Accounting for income taxes

Quarterly hot topics

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Accounting developments

FASB makes additional tentative decisions about income tax disclosure requirements

At its meeting on June 8, 2016, the Financial Accounting Standards Board (FASB) continued to deliberate various income tax disclosure requirements as part of its disclosure framework project. The Board made further tentative decisions relating to disclosures about 1) indefinitely reinvested foreign earnings, 2) operating loss and tax credit carryforwards, and 3) replacement of the term "public entity" as currently defined within Accounting Standards Codification (ASC) 740 with "public business entity" as defined within the Codification Master Glossary.

The Board asked its staff to draft a proposed Accounting Standards Update (ASU) for vote by written ballot. The proposed ASU will have a comment period of 60 days or ending on September 30, 2016, whichever is longer.

For more information on the tentative decisions, see the Deloitte Journal Entry dated June 16, 2016.

For summaries of the Board's earlier tentative decisions related to income tax disclosures under the disclosure framework project, see Deloitte's journal entries dated February 12, 2015 (undistributed foreign earnings);

August 28, 2015 (unrecognized tax benefits); October 26, 2015 (various income tax disclosure requirements); and March 29, 2016 (indefinitely reinvested earnings and other income tax disclosures).

FASB begins redeliberating project on business entities' disclosures about government assistance

At its June 8, 2016, meeting, the FASB began redeliberating its project on business entities' disclosures about government assistance and discussed the feedback received on the related proposed ASU. Topics addressed at the meeting included the project's scope, disclosures about government assistance received but not recognized directly in the financial statements, and restrictions that would preclude an entity from disclosing the information required.

During the meeting, the Board tentatively decided to not require disclosure of "the terms of any rights or privileges granted by a governmental entity directly to the reporting entity that have reduced, or may reduce, the [reporting] entity's income tax burden" as part of the government assistance disclosures project, but instead include a similar disclosure requirement in ASC 740, together with other proposed changes to income tax disclosure requirements (see discussion above).

For more information on the tentative decisions, see the Deloitte Journal Entry dated June 14, 2016.

FASB finalizes decisions on income tax consequences of intra-entity asset transfers

The Board redeliberated the proposal at its June 15, 2016, meeting and decided to retain the proposed amendment to remove the exception in ASC 740 that prohibits the immediate recognition of the tax consequences (both current and deferred) of intra-entity asset transfers, except for the tax consequences of intra-entity transfers of inventory. The Board's conclusion differs from its guidance in the proposed ASU because the final decision would retain the exception for intra-entity transfers of inventory.

The final ASU will be effective for public business entities for annual periods beginning on or after December 15, 2017, including interim and annual periods. For other entities, the amendments will be effective for annual periods beginning after December 15, 2018, and interim periods in annual periods beginning after December 15, 2019. The Board decided that early adoption would be allowed; however, the early adoption provisions will be different from those prescribed within other recent ASUs[1], which permit early adoption in any interim or annual period for which financial statements have not yet been issued. In contrast, the Board decided that entities would be allowed to early adopt the intra-entity asset transfers amendments only as of the beginning of an entity's annual period that begins after the final ASU is issued. For more information on the Board's decisions, see the Deloitte Journal Entry dated June 16, 2016.

SEC urges companies to take a fresh look at their non-GAAP measures

Recently, the SEC updated its Compliance and Disclosure Interpretations (C&DIs) on non-GAAP measures in response to its increasing concerns that such measures may be misleading, more prominently presented than comparable GAAP measures, or inconsistently presented from period to period. The C&DIs do not prohibit companies from using non-GAAP measures that comply with the SEC's existing rules. However, the SEC staff's tone in the C&DIs is intentionally forceful in an effort to "send a message," as stated by Chief Accountant Mark Kronforst in the SEC's Division of Corporation Finance (the "Division") at the May 18 meeting of the PCAOB's Standing Advisory Group (SAG). In his discussion of the SEC's concerns about non-GAAP measures, Mr. Kronforst announced that "this next quarter will be a great opportunity for companies to self-correct."

The months leading up to the updated C&DIs' release have been marked by extensive press coverage and SEC scrutiny of non-GAAP measures in reaction to the increased use of these measures as well as the progressively larger difference between the amounts reported for GAAP and non-GAAP measures. As reflected in its reviews and comment letters, speeches, and updated C&DIs, the SEC is urging companies to take a fresh look at their use of non-GAAP measures in earnings releases and periodic reports.

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[1] *Namely ASU 2015-17 - Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes and ASU 2016-09 - Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.*

Additional SEC comments are also expected on the usefulness of non-GAAP measures a company provides. If a company cannot justify why a non-GAAP measure is an appropriate way to measure a company's performance and how it is useful to investors, the SEC may object to the measure. A non-GAAP measure's usefulness to analysts cannot be the only support for presenting the measure, and justification for the measure must be substantive and specific to the company.

For more information on the SEC's recent commentary on non-GAAP measures, see Deloitte's May 23, 2016, Heads Up. Additionally, a new Deloitte Roadmap publication on non-GAAP financial measures is currently in development and is expected to be issued in the summer of 2016.

FASB simplifies the accounting for share-based payments

The FASB's new guidance in ASU 2016-09, issued in March of this year, simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The ASU also contains two practical expedients for nonpublic entities. For more information about ASU 2016-09, see Deloitte's April 21, 2016, Heads Up.

Since the issuance of ASU 2016-09, a number of questions have arisen about its implementation. In response to these questions, Deloitte has compiled a list of questions and answers that discuss many aspects of the new guidance that may be of interest to stakeholders, including those specific to income taxes. These questions and answers are contained within Deloitte's June 20, 2016 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 deferred tax liability (DTL) or deferred tax asset (DTA) is recognized as a discrete item in the interim period that includes the enactment date. The tax effects of a change in tax laws or rates on taxes currently payable or refundable for the current year are reflected in the computation of the annual effective tax rate (AETR) after the effective dates prescribed in the statutes, beginning no earlier than the first interim period that includes the enactment date of the new legislation. However, any effects of a tax law or rate change on taxes payable or refundable for a prior year, such as when the change has retroactive effects, is recognized upon enactment as a discrete item of tax expense or benefit for the current year.

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

Classified balance sheet: Before adopting ASU 2015-17[2], 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.

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

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

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

International

Several international income tax developments occurred during the second quarter of 2016, including:

- Australia – announced proposals for a diverted profits tax and anti-hybrid measures, the implementation of the OECD transfer pricing recommendations, and further significant increases in penalties applying to large businesses.
- India – India signed a protocol with Mauritius to amend the existing tax treaty between the two countries. The main purpose of the amendment is to remove the capital gain tax exemption on the sale of shares.
- United Kingdom - Brexit: UK votes to depart from the European Union. For more information see Deloitte's Financial Reporting Alert 16-1, and tax Insights.

For a summary of these and other 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 Federal

Proposed regulations under Sections 385

On April 4, 2016, the U.S. Treasury and the IRS published broadly applicable proposed regulations under Section 385 to address whether a purported debt instrument that is issued to a related party is treated as stock or debt, or as in part stock and in part debt, for U.S. federal income tax purposes. The proposed regulations would:

1. Authorize Bifurcation: Authorize the IRS to treat certain related-party interests as part stock and part debt for federal tax purposes;
2. Require Documentation: Establish contemporaneous documentation requirements that must be satisfied for certain related-party debt to be respected for federal tax purposes; and
3. Treat Related Debt as Equity: Treat certain related-party debt as stock for all purposes of the Code when issued in connection with certain distributions and acquisitions.

While ostensibly intended to limit the earnings stripping benefits of corporate inversion transactions, the proposed regulations, if adopted in their present form, apply well beyond inversions, and are also intended to apply to a broad range of related-party transactions. Consequently, they would significantly impact many ordinary business transactions and restructurings of domestic and foreign corporations. In general, the proposed regulations do not apply to instruments issued between members of an affiliated group that file a consolidated return. Special rules apply, however, when a debt instrument becomes, or ceases to be, a consolidated group debt instrument, or a consolidated group member that is a party to a debt instrument becomes, or ceases to be, a consolidated group member. While the proposed regulations contain a broad exception for debt between members of a consolidated group, companies should consider the extent to which these new rules would apply from a state tax perspective.

The proposed regulations have complex effective date provisions for the foregoing, but generally do not have substantive effect until they are finalized. Treasury has stated that it intends to "move swiftly" to finalize the proposed regulations.

While these regulations are only proposed regulations at this time, companies should give consideration to the prospective ASC 740 income tax accounting implications that will arise when these regulations are finalized.

More information may be found in the United States Tax Alert issued April, 6, 2016.

IRS Chief Counsel Advice (CCA) on treatment of deferred revenue following stock acquisition

In CCA 201619009 (Mar. 11, 2016), the Internal Revenue Service (IRS) concluded that a Target corporation in a stock acquisition that accounts for advance payments under the Deferral Method described in Rev. Proc. 2004-34 is required to recognize the deferred revenue balance at the acquisition date in its post-acquisition return notwithstanding the write down of the deferred revenue liability to its fair value at the acquisition date for financial reporting purposes under GAAP. Companies should consider the financial reporting for income taxes implications of this CCA.

Revenue Procedure 2016-29: Automatic change procedure updates

Rev. Proc. 2016-29 provides taxpayers with a new list of automatic changes and makes significant changes to previous automatic method changes. Rev. Proc. 2016-29 also includes filing procedures and transitional guidance for converting certain non-automatic changes to automatic changes. These conversions are for changes filed under the non-automatic consent procedures prior to May 5, 2016 and generally with notification made to the IRS prior to the issuance of consent or denial. Additionally, the new procedures extend the eligibility waivers for certain method changes to comply with the final tangible property regulations and changes under the remodel-refresh safe harbor provided in Rev. Proc. 2015-56.

New automatic method changes

- Under Rev. Proc. 2016-29, the following previously non-automatic method changes are now eligible for automatic consent:
  - Start-up expenditures under Section 195 - change does not rule on whether expenditures are start-up expenditures or when active trade or business begins.
  - Interest capitalization under Section 263A(f) - to change from either not capitalizing interest or following the taxpayer's book method to use a permissible method under Section 263A(f).
  - A taxpayer using the retail inventory method to change from including to not including temporary markups and markdowns in determining the retail selling prices of goods on hand at the end of the taxable year.

Changes removed from list of automatic changes

- The following changes that previously had automatic consent are now non-automatic method changes:
  - Changes from impermissible to permissible depreciation methods where the taxpayer has claimed a federal income tax credit with respect to the property subject to the change.
  - Changes for tangible property for amounts paid or incurred for repair and maintenance costs that the taxpayer is changing from capitalizing to deducting and for which the taxpayer has claimed a federal income tax credit or elected to apply Section 168(k)(4).
  - Changes for long-term contracts to the percentage of completion method under Treas. Reg. § 1.460-4(b).

Other significant changes

- Rev. Proc. 2016-29 also includes the following significant changes to various automatic method changes:
  - Waiver of the five-year prior change eligibility requirement is extended for an additional year for certain changes to comply with the tangible property regulations

- Waiver of the five-year prior change and final year of trade or business eligibility requirements is extended an additional year for changes related to the remodel-refresh safe harbor under Rev. Proc. 2015-56
- Waiver of the five-year prior change eligibility requirement for changes to comply with Section 267(a)(3)

US Multistate

Connecticut: On June 2, 2016, Governor Dannel Malloy signed into law Senate Bill No. 502. Effective immediately and applicable to income years commencing on or after January 1, 2016 for C corporations, the new law generally adopts a set of market-based sourcing rules for sourcing income from certain services and sales other than sales of tangible personal property for state corporation business tax apportionment purposes. These same new sourcing provisions generally will apply to pass-through entities effective January 1, 2017, applicable to income years commencing on or after January 1, 2017. The new law also provides that if a taxpayer concludes that it cannot reasonably determine the assignment of its receipts in accordance with these adopted market sourcing rules, the taxpayer may petition for use of a methodology that reasonably approximates the assignment of such receipts. For additional details on the Connecticut tax law changes, see Deloitte's June 10, 2016 issue of State Tax Matters.

Massachusetts: The Massachusetts Appeals Court recently upheld the decisions of the Appellate Tax Board in the companion cases of National Grid Holdings, Inc. v. Commissioner and National Grid USA Services Company, Inc., v. Commissioner regarding the disallowance of intercompany debt on cross-border hybrid instrument despite IRS determination allowing partial deduction. The cases concerned deferred subscription arrangements (DSAs) between affiliated entities in the US and UK. The IRS had previously audited the taxpayer for the same tax period and, as part of an audit closing agreement, had allowed a partial deduction. The taxpayer argued that the IRS' determination should be binding for Massachusetts tax purposes. The Massachusetts Appeals Court upheld the Board's finding that the IRS closing agreement did not constitute a binding determination of the interest deductions allowable for Massachusetts corporate excise tax purposes. The Massachusetts Appeals Court explained that the relevant Massachusetts statute defines net income as gross income less the deductions "allowable" under the IRC, but does not necessarily tie to the specific amount deducted for federal purposes.

For additional details and information regarding the Massachusetts Appeals Court's decision, see Deloitte's June 17, 2016 issue of State Tax Matters.

Michigan: The Michigan Court of Appeals recently reversed a lower court decision and held that three related entities did not constitute a unitary business group for Michigan Business Tax (MBT) purposes due to a lack of requisite control. The Michigan Department of Treasury (Treasury) had sought to require the taxpayer and two other entities (all three owned in a 50/50 capacity by two brothers) to file as a unitary business group for MBT purposes under the theory that constructive ownership, as used in various federal contexts, was sufficient to satisfy the statutory requirement that one unitary member own directly or indirectly, at least 50 percent of the other related member(s). The Michigan Court of Appeals disagreed with Treasury's interpretation and held, "indirect ownership in MCL 208.1117(6) means ownership through an intermediary, not ownership by operation of legal fiction, as [the Michigan Department of Treasury] urges." For additional details and information regarding the Michigan Court of Appeal's decision, see Deloitte's Michigan Multistate Tax Alert.

New Jersey: On April 25, 2016, the Tax Court of New Jersey in Kraft Foods Global, Inc. v. Director, Division of Taxation, held that the Director of the Division of Taxation (Director) did not err in determining that Kraft Foods Global, Inc. failed to establish that it was entitled to deduct interest payments made to its parent company during tax years 2005 and 2006 from its taxable income base for Corporate Business Tax (CBT) purposes. The Tax Court's holding in this case highlights the significance of the facts relative to whether a taxpayer may be eligible for an exception to New Jersey's interest add-back statute. For additional details and information regarding the Tax Court of New Jersey's decision, see Deloitte's New Jersey Multistate Tax Alert.

New York: On April 13, 2016, New York Governor Andrew Cuomo signed into law the 2016-2017 Budget Act (S6409C/A9009C) (Budget Act). This legislation includes amendments to the New York tax reform legislation contained in the 2014-2015 New York State Budget and the New York City tax reform legislation contained in the

2015-2016 New York State Budget, certain state credits and incentives, and state sales tax provisions. The legislation also conforms New York State and New York City filing due dates for certain tax returns to the recent changes made to federal income tax return due dates. For additional details on the New York tax law changes, see Deloitte's New York Multistate Tax Alert.

Additionally, the New York State Department of Taxation & Finance has issued a memorandum summarizing certain Article 9-A corporation tax changes that were enacted as part of the Budget Act. For additional details, including access to the Department's technical memorandum, see Deloitte's June 17, 2016 issue of State Tax Matters.

North Carolina: On May 11, 2016, North Carolina Governor Pat McCroy signed into law Senate Bill No. 729. Effective for taxable years beginning on or after January 1, 2016, the new law revises North Carolina's related member interest expense "addback" statute for state corporate income tax purposes by amending the calculation of the qualifying intercompany interest expense deduction. Additionally, for purposes of calculating the state corporate income tax sales factor for apportionment purposes, the new law excludes dividends and receipts from certain financial swaps and similar financial derivatives from the definition of "sales," as well as makes other clarifying changes. For additional details on North Carolina's tax law changes, see Deloitte's May 20, 2016 issue of State Tax Matters.

Tennessee: On April 27, 2016, Tennessee Governor Bill Haslam signed into law House Bill No.1554, which is applicable to tax years beginning on or after January 1, 2016. Notable provisions of the new law include:

- Additional circumstances under which the Tennessee Department of Revenue may waive penalties for delinquent state franchise and excise taxes;
- Alters the formula for calculating quarterly estimated payments for state franchise and excise taxes; and
- Reduces penalties for deficient or delinquent estimated state franchise and excise tax payments from five percent to two percent per month.

For additional details on Tennessee's tax law changes, see Deloitte's May 6, 2016 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.

- Arizona – May 20, 2016 issue of State Tax Matters
- Florida – April 20, 2016 issue of State Tax Matters
- Hawaii – May 6, 2016 issue of State Tax Matters
- Indiana issued FAQ's on IRC Conformity - April 22, 2016 issue of State Tax Matters
- Kentucky – May 6, 2016 issue of State Tax Matters
- North Carolina – June 10, 2016 issue of State Tax Matters
- South Carolina – April 29, 2016 issue of State Tax Matters
- Vermont – June 10, 2016 issue of State Tax Matters

State Amnesty Programs: Recently, both Alabama and Arizona have implemented programs applicable to income taxes and non-income taxes

- **Alabama**: Pursuant to legislation enacted last year (Senate Bill No. 20), the Alabama Department of Revenue (Department) has issued frequently asked questions and answers for an upcoming amnesty program that will run from June 30, 2016 through August 30, 2016. The Department explains that most taxes it administers, with the exception of motor fuel taxes, are eligible for this amnesty program – which includes, but is not limited to, state corporate and individual income, business privilege, excise, consumers use, sellers use, withholding, and sales taxes. Under this program, qualifying participants may receive a waiver of one-half of the interest and all of the penalties associated with the eligible taxes, as well as a three-year "look-back period." For additional details on the Program, including access to the Department's FAQs, see Deloitte's April 29, 2016 issue of State Tax Matters.

- **Arizona**: On May 10, 2016, Governor Doug Ducey signed into law House Bill No. 2708, which requires the Arizona Department of Revenue (Department) to establish a "Tax Recovery Program" from September 1, 2016 through October 31, 2016, for the purpose of reducing or waiving civil taxpayer penalties and interest for unpaid liabilities on most taxes administered by the Department for any period ending before January 1, 2014 for annual filers, and before February 1, 2015 for all other filers. The new law outlines the various qualifications for acceptance into this Tax Recovery Program, stipulating that such acceptance does not entitle taxpayers to any tax refunds or credits on amounts previously paid and that the underlying application constitutes a taxpayer waiver of all administrative and judicial rights of appeal. 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 May 20, 2016 issue of State Tax Matters.

Learn more

Financial Reporting for Taxes Training – Corporate tax and accounting professionals continue to face significant challenges in financial reporting for income taxes. Deloitte's interactive training seminars taught by our highly experienced accounting for income taxes specialists provide comprehensive and specialty course offerings that are available for registration as a single course or combination of courses. Our next seminar is set for December 5-9 in Las Vegas, Nevada. We encourage early registration due to capacity of meetings space, number of reserved hotel rooms, and to take advantage of early registration discounts.

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:

- 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 Dbriefs Webcasts Archive
- Deloitte Heads Up Newsletter Archive

As always, we're interested in your comments on our publications. Please take a moment to tell us what you think by sending us an e-mail.

Talk to Us

If you have any questions or comments about the ASC 740 implications described above or other content of Accounting for Income Taxes Quarterly Hot Topics, contact the Deloitte Washington National Tax Accounting for Income Taxes Group at: USNationalWNTActIncomeTaxesGrp@deloitte.com

1633 Broadway
New York, NY 10019-6754
United States