Deloitte.

In this issue:
International
Multistate
Controversy
Did You Know?

Additional resources:
Financial Accounting & Reporting – Income Taxes
Dbriefs Webcasts
Heads Up Newsletter
Tax Newsletters
Accounting for Income Taxes – International Tax Developments & Applicable Income Tax Rates

Accounting for Income Taxes
Quarterly Hot Topics

June 2012

International

Dual tax rate jurisdictions: Determination of an applicable tax rate

In some foreign jurisdictions, corporate earnings may be subject to different tax rates depending on whether or not such earnings are distributed, creating what is referred to as a dual rate tax regime. While in recent years certain jurisdictions, including Greece in 2011 and South Africa[1] in April 2012, have abolished their dual tax rate regimes, other jurisdictions like India and Taiwan continue to impose tax at different rates depending on whether earnings are distributed to owners. More specifically, Taiwan imposes a 10% tax surcharge on corporate profits that are retained by the company. Conversely, in India, where a domestic entity is generally subject to an initial tax rate of 30.9% or 32.445% (the latter rate applying when taxable income exceeds 10 million Indian Rupees), it is subject to an additional tax of 16.2225% (based on a 15% incremental tax adjusted for a surcharge and an education “cess”, with a cess being an additional local surcharge) when those earnings are either distributed as a dividend or in liquidation of the company. This incremental tax is commonly known as a Dividend Distribution Tax (DDT)[2] and becomes payable when previously taxed earnings are distributed to shareholders as either dividends or in liquidation of the company, increasing the total effective tax rate on earnings from 30.9% or 32.445% to 40.55% or 41.87%, respectively.

ASC 740 implications: ASC 740-10-30-8 establishes that a deferred tax liability or asset should be measured using the enacted tax rate(s) expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realized. In dealing with the dual tax rate regime jurisdictions U.S. GAAP, specifically ASC 740, provides limited guidance with regard to the tax rate that should be used when measuring deferred tax assets or liabilities.

ASC 740-10-25-39 through 740-10-25-41 address a specific situation where the “undistributed” tax rate is higher than the “distributed” tax rate. In the example presented therein, a distributing company receives a local tax credit equal to the difference between (1) the tax computed at the “undistributed rate” in effect the year

[1] Until recently, South Africa resident companies were not only subject to a general corporate tax of 28% levied on taxable income during the current tax year, but were also subject to a 10% Secondary Tax on Companies (STC) levied on net dividends declared. On April 1, 2012 South Africa’s STC regime came to an end and was replaced with a dividend withholding tax.

[2] A Dividend Distributions Tax (DDT) is distinguishable from a dividend withholding tax since the former is a tax on the company and the latter is intended to be a tax on the shareholder.

the income was subject to taxation and (2) the tax computed at the “distributed rate” in effect in the year the dividend is distributed.

ASC 740-10-25-40 states that the separate company financial statements of the distributing company should not reflect a deferred tax asset for the "tax benefits of future local tax credits that will be realized when the previously taxed income is distributed; rather, those tax benefits shall be recognized as a reduction of income tax expense in the period that the tax credits are included in the entity's tax return."

While ASC 740-10-25-40 (above) prescribes one accounting as being correct in the case of separate company financial statements of the subsidiary in a dual tax rate jurisdiction, ASC 740-10-25-41 prescribes two different approaches for the consolidated financial statements with the one that is applicable being determined from the parent’s intent regarding the future distribution of the subsidiary’s earnings. If the parent does not assert indefinite reversal with respect to the outside basis difference of the foreign subsidiary in accordance with ASC 740-30-25-17, then the foreign subsidiary’s deferred taxes are to be determined using the lower “distributed” tax rate, taking into account the expected refund of taxes previously paid at the higher “undistributed” rate. In addition to tax effecting deferred tax balances at a lower “distributed” tax rate, it is necessary to record the future tax credits available upon distribution of income currently taxed at a higher “undistributed” rate. For example, Company Y is incorporated and operating in a jurisdiction with a dual rate tax regime where a current “undistributed” tax rate is 30% and a lower “distributed” tax rate is 20%. In Year 1, Company Y earns 100u and accrues a current tax liability of 30u. At the same time, it would need to record a deferred tax asset of 10u for the future tax credit available upon future distribution of previously taxed earnings, lowering Company Y’s effective tax rate in Year 1 to 20%. Conversely, the higher “undistributed” tax rate should be used if the parent has not provided deferred taxes on the unremitted earnings as a result of applying the indefinite reversal criteria of ASC 740-30.

As noted above, in certain jurisdictions, the situation is the opposite of the one addressed by ASC 740-10-25-39 through 41 and additional taxes can be levied when an entity distributes its earnings to shareholders (e.g., Indian DDT). In these instances, where the “distributed” rate is higher than the “undistributed” rate, ASC 740 does not provide any guidance with regard to the applicable tax rate. In an attempt to resolve this matter, in its November 2002 and March 2003 meetings the AICPA International Practices Task Force (IPTF) was asked to address the deferred income tax accounting for entities that were subject to the now-abolished South Africa STC regime. As a result of these discussions, two competing views were developed.

View A was that the higher distributed rate should be used for measuring deferred taxes and that a deferred tax liability should also be maintained for the future distribution of prior earnings. The proponents of View A noted the following in support of this view:

- A taxable temporary difference originates in the period that earnings are generated since the incremental tax due when earnings were distributed could not be avoided. The incremental tax became payable whether the earnings were distributed or paid out in liquidation of the company.
- Under the South African law in question, there was no means by which accumulated earnings could be transferred to a company’s shareholder in a tax-free manner.
- They noted that EITF 93-16 required a deferred tax liability to be recognized for “revaluation surpluses” that arise as a result of an elected step-up in the tax basis of fixed assets under Italian tax law (where that

surplus will have to be reported in taxable income at some future date, and cannot be avoided). This requirement is now codified at ASC 830-740-25-7.

- Due to the above (the working of the South African tax law), the government's claim against the assets of the subsidiary will never revert to the benefit of the shareholders unless there is a change in the tax law.
- They noted that in paragraph 251 of FAS 109, which is now codified at ASC 740-10-55-46, an ability to postpone the incurrence of a tax is not considered in determining whether a taxable temporary difference is present.
- They noted that the consensus in EITF 95-10 (the guidance related to separate company financial statements of a subsidiary in a dual tax rate jurisdiction – now codified at ASC 740-10-25-40) precluded the consideration of the distributed tax rate since, in that instance, to consider the distributed tax rate would be to recognize a deferred tax asset. They noted that deferred tax assets are subject to a "more likely than not" realization standard that does not apply to deferred tax liabilities.
- Finally, proponents of View A noted that the SEC staff outline entitled "International Financial Reporting and Disclosure Issues" addressed an analogous issue and the framework provided by the SEC in that instance would indicate that the deferred tax liability should be recognized. The issue that the SEC was addressing was a tax holiday in Israel for earnings within specific "Approved Enterprise Zones". The earnings within the zone were subject to a zero tax rate, but if distributed, tax was due. The SEC indicated that the deferred tax liability for the taxes, which would be due when the earnings are distributed, should be recognized unless the earnings could be recovered tax-free in a liquidation and the company's earnings were indefinitely reinvested.

View B was that the incremental tax payable when earnings are distributed should be recognized only when the dividend has been declared and recognized as a liability.

- Proponents of View B did not believe the deferred tax liability for the future taxes payable when dividends are paid met the definition of a liability. They noted that to meet the definition of a liability given in the conceptual framework, it must embody a present responsibility, the entity has no discretion to avoid the future sacrifice, and the obligating event has already occurred.
- In some cases, the incremental tax payable when dividends are paid will never be paid because the entity does not have a policy of paying dividends and it is not inevitable that the company will eventually liquidate.
- Proponents of View B also noted that unremitted earnings do not meet the definition of a temporary difference, and as such, should not be treated as a taxable temporary difference (undistributed earnings are neither a basis difference in an asset or liability nor a carryforward).
- Proponents of View B also noted that the consensus in EITF 95-10 (the guidance related to separate company financial statements of a subsidiary in a dual tax rate jurisdiction – now codified at ASC 740-10-25-40) should be followed (i.e., the undistributed rate should be used). The distinction that proponents of View A make between incremental tax being payable upon a dividend (requiring a deferred tax liability) and a refund of past taxes upon a dividend (requiring a deferred tax asset) is not a distinction made in the literature. Proponents of View B rejected the notion that there are different

> thresholds for the recognition of deferred tax assets and liabilities. The "more likely than not" requirement related to deferred tax assets pertains only to realizability and not to whether the deferred tax asset should be recognized.

Following the discussions of View A and View B, the general agreement within the IPTF was that it is preferable to use the higher "distributed" tax rate to record deferred income taxes. However, it was noted that since there is nothing in the existing authoritative literature prohibiting use of the lower "undistributed" tax rate, such approach should also be appropriate if accompanied by appropriate disclosures. The SEC staff accepted View A and then further agreed to not object to View B (pending EITF consideration, which has not been forthcoming) if accompanied by appropriate disclosures. It is important to note that the SEC acceptance of the lower "undistributed" rate approach, (i.e., View B, cannot be reconciled with their position with respect to the earnings subject to the zero rate Israeli tax holiday within specific Approved Enterprise Zones as stated in the SEC's "International Financial Reporting and Disclosure Issues" outline).

The IPTF also submitted a paper on the dual rate tax regime matter to the EITF Agenda Committee for its consideration, but the matter has not been addressed to date. The FASB staff included the "dual rate" issue as part of the U.S. GAAP/IFRS short-term convergence project. The FASB identified its tentative decision in the matter to require an entity that expects to distribute income to owners and has the ability to do so, to measure deferred tax assets or liabilities using the distributed rate. In all other cases, entities are required to use the undistributed rate. The FASB has not communicated any final decision and has suspended its deliberations on the U.S. GAAP/IFRS short-term convergence project.

In the absence of clear authoritative guidance, companies with subsidiaries in dual rate tax regimes with a higher distributed tax rate can continue to follow View B if they have adopted that policy. However, in light of the seeming consensus of the IPTF members and the SEC regarding the use of the distributed tax rate when the distributed tax rate is greater than the undistributed tax rate, companies with subsidiaries in such jurisdictions that follow View B should ensure that proper disclosures, as outlined in the IPTF highlights, are provided and should continue to closely monitor this matter.

Note: Given the diversity in practice and the differing views as to the acceptability of the approaches used to account for an additional tax liability arising upon distribution in a jurisdiction with a dual tax rate regime, an entity is encouraged to discuss its approach with its external auditor.

India's Finance Act 2012 and the impact of certain retrospective provisions

On May 28, 2012 the Indian 2012 Budget was signed into law as India's Finance Act 2012 ("the Act"). The Act includes a number of significant and far-reaching tax measures. One of the more significant and controversial amendments made by the Act was a provision that is intended to nullify the Indian Supreme Court's decision in favor of the taxpayer in *Vodafone*. That decision denied the Indian government the ability to enforce an existing law that requires the parties involved in the indirect transfer of ownership of an Indian company (i.e., by the transfer of parent shares outside of India) to pay tax on such exchange to India.

Leading up to and following the *Vodafone* decision, the taxation of indirect share transfers outside India was the subject of significant debate. The controversy began with the Indian tax authorities' attempt to tax the *Hutchison-Vodafone* transaction in 2007, which involved the transfer of shares by *Hutchison* to *Vodafone* of a non-Indian holding company that indirectly held the shares in an Indian company. The

tax authorities initiated proceedings against *Vodafone*, the overseas acquiring entity, for not withholding Indian tax on the payment of the sales consideration to *Hutchinson*, the overseas entity that sold the shares of the non-Indian holding company. *Vodafone* took the position that it was not required to withhold tax because the transfer by *Hutchison* was of a capital asset situated outside of India. The Indian tax authorities, however, were of the view that the transfer was of rights and interests held by *Hutchison* in the Indian entity and indirectly involved the transfer of assets situated in India.

After a protracted and contentious dispute, in January 2012, the Indian Supreme Court ruled that the Indian tax authorities could not tax the capital gains derived by *Hutchison* on the sale of the shares because the transaction was structured as a deal between two foreign entities. On March 20, 2012, the Supreme Court rejected the government's petition to review its decision. In the wake of the decision in *Vodafone*, it had been expected that the Indian government would introduce rules that would allow India to tax cross-border transactions in which the underlying assets were located in India; however, the mechanism through which this would be accomplished was unclear.

Prior to the enactment of the Act, Section 9(1)(i) of Income Tax Act, 1961 provided that a foreign company would be liable for tax in India on income accruing in India, income deemed to accrue in India, or income received in India. In the context of a transfer of shares, income was deemed to accrue in India if it accrued through or from the transfer of a capital asset situated in India.

The Act promulgated "clarificatory" amendments to Section 9(1)(i) which are intended to make clear that an economic nexus exists with respect to an indirect share transfer, such as the one described above, giving the source country (India) the right to tax such gains when the value of the transaction is attributable to underlying assets in the source country. More specifically, the Indian taxation of capital gains would extend to a nonresident's transfer of shares in a company incorporated outside India, which in turn, has "substantial" assets or interests in India. The "situs" of shares in a company incorporated outside India would be deemed to be in India if the shares derive their value, whether directly or indirectly, "substantially" from assets (including shares) located in India.

The amendments contained in the Act have been passed with retrospective effect from April 1, 1962; thereby effectively nullifying the Supreme Court's decision in the Vodafone case. Prior to the enactment of the Act, the general statute of limitations, under Indian tax law, provided that tax assessments could be made within a seven-year period following the end of the tax year in which the income arose, regardless of whether a tax return was actually filed. Thus, notwithstanding the retrospective nature of the amendments, tax assessments with respect to capital gains in relation to assets situated in India can generally only be made seven years from the end of the tax year in which the income arose.

Moreover, on May 29, 2012, the Central Board of Direct Taxes (CBDT) of India issued a clarification letter with respect to certain retrospective amendments introduced by the Act, including amendments to Section 9(1)(i). This letter clarified that in cases where, in accordance with Income Tax Act, 1961, assessment proceedings have been completed before April 1, 2012 and no notice for reassessment has been issued prior to that date, then such cases shall not be reopened pursuant to the retrospective amendments introduced by the Act. However, assessments or any other order which is supported by the retrospective amendments would be enforced.

ASC 740 implications: The retrospective amendments to Section 9(1)(i) included in the Act should be considered as a change in tax law in accordance with ASC 740.

A company might have a deferred tax liability related to its investment in a subsidiary if it intends to recover that investment within the foreseeable future. If that subsidiary holds an interest (directly or indirectly) in an Indian company, the potential to owe Indian tax might not have been considered previously (say, because the parent expected the manner of recovery of its investment in the upper tier subsidiary would be by sale and the company expected *Vodafone* to be applicable). Such a company will need to reassess whether a deferred tax is required for Indian taxes that would become payable upon such sale. The re-measurement should be done in the financial reporting period that includes the Act's enactment date, May 28, 2012.

Similarly, taxpayers that have taken positions in prior years related to transactions that may be affected by the retrospective amendments to Section 9(1)(i) should re-assess recognition and measurement of such tax positions taking into account the new law in accordance with guidance in ASC 740-10-25. In light of the retrospective nature of the amendments, it is important to determine how far back in time a taxpayer should go when identifying tax positions to be re-evaluated. Following the guidance in ASC 740-10-25, tax positions under consideration should include positions taken with respect to transactions consummated in years open under an applicable statute of limitation.

As discussed above, Indian tax law provides for a seven year statute of limitation (i.e., the Indian tax authorities can go back up to seven years from the end of the tax year in which income "escaping assessment" is generated). However, it is possible that the policy of restraint outlined in the CBDT letter dated May 29, 2012 may be viewed as an "administrative practice" for purposes of applying the rules in ASC 740-10-25. Hence, tax positions related to transactions that are affected by the retrospective amendments but for which assessment proceedings have been completed before April 1, 2012 (and no notice for assessment has been issued prior to that date), may possibly be excluded from the re-assessment of tax benefits.

Under ASC 740, the effects of a change in tax law are recognized as a component of income tax expense or benefit from continuing operations in the financial statements for the interim or annual period that includes the enactment date of May 28, 2012. Amounts pertaining to the effect of the change on prior annual accounting periods must be recognized discretely in the period that includes the enactment date. However, if the enactment date occurs within an interim period, the effect of a tax law change on the current annual accounting period is generally recognized by updating the annual effective tax rate (AETR) for the effect of the retrospective legislation. Generally, the entire amount attributable to the effects of a change in a tax law is recorded in continuing operations and is not subject to the intra-period allocation rules.

ASC 740-10-50-9(g) requires the separate disclosure of adjustments to deferred tax liabilities or assets which result from enacted changes in tax law where such adjustments constitute significant components of income tax expense attributable to continuing operations.

Multistate

State Amnesty Program

Recently, Texas implemented an amnesty program applicable to income taxes and non-income taxes.

Texas – On March 15, 2012, Texas Comptroller, Susan Combs, announced the "Fresh Start" amnesty program, which will run from June 12, 2012, through August

17, 2012.[3] During this time, the Texas Comptroller of Public Accounts ("Comptroller") will waive penalties and interest for eligible taxpayers that file delinquent tax reports and pay all taxes due, or that amend reports that underreported taxes and pay the taxes due. The program applies to all tax periods for which the original tax return was due before April 1, 2012.

All state and local taxes and fees administrated by the Comptroller's office, with the exception of Public Utility Commission gross receipts assessments, are included in the amnesty program. Regarding International Fuel Tax Agreement (IFTA) taxes, the amnesty covers only those taxes due to Texas as shown on the IFTA tax report supplement (form #56-102).

To participate in the amnesty program, an eligible taxpayer must, between June 12, 2012 and August 17, 2012:

- File an original report by submitting a paper return, and write "Amnesty" across the top of the return and on the check or money order.
- If amending a report, submit the corrected figures on a paper return, and write "Amnesty" across the top of the return and on the check or money order.
- If submitting a tax application and registering for the first time, write "Amnesty" on the application, as well as the return and check or money order.

As noted above, all amnesty reports and payments must be submitted via a paper return in order for the waiver of penalty and interest to apply under the program. Thus, electronic return filing and payment are not permitted. Also, all amnesty returns and payments must be postmarked by August 17, 2012.

For businesses that are "closed, or if the tax being reported is a one-time event, no business registration is required." However, if the taxpayer is doing business in Texas, the applicable tax application or questionnaire must be completed and submitted by August 17, 2012, along with all tax returns and applicable tax due.[4]

Eligible taxpayers include those that did not file a required return or report originally due before April 1, 2012, and those that underreported taxes or fees due for any reason, such as erroneously claiming credits or deductions. Taxpayers who were not registered for certain taxes may also take part in the amnesty program by completing the proper registration forms and tax returns and making payment of the related tax due in accordance with the terms of the program. However, taxpayers that filed a return reporting tax owing but then failed to pay the applicable tax amount (referred to in the Comptroller's FAQs as "underpaid tax returns") are not eligible for amnesty.[5] In addition, "filing periods under audit or identified for an audit" are not covered by the amnesty.[6] Finally, taxpayers that have signed "a settlement agreement or voluntary disclosure agreement … before the beginning of the amnesty period … [are] ineligible."[7]

The Comptroller reserves the right to audit taxpayer information submitted under the terms of the amnesty program.

For additional details, please refer to **Multistate Tax: External Alert – March 16, 2012**

ASC 740 and ASC450 implications: Companies need to consider amnesty

[3] See, Project Fresh Start online bulletin, accessible on the Comptroller's website at: **www.freshstart.texas.gov**.
[4] See Project Fresh Start FAQs available at: **www.freshstart.texas.gov**.
[5] Id.
[6] Id.
[7] Id.

programs when determining the amount of unrecognized tax benefits (UTB) and the penalties and interest related to their UTBs recorded for income taxes accounted for pursuant to ASC 740-10. In the case of amnesty programs for non-income taxes, a taxpayer must consider amnesty programs when determining the amount of loss contingencies, including penalties and interest, accounted for under ASC 450.

Generally, adjustments to UTBs, contingencies, interest, and penalties, as a result of participation in state programs, should be recorded in the period that all necessary actions have been taken to participate in the program and obtain its benefits.

Arizona expands tax credits and increases net operating loss carryforward period for corporations

The State of Arizona adopted House Bill 2815 (H.B. 2815)[8] on May 11, 2012, which includes the following modifications to Arizona law:

- Beginning with corporate net operating losses (NOLs) arising in tax year 2012, increases the carryover period to 20 years;
- Beginning in tax year 2012 and applicable through tax year 2019, adopts a new individual and corporate income tax credit for investment in qualified facilities; and
- Establishes investment timeframes and additional employment requirements for the individual and corporate tax credit for new employment that was adopted in 2011.

Corporate NOLs

For corporate NOLs arising in taxable periods beginning from and after December 31, 2011, H.B. 2815 increases the carryover period from five years to 20 years.[9]

Income tax credit for qualified facilities

H.B. 2815 adds a new individual and corporate income tax credit for expanded investment in qualified facilities in the state.[10] To be eligible for the credit, taxpayers must be prequalified by the Arizona Commerce Authority (ACA) prior to investment and receive ACA post-approval once the facility begins operations.[11] A "qualified facility" is one that devotes at least 80% of the property and payroll at the facility to one or more of the following:

- Qualified manufacturing of tangible products of which 65% will be sold out of state;
- Qualified global, national, or regional headquarters of a taxpayer involved in manufacturing that derives at least 65% of its revenue from out-of-state sales; and
- Qualified research as defined in IRC Section 41(d) that is conducted by a taxpayer involved in manufacturing that derives at least 65% of its revenue from out-of-state sales.[12]

---

[8] Laws 2012, Ch. 343, 50th Legislature, 2nd Regular Session.
[9] H.B. 2815, Section 14, amending A.R.S. Section 43-1123.
[10] H.B. 2815, Sections 12 and 17, adding A.R.S. Sections 43-1083.03 and 43-1164.04.
[11] H.B. 2815, Section 3, adding A.R.S. Section 41-1512.
[12] H.B. 2815, Section 3, adding A.R.S. Section 41-1512(x)(5), (6), (7) and (8).

The taxpayer must invest in a new qualified facility or expand an existing qualified facility and produce new full-time employment positions that meet specified wage and insurance requirements. The credit is 10% of the lesser of the taxpayer's total capital investment in the qualified facility or $200,000 for each net new full-time employment position at the facility.[13] The credit cannot exceed the post-approval amount and is claimed in five equal installments in each of the five consecutive taxable years.[14] Credit that cannot be utilized in the five-year period is refundable.[15] The certification of qualification can be revoked or terminated by the ACA for failure to meet the terms and conditions for credit qualification, and the credit can be subject to recapture upon a finding of fraud or relocation to another state within five taxable years after first receiving the credit.[16]

The maximum amount that the ACA can preapprove for all taxpayers for this credit and the previously enacted renewable energy tax credit combined is $70 million per year unless taxpayers have voluntarily relinquished unused credits back to the state.[17] In addition, the ACA cannot preapprove either credit in excess of $30 million per taxpayer per year.[18] A taxpayer cannot be preapproved by the ACA to claim both the renewable energy tax credit and the qualified facilities tax credit for the same capital investment.[19]

Modification to credit for new employment

H.B. 2815 makes clarifying amendments to the credit for new employment, which was adopted previously as part of the 2011 tax package. In order to be eligible for the credit, both the capital investment and new qualified employment position requirements of the credit must be accomplished within 12 months after the start of the required capital investment, and the credit cannot be claimed until both the investment and employment requirements are met.[20] H.B. 2815 repeals the previously-enacted cap on the credit of 400 qualified employment positions per taxpayer per year.[21]

Additional requirements for determining the qualified employment positions are also included in the amendment.

For more information, see the **Multistate Tax: External Alert – May 29, 2012**.

ASC 740 implications:

Recognition – To the extent that current year losses were expected and companies determined that it was not more likely than not that the current year losses would be realized, and therefore recorded a valuation allowance, companies should evaluate the impact of the increase in the NOL carryforward period from five to twenty years.

Interim – Pursuant to ASC 740-270-25-5, the tax effect of a change in tax laws or rates on taxes currently payable or refundable for the current year should be recorded after the effective dates prescribed in the statutes and reflected in the computation of the AETR beginning no earlier than the first interim period that includes the enactment date of the new legislation. Companies should consider how the increase to the NOL carryover period and the modifications to the New Employment Tax Credit may impact their quarterly estimated AETR.

[13] H.B. 2815, Sections 12 and 17, adding A.R.S. Sections 43-1083.03(B) and 43-1164.04(B).
[14] H.B. 2815, Sections 12 and 17, adding A.R.S. Sections 43-1083.03(B)(2) and (3) and 43-1164.04(B)(2) and (3).
[15] H.B. 2815, Sections 12 and 17, adding A.R.S. Sections 43-1083.03(F) and 43-1164.04(F).
[16] H.B. 2815, Sections 12 and 17, adding A.R.S Sections 43-1083.03(G) and 43-1164.04(G).
[17] H.B. 2815, Sections 2 and 3, amending A.R.S. Section 41-1511(J) and adding A.R.S. Section 41-1512(J).
[18] H.B. 2815, Sections 2 and 3, amending A.R.S. Section 41-1511(J) and adding A.R.S. Section 41-1512(J).
[19] H.B. 2815, Section 3, adding A.R.S. Section 41-1152(J).
[20] H.B. 2815, Sections 10 and 15, amending A.R.S. Sections 43-1074(C) and 43-1161(C).
[21] H.B. 2815, Sections, 4, 10 and 15, amending A.R.S. Sections 41-1525(D), 43-1074(B)(1) and 43-1161(B)(1).

Scope – Since realization of the Tax Credit for Qualified Facilities does not depend on the entity's generation of future taxable income or the entity's ongoing tax status or tax position, the credit is not considered an element of income tax accounting under ASC 740. Thus, even if the credit claims are filed in connection with a tax return, the refunds are not considered part of income taxes and therefore are not within the scope of ASC 740.

California officially adopts regulation on market sourcing for sales of other than tangible personal property

On March 27, 2012, new California Code of Regulations (CCR), Title 18, Section 25136-2 (the "Regulation") was published, and it is applicable retroactively to taxable years beginning on or after January 1, 2011.[22] The Regulation includes, but is not limited to, guidance related to sales factor assignment for sales of other than tangible personal property under California's market-sourcing statute applicable to taxpayers electing to use single sales factor (SSF) apportionment.[23]

The Regulation provides various market sourcing rules for the: (1) sale of services (differentiating between individual and business entity customers); and (2) sales, or other transfers, of intangible property (differentiating between complete transfer[24] and licensing, leasing, rental or other use of intangible property, the latter of which further differentiates between "marketing intangibles,"[25] "non-marketing and manufacturing intangibles,"[26] and "mixed intangibles"[27]). For each type of sale or other transfer, the Regulation provides cascading rules to properly determine the "market" for the sale.

In contrast to the sourcing rules for the sale of tangible personal property, the Regulation related to sales of other than tangible personal property does not include a throwback provision for sales made to jurisdictions where the taxpayer does not have nexus. Additionally, the Regulation incorporates by reference, with exceptions, the sales factor provisions of the special industry apportionment rules found in CCR Sections 25137 through 25137-14.[28]

For additional details, please refer to **Multistate Tax: External Alert – March 27, 2012**.

[22] California Code of Regulations (CCR) tit. 18, Section 25136-2. The Regulation was approved by the California Office of Administrative Law on February 27, 2012. We understand that the Regulation was published on March 27, 2012.

[23] For background on electing single sales factor apportionment methodology, please see our prior **Tax Alert "California Close to Adopting Regulation on Single Sales Factor Election" dated July 7, 2011**.

[24] The Regulation defines "the use of intangible property in this state" at CCR Section 25136-2(b)(7) to address new provisions, subsections (d)(1)(A)1 and (d)(1)(A)1.a and b, which clarify treatment of the sale of stock in a corporation or an interest in a pass-through entity. The Regulation includes definition language stating that the location of the use of the intangible property is the location of the use of the underlying assets of the business entity sold. Sales from intangible property (as defined within the Regulation, and further explained herein) pertains to the complete transfer of all property rights. CCR Section 25136-2(d)(1).

[25] A "marketing intangible" includes, but is not limited to, the license of a copyright, service mark, trademark, or trade name where the value lies predominantly in the marketing of the intangible property in connection with goods, services, or other items. CCR Section 25136-2(b)(4)(A).

[26] A "non-marketing and manufacturing intangible" includes, but is not limited to, the license of a patent, a copyright, or trade secret to be used in a manufacturing or other non-marketing process, where the value of the intangible property lies predominantly in its use in such process. CCR Section 25136-2(b)(4)(B).

[27] A "mixed intangible" includes, but is not limited to, the license of a patent, a copyright, service mark, trademark, trade name, or trade secrets where the value lies both in the marketing of goods, services, or other items as described in subparagraph (A) and in the manufacturing process or other non-marketing purpose as described in subparagraph (B). CCR Section 25136-2(b)(4)(C).

[28] CCR Section 25136-2(g)(3). Special industry rules not incorporated into this Regulation include: CCR Section 25137(c)(1)(C) (Special Rules / Sales Factor); the throwback provision in CCR Section 25137-3 (Franchisors); the income producing activity, costs of performance, and throwback provisions in CCR Section 25137-4.2 (Banks and Financials); the throwback and sales factor inclusion of property shipped from California provisions in CCR Section 25137-12 (Print Media); and the throwback provision in CCR Section 25137-14 (Mutual Fund Service Provider).

ASC 740 implications:

Deferred taxes

Recognition and measurement – Taxpayers that intend to file their 2011 tax return following the guidance provided by the Regulation should consider the impact of the guidance on the 2011 tax return as a change in estimate (i.e., a return to provision adjustment). Taxpayers that do not intend to follow the guidance provided by the Regulation should take the Regulation in account when measuring unrecognized tax benefits, interest, and penalties related to uncertain tax positions. New information must be accounted for in the period the new information becomes available, which in this case is the annual or interim period that includes March 27, 2012.

In addition, deferred taxes should be measured using the applicable tax rate (the product of the apportionment rate and the enacted tax rate) expected to apply in the periods in which the deferred tax asset or deferred tax liability is expected to be realized or settled. Companies should consider the apportionment factor rules provided by the Regulation when determining the applicable state rate to use when measuring deferred taxes.

Interim – Pursuant to ASC 740-10-25-15, a change in judgment that results in subsequent recognition, de-recognition, or change in measurement of a tax position taken in a prior annual period (including any related interest and penalties) shall be recognized as a discrete item in the period in which the change occurs. A change in the measurement of a tax position taken in a prior interim period within the same fiscal year is reflected through an adjustment to the annual effective tax rate pursuant to ASC 740-270-35-6.

Nebraska adds new defined corporate income tax terms and adopts market sourcing for sales other than sales of tangible personal property

Nebraska Governor, Heineman, recently signed into law Legislative Bill 872 (LB 872), a revenue committee bill that contains various modifications to Nebraska's corporate income tax. LB 872 becomes operative for all tax years beginning on or after January 1, 2014 and significantly expands the defined terms and clarifies existing defined terms in Neb. Rev. Stat. Section 77-2724.04.

LB 872 amends the current statute by significantly developing and expanding the sourcing guidance related to sales other than sales of tangible personal property. Additionally, the new law amends the current sourcing of these sales from an income-producing activity method to a market-based method. Under current law, a sale is in Nebraska if "the income-producing activity is performed in this state; or the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance."

LB 872 amends the method for determining when a sale of a service is in Nebraska, stating that such sales are in this state if they are derived from a buyer within this state. Sales of a service are derived from a buyer within this state if: (1) the service relates to real or tangible personal property located in Nebraska; (2) the service is provided to an individual physically present in Nebraska when the service is received; or (3) if the service, when rendered, is provided to a buyer engaged in a trade or business in Nebraska and relates to that part of the trade or business then operated in Nebraska. Furthermore, LB 872 provides that if a buyer uses the service within and without Nebraska, the sales are apportioned between the use in Nebraska in proportion to the use of the service in Nebraska and the use within the other state(s).

With respect to intangible property, the new law provides that a sale is in Nebraska if the buyer uses the intangible at a location in this state. If the buyer uses the intangible property within and without Nebraska, the sale is apportioned between this state in proportion to the use of the property in this state and the use in the other state(s). If the location of an intangibles sale cannot be determined, the sale is in Nebraska if the buyer's billing address is in this state.

In addition, LB 872 employs a catch-all provision that states that sales other than sales of tangible personal property not specifically addressed elsewhere in the law are sourced so as to fairly represent the taxpayer's business activity in Nebraska. Applying this provision, if the buyer is an individual, a sale is deemed to occur at the buyer's billing address. Also, the new law provides, "if the buyer is not an individual and the sale is from an order placed in the regular course of the customer's business, the sale is deemed to have occurred in the state from which the order was placed and, if that place cannot be readily determined, the sale is deemed to have occurred at the customer's billing address."

Finally, LB 872 specifies a departure from the new market-based sourcing rules for sales other than sales of tangible personal property by communications companies as defined under LB 872. These companies will have sales in Nebraska if the income producing activity is performed in Nebraska or the income producing activity is performed both in and outside Nebraska and a greater proportion of the income producing activity is performed in Nebraska than in any other state, based on costs of performance.

For additional details, please refer to **Multistate Tax: External Alert – April 26, 2012**.

ASC 740 implications:

Deferred taxes

Measurement – Pursuant to ASC 740-10-10-3, deferred taxes should be measured using the applicable tax rate (the product of the apportionment rate and the enacted tax rate) expected to apply in the periods in which the deferred tax asset or deferred tax liability is expected to be realized or settled. Companies should schedule the reversals of temporary differences in order to determine the applicable Nebraska tax rate for measuring deferred tax assets and deferred tax liabilities considering the apportionment factor changes under LB 872, which become operative for tax years beginning on or after January 1, 2014.

Interim – ASC 740-270-25-5 provides that the effects of new tax legislation shall not be recognized prior to enactment. The effect of a change in tax laws or rates on a or deferred tax liability or deferred tax asset (such as a change in the apportionment rules) that existed as of the beginning of the year shall not be apportioned among interim periods through an adjustment of the AETR.

Intraperiod allocation – Pursuant to ASC 740-10-45-15, when deferred tax accounts are adjusted for the effect of a change in tax law, the effect shall be included in income from continuing operations in the financial reporting period that includes the enactment date of the applicable law change. This is true even if the deferred tax asset or deferred tax liability was originally established through an item other than continuing operations – e.g., other comprehensive income or discontinued operations.

Controversy

Supreme Court affirmed Home Concrete

In the December 2009 issue of *Accounting for Income Taxes Quarterly Hot Topics*, we discussed the possibility that an overstatement of basis could constitute an omission of income for purposes of triggering a six-year statute of limitations.

The Supreme Court affirmed the Fourth Circuit holding in *Home Concrete & Supply LLC v. United States* (4th Cir. 2011) finding that an overstatement of basis is not an omission of income for the purpose of triggering a six-year statute of limitations on assessment under IRC Section 6501(e)(1)(A).

Under IRC Section 6501(e)(1)(A), the statute of limitations for assessing a deficiency against a taxpayer is extended from three to six years when the taxpayer omits from gross income an amount in excess of 25% of the gross income stated on the return. The Taxpayer in *Home Concrete* overstated the basis of certain assets when reporting the disposition of the assets on its federal income tax return, resulting in an understatement of its income that exceeded 25% of the gross income stated on the return. The issue for the Court was whether the understated amount of gross income resulting from the offset of the overstated basis against an amount realized on a disposition of the asset extends the statute of limitations under IRC Section 6501(e)(1)(A).

Resolution of the issue required the Court to revisit its prior decision in *Colony Inc. v. Commissioner*, 357 U.S. 28 (1958), which interpreted identical language in the 1939 Internal Revenue Code to mean that the extended statute of limitations did not apply. But in 2010, the government issued regulations under IRC Section 6501 stating that an understated amount of gross income resulting from an overstatement of unrecovered cost or other basis constitutes an omission from gross income for purposes of IRC Section 6501(e)(1)(A).

The Court agreed with the Fourth Circuit's reliance upon *Colony Inc. v. Commissioner*, 357 U.S. 28 (1958). In *Colony*, the Supreme Court interpreted the language of IRC Section 6501(e)(1)(A), "omits….an amount," to mean that specific receipts are left out of the computation of gross income. As a result, the misstatements overstating the basis in property by the taxpayer in *Colony* did not fall within the scope of the statute. Although *Colony* was decided under the 1939 Code, the Court in *Home Concrete* found that the language used in the 1939 Code is indistinguishable from the language used in current IRC Section 6501(e). The Government argued that changes in other subsections of IRC Section 6501(e) favored a different interpretation from the 1939 Code; however, the Court rejected this argument. The Court stated:

> In our view, *Colony* determines the outcome in this case. The provision before us is a 1954 reenactment of the 1939 provision that *Colony* interpreted. The operative language is identical. It would be difficult, perhaps impossible, to give the same language here a different interpretation without effectively overruling *Colony*, a course of action that basic principles of stare decisis wisely counsel us not to take.

The Government also argued that Treasury Regulation Section 301.6501(e)-1 should be given deference in interpreting IRC Section 6501(e)(1)(A). The Treasury Regulation was promulgated in final form in December of 2010 in the midst of litigation over this issue and interprets the language of IRC Section 6501(e)(1)(A) to include an overstatement of basis as an omission of income. However, the Court determined that because *Colony* "squarely applies to this case," there was no ambiguity for the agency to interpret through the Treasury Regulation. In other

words, as stated by Justice Breyer, "There being no gap to fill, the Government's gap-filling regulation cannot change Colony's interpretation of the statute."

Justice Scalia concurred in part and in the judgment, but wrote separately to address the issue of judicial construction of a statute in connection with an agency's interpretation. Justice Scalia pointed out that *National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967 (2005), pronounced that a "court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute." Justice Scalia further explained that in cases decided before *Brand X*, the Court would have had no idea that it needed to make a finding that a statute was ambiguous or unambiguous in order to allow agency interpretation of a statute contrary to case law precedent. Justice Scalia explained that in order to uphold *Colony* and also stand by Brand X, the Court should have found that the Treasury Department's interpretation was unreasonable. In Scalia's words, the majority's analysis makes the Court's judicial review jurisprudence "curiouser and curiouser."

While the opinion in *Home Concrete* leaves no clear path of interpretation should an issue like this arise again in the context of determining deference to an agency's interpretation of a statute, the holding resolves the controversial issue of whether an overstatement of basis is an omission of income. An overstatement of basis is not an omission of income under IRC Section 6501(e)(1)(A) and does not trigger a six-year statute of limitations on assessment.

For additional information, please refer to **IRS Insights, May 2012**.

ASC 740 implications: The Supreme Court decision resolved the question of whether an overstatement of basis is treated as an omission of income for the purpose of triggering a six-year statute of limitations on assessment. Taxpayers should consider the of the Supreme Court case as new information to be considered when evaluating unrecognized tax benefits for recognition and measurement as well as for the calculation of related interest and penalties. New information must be accounted for in the period the new information becomes available. Taxpayers must analyze all tax positions taken in open tax years and this Supreme Court case should be considered when determining which years are open. Furthermore, pursuant to ASC 740-10-50-15(e) taxpayers must disclose in their financial statements tax years that remain subject to examination.

Did You Know?

Application of ASC 740-20-45-11(g) to noncontrolling interest transactions

Prior to 2009, when a parent increased its ownership in a subsidiary, any amount paid in excess of the carrying amount of the underlying subsidiary assets was accounted for under acquisition accounting (i.e., the corresponding interest in the underlying assets was recorded at fair value) for financial reporting purposes. However, FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, (now codified in ASC 810, *Consolidation*) prohibited the application of fair value accounting to the acquisition of an incremental interest in a subsidiary (often referred to as a "control to control" transaction). Rather, the parent accounts for a change in its ownership interest in a subsidiary, when it maintains control, as an equity transaction pursuant to ASC 810, *Consolidation*[29]. Accordingly,

[29] ASC 810-10-45-23 – Changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary shall be accounted for as equity transactions (investments by owners and distributions to owners acting in their capacity as owners). Therefore, no gain or loss shall be recognized in consolidated net income or comprehensive income. The carrying amount of the noncontrolling interest shall be adjusted to reflect the change in its ownership interest in the subsidiary. Any difference between the fair value of the consideration received or paid and the amount by which the noncontrolling interest is adjusted shall be recognized in equity attributable to the parent.

in the case of a parent increasing its ownership in a subsidiary, any premium paid relative to the underlying cost of the subsidiary's assets is recorded as a reduction of the parent's equity.

If the amount paid in excess of the carrying amount of the underlying assets is deductible for income tax purposes (e.g., when the entity is a flow-through entity and the difference between the amount paid and the underlying cost can be amortized for tax purposes) then a deferred tax asset is recognized with a corresponding tax benefit.

There appears to be two competing sources of guidance, each potentially applicable to the tax benefit described above. One source of guidance, ASC 740-20-45-11(c), pertains to tax benefits related to amounts recorded as a decrease in contributed capital. As noted above, the amount paid in excess of the carrying amount of the subsidiary's assets is recorded as a decrease in contributed capital and those same dollars result in amortizable tax basis with no corresponding financial reporting basis. From an intraperiod tax allocation perspective, the tax benefit associated with the deferred tax asset recorded for the amortizable tax basis would appear to be appropriately allocated to equity pursuant to ASC 740-20-45-11(c).

The second piece of guidance that would appear to be potentially applicable is contained in former EITF Issue No. 94-10, *Accounting by a Company for the Income Tax Effects of Transactions among or with Its Shareholders under FASB Statement No. 109* (now codified at ASC740-20-45-11(g)) (EITF Issue No. 94-10). That guidance pertains to an increase in the tax basis of assets as a consequence of a transaction with or among shareholders. The guidance indicates that the related deferred tax benefit related to the increase in tax basis should be recognized within equity. If the holder of a noncontrolling interest is considered to be a shareholder, then this particular guidance would be applicable to the tax benefit described above since this guidance would more closely describe the transaction that is giving rise to the tax benefit.

Since both items of guidance indicate that the tax benefit is recognized within equity, one might question why it is important to determine which guidance is applicable. However, it is important to distinguish the change in tax basis resulting from a transaction with or among shareholders from the change in tax basis associated with an amount recorded as a decrease in contributed capital due to the two transactions being subject to different intra-period tax allocation rules. When a tax benefit relating to an amount recorded as a decrease in contributed capital cannot be recognized in the same period (due to a valuation allowance) the subsequent realization of the benefit must be backwards traced to equity.[30] However, when the tax benefit relates to an increase in tax basis resulting from a transaction with or among shareholders, and that benefit cannot be recognized in the same period (due to a valuation allowance) the subsequent realization of the benefit is not backwards traced to equity, but rather is recognized in income.[31]

In former EITF Issue No. 94-10, there was specific language stating that the tax effects of transactions with shareholders did not apply to transactions with minority interests (the former term for the owner of a noncontrolling interest). That, combined with the fact that the income allocable to noncontrolling interest owners is subtracted when determining the earnings attributed to the shareholders of the parent, suggests

[30] ASC 740-10-45-20 provides that the initial recognition in a subsequent year of the tax benefit of deductible temporary differences and carryforwards that relate to the tax effects of items specified in paragraph 740-20-45-11(c)-(f) should be recorded in equity.

[31] ASC 740-20-45-11(g) provides that all changes in the tax bases of assets and liabilities caused by transactions among or with shareholders should be included in equity including the effect of valuation allowances initially required upon recognition of any related deferred tax assets. Changes in valuation allowance due to changed expectations about the realization of deferred tax assets caused by transactions among or with shareholders shall be included in the income statement.

that there continues to be a distinction between shareholders of the parent and the holders of the noncontrolling interest.

However, Accounting Standards Update (ASU) No. 2010-08, *Technical Corrections to Various Topics* (*ASU No. 2010-08*), amended former EITF Issue No. 94-10 to eliminate the statement that the guidance did not apply to transactions with holders of a minority interest.

ASU No. 2010-08, A.19 (e), *Amendments Resulting from Statement 160*,[32] provides the following:

> Issue 94-10 is amended as follows:
>
> (1) The second paragraph of the Issue section, to eliminate the reference to *minority interest* because transactions with minority/noncontrolling interests are accounted for in the same manner as transactions with other shareholders in accordance with Statement 160.
>
> Other transactions among shareholders may change the tax bases of the assets and liabilities of the company. For example, an investor purchases 100% of the outstanding stock of a company in a transaction that is treated as a purchase of assets for tax purposes but does not "push down" the purchase price for financial reporting purposes to the acquired company. In that situation, the acquired company's financial reporting bases of its assets and liabilities do not change but the tax bases of its assets and liabilities are adjusted and, consequently, the deferred tax liabilities and assets are also adjusted accordingly. This Issue does not address shareholder transactions ~~among or with minority shareholders of a subsidiary or shareholder transactions~~ that involve a change in the tax status of a company (such as a change from nontaxable S corporation status to taxable C corporation status).

The application of the ASU amendment to former EITF Issue No. 94-10 is illustrated as follows:

> P currently owns a 90% controlling interest in S, a partnership. The remaining 10% is recorded as a noncontrolling interest (NCI) in the equity section of P's consolidated financial statements. Further assume that P has recorded a full valuation allowance against its net deferred tax assets due to significant negative evidence. In 20X2, P acquires an additional 5% ownership interest in S. For financial reporting purposes, the acquisition of additional interest in S units is accounted for as an equity transaction under ASC 810-10-45-23, as P had a controlling interest in S both before and after the transaction with the NCI holder. For income tax reporting purposes, S made an Internal Revenue Code (IRC) Section 754 election. As a result, S's assets received a step-up in tax basis to fair value for income tax reporting purposes and resulted in tax-deductible component 2 goodwill (excess of tax-deductible goodwill over financial reporting goodwill), for which the Company recorded a deferred tax asset and an offsetting valuation allowance, resulting in no entry to equity.[33]
>
> In 20X4, based on the weight of positive and negative evidence, P releases the valuation allowance on its deferred tax assets.

---

[32] It should be noted that the modification of former EITF Issue No. 94-10 is not a consequence of codification, which was not supposed to result in any modification of existing GAAP. Rather, as stated here, this change is an actual amendment of former EITF Issue No. 94-10 made necessary by the fact that it was the intent of the FASB that a transaction with the holder of a noncontrolling interest be accounted for in the same manner as a transaction with a shareholder.

[33] ASC 740-20-45-11(g)

While the amendment of former EITF Issue No. 94-10 by ASU No. 2010-08 appears to support a conclusion that the subsequent release of the valuation allowance (including the part of the valuation allowance related to the additional tax basis from the transaction with the NCI holder) can be recognized in income and is not subject to a backwards tracing requirement, there might be diversity in practice and views. Accordingly, an entity should discuss its proposed approach with its external auditor.

Potential limitation on the ability to deduct foreign tax credits

Under the U.S. taxation rules[34] a taxpayer must choose between either deducting or claiming a credit for the foreign taxes that are paid in a particular tax year. For example, when a company receives dividends from its foreign subsidiary, the company will either report the dividend income received net of foreign tax paid on the distributed earnings, which means the underlying foreign taxes have been deducted, or the company can gross-up the dividend by the underlying taxes paid by the foreign subsidiary and then claim a credit for the foreign taxes paid, effectively paying a tax equal to 35% (assumed applicable U.S. tax rate) of the foreign subsidiary's pretax income, determined by adding the gross-up amount to the dividend received, pursuant to IRC Section 78.

The election to claim the credit or deduction is made annually and it may be possible to change such election while the 10-year statute of limitations under IRC Section 6511(d)(3)(a) remains open. Foreign tax credits (FTCs) claimed in a given year may be subject to certain limitations (e.g., such credits are limited to the amount calculated by using the U.S. statutory rate and cannot be used against U.S. taxes imposed on domestic income). Any FTCs not currently allowed because of various current-year limitations can be carried forward for 10 years. Therefore, if the amount of FTC expected to be utilized prior to the expiration of the carryforward period is less than 100% of the credit, a valuation allowance is required. When the amount of the credit expected to be utilized before expiration drops below 35% of the credit originally claimed, a company would normally amend the prior year's tax return to change the election from claiming FTCs to deducting foreign taxes. While this requires the credit to be surrendered, it also results in a recovery of the 35% tax paid on the gross-up amount that was required to claim the credit originally. It has been the expectation of taxpayers that IRC Section 6511(d)(3)(a) permitted such amended tax returns, resulting in refunds, even for years otherwise barred by the statute of limitations from amendment.

A recently published Chief Counsel Advice (CCA 201204008) denied a taxpayer's refund claim for an increased NOL deduction resulting from the taxpayer's election to deduct foreign taxes rather than claim a credit. In supporting its determination, the IRS stated that, based on the language of the law, the special 10-year statute of limitation period under IRC Section 6511(d)(3)(a) is only applicable where the claim for a refund or credit for an overpayment results from a FTC allowed. Therefore, a shorter statute of limitation period under IRC Section 6511(a)[35] and not the extended 10-year period statute of limitation should apply where a claim for refund or credit results from a deduction of foreign income taxes paid.

ASC 740 considerations:

FTCs carried forward because of various current-year limitations should be recognized as a deferred tax asset, which is then, in accordance with ASC 740-10-30-2(b), reduced, if necessary, to the amount that is more likely than not expected to

[34] IRC Section 275 and Treas. Reg. Section 1.901-1(h)(2)

[35] In general, IRC Section 6511(a) prescribes that "[C]laim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later…"

be realized. The taxpayer's ability to retrospectively change its decision of whether to take a credit or deduct foreign taxes qualifies as a tax-planning strategy under ASC 740-10-30-19, and should be taken into account in the determination of the minimum amount of FTC deferred tax asset that should be recognized for financial reporting purposes as of any reporting date.

Certain entities that determine the amount of FTC deferred tax asset expected to be realized with reference to its ability to retrospectively change the election from claiming FTC to deducting foreign tax for the periods not covered by the statute of limitation period under IRC Section 6511(a) may need to consider, with their tax advisors, the consequence of the IRS view communicated in CCA 201204008 to determine the extent to which such tax-planning strategy remains (a) prudent and feasible, (b) would prevent a tax credit from expiring unused, and (c) would result in realization of deferred tax asset, and to reassess the valuation allowance analysis for a relevant FTC deferred tax asset.

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**.

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte Tax LLP and Deloitte & Touche LLP, which are separate subsidiaries of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Deloitte.com | **Security** | **Legal** | **Privacy**

1633 Broadway
New York, NY 10019-6754
United States

Copyright © 2012 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited

Deloitte RSS feeds