Accounting for income taxes

Quarterly hot topics

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Accounting developments

FASB proposes updates to income tax disclosure requirements

On July 26, 2016, the Financial Accounting Standards Board (FASB) issued a proposed ASU[1] that would modify or eliminate certain disclosure requirements related to income taxes as well as establish new requirements. Comments on the proposed Accounting Standards Update (ASU) were due by September 30, 2016.

The proposal is part of the FASB's disclosure framework project, which is intended to "improve the effectiveness of disclosures in notes to financial statements by clearly communicating the information that is most important to users of each entity's financial statements."

In March 2014, the FASB issued a proposed concepts statement[2] on its conceptual framework for financial reporting. The Board later decided to test the guidance in that proposal by considering the effectiveness of financial statement disclosures related to inventory, income taxes, fair value measurements, and defined benefit pensions and other postretirement plans. The proposed ASU is the result of the application of the guidance in the proposed concepts statement to income taxes.

The proposed amendments would affect disclosures related to the following items:

- Indefinitely reinvested foreign earnings
- Unrecognized tax benefits
- Operating loss and tax credit carryforwards
- Rate reconciliation
- Government assistance
- Other income tax disclosure requirements

Although many of the amendments would apply to all entities that are subject to income taxes, certain amendments would apply only to public business entities.

The proposed ASU's amendments would be applied prospectively. The FASB will determine an effective date for the final guidance after it has considered feedback from stakeholders.

For more information on these proposed updates, see Deloitte's July 29, 2016, Heads Up.

SEC continues focus on non-GAAP measures

As part of its current focus on non-GAAP measures, the SEC has questioned whether companies and audit committees have implemented appropriate controls regarding the disclosure of such measures. To assist companies in understanding these issues, Deloitte has issued a *Heads Up* that discusses the types of controls that could be established and provides high-level examples of control issues and related responses for consideration in connection with non-GAAP measures. The topics covered in the Heads Up include:

- Disclosure controls and procedures (DCPs) versus internal control over financial reporting
- Non-GAAP measures, earnings releases, and DCPs
- Disclosure committee considerations
- Controls associated with the disclosure of non-GAAP measures

For more information on non-GAAP measures, see Deloitte's *A Roadmap to Non-GAAP Financial Measures*.

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[1] FASB Proposed Accounting Standards Update, *Disclosure Framework — Changes to the Disclosure Requirements for Income Taxes.*
[2] FASB Proposed Concepts Statement, *Conceptual Framework for Financial Reporting — Chapter 8: Notes to Financial Statements.*

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[3], 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.

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.

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

International

Negative decision for Apple and for Ireland to be appealed

According to the European Commission ("EC"), Apple has to pay Ireland back up to €13 billion in 'State Aid' that it (allegedly) received over the past decade. This decision is likely to be the subject of a lengthy appeals process in the courts. The EC's view is that the advance transfer pricing arrangements provided by the Irish Revenue Commissioners to Apple regarding the allocation of profits to Irish branches of companies that were not managed and controlled in Ireland (i.e. non-Irish tax resident) constitute State Aid, which is incompatible with the EU treaty. For more information see Deloitte's 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 Multistate

California: The California Franchise Tax Board (FTB) recently filed with the California Secretary of State its finalized amendments for revising California's regulation reflecting market-based rules for sourcing sales other than sales of tangible personal property as applicable to most taxpayers filing a combined report in taxable years beginning on or after January 1, 2013. The amendments provide a general definition of "marketable securities," a specific definition of "marketable securities" for registered broker-dealer type taxpayers, and accompanying sourcing rules for assigning sales of marketable securities to California. The finalized language also includes assignment rules for interest, dividends, and goodwill. Generally, the amendments to this regulation apply to taxable years beginning on or after January 1, 2015. Note that these finalized amendments do not include two examples discussed earlier during the rulemaking process that had addressed how to assign sales from asset management services provided by a taxpayer not subject to CCR Section 25137-14 (i.e., taxpayers not providing services to regulated investment companies) "due to concerns raised by some members of the public". For additional details, including access to the FTB's finalized amendments, see Deloitte's September 23, 2016 issue of State Tax Matters..

New York: An administrative law judge (ALJ) from the New York State Division of Tax Appeals recently ruled in favor of the New York State Division of Taxation (Division), denying the petition brought by Whole Foods Marketing Group, Inc. (Taxpayer) claiming that it had no obligation to file an Article 9-A corporation franchise tax combined report with an affiliated entity during the audit period. An important question in this ruling concerned which set of statutory rules must be applied first: the combined reporting rules or the "add-back" modification to intercompany royalties (i.e., making such royalty expenses nondeductible). Had the add-back modification to intercompany royalties applied first in this case, it would have eliminated the underlying intercompany transaction and thus eliminated the combined reporting requirement. If the combined reporting rules applied first in this case, the underlying intercompany transaction would survive, thereby requiring combined reporting with the affiliated entity. The ALJ agreed with the Division and ruled that determining whether combined reporting was required must precede application of the royalty add-back modification, and only if combination was not warranted would the royalty add-back modification apply. In this case, the ALJ held that the substantial intercorporate transactions requirement was satisfied because payments made by the Taxpayer as royalties for the use or license to use the intellectual property owned by the affiliate constituted in excess of 50 percent of its total receipts for each of the years during the audit period. As such, because all of the combined reporting requirements under then applicable state law pursuant to N.Y. Tax Law § 211(4) were met, combined reporting was required during the audit years. For additional details and information regarding the ALJ's decision, see Deloitte's July 29, 2016 issue of State Tax Matters.

North Carolina: The North Carolina Secretary of Revenue recently confirmed via notice that North Carolina's net General Fund tax collections for fiscal year 2015-2016 exceeded the targeted amount of $20,975,000,000, thus meeting the statutory "trigger" required for a one percent reduction in the state corporate income tax rate effective January 1, 2017, pursuant to legislation enacted during 2013. Currently, North Carolina's corporate income tax rate is 4 percent and will thus be reduced to 3 percent for tax years beginning on or after January 1, 2017, under this most recent statutory trigger. For additional details on North Carolina's tax law changes, see Deloitte's August 12, 2016 issue of State Tax Matters

Puerto Rico: The United States Court of Appeals for the First Circuit (the 1st Circuit) has affirmed a district court decision that had struck down certain provisions of the alternate minimum tax regime (AMT) of the Puerto Rico Internal Revenue Code of 2011, as amended – thereby continuing the injunction against enforcement of the AMT specific to the taxpayer at issue. In doing so, the 1st Circuit stated that the AMT is a discriminatory statute that does not meet the heightened level of scrutiny required to survive under the dormant Commerce Clause. The 1st Circuit explained that the amended AMT facially discriminates in that it only taxes cross-border transactions between a Puerto Rico corporate taxpayer and a home office or related entity outside of Puerto Rico. In addition, the 1st Circuit concluded that the existence of various alternatives with respect to enforcing transfer pricing provisions was sufficient to invalidate the AMT under the dormant Commerce Clause. For additional details and information regarding the United States Court of Appeal's decision, see Deloitte's September 2, 2016 issue of State Tax Matters.

State Amnesty Programs: Recently, Pennsylvania has implemented a program applicable to income taxes and non-income taxes

- **Pennsylvania:** Pursuant to legislation enacted last year (House Bill No. 1198), the Pennsylvania Department of Revenue (Department) has announced the establishment of a tax amnesty program (Program) that will run from April 21, 2017 through June 19, 2017. This program will generally apply to all taxes administered by the Department that are delinquent as of December 31, 2015, whether known or unknown to the Department. Under this program, amnesty will be granted for eligible taxes to qualifying taxpayers, and potentially will permit 100% waiver of the underlying penalties and 50% waiver of the underlying interest. Recently issued Department guidance on this amnesty program explains that participants reporting and paying taxes which are unknown to the Department (i.e., the taxpayer has not filed, not paid, or underreported the state taxes, and has not been contacted by the Department about the taxes) may possibly qualify for a limited filing period. In such cases, only unknown tax delinquencies dating back to January 1, 2011, must be filed and paid before the close of the 2017 tax amnesty period. All non-filed or underreported periods due after December 31, 2015 must be filed by June 19, 2017 to be approved for tax amnesty. The guidance also explains that taxpayers who participated in the 2010 tax amnesty program are ineligible to participate in this upcoming 2017 tax amnesty program. The guidance also notes that Pennsylvania's Voluntary Disclosure program will remain active during the 2017 tax amnesty program; accordingly, "taxpayers should consult with their tax preparer to determine if the Voluntary Disclosure program is more appropriate." 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 September 16, 2016 issue of State Tax Matters.

On the Horizon

New partnership audit rules: IRS aiming to issue proposed regulations by the end of the year.

In September 2016, an IRS official was quoted as stating that Treasury is currently working on completing the proposed regulations. The proposed regulations should provide insight to the IRS' interpretation of the new partnership audit rules that are effective for tax years beginning after December 31, 2017.

The Bipartisan Budget Act of 2015 repeals the current Tax Equity and Fiscal Responsibility Act (TEFRA) and electing large partnership rules and replaces them with one set of partnership-level audit rules that will apply to all partnerships, subject to an election out by certain partnerships with 100 or fewer partners. Under these streamlined audit rules, IRS examinations continue to be conducted at the partnership level. However, absent any exceptions or elections, the tax is collected from the partnership and will be computed at the highest individual or corporate income tax rate in effect for the reviewed year. For prior coverage, see December 2015 issue of this newsletter.

Learn more

Financial Reporting for Taxes Training: Professionals continue to face significant challenges in financial reporting for income taxes. Deloitte's interactive training seminar taught by our highly experienced Tax Accounting & Provision Services specialists provide comprehensive and specialty course offerings that are available 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 meeting 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

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