revenue standard for one year

On April 29, 2015, the FASB issued a **proposed ASU** to defer for one year the effective date of the new revenue standard for entities reporting under US Generally Accepted Accounting Principles (US GAAP) . Under the proposal, entities reporting under US GAAP would adopt the new standard as follows:

- **Public entities** — The standard would be effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2017. Early adoption would be permitted as of the original effective date in ASU 2014-09 (i.e., annual reporting periods beginning after December 15, 2016, including interim reporting periods within the annual periods).
- **Nonpublic entities** — The standard would be effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Nonpublic entities would also be permitted to elect to early apply the standard.

For more on this proposed ASU, see Deloitte's April 29, 2015, **Heads Up**.

PCAOB issues Audit Committee Dialogue

On May 7, 2015, the PCAOB released the **first edition** of Audit Committee Dialogue, a publication series that provides insights into how audit committees can improve their oversight of, and communication with, public-company auditors. In addition to outlining key topics that are of recurring concern to audit committees, the publication highlights emerging risks that may affect the PCAOB's inspections in the coming year. The publication specifically identifies undistributed foreign earnings as one of four risk areas the PCAOB is monitoring and acknowledges that, "inspectors have found problems in the auditing of management's assertion, including the failure to evaluate the impact on that assertion of significant cash transfers from a foreign subsidiary to the U.S. parent." The publication also notes that inspectors, in general, have identified issues with the controls over income tax accounting and related disclosures.

FASB proposes to simplify the accounting for share-based payments

On June 5, 2015, the FASB issued a **proposed ASU** on share-based payments as part of its simplification initiative. The proposed ASU would simplify several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes.

Under current guidance, when a share-based payment award is granted to an employee, the fair value of the award is generally recognized over the vesting period as compensation expense, and a corresponding deferred tax asset (DTA) is recognized to the extent that the instrument ordinarily would result in a future tax deduction under existing tax law. The tax deduction is generally based on the intrinsic value at the time of the exercise or vesting of the award, which generally results in a deduction that is greater (excess tax benefit) or less (tax deficiency) than the compensation cost recognized in the financial statements. All excess tax benefits are recognized in additional paid-in capital (APIC), and tax deficiencies are recognized either in the income tax provision or in APIC to the extent that there is a sufficient APIC pool.

Under the proposed ASU, an entity would recognize all excess tax benefits and tax deficiencies as income tax benefit or expense in the income statement. This change would eliminate the notion of the APIC pool and significantly reduce the complexity and cost of accounting for excess tax benefits and deficiencies. Further, the ASU would eliminate the requirement to defer recognition of an excess tax benefit until the benefit is realized.

In addition, under the proposed ASU, excess tax benefits would no longer represent financing activities for purposes of cash flow presentation; therefore, excess tax benefits should be classified in the same manner as other cash flows related to income taxes. Accordingly, the proposal eliminates the requirement to reclassify excess tax benefits from operating activities to financing activities.

The proposed change to recognize all excess tax benefits/deficiencies in the income statement would be applied prospectively. The ASU proposes a modified retrospective approach for changes to previously unrecognized excess tax benefits under which entities would recognize the unrecognized excess tax benefits upon adoption as a cumulative-effect adjustment in retained earnings.

An entity would also be required to apply the change in presentation in the statement of cash flows retrospectively to all periods presented.

Comments on the proposed ASU are due by August 14, 2015.

For more on this proposed ASU, see Deloitte's June 12, 2015, **Heads Up**.

Tax law developments

Under US GAAP, the effects of new legislation are recognized upon enactment (Accounting Standards Codification (ASC) 740-10-25-47). More specifically, the effect of a change in tax laws or rates on a deferred tax liability (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.

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 DTLs and DTAs 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. Please note the Global Tax Developments publication will be issued shortly after the release of this publication and includes a summary of tax rates applicable in several key jurisdictions and the dates of enactment of rate changes, if applicable. The publication also contains select sample financial statement disclosures that may be considered relevant to accounting for changes in tax law.

US Federal

Final regulations on $1,000,000 compensation deduction limit for certain employees

Section 162(m) generally imposes an annual $1,000,000 per “covered employee” limit on a publicly traded corporation’s compensation deductions, but there are several exceptions. Two of these exceptions were clarified in final regulations (**T.D. 9716**) (“the Final Regulations”) published in the Federal Register on March 31, 2015.

The Final Regulations provide the following clarifications:

1. The exception for performance-based compensation does not apply to stock options or stock appreciation rights (SARs) unless the shareholder-approved plan specifies a per-person aggregate maximum number of shares with respect to which stock options or SARs may be granted during a specified period. This clarification applies to stock options and SARs granted on or after June 24, 2011.
2. Corporations that become publicly held generally are entitled to transition relief for compensation deductions taken before the earliest of four events. A special rule for stock options, SARs, and restricted stock effectively extends the transition relief for these types of compensation by looking to the date of grant rather than the date of payment for purposes of determining if the compensation is within the transition period. The Final Regulations clarify that restricted stock units (RSUs) and phantom stock are not eligible for this special rule. This clarification applies to grants on or after April 1, 2015.

These regulations were effective as of March 31, 2015.

US Multistate

Connecticut: On June 30, 2015, Connecticut Governor Malloy signed budget legislation (House Bill 7061) as well as an “implementer bill” (House Bill 1502). House Bill 1502 revises certain tax legislation included in House Bill 7061. Collectively, the articles of legislation include modifications to the Connecticut Corporate Income Tax Code with various effective dates. The following are the more significant corporate tax changes included in the newly enacted legislations:

- Adopting mandatory unitary combined reporting effective for tax years beginning on or after January 1, 2016
- Establishing rules for determining which members are included in a “water’s edge” combined group
- Extending the 20% surtax for both the income base and the capital base for all income years beginning prior to January 1, 2018
- Reducing the surtax to 10% for income years beginning on or after January 1, 2018 and eliminating the surtax for all income years beginning on or after January 1, 2019
- Adopting Net Operating Loss (“NOL”) and tax credit limitations effective January 1, 2015.

For additional details on the proposed Connecticut tax law changes, look for Deloitte’s **Multistate Tax Alert.**

Florida: On May 14, 2015, Governor Scott signed Florida House Bill 7009 ("H.B. 7009"), which includes modifications to the Florida Corporate Income Tax Code updating the state’s conformity to the Internal Revenue Code (IRC) effective as of January 1, 2015, and decouples from federal bonus depreciation and IRC Section 179 expense deductions (to the extent that such Section 179 expense deductions exceed $128,000) for assets placed in service during taxable years ending after December 31, 2013 and before January 1, 2015. For additional details on the law changes for Florida, see Deloitte’s **Florida Multistate Tax Alert.**

Indiana: Indiana Governor Pence recently signed into law Senate Bill 441 and House Bills 1472, 1271, and 1001, which collectively include modifications to the Indiana tax code. The new legislations, which have various effective dates, include elimination of the sales factor “throwback” rule, revisions to the intercompany expense “add-back” statute, and redefinition of business income, amongst other law changes. For additional details on the law changes for Indiana, see Deloitte’s **Indiana Multistate Tax Alert.**

Maryland: Maryland Governor Hogan recently signed Senate Bill 763 (Chapter 50, Acts of 2015), requiring that the Comptroller create a Tax Amnesty Program ("Program"). The amnesty period runs from September 1, 2015, through October 30, 2015, and offers a waiver of all civil penalties (except previously assessed fraud penalties) and one-half of the interest imposed as a result of the non-reporting, underreporting or nonpayment of eligible taxes. The Program covers taxpayers who on or before December 31, 2014, failed to file a return or pay the applicable tax amount under the Maryland corporate income tax, withholding tax, sales and use tax, or admissions and amusements tax. 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 **Maryland Multistate Tax Alert.**

Missouri: Missouri Governor Nixon recently signed into law House Bill 384 ("H.B. 384") authorizing a tax amnesty from the assessment or payment of all penalties, additions to tax, and interest on delinquencies of unpaid taxes administered by the Missouri Department of Revenue with respect to tax liabilities generally due on or before December 31, 2014. This amnesty program will run from September 1, 2015 through November 30, 2015, and will generally apply to unpaid taxes regardless of whether previously assessed, except for penalties, additions to tax, and interest paid before September 1, 2015.

Additionally, Governor Nixon signed into law Senate Bill 19 ("S.B. 19") clarifying that the optional single sales factor apportionment method applies to sales other than the sale of tangible property and establishes market-based sourcing rules for such sales. For additional details on Missouri's new legislation, see Deloitte's **Missouri Multistate Tax Alert.**

New York City: On April 13, 2015, New York Governor Cuomo signed S4610A/A6721A into law. With some exceptions, the New York City corporate tax reforms contained in S4610A/A6721A are generally consistent with New York State's corporate tax reform enacted in 2014. The more significant corporate tax reforms include:

- Reducing the income tax rate for certain corporate taxpayers.
- Adopting full water's-edge unitary combined reporting with an ownership test of more than 50 percent and providing for a new combined group seven-year election for certain commonly owned groups.
- Adopting limited bright-line statutory nexus thresholds for corporations that issue credit cards
- Adopting customer-based (market) sourcing rules with specific sourcing rules for digital products and financial service receipts.
- Maintaining the current law's schedule to phase-in single sales factor apportionment by 2018 but offering a one-time election for certain taxpayers to retain the 2017 apportionment factor weighting.
- Using federal tax law effectively connected income concepts (without regard to tax treaties) as the starting point in determining New York City entire net income for non-US corporations.

With limited exceptions, the law changes apply retroactively to tax years beginning on or after January 1, 2015, to align with the New York State changes that were enacted in the prior year. For additional in-depth details on the law changes for New York City, see Deloitte's **New York City Multistate Tax Alert.**

New York State: On April 13, 2015, New York Governor Cuomo signed into law S2009B/A3009B and S2006B/A3006B, referred to generally as "Budget Bills" forming part of the 2015-16 State Budget. This legislation makes technical corrections and other revisions to the New York State corporate tax reform provisions enacted in 2014, and makes changes to certain sales and use tax provisions and other tax laws. There were numerous revisions to the corporate income tax reforms including amending certain apportionment provisions, clarifying the application of the bright-line economic nexus tests for unitary combined reporting and modifications to the calculation of taxable income for certain taxpayers. For additional in-depth details on the law changes for New York, see Deloitte's **New York Multistate Tax Alert.**

South Carolina: On June 8, 2015, South Carolina Governor Haley signed into law **Senate Bill 526** ("S.B. 526"), which is effective immediately. The new law authorizes the South Carolina Department of Revenue

("Department") to designate an amnesty period which has a beginning and ending date as determined by the Department. During the amnesty period, the Department shall waive the underlying penalties and interest or portion of them at its discretion for a taxpayer that voluntarily files delinquent returns and pays all taxes owed. If the Department establishes an amnesty period pursuant to this new law, it must notify the South Carolina General Assembly of the amnesty period at least sixty days before the commencement of the amnesty period. At the time of issuance of this newsletter, the amnesty period has not been confirmed.

Additionally, the South Carolina Department of Revenue has issued a finalized **revenue ruling** that addresses some of the issues that may arise when South Carolina requires or a taxpayer requests an alternative apportionment method, including combined unitary reporting, for state corporate income tax purposes. A separately issued revenue procedure explains how a taxpayer may request use of an alternative apportionment method if the taxpayer believes that the prescribed statutory formula does not fairly represent the extent of the taxpayer's business activities in South Carolina, including when and where to file such an application and the contents to include within it. See Deloitte's June 19, 2015 issue of **State Tax Matters.**

Tennessee: Tennessee Governor Haslam recently signed into law the Revenue Modernization Act (the "Act") (H.B. 0644). The Act, among other tax law changes, amends Tennessee law by adopting economic nexus thresholds for the business tax and the franchise and excise tax, and adopts market-based sourcing for sales other than the sale of tangible personal property. Owing to the new nexus provisions, taxpayers with no prior nexus with Tennessee may now have a filing obligation for both income and indirect tax purposes. Taxpayers with a significant market and sales presence in Tennessee should review the effects the new law will have on their tax reporting and compliance obligations. For additional details on the law changes for Tennessee, see Deloitte's **Tennessee Multistate Tax Alert.**

Texas: Texas Governor Abbott recently signed into law House Bill 32 ("H.B. 32"). The new law, effective January 1, 2016, and applicable "only to a report originally due on or after the effective date," permanently reduces the Texas franchise tax rate to 0.75% for certain taxpayers (i.e., those currently taxed at the rate of 0.95% of taxable margin), and to 0.375% for retailers and wholesalers (i.e., those currently taxed at the rate of 0.475% of taxable margin). Previously, these franchise tax rates had been scheduled to return to 1.0% and 0.5%, respectively, in 2016. This new law additionally reduces the franchise tax rate for those electing the "EZ computation" from the current rate of 0.575% to 0.331%, as well as raising the threshold for such use from $10 million to $20 million in total revenue. For additional details on the law changes for Texas, see Deloitte's **Texas Multistate Tax Alert.**

Also, on May 13, 2015, the Texas Comptroller ("Comptroller") released a memorandum announcing a new policy related to the Franchise Tax cost of goods sold (COGS) deduction for taxpayers that do not produce the goods they sell (i.e., taxpayers that contract out the manufacturing of their product). In the policy memorandum, the Comptroller stated "regardless of whether the taxable entity is the producer of the good or not, that taxable entity may include in its COGS deduction research, experimental, engineering, and design activity costs…." For additional details on the Comptroller's new policy, see Deloitte's **Texas Multistate Tax Alert.**

Learn more

Roadmap to Accounting for Income Taxes: The second edition of **A Roadmap to Accounting for Income Taxes** has been added to 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:

- Disclosure examples.
- Samples of recent SEC comments on income tax matters.
- A broad-based discussion of the income tax accounting guidance under IFRSs.

We hope that you find this new 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: Professionals continue to face significant challenges in financial accounting and reporting for income taxes. Deloitte's training seminars can help you stay informed. Seminars with half-day, one-day, and two-day courses are set for December 8-12 in Las Vegas, Nevada. Course descriptions, pricing, registration, and additional information can be found **here**. Early registration discounts are available, and combination course discounts are available after early registration discounts expire.

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**.

Example SEC Comments: Income Taxes: We have compiled a sample of comments issued to public registrants by the SEC on income tax matters under ASC 740. A copy of this publication can be found **here**.

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**