Accounting for Income Taxes

Q2 2017 Hot Topics

Accounting developments

FASB amends the scope of modification accounting for share-based payment arrangements

On May 10, 2017, the FASB issued ASU 2017-09, which amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718, Compensation – Stock Compensation. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification.

When ASU 2016-09 was issued in March 2016 under the Board's simplification initiative, it made a change to ASC 718 regarding the exception to liability classification of an award related to an employer's use of a net-settlement feature to withhold shares to meet the employer's statutory tax withholding requirement. Under ASU 2016-09, the net settlement of an award for statutory tax withholding purposes does not result, by itself, in liability classification of the award as long as the amount withheld for taxes does not exceed the **maximum** statutory tax rate in the employee's relevant tax jurisdiction(s). Before an entity adopts ASU 2016-09, the exception applies only when the entity repurchases or withholds no more than the number of shares necessary for the **minimum** statutory tax withholding requirement to be met.

Upon adopting ASU 2016-09, some entities may change the net-settlement terms of their share-based payment arrangements from the minimum statutory tax rate to a higher rate up to the maximum statutory tax rate. Some constituents questioned whether they would be required to apply modification accounting under ASC 718-20-35-3 if they changed existing awards in this manner. On the basis of discussions with the FASB staff, we noted in our April 21, 2016, Heads Up that if entities made such a change, they would not be required to apply modification accounting.

The FASB staff subsequently conducted research on whether the Board should change the scope of the modification guidance in ASC 718 given that ASC 718-20-20 defines a modification as a "change in any of the terms or conditions of a share-based payment award." As a result of that broad definition, there may be diversity in practice regarding the types of changes to share-based payment awards to which an entity applies modification accounting. For example, some entities may apply it only to substantive changes while others may apply it broadly to all changes other than solely administrative ones. Accordingly, to provide clarity and reduce diversity, cost, and complexity, the FASB issued ASU 2017-09.

See Deloitte's May 11, 2017, Heads Up for additional information.

FASB proposes improvements to the accounting for share-based payment arrangements with non-employees

On March 7, 2017, the FASB issued a proposed ASU that would simplify the accounting for share-based payments granted to non-employees for goods and services. Under the proposal, most of the guidance on such payments to non-employees would be aligned with the requirements for share-based payments granted to employees.

Currently, share-based payment arrangements with employees are accounted for under ASC 718, while non-employee share-based payments issued for goods and services are accounted for under ASC 505-50. ASC 505-50 differs significantly from ASC 718. Differences include (but are not limited to) the guidance on (1) the determination of the measurement date (which generally is the date on which the measurement of equity-classified share-based payments become fixed), (2) the accounting for performance conditions, (3) the ability of a non-public entity to use certain practical expedients for measurement, and (4) the accounting for (including measurement and classification) share-based payments after vesting. The proposed ASU would eliminate most of the differences. Note that while the proposed ASU would amend the guidance on measurement and attribution of non-employee share-based payments, the tax considerations pertaining to temporary differences before exercising or vesting of such awards would not change under the proposed ASU.

See Deloitte's March 10, 2017, Heads Up for additional information.

Federal Financial Instruments

IRS holds that unamortized debt issuance costs are not deductible upon conversion of debt into stock

In a legal memorandum, the IRS held that a taxpayer is not entitled to deduct its remaining unamortized debt issuance costs in the taxable year the convertible debt was converted into stock. The taxpayer issued convertible debt and incurred debt issuance costs. The costs were capitalized and amortized over the life of the debt. Subsequently, the holders exercised their conversion right pursuant to the terms of the debt. The taxpayer argued that it is entitled to deduct the remaining unamortized debt issuance on the grounds that Rev. Rul. 72-348 is obsolete following Congress' enactment of section 108(e)(8). The taxpayer further asserted that, under current law, the retirement of debt for stock is treated the same way as a retirement for cash. The IRS countered that Rev. Rul. 72-348 is still a good law arguing that had Congress intended, with the repeal of the stock-for-debt exception, to overturn Rev. Rul. 72-348 or to cause stock-for-debt exchanges to be treated as cash retirements for all purposes of the Code, Congress would have said so explicitly in the statute.

Federal Periods and Methods

Notice 2017-17: Proposed revenue procedure for requesting consent to change a method of accounting made due to the adoption of the new financial accounting standards "Revenue from Contracts with Customers"

On March 28, 2017, the IRS issued Notice 2017-17, requesting comments on a proposed revenue procedure, that if finalized, would provide automatic consent procedures for a taxpayer to change its tax revenue recognition methods when the change is made in the same taxable year for which the taxpayer adopts the new financial accounting standards for recognizing revenue in Accounting Standards Codification Topic 606 ("ASC 606") or IASB International Financial Reporting Standard (IFRS) 15, and such change is a result of or directly related to such adoption (a so-called "qualifying same-year method change").

For qualifying same-year method changes, if the method change qualifies under existing automatic change guidance and the taxpayer is otherwise eligible to use the automatic consent procedures, then the taxpayer would be required to follow existing automatic change procedures. If the method change is not otherwise eligible for automatic consent under another provision, then the qualifying same-year change would be required to be made under the automatic method change proposed in Notice 2017-17.

This is a proposed revenue procedure that will not be effective, unless or until issued in final form.

On the Horizon

Tax Reform – Federal / Multistate Considerations: On April 26, 2017, the Trump administration released a one-page fact sheet outlining principles for tax reform (the Proposal). Please refer to the Deloitte Tax News and Views alert dated April 26, 2017 for an overview of potential federal income tax considerations and the Deloitte Multistate Tax alert dated April 28, 2017 for an overview of potential associated multistate tax considerations of the proposal.

Oregon: S.B. 30 was signed by the governor on May 30, 2017 and is applicable to tax years beginning on or after January 1, 2018. S.B. 30 essentially allows consideration of the role of foreign affiliates when making a decision as to whether or not corporations included in the same consolidated federal return comprise a unitary business for state corporate income tax purposes – that is, it permits considering the connections corporations included in the same consolidated federal return have with foreign affiliates in determining if such corporations are members of a unitary group. More specifically, S.B. 30 adds reference to “any corporation that is owned or controlled directly or indirectly by the same interests” in deciding whether corporate affiliates included in the same consolidated federal return are engaged in a unitary business for state corporate income tax purposes. S.B. 30 is not considered enacted. Oregon law requires a 90-day waiting period after the date on which the 2017 session of the 79th Legislative Assembly adjourns sine die, which is expected to occur during July of 2017, in order to provide Oregon voters the opportunity to file a petition to have the new tax law ratified into law by Oregon voters via an election. For additional details, see Deloitte’s June 9, 2017 issue of State Tax Matters.

United Kingdom: Finance Act 2017 receives Royal Assent and is enacted: The United Kingdom Finance Act 2017 received Royal Assent on April 27, 2017 and was enacted. The final enacted legislation did not contain significant United Kingdom corporate income tax law changes. Extensive omissions were made from the legislation originally introduced (for prior coverage, see United Kingdom Tax Alert dated March 8, 2017), including the following: corporate loss carryforward rules; corporate interest restriction rules; changes to the substantial shareholdings exemption; non-domicile changes; and changes on “Making Tax Digital” and the associated changes regarding trading and property allowances. Some of these omitted provisions (including the corporate interest restriction rules) had been expected to apply from April 1, 2017. The outgoing government confirmed that, if re-elected, it would reintroduce the measures with the same effective date.

Refer to the Monthly Tax Update dated May 12, 2017 for more information.

International

Australia: Diverted profits tax becomes law

Legislation that introduces a diverted profits tax (“DPT”) became enacted law on April 4, 2017, and will be effective for income years starting on or after July 1, 2017 (for prior coverage, see Australian tax alert issued on December 2, 2016). The legislation also includes measures significantly increasing penalties for taxpayers taking insufficient care in calculating their tax liability or failing to file certain documents on time, as well as an updating of transfer pricing rules.

The DPT aims to prevent multinational corporations from “shifting profits” made in Australia offshore to reduce the Australian tax on those profits, by imposing a 40% tax charge on such profits. This also should help to ensure that the Australian tax payable by significant global entities properly reflects the economic substance of the activities that those entities carry on in Australia. The DPT also enhances the power of the Australian Taxation Office (ATO) to combat “artificial” or “contrived” tax avoidance arrangements.

Given the broad scope and punitive nature of the DPT rules, taxpayers should (i) ensure proper documentation is in place to support existing arrangements; (ii) assess potential risk exposures; (iii) consider how to document and implement future transactions; and (iv) consider how best to engage with the ATO to manage future inquiries and disputes.

Refer to the World Tax Advisor Alert dated April 14, 2017 for more details on the DPT legislation.

Japan: 2017 tax reform enacted

Japan’s National Diet enacted the 2017 tax reform proposals on March 27, 2017, which include the following major corporate tax changes:

- The R&D tax credit regime is revised to increase competitiveness.
- The deductibility of director compensation is amended, including revisions to increase flexibility for companies to use profit-linked compensation.

- Provisions related to corporate reorganizations are revised, including the expansion of the definition of a tax-qualified horizontal-type corporate division to include certain horizontal-type corporate divisions via incorporation. The scope of tax relief for small and medium-sized enterprises will be limited for fiscal years beginning on or after April1, 2019.
- The controlled foreign corporation rules are fundamentally revised in accordance with the basic concepts of the OECD's BEPS project. The new rules will become effective for accounting years beginning on or after 1 April 2018 of the foreign related company.

Refer to the World Tax Advisor Alert dated April 28, 2017 and the Tax@Hand article dated January 24, 2017 for more details.

For a summary of these and other major international income tax developments for the current quarter please refer to the World Tax Advisor site and Accounting for Income Taxes – Global Tax Developments publication. The Global Tax Developments publication will be issued shortly after the release of this publication and 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 Multistate

Alabama: Effective immediately and applicable to all tax years beginning on and after January 1, 2017, a new law that was enacted on April 20, 2017, provides that loans and credit card receivables must be included within a financial institution's property factor for Alabama financial institution excise tax (FIET) purposes and sourced using the same methods as the Alabama Department of Revenue (Department) uses to allocate and apportion a financial institution's interest receipts from related loans and credit card receivables. This new law apparently is intended to statutorily reverse an administrative rule promulgated by the Department in 2016, which had removed loans and credit card receivables from the property factor of the FIET apportionment formula in accordance with Multistate Tax Commission model rules. For additional details, please see the April 28, 2017 issue of the Deloitte State Tax Matters.

California: On April 6, 2017, the California Franchise Tax Board (FTB) issued Technical Advice Memorandum 2017-03 (TAM 2017-03) regarding the application of Internal Revenue Code (IRC) Sections 382, 383, and 384 for California tax purposes to multistate corporate taxpayers subject to apportionment. Specifically, TAM 2017-03 provides guidance on whether the limitations on the use of tax attributes under IRC Sections 382, 383, and 384 are determined on a pre- or post-apportionment basis. With respect to the IRC Section 382 and 383 limitations in general, the FTB concluded that, for California corporate tax purposes, the IRC Section 382 and 383 limitations should be determined on a pre-apportionment basis. Additionally, the FTB concluded that NUBIGs, RBIGs (including those considered under IRC Section 384), NUBILs, and RBILs should be determined on a post-apportionment basis. For additional details, including background on IRC Sections as well as access to the TAM, see Deloitte's Multistate Tax alert dated April 17, 2017.

Michigan: On May 22, 2017, the US Supreme Court denied review of petitions filed by multiple taxpayers that had challenged the Michigan Court of Appeals' holding that the enactment of Michigan Public Act 282 of 2014 (PA 282), which retroactively rescinds Michigan's membership in the Multistate Tax Compact (Compact) effective January 1, 2008, was consistent with both the Contract and the Due Process Clauses of the US Constitution. For additional details, including links to prior Multistate Tax alerts on the topic, see Deloitte's May 26, 2017 issue of State Tax Matters.

Minnesota: Effective for taxable years beginning after December 31, 2016, new law that was enacted on May 30, 2017 modifies the definition of "financial institutions" for Minnesota corporate income tax purposes to include certain non-corporate subsidiaries and affiliates of financial institutions in calculating the income and apportionment factors of the taxpayer. Under the new law, a financial institution now also includes any corporation or other business entity that is more than 50 percent owned, directly or indirectly, by any person or business entity that is:

- Registered under state law as a bank holding company; under the federal Bank Holding Company Act of 1956, as amended; or as a savings and loan holding company under the federal National Housing Act, as amended;
- A national bank organized and existing as a national bank association pursuant to the provisions of United States Code, title 12, chapter 2;
- A savings association or federal savings bank as defined in United States Code, title 12, section 1813(b)(1);
- Any bank or thrift institution incorporated or organized under the laws of any state;
- Any corporation organized under United States Code, title 12, sections 611 to 631; or
- Any agency or branch of a foreign depository as defined under United States Code, title 12, section 3101.

For additional details, see Deloitte's June 9, 2017 issue of State Tax Matters.

Montana: Effective January 1, 2018 and applicable to tax years beginning after December 31, 2017, a new law that was enacted on May 3, 2017 revises Montana's adopted version of the Multistate Tax Compact, as recommended by the Multistate Tax Commission, including implementing market-based sourcing of certain sales of other than tangible personal property for state corporate income tax apportionment purposes, as well as for purposes of determining Montana source income for some pass-through businesses, in lieu of Montana's current "costs of performance" sourcing methodology. The legislation adopts a "throw-out" rule, generally providing that if the taxpayer is not taxable in a state to which a receipt is assignable under the delineated sourcing rules, or if the state of assignment cannot be determined or "reasonably approximated," such receipt must be excluded from the denominator of the receipts factor. For additional details, see Deloitte's External Multistate Alert dated May 30, 2017.

New Jersey: In a case involving New Jersey's intercompany expense "addback" statute under state corporation business tax (CBT) law provisions, a New Jersey Tax Court (Court) decision released on May 24, 2017 granted summary judgment in favor of the taxpayer, holding that a subsidiary was entitled to a deduction for termed "royalty" payments made to its parent. The Court explained that the intercompany payments at issue qualified for the "unreasonable" exception to the CBT intercompany expense addback statute because they were "substantively equivalent to an unrelated party transaction." For additional details on the Court's conclusion, see Deloitte's June 2, 2017 issue of State Tax Matters.

Oklahoma: Effective immediately, new law that was enacted on May 24, 2017 authorizes and directs the Oklahoma Tax Commission (Commission) to establish a "Voluntary Disclosure Initiative" for eligible taxes (including the state corporate income and sales and use taxes) that permits a waiver of penalty, interest and other collection fees due on eligible taxes if a qualifying taxpayer voluntarily files the delinquent tax returns and pays, or agrees to pay pursuant to a written payment program with the Commission, the taxes due during the period beginning September 1, 2017, and ending November 30, 2017. For additional details, including eligibility requirements, see Deloitte's May 26, 2017 issue of State Tax Matters.

Tennessee: Effective immediately and applicable to tax years beginning on or after January 1, 2017, a new law that was enacted on April 26, 2017 permits taxpayers whose principal business in Tennessee is "manufacturing" to elect to apportion its net worth and net earnings to Tennessee via a single sales factor for Tennessee franchise and excise tax purposes. That is, such electing taxpayers may apportionment their net worth and net earnings to Tennessee by a fraction, the numerator of which is the total receipts of the taxpayer in Tennessee during the taxable year and the denominator of which is the total receipts of the taxpayer from any location within or outside of Tennessee during the taxable year. Such elections generally would remain effective for a minimum of five years until revoked. For additional details, see Deloitte's May 5, 2017 issue of State Tax Matters.

The Tennessee Department of Revenue also issued a notice pursuant to the recently enacted legislation. For additional details on the notice, including access to the notice, see Deloitte's May 26, 2017 issue of State Tax Matters.

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.

- **Florida** — June 9, 2017 issue of State Tax Matters
- **Georgia** — March 31, 2017 issue of State Tax Matters
- **Maine** — May 5, 2017 issue of State Tax Matters
- **South Carolina** — April 21, 2017, issue of State Tax Matters
- **West Virginia** — March 31, 2017 issue of State Tax Matters

Did you know?

International Accounting Standards Board (IASB) publishes IFRIC 23 'Uncertainty over Income Tax Treatments' to clarify accounting for uncertainties in income taxes.

On June 7, 2017 the IASB published IFRIC 23 'Uncertainty over Income Tax Treatments'. IFRIC 23 was developed by the IFRS Interpretations Committee (IFRIC) to clarify the accounting for uncertainties in income taxes. The IFRIC observed diversity in practice regarding the recognition and measurement of current tax, deferred tax liabilities and deferred tax assets when there are uncertainties in the amount of income tax payable (recoverable). As a consequence, the Interpretations Committee decided to develop an interpretation. The Interpretation requires an entity to:

- determine whether uncertain tax positions are assessed separately or as a group; and
- assess whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings:
  - If yes, the entity should determine its accounting tax position consistently with the tax treatment used or planned to be used in its income tax filings.
  - If no, the entity should reflect the effect of uncertainty in determining its accounting tax position. The effect of uncertainty should be estimated using either the most likely amount or the expected value method, depending on which method better predicts the resolution of the uncertainty.

IFRIC 23 is effective for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted.

See Deloitte's June 7, 2017 IFRS in Focus for more information.

PCAOB adopts changes to the auditor's report

On June 1, 2017, the PCAOB approved a new auditing standard on the auditor's reporting model, subject to final approval by the SEC. The new auditor reporting standard will significantly modify the auditor's reporting model.

For more information, refer to the June 1, 2017 news release on USGAAP Plus.

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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