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Accounting for Income Taxes
Quarterly Hot Topics

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Accounting developments

FASB adds an income taxes project to its agenda

On August 13, 2014, as part of its **Simplification Initiative**, the Financial Accounting Standards Board (FASB) voted to add a narrow-scope, accounting for income tax project to its agenda concerning:

- Intra-Entity Asset Transfers: The Board will address the exception contained in Accounting Standards Codification (ASC) 810 and ASC 740-10-25-3(e) related to the tax effects of intra-entity transfers of assets. This guidance requires entities to defer the income statement charge for income taxes paid on a gain resulting from an intra-entity transfer of an asset which remains in the financial reporting group and prohibits recognition of a deferred tax asset (DTA) in the buyer's jurisdiction. The Board will consider whether this exception should be eliminated, resulting in immediate recognition in net income of the income tax effects of an intra-entity transaction, an approach that would be consistent with that under International Financial Reporting Standards (IFRS).
- Balance Sheet Classification of Deferred Taxes: The Board will consider requiring that entities classify all deferred taxes as noncurrent in a classified balance sheet, which would also be consistent with the IFRS approach.

During the meeting, the Board also discussed other topics concerning the accounting for income taxes (e.g., indefinite reinvestment of foreign earnings) that were identified in stakeholder feedback as challenging to apply. Although no additional topics were added to the FASB's agenda, the Board directed the FASB staff to perform further preagenda research on the difficulties specific to intraperiod tax allocation.

On September 10, 2014, separate from the income tax project, the Board held a preliminary discussion about potential simplifications and improvements to the accounting for share-based payment awards. Among the topics identified were (1) the accounting for income taxes upon vesting or settlement of awards

and (2) the presentation of excess tax benefits on the statement of cash flows. The Board directed the FASB staff to perform additional outreach and research into these and other matters identified.

The Board has not yet announced when it will start deliberations on the income tax project. For additional information, refer to the FASB's **Project Update**.

FASB revisits proposed elimination of leveraged leases

On August 27, 2014, the FASB redeliberated certain U.S. Generally Accepted Accounting Principles (U.S. GAAP)-specific matters in connection with the **Leases Project**, including whether to eliminate leveraged-lease accounting. Leveraged leases allow a lessor to secure the tax benefits of equipment ownership (i.e., depreciation) with an investment that is significantly less than the cost of the equipment. The May 2013 leases exposure draft eliminated the current guidance on accounting for leveraged leases and did not include any specific transition guidance. At the recent meeting, the FASB reaffirmed its decision to eliminate leveraged-lease accounting but tentatively decided to allow entities to continue to apply the current leveraged-lease guidance to arrangements that exist as of the final standard's effective date. The Board's decision to grandfather existing leveraged leases acknowledges stakeholder concerns about the cost and complexity of revising the accounting for these transactions upon transition. For additional information on decisions made at this meeting and the next steps under the leases project, refer to Deloitte's August 28, 2014 **Accounting Journal**.

IASB proposes amendments to IAS 12

On August 20, 2014, the International Accounting Standards Board (IASB) issued **ED/2014/3**, *Recognition of Deferred Tax Assets for Unrealised Losses (Proposed amendments to IAS 12)*, aimed at reducing the diversity in practice concerning the recognition of a DTA that is related to a debt instrument measured at fair value. The proposed amendments would clarify that unrealized losses on debt instruments measured at fair value and measured at cost for tax purposes can give rise to a deductible temporary difference. The proposed amendments would also clarify that the carrying amount of an asset does not limit the estimation of probable future taxable profits. It would specify that, when comparing deductible temporary differences with future taxable profits, the future taxable profits would exclude tax deductions resulting from the reversal of those deductible temporary differences. In addition, it specifies that an entity assesses whether to recognize the tax effect of a deductible temporary difference as a DTA in combination with other DTAs of the same type (e.g., ordinary or capital); this, in particular, is consistent with the FASB's recent decisions regarding the recognition of a valuation allowance in the Financial Instruments – Classification and Measurement project, which was covered in the **June 2014 Accounting for Income Tax Quarterly Hot Topics** newsletter.

The proposal indicates an entity may apply the amendments retrospectively, but full retrospective adoption is not required. Additionally, the exposure draft did not specify an effective date and comments on the exposure draft are due December 18, 2014. For additional information on this proposal, refer to Deloitte's August 20, 2014, **IFRS in Focus**.

Tax law developments

Under U.S. 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 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.

Classified balance sheet: An entity that presents a classified balance sheet must classify the deferred 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.

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 deferreds 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

Chile tax reform bill approved by Congress

On September 10, 2014, the Chilean Congress gave final approval to the 2014 tax reform bill initially presented in April of this year. The bill was signed by President Michelle Bachelet and published, and thus became effective, September 29, 2014. The new tax law primarily aims to increase tax revenue to fund an extensive reform of the education system, but also is designed to provide for a more equitable distribution of the tax burden, promote investment and savings, and reduce tax avoidance. Many of the proposed changes would have an effect on companies (both domestic and foreign) doing business in the country.

Previously, income derived by an enterprise in Chile was subject to a 20% First Category Income Tax (FCIT), but such income was also subject to income tax on a cash basis when distributed to the shareholders/partners of the enterprise, at rates that vary depending on whether the shareholder/partner is resident or nonresident. Nonresident shareholders were subject to a 35% withholding tax on dividends. The tax paid by the enterprise was eligible to be used as a credit against the liability of the shareholders/partners, resulting in an overall income tax rate of 35% on distributed profits for nonresident shareholders.

Under the new law, starting 2017, shareholders are able to opt to be subject to one of the following systems:

- Attributed income system: Shareholders would be taxed on an accrual basis, with a FCIT rate of 25% imposed at the level of the operating entity, plus global complementary tax at progressive

rates for resident individuals or an additional withholding income tax (AWIT) of 35% for nonresident shareholders (the FCIT being 100% creditable), resulting in an overall income tax charge of 35% for nonresidents. Under this system, profits would be required to be attributed to the owners or shareholders, irrespective of whether a distribution actually is made.

- Semi-integrated system: Shareholders would be taxed on a cash basis (when profits are distributed), but at a FCIT rate of 25.5% for 2017 (and 27% as from 2018). The FCIT still would be creditable against the 35% AWIT under that system, but 35% of the credit would have to be paid to the Treasury, so, in practice, only 65% of the FCIT would be creditable. Thus, taxpayers would pay for the ability to defer shareholder taxation until profits actually are distributed with a higher overall income tax rate than under the attributed income system.

The way in which a decision on the election between the two systems would be made would depend on the type of entity. A unanimous decision of the owners would be required for limited liability companies and companies divided by shares (i.e. a corporation with at least two shareholders). For stock corporations (i.e. a corporation with a single shareholder), the determination would be made in an extraordinary shareholder meeting, by approval of owners of a majority of at least two-thirds of the issued voting stock. New entities would be required to notify the Chilean tax authorities of their election at the time the entities register to commence activities. Existing taxpayers wishing to make or change an election would be required to give notice during the last three months of the year preceding the year in which the taxpayer intends to operate under the new system. Once an election is made to use a particular system, the taxpayer would be required to remain under that system for at least five years; at the end of this time, the taxpayer would be free to opt into another system. If a taxpayer opts into another system, any item pending taxation at that time would be subject to tax.

By virtue of a provision known as the “Chile clause,” Chilean tax treaties do not limit the application of Chilean AWIT on dividends paid by Chilean companies, provided the FCIT is creditable against the AWIT. Depending on the treaty, the semi-integrated system (under which only 65% of the FCIT would be creditable) could trigger application of treaty caps. To prevent this result, investors from countries with treaties containing the Chile clause would be entitled to 100% of the FCIT credit, even if they have opted into the semi-integrated system. Thus, investors from such treaty countries would enjoy the advantage of deferring shareholder taxation until profits are distributed, and yet retain the benefit of the overall 35% income tax charge. This could lead to a shift in the jurisdictions commonly used to make investments into Chile.

The prior FCIT rate of 20% is increased gradually to 25% under the attributed income system, as described below. In the case of the semi-integrated system, the rate will increase to 27%.

Year	Rate
2014	21%
2015	22.5%
2016	24%
2017	25%/25.5% (semi-integrated system)
2018	25%/27% (semi-integrated system)

The new tax law includes several other new measures and changes, which are highlighted below.

- New rules on the deductibility of financing expenses;
- New restrictions on interest deductions (thin capitalization rules);
- The introduction of controlled foreign company (CFC) rules;
- The introduction of a general anti-avoidance rule;
- New restrictions on payments to related entities abroad;
- Repeal of the foreign investment statute;

- The bill includes a proposal to introduce a voluntary disclosure opportunity for taxpayers to report previously untaxed assets and income abroad;
- One-year opportunity to withdraw historic accumulated profits (historic FUT), subject to a reduced tax rate; and
- Additional changes to value-added tax (VAT) taxes, “Sin” taxes, Green taxes, etc.

Refer to the following alert Deloitte **Chile Tax Alert** for an in-depth analysis on the new tax law. Companies should consider which tax system they intend to utilize and measure the deferred tax balances appropriately. Refer to the **June 2012 Accounting for Income Tax Quarterly Hot Topics** newsletter for additional details on how to determine the applicable tax rate to measure deferred balances in a dual tax rate jurisdiction.

France Amended Finance Law for 2014 passed

The French national assembly adopted the Amended Finance Law for 2014 on July 23, 2014 and the law was enacted on August 10, 2014. Previously, the standard corporate income tax rate in France was 33.33%, in addition to which a 3.3% social surcharge applies to the amount of corporate income tax liability exceeding EUR 763,000 (a tax on the tax). For taxpayers with turnover exceeding EUR 250 million (on a standalone or a tax group basis), an exceptional 5% surtax (an additional tax on the corporate income tax liability) was introduced in 2011 and will now be increased to 10.7% for fiscal years ending on or after December 31, 2013, resulting in an overall effective corporate income tax rate of 38%[1] for the largest companies. The surtax is temporary and initially was set to apply only to fiscal years ending on or before December 30, 2015. The Amended Finance Law extends the exceptional surtax to apply up to fiscal years ending on or before December 30, 2016. For fiscal years closing after that date, the overall effective corporate income tax rate should fall to 34.43% -- including the 3.3% social surcharge, but excluding the 3% surtax that applies on dividend distributions.

India’s Delhi High Court clarifies tax consequences of indirect share transfers

Following the India Supreme Court’s decision in the Vodafone case in 2012, the Finance Act 2012 introduced a controversial and far-reaching amendment into the Income Tax Act (ITA) that clarified that a nonresident would be subject to tax in India on a transfer of shares or an interest in a foreign entity if such shares/interest *substantially* derive their value from assets located in India. The amendments contained in the Act were passed with retrospective effect from April 1, 1962; thereby effectively nullifying the Supreme Court’s decision in the Vodafone case. The fact that the word “substantially” is not defined in the amended rules has created considerable uncertainty regarding the application of the rules. For additional details on India’s Finance Act of 2012 and the impact of certain retrospective provisions, refer to the **June 2012 Accounting for Income Tax Quarterly Hot Topics** newsletter.

In a decision issued on August 14, 2014 (Director of Income Tax (International tax) v. Copal Research Limited, Mauritius), the Delhi High Court examined the meaning of the term “substantially” in the amended version of the provisions of the Income Tax Act (ITA) dealing with indirect transfers, and opined that the purpose of the amended rules is not to expand the scope of taxation to include income derived from transfers that do not have a territorial nexus with India. The court ruled in favor of the taxpayer and stated that capital gains arising from a transfer of shares of a foreign company should not be liable to tax in India if such shares derive less than 50% of their value from underlying assets located in India. In other words, a threshold of 50% or more should be met before taxation of capital gains is triggered in India. The court also upheld the applicability of the capital gains tax exemption under the India-Mauritius tax treaty. While the Delhi High Court decision provides welcome clarification with respect to the interpretation of the term “substantially” that is used in the provisions of the ITA relating to indirect transfers, the fact that the court addressed the meaning of the term even though this issue was not specifically part of the case, may result in the courts interpretation to be considered nonbinding dicta that may have only persuasive value in other

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[1] 33.33% + 33.33% X (3.3% + 10.7%) = 38%

cases. For additional details on this case, refer to the Deloitte September 12, 2014 **World Tax Advisor**. On August 28, 2014, India's Central Board of Direct Taxes (CBDT) established a committee to analyse new cases involving indirect transfers of capital Indian assets that arose before April 1, 2012, after application of a retrospective amendment to India's Income Tax Act, 1961.

India – Budget for 2014-15 passed

The Indian finance minister presented the budget for 2014-15 to parliament on July 10, 2014 and that budget received the president's assent on August 6, 2014 (the last step for enactment under India tax law). Some of the highlights of the budget changes related to taxes include the following:

- There would be no change to the corporate tax rate, surcharge or cess;
- The 15% investment allowance for manufacturing companies that invest more than INR 1 billion in new plant and machinery would be extended to investments made until March 31, 2017, and an additional 15% deduction introduced for investments exceeding INR 250 million in new plant and machinery on or after April 1, 2015;
- Expenditure incurred on corporate social responsibility activities (which are mandatory for certain companies as from April 1, 2014) generally would not be deductible for tax purposes;
- Capital gains from the sale of shares of an unlisted company (private or public) would qualify as long-term capital gains eligible for concessional tax treatment only if the shares have been held for a period of more than 36 months (increased from 12 months);
- The dividend distribution tax (15% plus a 10% surcharge and 3% cess) that currently is payable on the amount of the actual (net) dividends distributed by an Indian company would instead be payable on a "grossed up" basis for dividends distributed on or after October 1, 2014. This would increase the effective dividend distribution tax rate by 3%;
- Effective October 1, 2014, a specific tax regime is introduced for Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) set up in accordance with Securities and Exchange Board of India regulations;
- The tax holiday for power sector undertakings would be extended to cover eligible activities that commence from March 31, 2014 to March 31, 2017;
- An advance pricing agreement signed with the government may apply retroactively for a period of up to four prior tax years (subject to conditions and procedures to be provided by the government);
- The transfer pricing regulations have been amended to introduce a "range" concept for determining an arm's length price; the arithmetic mean concept continues to apply where the number of comparable are inadequate;
- The concessional withholding tax rate of 5% is applicable to interest on monies borrowed in foreign currency up to June 30, 2017 under any loan agreement, or on all long-terms bonds;
- The current Transfer Pricing (TP) regulations contain a deeming provision covering transactions with unrelated parties within the ambit of TP law in certain circumstances. The law has been amended to clarify that the deeming provision would also apply to cases where the third party is an Indian resident, once the currently prescribed conditions are fulfilled;
- The beneficial 15% tax rate on dividends declared, distributed or paid by specified foreign companies to an Indian company would be extended indefinitely (currently, it applies only to dividends received up to March 31, 2014); and
- Where withholding tax is not deducted on payments to residents, the nondeductible portion of the payments would be limited to 30% (currently, the payments are 100% nondeductible).

Italy changes to IRAP tax rates enacted

The Italian government passed Law Decree No. 66 on April 24, 2014, which was enacted into law on June 18, 2014. This law reduces the standard Italian regional tax on productive activities (IRAP) rate of 3.9% to 3.5%. The standard rates for financial institutions and insurance companies are reduced from 4.65% and 5.9% to 4.2% and 5.3%, respectively. The new rates are effective for fiscal years starting after December

31, 2013. Due to the rate reduction, special rules will apply to advance payments of IRAP under the forecast method for the 2014 fiscal year. Each Italian region may increase or decrease the standard IRAP rate by up to 0.92%.

Puerto Rico tax law change

The Governor of Puerto Rico recently enacted Puerto Rico House Bill 1919 as Puerto Rico Act 77 of June 30, 2014 (Act 77-2014). Act 77-2014 introduces significant amendments to the 2011 Puerto Rico Internal Revenue Code (IRC) (2011 PR Code). Act 77-2014 makes significant changes to the alternative tax on gross income (ATGI), which was originally established through Act 40 of 2013 (see the **September 2013 Accounting for Income Tax Quarterly Hot Topics** newsletter), and modified by Act 117-2013 (see the **December 2013 Accounting for Income Tax Quarterly Hot Topics** newsletter).

Under Act 77-2014, corporations, partnerships, special partnerships and corporation of individuals, engaged in trade or business, are subject to a new ATGI ("New ATGI") as follows:

Gross Income	***Rate***
$3,000,000 - $100,000,000	0.35%
$100,000,001 - $300,000,000	0.50%
$300,000,001 - $600,000,000	0.70%
$600,000,001 - $1,500,000,000	0.80%
In excess of $1,500,000,000	1.00%
Financial Business	1.00%

The New ATGI is a deductible expense reported in pre-tax book income (not an income tax as the tax liability is based on gross income), in arriving at the net taxable income of the taxpayer, if paid on or before the due date for the filing of the applicable tax return for the taxable year.

Under Act 40, taxpayers other than financial institutions were able to request a reduction of the ATGI (but not below 0.2%) if the additional tax was found to be significant when compared to the gross margin of the taxpayer or if the tax results in an undue economic hardship (Relief). Approved rate reductions are effective for two years. Taxpayers that were granted a Relief can elect to use the tax rate established on the Relief or the tax rate provided by the New ATGI.

When the 2011 PR Code was enacted, corporations automatically became subject to the 2011 PR Code rather than remaining subject to the 1994 Puerto Rico tax code. Corporations that wanted to remain subject to tax under the 1994 Puerto Rico tax code had the option of electing to do so (Option 94 Election). Corporations that made the Option 94 Election will remain subject to tax under the 1994 Puerto Rico tax code for five years beginning in 2011. The ATGI has been considered outside the scope of the alternative minimum tax (AMT) computation for taxpayers that had made the Option 94 Election, but under Act 40 and Act 117-2013, the ATGI was considered part of the AMT computation for taxpayers under the 2011 PR Code. Act 77-2014 removed the ATGI from the AMT regime and introduced it as an additional tax effective for taxable years commencing after December 31, 2013.

Act 77-2014 also establishes a 10% deemed dividend tax (DDT) for taxable years commencing after December 31, 2013, which is imposed on dividend amounts deemed received by a foreign owner from a corporation. "Foreign owner" is a person not resident of Puerto Rico, that is not engaged in trade or business herein, and that owns, directly or indirectly, at least 50% or more interests in the corporation. The deemed dividend amount is the lesser of the total average value of foreign assets; or, the accumulated earnings and profits at the end of the taxable year. Foreign assets include:

- Tangible property located outside of Puerto Rico;
- Stock of a foreign corporation;
- Obligations of a foreign corporation or a non-resident individual; and
- Certain intangibles acquired or developed by a domestic corporation for use outside of Puerto Rico

Accumulated earnings and profits is reduced by income generated under tax incentives acts such as Act 73-2008, Act 74-2010, Act 225-1995, Act No. 52 of August 11, 1989, or other similar incentives acts; and the deemed dividend that has been subject to the tax. Total average value of Foreign Assets is the sum of all average values at the end of each taxable year reduced by the deemed dividend amount that has been subject DDT in prior years. The average value is the adjusted basis of each asset at the end of each quarter divided by four. The DDT does not apply to nonprofit organizations, international insurers, international financial entities, and foreign corporation subject to the Branch Profit Tax. The DDT must be paid with the corporation income tax return, and it is creditable against future tax withholding requirements on actual dividend distributions. For additional details on Act 77-2014 see Deloitte's August 22, 2014 **World Tax Advisor.**

U.S. Federal

U.S. anti-inversion developments

On September 22, 2014, the U.S. Treasury issued **Notice 2014-52** intended to reduce the tax benefits of – and when possible, stop – corporate tax inversions. The notice eliminates certain techniques inverted companies currently use to access the overseas earnings of foreign subsidiaries of the U.S. Company that inverts without paying U.S. tax and applies to deals closed on or after September 22. 2014. For additional details on Notice 2014-52 see Deloitte's September 23, 2014 **Tax News & Views**.

Prior to the issuance of Notice 2014-52, several legislators proposed legislation intended to prevent U.S. companies from moving their tax residence overseas to avoid U.S. taxation. For additional details on the proposed legislation, refer to the following Deloitte publications:

- Levin brothers introduce retroactive anti-inversion bills; Wyden backs rule changes as part of tax — May 23, 2014 **Tax News & Views**.
- Wyden open to near-term inversion bill as Treasury calls for immediate action — July 18, 2014 **Tax News & Views.**
- Senate taxwriters at odds on how to address inversions — July 25, 2014 **Tax News & Views.**
- Inversion debate resumes with no clear path forward — September 12, 2014 **Tax News & Views.**
- Inversion guidance imminent, Lew says — September 19, 2014 **Tax News & Views**.

IRS memorandum provides implementation guidance for Phase 2 of the Appeals Judicial Approach and Culture (AJAC) Project

On July 2, 2014, the IRS Director for Policy, Quality and Case Support issued a Memorandum for Appeals Employees, AP-08-0714-0004, which discusses the implementation of Phase 2 of the AJAC Project ("Phase 2 Memo"). The Phase 2 Memo is effective September 2, 2014, with the exception of Internal Revenue Manual (IRM) 8.4.1.15.4 (Assistance to Counsel/Appeals), which will have an effective date of October 1, 2014. The guidance is effective for all new Appeals case receipts on or after September 2, 2014, and will be incorporated into the IRM by September 2, 2016.

The overall objective of the changes to the IRM implemented as part of AJAC Phase 2 is to create a clearer delineation between the roles of Examination and Appeals. Examination is to serve a fact-finding and investigatory function; whereas, Appeals is to serve as the independent arbiter weighing the hazards of litigation, based on the evidence gathered during the examination. The IRM states that Appeals Officers are not investigators or examining officers and may not act as such. Consequently, the IRM instructs Appeals Officers not to take investigative actions or perform analysis of new information or new issues. Some of the more relevant topics are as follows:

- Grounds for returning a case to Examination;
- Clarification as to the definition of "new information" and the appropriate action for Appeals to take when a taxpayer introduces new evidence;
- Procedures for when the taxpayer raises a new theory or alternative legal argument;
- Procedures relating to ensuring that sufficient time remains on the statute of limitations in cases returned to Examination because the taxpayer raises a new issue; and
- Guidance as to the period of limitations in claim and over assessment cases.

Taxpayers should be aware of the changes in the Appeals case procedures and the potential impact upon various Appeal activities. Taxpayers who have issues in front of Appeals should consult the Phase 2 Memo for interim guidance. Refer to the Deloitte Tax Controversy Services September 2014 **IRS Insights newsletter** for a more detailed summary of the Phase 2 Memo.

Final regulations on dispositions of depreciable property and general asset accounts

On August 14, 2014, the U.S. Department of the Treasury and the Internal Revenue Service (IRS) issued final regulations (T.D. 9689) (the "Final Regulations") addressing dispositions of property subject to depreciation under IRC Section 168, and amending the regulations for general asset accounts (GAAs) and the accounting for Modified Accelerated Cost Recovery System (MACRS) property. The Final Regulations generally retain the provisions of the 2013 Proposed Regulations (REG-110732-13), with insignificant clarifications.

The Final Regulations are generally effective for taxable years beginning on or after January 1, 2014. For taxable years beginning on or after January 1, 2012 and before January 1, 2014, taxpayers may apply the Final Regulations, the 2013 Proposed Regulations, or the 2011 Temporary Regulations (T.D. 9564) or alternatively, taxpayers may wait to comply with the Final Regulations with their first tax year beginning on or after January 1, 2014. The IRS issued Rev. Proc. 2014-54, which provides procedural guidance for taxpayers to obtain automatic consent for method changes to comply with the Final Regulations.

Rev. Proc. 2014-54 modifies the procedures in Rev. Proc. 2014-17 regarding certain changes in method of accounting for dispositions of tangible depreciable property and allows for a one-year extension of late partial disposition elections under Section 168. Rev. Proc. 2014-54 also revises Rev. Proc. 2014-17 to provide that IRC Section 280B does not apply to the demolition of a building in a GAA, unless the taxpayer elects to terminate the GAA upon the disposition of all or the last asset in the GAA or makes a qualifying disposition election. Thus, a taxpayer that may continue to depreciate the demolished building in a GAA rather than to capitalize the undepreciated cost of the building at demolition as additional basis in land as required by IRC Section 280B.

Research & experimentation expenditures

The IRS recently issued final regulations (TD 9680) (the "Final Regulations") to amend the definition of research and experimental (R&E) expenditures under IRC Section 174. The Final Regulations provide guidance on the treatment of amounts incurred in connection with the development of tangible property, particularly costs incurred to design and construct prototypes and pilot models that ultimately are placed in service by the taxpayer or sold to customers. The Final Regulations are very similar to the proposed regulations issued in September of 2013, providing much-needed clarity of the expenditures that fall within the scope of IRC Section 174 and that (in some situations) may also qualify for the research credit allowed under IRC Section 41.

Notably, the Final Regulations expressly provide (as did the proposed regulations) that "[t]he ultimate success, failure, sale, or use of the product is not relevant to a determination of eligibility under IRC Section 174." Along with this provision, the Final Regulations clarify that "pilot models" eligible for IRC Section 174 treatment include any representation or model of a product- - even a "fully-functional" unit of property produced by the taxpayer or on its behalf — that is produced to evaluate and resolve uncertainty concerning the product during the development or improvement of the product (meaning that production may have begun but design uncertainty has not yet been eliminated). The Final Regulations clarify that this concept

may include multiple pilot models produced to be used in testing the appropriate design of a product in one or more different environments, without requiring that each pilot model be tested for a purpose that is different from the other pilot models. Eleven examples are contained in the Final Regulations to illustrate the various expenditures that may be deducted under IRC Section 174 when incurred to develop a new product for sale or use by the taxpayer (including a “variant product” with different dimensions than an existing commercial product) or to integrate a new or improved component into an existing product for which there otherwise is no design uncertainty as to the product as a whole.

The Final Regulations are generally effective for taxable years ending on or after July 21, 2014. However, Treas. Reg. Section 1.174-2(d) specifically provides that taxpayers may apply the provisions of the Final Regulations to taxable years for which the limitations for assessment of tax has not expired. Consequently, the pro-taxpayer clarifications may be used to address issues currently raised by IRS examiners, as well as for taking positions on taxable year 2013 returns, amending prior open-year returns, and possibly modifying carry-forward schedules to reflect increased NOLs or credit amounts from closed taxable years. Taxpayers wanting to change their tax-accounting method for R&E expenditures from capitalization to expensing treatment should also consider requesting IRS consent for a method change (by filing Form 3115).

Final identified mixed straddle regulations to apply prospectively

On July 17, 2014, the IRS issued final regulations (T.D. 9678) related to Section 1092 identified mixed straddles. The final regulations adopt proposed regulations (REG-112815-12) published in August 2013 and will apply to identified mixed straddles established after August 18, 2014. The proposed regulations eliminated the taxpayer’s ability to recognize the built-in gains or losses on existing positions at the time such positions become part of an identified mixed straddle. The new rule requires marking immediately before entering into the identified mixed straddle, which establishes the amount of the gain or loss and the character, and resets the holding period. However, the gain or loss from marking the position is not recognized until the straddled position is actually sold.

Public utility ratemaking developments

The IRS has recently released multiple private letter rulings (PLRs) that address how rate-regulated public utility taxpayers should take DTAs for NOL carryforwards into consideration when setting rates. These PLRs address an issue that has been relevant in numerous rate cases in recent years. While these PLRs relate to deferred tax accounting for carryforwards, they will not have a direct bearing on the application of ASC 740 when preparing a Public Utility’s financial statements (the PLRs relate to rate making). For an in-depth analysis on these recent developments, please refer to the Deloitte Power & Utilities external release which will be issued subsequent to this newsletter.

U.S. Multistate

Alaska: In Schlumberger Technology Corp. v. Alaska Department of Revenue, the Alaska Supreme Court recently held that IRC Section 882(a)(1), which “requires a foreign corporation to report only income ‘effectively connected with the conduct of a trade or business within the United States . . .’” (often referred to as effectively connected income or ECI), has not been adopted by reference because it is inconsistent with the formula provided by the Alaska Net Income Tax Act. Instead, the court held that Alaska Stat. Section 43.20.145 limits the types of corporations that may be included in a water’s edge group, but not the types of income to be included in apportionable income. In particular, Section 43.20.145(b)(1) requires a corporation filing as part of a water’s edge combined return (whether such corporation is foreign or domestic) to include 20% of dividends received from foreign corporations without regard to whether such dividends are ECI. For additional details on the Alaska Supreme Court Ruling, see Deloitte’s **Alaska Tax Alert**.

California: California Governor Jerry Brown signed into law California Assembly Bill (AB) 2389 on July 10, 2014, which temporarily modifies the capital investment incentive program (CIIP) (a property tax rebate

program) and creates the aerospace income tax credit (ATC) for wages paid by certain eligible aerospace manufacturers. The changes contained in AB 2389 include:

- CIIP
    - The temporary increase of the property tax incentive amount available under the CIIP, effective July 10, 2014, through June 30, 2015
    - The temporary narrowing of the definition of “qualifying manufacturing facility,” effective July 10, 2014, through June 30, 2015
    - The extension of the CIIP sunset date from January 1, 2017, to January 1, 2018
- ATC
    - The creation of the new ATC equal to 17.5% of wages paid to qualified full-time employees for taxable years beginning on or after January 1, 2015, and ending before January 1, 2030

For additional details on the new California tax law, see Deloitte’s **California Tax Alert**.

The California Competes Tax Credit (CCTC) is an income tax credit available to businesses expanding in or relocating to California. The CCTC was enacted on July 11, 2013, with the initial application period having closed on April 14, 2014. For fiscal year 2013/2014, the CCTC Committee awarded $28,904,663 in tax credits in amounts ranging from $20,000 to $6,000,000 to 29 taxpayers. For fiscal year 2014/2015, the Governor’s Office of Business and Economic Development (“GO-Biz”) anticipates $150 million in available CCTC. Two of the three application periods and all CCTC committee hearing dates have been released by GO-Biz, and the application process should open shortly. For additional details on the California Competes Tax Credit and Application Process, see Deloitte’s **California Tax Alert.**

Louisiana: Louisiana Governor Bobby Jindal signed into law House Bill 6631 (H.B. 663 or “the new law”) effective August 1, 2014, amending certain provisions of the Louisiana Tax Delinquency Amnesty Act of 2013 (“H.B. 456” or the “2013 Amnesty Act”). Among various other changes, H.B. 663:

i. Establishes covered tax periods for 2014 and 2015;
ii. Amends the penalty and interest waiver provisions;
iii. Adds a double penalty provision applicable to certain nonparticipating taxpayers; and
iv. Creates an installment payment program.

H.B. 663 does not, however, change the tax types covered under the amnesty program (as specified under the 2013 Amnesty Act), which continues to apply to all taxes administered by the Louisiana Department of Revenue (LADOR), except motor fuel taxes. As specified by the LADOR, the Amnesty Program is scheduled to begin on October 15, 2014 and end November 14, 2014. For additional details on the Louisiana amnesty program, see Deloitte’s **Louisiana Tax Alert**.

Michigan: On July 14, 2014, a four justice majority of the Michigan Supreme Court in International Business Machines (IBM) v. Michigan Department of Treasury reversed an earlier Michigan Court of Appeals decision and held that the enactment of the Michigan Business Tax Act ("MBT Act") did not "repeal by implication" the election provision of the Multistate Tax Compact ("Compact") codified in the Michigan Revenue Act, Michigan Compiled Law (MCL) Section 205.581, Article III(1). Therefore, the court held that the taxpayer could elect to compute its Michigan Business Tax (MBT) liability for the 2008 tax year pursuant to the equally-weighted, three-factor apportionment formula (property, payroll and sales) provided by Article III of the Compact ("Compact election") in lieu of the 100% sales-weighted apportionment formula under the MBT Act. The court also held that the Modified Gross Receipts Tax (MGRT) component of the MBT fit the Compact’s broad definition of an "income tax" and therefore the taxpayer could elect to apply the Compact’s equally-weighted, three-factor formula in computing the MGRT in addition to the Business Income Tax (BIT) component of the MBT. For additional details on the Michigan Supreme Court opinion, see Deloitte’s **Michigan Tax Alert.**

In response to the IBM decision, the Michigan Department of Treasury (“Treasury”) filed two motions with the court: a Motion for Rehearing, requesting that the court reconsider its decision; and a Motion to Stay,

asking that the court suspend the effects of the case pending the outcome of the Motion for Rehearing. The Deloitte **Michigan Tax Alert** summarizes Treasury's two motions and other considerations.

On September 11, 2014, Michigan Governor Snyder signed Senate Bill 156 (S.B. 156), repealing retroactively MCL Sections 205.581 to 205.589, the Multistate Tax Compact ("Compact") provisions of Michigan law, and adopting various retroactive amendments to the MBT Act. S.B. 156 provides for an outright repeal of all elements of the Compact and, of greatest significance, the Compact provisions are "repealed retroactively and effective beginning January 1, 2008[,]" with "the intent . . . that the repeal . . . is to express the original intent of the legislature regarding the application of Section 301 [providing for the 100% sales-weighted apportionment formula] of the Michigan business tax act . . . ." Refer to Deloitte's **Michigan Tax Alert** for a summary of taxpayer considerations associated with the retroactive repeal of the Compact and certain retroactive MBT amendments and possible taxpayer considerations contained in S.B. 156.

New York City: A new law (A.B. 9462) signed on September 15, 2014 extends certain New York City general corporation tax (GCT) rate provisions, some of which have been in effect since 1978 and were set to expire by January 1, 2015, through to December 31, 2017. The current tax rate is the greater of:

i. 8.85% on income,
ii. 1.5 mills[2] on business and investment capital,
iii. 8.85% of 15% of income plus the amount of salaries and other compensation paid to any person who at any time during the taxable year owned more than 5% of the taxpayer's capital stock, or
iv. A minimum tax based on the amount of New York City receipts.

There is also a 0.75 mill tax on subsidiary capital. Prior to this new law, these rate provisions had been scheduled to drop on January 1, 2015 to i) 6.7%, ii) 1 mill, iii) 6.7%, and iv) $25, respectively, and to 0.5 mill on subsidiary capital. Under this new law, the current General Corporation Tax (GCT) rate provisions now will remain in effect through December 31, 2017. Note this new law does not conform the New York City corporate tax regime to the New York corporate tax regime (which was significantly modified on March 31, 2014).

North Carolina: On May 29, 2014, North Carolina Governor McCrory signed House Bill 1050. The adopted legislation amends various provisions of the State's corporate income tax, replacing the Net Economic Loss with a State Net Loss and providing additional guidance regarding bonus depreciation and actual or deemed asset transfers. For additional details on the North Carolina law change, see Deloitte's **North Carolina Tax Alert**.

Vermont: Governor Peter Shumlin signed a new law (H.B. 884) on June 5, 2014, which provides that, effective retroactively to January 1, 2014 and applicable for tax year 2014 and thereafter, a qualifying affiliated group of corporations electing to file a consolidated state corporate income tax return in lieu of separate returns must continue to do so "for five years, including the year the election is made." Previously, such elections to file state consolidated versus separate returns were not binding and could be made each tax year.

Looking forward

The section below highlights some of the legislative proposals that may affect a company's income tax provision in the future. An entity should not consider changes in tax laws or rates when measuring deferred tax balances and assessing the realizability of a DTA before the period in which the change is enacted. This is an exception to the general rule in ASC 740-10-30-17, under which entities should consider all currently available information about future events when determining whether a valuation allowance is needed for a DTA. Financial statement preparers should consider whether potential changes represent an uncertainty that management reasonably expects will have a material effect on the results of operations, liquidity, or

[2] 1 mill is equal to $0.001

capital resources. If so, financial statement preparers should consider disclosing information about the scope and nature of any potential material effects of the changes.

Spain broad-based corporate tax reform proposed

The Spanish government presented a broad-based draft tax reform package on June 20, 2014, which proposes the introduction of a new corporate income tax law (as well as extensive changes to the personal income tax, nonresident income tax, VAT and general tax law). The reform initiative is designed to address the country's budget deficit, stimulate investment and help to make Spanish companies more competitive abroad. A summary of the proposed changes can be found in the Deloitte July 2, 2014 **Spain Tax Alert**. As a second step in the legal procedure for the reform, the government has drafted an amended proposal that includes some modifications to the first draft; details of the amendment can be found in the Deloitte September 12, 2014 **World Tax Advisor**. A highlight of some of the proposed changes is as follows:

- The proposed law would reduce the current general corporate income tax rate of 30% to 28% in 2015 and to 25% in 2016.
- A special anti-abuse rule for hybrids would operate to disallow deductions for expenses incurred in transactions with related parties where, as a result of different tax characterizations, income would not be subject to tax, no income would be generated or the income would be subject to a nominal tax rate of less than 10%.
- Intragroup profit participating loans would be characterized as equity instruments (rather than debt) and, therefore, "interest" payments on such loans would be nondeductible.
- NOLs would be able to be carried forward indefinitely; however, current law limiting the use of the NOLs to a specified percentage of taxable income would remain in effect;
- Several tax credits would be abolished (including the environmental investment credit, the reinvestment credit and the profit investment credit) and would be replaced by a new "capitalization reserve".
- Various changes to the controlled foreign corporation (CFC) regime.

No dates for parliamentary debate on the draft bill have been announced, but proposed rules would become effective on January 1, 2015, the legislative process would need to be finalized by December 2014 to meet this deadline. Changes to the draft bill are likely to be made before it is finalized.

Switzerland draft legislation on Corporate Tax Reform III published

On September 22, 2014, the Swiss federal government published draft legislation on the Corporate Tax Reform III, the most comprehensive corporate tax reform in more than 50 years. The main objective of the reform, which likely will become effective on January 1, 2019, is to further enhance Switzerland's attractiveness as a location for multinational companies.

Many Swiss companies would benefit from lower taxation under the reform. The proposed measures generally would confirm that companies that currently benefit from a lower tax rate under one of the special tax regimes that would be abolished effectively could retain their beneficial tax rate for up to 10 years following the reform. Assuming the reform takes effect in 2019, the current tax rate for these companies essentially would be guaranteed up to 2029 – i.e., for a period of 14 years, which would offer considerable certainty for affected companies. The reform would phase out all special corporate tax regimes, such as the mixed, domiciliary, holding and principal company regimes, as well as the Swiss finance branch regime, likely as from January 1, 2019. A number of beneficial measures are included in the Corporate Tax Reform III to compensate for the elimination of the beneficial tax regimes. For additional details on the draft legislation, see Deloitte's **Switzerland Tax Alert**.

The draft legislation will be subject to an extensive consultation process where interested parties, such as political parties and the business community, can comment on the legislation and suggest changes. The consultation period will last through January 31, 2015; the government is expected to submit formal legislation to the parliament in June 2015, so that the parliament still would be able to pass the legislation during 2015. There also may be a referendum and a national vote on the legislation. Cantonal tax laws subsequently would have to be amended to reflect the changes, so the most likely date for the law to become effective would be January 1, 2019.

OECD Releases Guidance on Transfer Pricing Issues

On September 16, 2014, the Organization for Economic Cooperation and Development (OECD) issued the first seven deliverables under the Base Erosion and Profit Shifting (BEPS) Action Plan that had been endorsed by G20 leaders in September 2013. Of the seven deliverables the OECD released, two relate to transfer pricing topics: Action 8 on the transfer pricing aspects of intangibles, and Action 13 on transfer pricing documentation and country-by-country reporting. The guidance released by the OECD amends Chapters I, V, and VI of the Transfer Pricing Guidelines. Deloitte's transfer pricing practice has prepared an in-depth analyses of the new transfer pricing guidance, which can be found in the Deloitte September 2014 **Arm's Length Standard newsletter**.

For additional details on the recent OECD developments, refer to the below resources:

- **Deloitte BEPS Central** — your one-stop shop for information on the BEPS Project. Here you can find all the official documents on the BEPS Project, as well as related Deloitte comments.
- **2014 Global Transfer Pricing Country Guide** — This guide compiles essential information regarding the transfer pricing regimes in 64 jurisdictions around the world and the OECD as of December 31, 2013.

Learn more

Register for Financial Reporting for Taxes Training: Corporate tax and accounting professionals are invited to participate in Deloitte's 2014 **Financial Reporting for Taxes** training seminar in Las Vegas from December 8-12. The seminar features half-day, one-day, and two-day courses that are available on a first-come, first-served basis. Early registration discounts are available through October 27 and multiple course discounts are available after early registration discounts expire. Sign up today!

Accounting for Income Taxes – Global Tax Developments: This publication is issued on a quarterly basis and also periodically, as warranted by specific changes, and provides a user-friendly source of global tax information that may be considered in conjunction with accounting for income taxes under U.S. GAAP. It generally includes a brief summary of major international income tax developments and provides a summary of combined tax rates applicable in several key jurisdictions and the dates of enactment of rate changes, if applicable, under U.S. GAAP. The publication also contains select sample financial statement disclosures that may be considered relevant to accounting for income taxes. The September 2014 publication and archives of prior issues can be found **here**.

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, 2013. 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**.

International Core of Excellence (ICE) 2014 Country Essentials: Deloitte Tax LLP's International Core of Excellence (ICE), our foreign tax desk program, is a local resource designed to help U.S. companies doing

business in multiple jurisdictions. ICE is a U.S.-based team of highly experienced tax professionals from key jurisdictions around the world. ICE team members, who are specialists in the tax systems of their home jurisdictions, can identify and address how foreign tax considerations impact a U.S. multinational's U.S. business drivers and tax planning. The **ICE Country Essentials** provide information on the tax rules in ICE countries, covering direct and indirect taxes and rates, tax basis and residency rules, plus forms of business organization, accounting standards and foreign exchange controls. The ICE Country Essentials are drawn from the larger Deloitte Highlights series reviewing the tax landscape of nearly 150 jurisdictions. The Essentials serve as companion pieces to the **Deloitte Taxation and Investment Guides**, which help potential investors understand the investment climate, operating conditions and tax system of most major trading jurisdictions in greater detail.

Additional resources that you may find helpful:

- **Deloitte Financial Accounting & Reporting - Income Taxes Home Page**
- **Deloitte Dbriefs Webcasts Archive**
- **Deloitte Heads Up Newsletter Archive**
- **Other Deloitte Tax Publications**

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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