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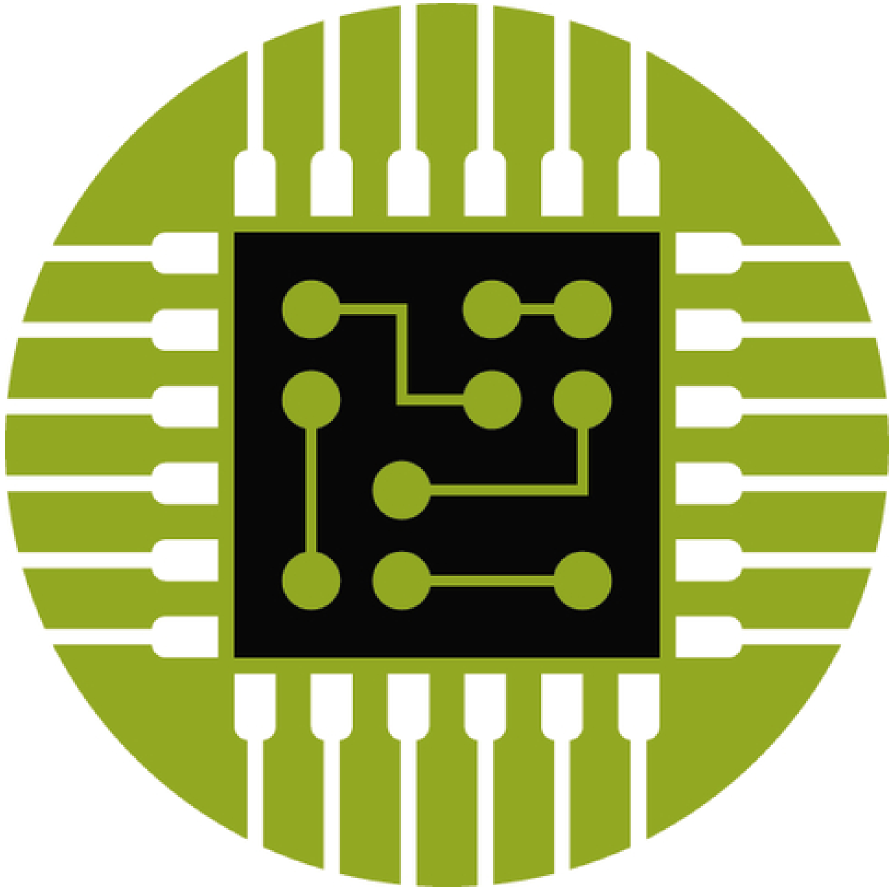


2017 Corporate Tax Spring Training

Domestic tax update - federal and state

May 24, 2017

Rate reduction planning–permanent cash savings

Tax reform proposals include a reduction in corporate rates between 10–20%

Accounting Method Planning Implemented Prior to Rate Reform May Result in Permanent Rate Reduction for Taxpayers

Current Gross DTA	Cash Tax Reduction if Deduct in 2017 at 35% Rate	Cash Tax Reduction if Deduct in 2018 at 25% Rate	Permanent Benefit of Accelerating Deduction into 2017
$100,000,000	$35,000,000	$25,000,000	$10,000,000

- Generally, a taxpayer changing its method of accounting for an item of income or expense only shifts the recognition of such items between deferred and current tax expense. The change would typically produce cash tax savings but rarely creates a permanent tax benefit.
- In taxable years bordering a change in federal corporate tax rates, however, taxpayers can capitalize on a permanent tax savings opportunity by decreasing current tax expense as much as possible in years where a decrease in rates is anticipated.
- **Tax Reform has provided Companies with an opportunity to use accounting method changes that may result in cash tax savings as well as permanent rate savings.**

Federal Tax Planning Considerations

Fixed Assets
- Repair analysis
- Dispositions / Casualty loss
- Indirect cost analysis for self-constructed property
- Bonus depreciation
- IRC §174 costs
- Ready and available/lag
- Asset reclasses

Deductions & Credits
- Prepaid expenditures
- Accruals and reserves review
- Rebate methods
- Recurring Item Exception
- Inventory and UNICAP analysis

Revenue Recognition
- Unbilled revenue on professional services
- Deferred revenue
- Disputed revenue
- Defer advanced payments

Captive Insurance & VEBA
- Consider captive insurance co:
- Workers comp
- Environmental
- FAS 106
- Other Risk
- Consider prefunding VEBA:
- Severance
- Training
- Vacation

Permanent Attribute Planning
- IRC §199 enhancement
- Lobbying reviews
- Meals and entertainment
- Tax basis reviews (federal and state)
- Federal Credits and Excise Taxes

State Tax considerations:

Conformity to expanded Tax base:

- Rolling Conformity (state automatically adopt IRC provisions as they are enacted):
  - Approximately 20 states
- Fixed Date Conformity (state adopts IRC as of a specified date – requires state legislative action to update conformity date to incorporate federal changes to broaden tax base):
  - Approximately 20 states
- Selective Conformity (state adopts select IRC provisions as of a specified date – or may make material modifications to specific IRC provisions
  - Approximately 5 states

State Tax considerations:

Deemed repatriation

- State Taxation of Deemed Dividends–generally excluded in most states
- If followed by actual repatriation–taxable in several states
- Consider structural planning in advance of cash repatriation
- Credits/Incentives-incremental US investment of repatriated cash

Federal rate reduction

Accelerate State Tax Liability (35% Fed Benefit Vs. Something Less):

1. Elective Worldwide Vs. W/E Filing Options
2. Resolution Of State-Only ASC740 Reserves
   - VDAs/nexus determinations
   - Business/nonbusiness income
   - Apportionment
   - Unitary filing method
3. State Tax Audit Issues
   - Accelerate resolution
   - Settlement of specific issues
   - Utilize closing agreements
4. Accelerate State Reporting of RAR Adjustments
   - Report changes to agreed upon federal changes
     - May require multiple amended returns
     - Consider in those states where material tax impact?

State Tax legislative/administrative updates

- Connecticut–Unitary tax filing and SSF beginning in 2016
- Delaware–Phase in of SSF beginning in 2017 over 4 years (i.e., 2x; 3x; 6x; SSF)
- Indiana–Adopts $100K economic nexus standard (S&U tax) in 2017
- Louisiana–Adopted market sourcing beginning in 2016; other substantial changes to NOL utilization
- Massachusetts DOR Directive #17-1–Promulgates MA sales/transaction-based EP nexus (S&U tax) beginning 7/1/17
- Montana–Adopts market sourcing for sales of non-TPP beginning in 2018
- New Hampshire–lowered the business profits tax rate to 8.2% beginning in 2017
- New Mexico–Continues to phase-in a reduced tax rate through 2018
- NYS–Unitary tax filing; eliminated additional tax on subsidiary capital; significant changes to NOLs; other changes; effective 1/1/15
- NYC–Completes phase-in of SSF in 2018
- North Carolina–Phase in of SSF by 2018 and lowered tax rate to 3% beginning 2017
- Tennessee–Adopted market sourcing; 3X weighted sales factor and new economic nexus standard beginning in 2016
- Texas–Reduced margin rate to 0.75% for 2016 & later
- Wyoming–Adopts $100K economic nexus standard (S&U tax) in 2017

ASC 606 Tax implications
Common misconceptions

I don't expect the GAAP changes to be significant.

I don't need to start now because the changes are not effective until 2018/2019.

The tax impacts will be timing only.

There are new GAAP revenue recognition standards?

The changes made to GAAP will not impact my tax calculation as I can just follow book for tax.

The tax impacts will be compliance only.

ASC 606 Tax implications

Key points—Adoption of ASC 606/IFRS 15

Effective date

Annual reporting periods beginning after December 15, 2017 and December 15, 2018 for public entities and nonpublic entities, respectively

Overall tax impacts

Will result in numerous tax impacts from both a technical and systems standpoint

IRS expectations

The Internal Revenue Service understands that the adoption of the new revenue recognition standards will have federal income tax implications and expects companies to perform the requisite procedures in order to address these implications

GAAP analysis

Will require companies to perform an in depth analysis of each type of revenue stream for financial statement purposes. Tax departments should be involved throughout this analysis to assess the areas of tax compliance and planning, as well as the associated magnitudes.

Cash tax impact

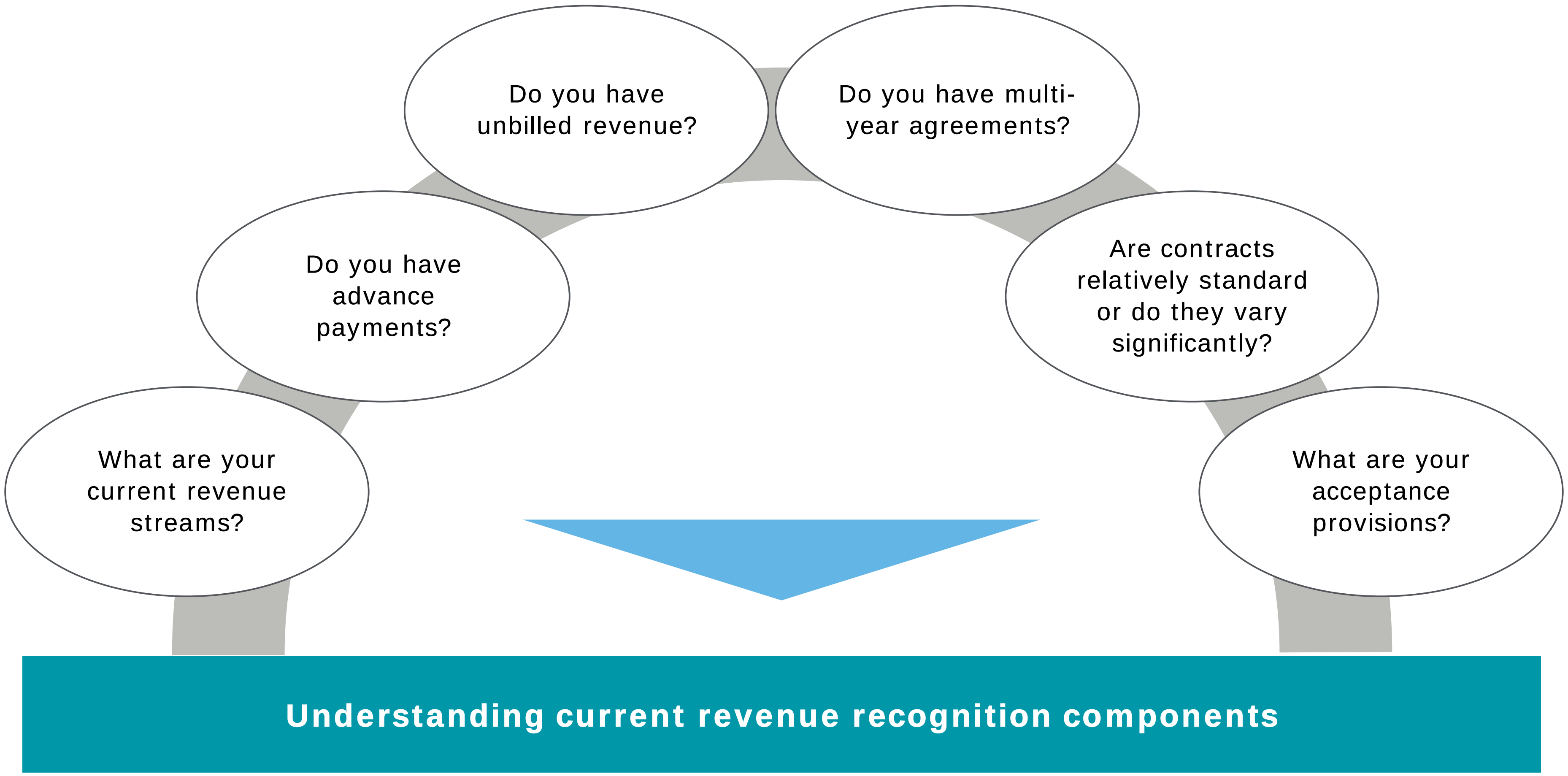
The new revenue recognition standards may result in accelerated revenue recognition for tax purposes and associated cash outlays to taxing authorities

System impacts

May impact the way data is captured, as well as additional information that may be required

ASC 606 Tax implications

Key Questions



ASC 606—revenue recognition:
State Tax considerations:

State income Tax

- NEXUS STANDARDS: Receipts from sales of intangibles

- STATE APPORTIONMENT:
  - How are sales currently computed?
    - Sales receipts versus revenue reporting
    - Most tie to federal revenues on IRS Form 1120 – may or may not change
  - Larger variances between sales/revenue may create additional audit scrutiny
  - Jurisdictional challenges:
    - Sourcing receipts for service component when bundled with product?
    - Cost of Performance versus market sourcing?

Indirect Taxes

- Bundled Transactions – generally taxable if mix of taxable goods and nontaxable services.
  - Some states now looking to apportion software receipts based on ratio of use in the state regardless of delivery point (e.g., Massachusetts)
  - May want to consider unbundling purchase price if nontaxable component is significant

ASU 2016-02 (Topic 842)
New leasing standards primer

- The FASB's new leasing standard, ASU No. 2016-02 (Topic 842), was issued on February 25, 2016.
- The primary objective of the new standard is to introduce a lessee model that brings most leases onto the balance sheet.
- The lessor model is largely unchanged (some changes result from alignment with the new revenue recognition standard).
- The new standard is effective for public entities for calendar years beginning on January 1, 2019, and January 1, 2020 for all other entities.
  - Early adoption is permitted.
  - Modified Retrospective Transition Method: apply new standard to earliest year presented in the financial statements (i.e., calendar year beginning 1/1/2017 for public entities).

ASU 2016-02 (Topic 842)—Leasing Primer

State Tax considerations:

Net Worth Taxes:

- Incremental Assets/Liabilities on Balance Sheet
- Changes to Investment in Domestic (or Foreign) Subs

Apportionment:

- Capitalized Property Versus Rent Expense

Indirect Tax:

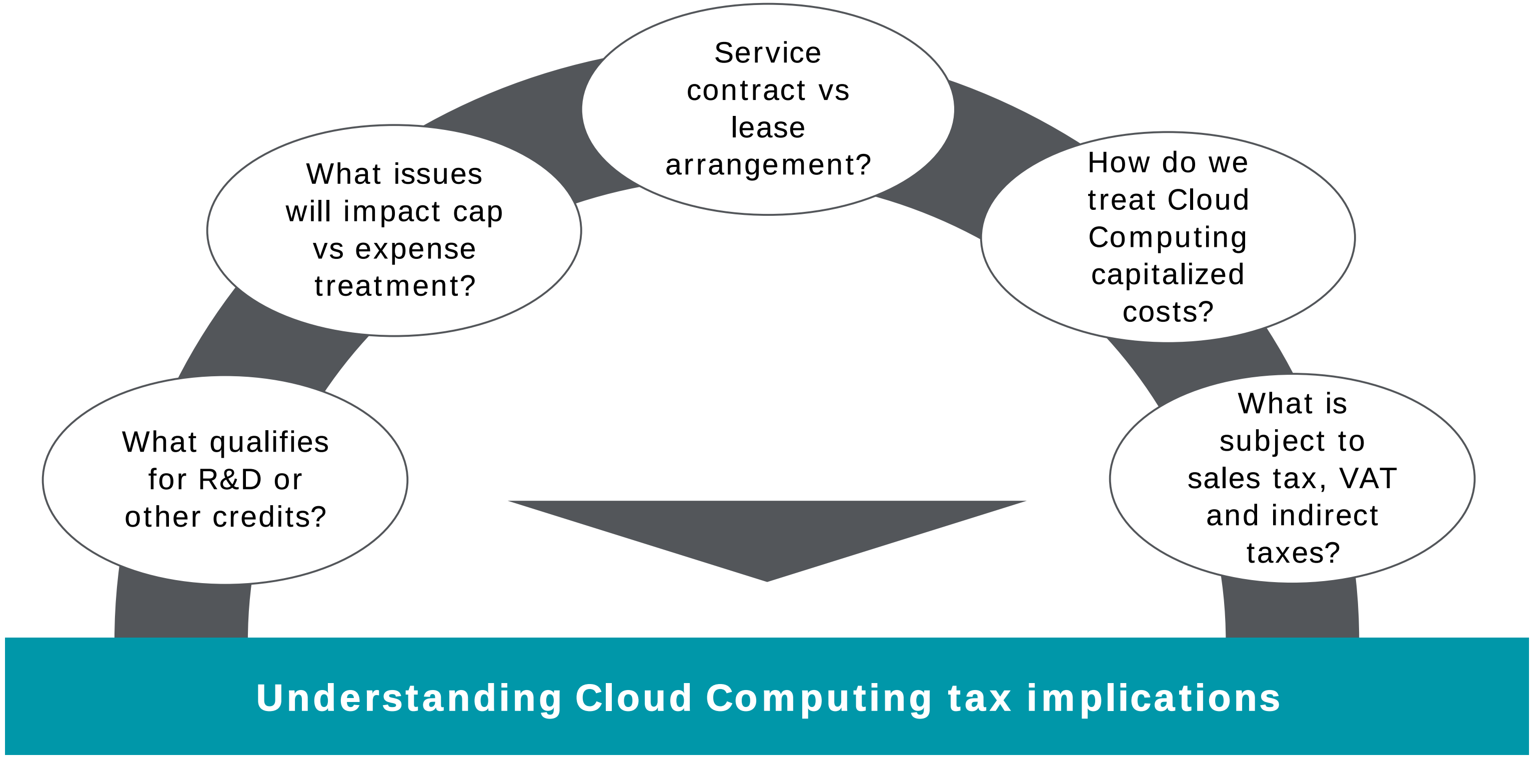
- Gross Receipts Tax – States Taxing Lease Payments
- Property Tax – Valuation Issues On Leased Property

Cloud provides opportunities to address traditional tax challenges

Traditional challenges	Key opportunities
Multiple ERPs due to volume of data	Single instance ERP
Accessibility of data	Ability to drill down to transactional data
Fragmentation of data	Less time spent gathering and validating data
Data is lacking key attributes	Capture key attributes through extensions to the code block
Business process challenges	Gain efficiency through redesign of business processes
Multiple Charts of Accounts	Single Chart of Accounts
Lack of insight into intercompany accounting	Automation of intercompany processes, insightful analytics, and transfer pricing automation

Other Hot Topics – Cloud Computing

Key Questions



Other Developments in State and local Tax

California—Sales & Use

- The California Board of Equalization (BOE) has begun processing Technology Transfer Agreement (TTA) Refund Claims that constitute non-custom software transactions under fact patterns similar to the software TTA considered in Lucent Technologies, Inc. v. Board of Equalization ("Lucent").
- The BOE has identified taxpayers who have filed TTA refund claims and has sent identified taxpayers a standardized form letter from the TTA Refund Team, Audit Determination & Refund Section (Letter) along with a Technology Transfer Agreement Claim for Refund Questionnaire to help process refund claims with facts similar to Lucent.
- Considerations
  - If refund claims filed, consult with tax advisers when responding to the Letter and Questionnaire.
  - Consider whether there are any additional California sales and use tax refund opportunities available for years open under the statute of limitations for tax paid on software, or other copyrighted or patented interests, embedded or pre-loaded in tangible personal property.

California—Income/Franchise

The California Franchise Tax Board (FTB) Chief Counsel Ruling 2016-03: Application of "Doing Business" Standard for Throwback Rule

Chief Counsel Ruling 2016-03 provides guidance for multistate corporations with sales of both tangible personal property ("TPP") and sales of other than tangible personal property in determining whether they are taxable in another state for purposes of the throwback rule and how California's bright line sales factor "doing business" standard applies in this context.

- Must aggregate sales of TPP with royalties received in determining whether it met California's "doing business" standard.
- In determining whether the taxpayer is "taxable in another state", if the taxpayer meets the bright line sales factor "doing business" standard and its activities exceed the protections under P.L. 86-272, sales of TPP do not need to be throw back to California.

California—Income/Franchise (cont.)

California Penalty Relief Offered for 2015 on Market Sourcing Regulation

- Notice 2017-02 provides relief from late payment penalties imposed as a result of an underpayment of tax due to complying with the new amendments to California's market sourcing regulation that were finalized on September 15, 2016.
- Relief is limited only to tax liabilities shown on timely filed returns for taxable years beginning on or after January 1, 2015 and before January 1, 2016.

Second Interested Parties Meeting Scheduled for Market Sourcing Regulation

- Scheduled for June 16, 2017 to discuss proposed amendments to California's market-based sourcing regulation.
  - Topics to be addressed include:
    - The reintroduction of asset management fee examples;
    - Issues in connection with the benefit of the services received, including the assignment of services performed on tangible personal property and the assignment of long-term government and research and development contracts;
    - Issues in connection with the sale of intangible property, including interest and dividends; and
    - Issues in connection with reasonable approximation.

California—Income/Franchise (cont.)

FTB Issues Guidance on Carryover of Tax Attributes for Apportioning Taxpayers

- Technical Advice Memorandum 2017-03 discusses the application of IRC Sections 382, 383, and 384 to California.
- Provides guidance on whether the limitations on the use of tax attributes under IRC Sections 382, 383, and 384 are determined on a pre- or post-apportionment basis
- IRC Section 382 applies when there has been a substantial change in a corporation's stock ownership and the acquired corporation possesses net operating losses ("NOLs") and/or net unrealized built-in losses ("NUBILs").
  - This type of corporation is referred to as a "loss corporation."
  - Specifically, IRC Section 382 limits a corporation's ability to use pre-change NOLs and NUBILs to offset income in a post-change year.
  - This NOL limitation generally equals the value of the loss corporation at the time of its change in ownership multiplied by the federally approved long-term tax-exempt rate.

California—Income/Franchise (cont.)

Single Member LLC ("SMLLC") Credit Limitation

- Under California Revenue & Taxation Code ("CRTC") § 23036, the amount of credit which may be applied against tax is limited to the amount of the owner's regular tax attributed to the income of the SMLLC.
- As a result of this limitation, the amount that a taxpayer may apply against its "tax" is equal to the amount of the taxpayer's regular tax attributed to the income of the disregarded entity.
  - Requires the taxpayer to determine its regular tax (1) including income of the disregarded business entity and (2) excluding income of the disregarded business entity.
  - If the taxpayer's regular tax, including such income, is greater than the regular tax, excluding such income, the taxpayer is entitled to apply the difference between such amounts against the taxpayer's "tax."
  - If the taxpayer's regular tax, including such income, is less than the taxpayer's regular tax, excluding such income, no amount of the credit would be allowed to be applied against the taxpayer's "tax."

California—Income/Franchise (cont.)

Defective Credit Assignment

- CRTC § 23663 permits the assignment of credits among affiliated members of the same combined reporting group.
- Credit assignment rules are operative for assignments made in taxable years beginning on or after July 1, 2008. The rules first permit assigned credits to be claimed against the “tax” of the assignee in taxable years beginning on or after January 1, 2010.
- An assignment is made as an election on a taxpayer's original tax return on Form FTB 3544 and is irrevocable once made. In some situations, taxpayers have made defective assignments.
  - Examples:
    - Mismatched entity names
    - Failure to identify tax year
    - Failure to identify type of credit
- The FTB is specifically authorized to issue necessary regulations to specify the treatment of any assignment that does not comply with the requirements of the statute, including where the taxpayer and assignee are not members of the same combined reporting group on the dates required.

Texas

Texas Policy Change on Combined Group Extension Payments

- In the April 2017, the Texas Comptroller of Public Accounts released a statement that a combined group can use the 100 percent tax due extension option regardless of any changes (notably the addition of a new member) to the combined group

Texas Comptroller Amends Franchise Tax Rules for Retail or Wholesale Trade

- On December 2, 2016, the Texas Comptroller of Public Accounts (Comptroller) adopted amendments to Tex. Admin. Code § 3.584 (Rule 3.584), including changes to the application of the reduced franchise tax rate available for certain entities primarily engaged in retail or wholesale trade.
- Elements of the originally proposed amendments affecting the Self-Production Test were not formally adopted.
  - The Comptroller has indicated the policy surrounding the proposed amendments to the Self-Production Test continues to apply and that additional amendments will be proposed in the future related to Rule 3.584.

Presenter Biographies

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Brian Rose is one of the national leaders of Deloitte's Strategic Tax Review practice. Brian specializes in tax accounting methods with a strong emphasis in revenue recognition and cost recovery issues. His work includes the identification of significant recurring tax saving considerations for his clients as well as assisting clients with regulatory, compliance, IRS and Industry issues. Brian is also one of the leaders of the Deloitte Tax Accounting Periods and Methods National Competency Group. Over the past twenty years, Brian has worked with over 400 companies on various accounting methods and strategic tax review engagements.

Brian has been a lecturer for the Tax Executive Institute's National—Level I Training on several occasions specific to accounting methods topics. Additionally, he speaks regularly across the country to professional organizations including: Tax Executives Institute; COPAS; Financial Services Industry Events; colleges; and, for internal Deloitte Tax LLP trainings and seminars on various accounting methods topics.

Brian received his BA from the University of California at Los Angeles and his MBT from the University of Southern California.

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Jerry McTeague is a Partner in the Firm's San Jose office specializing in state and local tax matters. Jerry has over twenty five years of state and local tax experience leading a large group of state and local tax specialists responsible for providing the Firm's tax professionals and clients with a full range of multistate tax consulting services, including income/franchise taxes, sales/use taxes, payroll and state tax incentives/credits.

Jerry's primary area of specialization is income and franchise tax matters for companies operating in the technology industries. His experience includes review and analysis of the state income/franchise tax implications of proposed business reorganizations; analysis of state tax filings; development and implementation of strategies to reduce overall state tax burdens and associated tax rates; and representation of clients in state tax controversies.

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