Accounting for Income Taxes
Quarterly Hot Topics

March 2014

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Accounting developments

FASB offers simplified approaches to goodwill accounting for private companies

On January 16, 2014, the Financial Accounting Standards Board (FASB) issued **Accounting Standards Update (ASU) 2014-02**, which offers eligible private companies a simplified, alternative approach to account for goodwill that, when elected, affects:

- Amortization of goodwill — Goodwill relating to each business combination (or reorganization event resulting in fresh-start reporting) shall be amortized on a straight-line basis over a useful life of 10 years, or less than 10 years if the entity is able to demonstrate that a shorter useful life is more appropriate.
- Frequency of the test for impairment — Private companies are required to test goodwill for impairment only when a triggering event occurs instead of having to perform the test annually (or more frequently if indicators of impairment exist).
- Method of impairment testing — Private companies can make an accounting policy election to test goodwill for impairment at either the entity level or the reporting-unit level, applying only Step 1 when measurement of impairment is required.

The ASU is effective for annual periods beginning after December 15, 2014; however, entities can early adopt the accounting alternative and apply it in any period for which financial statements have not yet been made available for issuance. If elected, the goodwill accounting alternative must be applied prospectively to goodwill existing as of the beginning of the period of adoption and all new goodwill subsequently recognized.

Although only private companies are eligible to elect the goodwill alternative, the FASB has commenced a project to simplify goodwill accounting for all entities. Under the project, the FASB is considering four possible options: (1) the accounting alternative provided to private companies, (2) the amortization of goodwill not to exceed a maximum number of years (with impairment tests over its useful life), (3) the direct write-off of goodwill, or (4) a simplified impairment test. The Board has not yet made any tentative decisions, but directed the FASB staff to perform additional research and outreach on the direct write-off and simplified impairment test options.

Accounting Standards Codification (ASC) 740 implications: A private entity which elects the goodwill accounting alternative should consider several things when preparing its provision for income taxes. Those considerations vary, in part, depending on whether the goodwill is deductible for tax purposes:

- Goodwill that is not tax deductible — The ASU does not change the prohibition on the recognition of a deferred tax liability (DTL) on goodwill that is not deductible for tax purposes (ASC 740-10-25-3(d)). The amortization of goodwill for financial reporting will typically create an effective tax rate reconciling item (i.e., an unfavorable permanent difference).
- Goodwill that is tax deductible —The financial reporting goodwill amortization will typically either (1) increase a deferred tax asset (DTA) for goodwill that has excess tax over book basis, or (2) reduce a DTL that was created by historical tax amortization.

When both tax-deductible and non-tax-deductible goodwill are present, entities must make a determination of the amount of financial reporting goodwill amortization attributable to the "components" of goodwill that were originally determined in acquisition accounting. Entities should consider whether they have already established a policy for such an allocation in connection with a past goodwill impairment and, if so, apply a consistent methodology.[1] One common method used to allocate goodwill impairments, for example, is a pro rata allocation. Under a pro rata allocation approach for goodwill amortization, an entity would proportionally allocate the amortization to tax-deductible and nondeductible goodwill on the basis of the proportion of each. Other approaches may also be acceptable. Further allocation considerations may exist when the goodwill is associated with a specific business combination, multiple legal entities, and/or different jurisdictions.

In addition, an entity's post acquisition accounting for goodwill may have created DTLs. Because these DTLs were previously associated with an indefinite-lived intangible asset, they generally would not have been considered a source of income for the realization of DTAs. However, due to the recharacterization of goodwill as a finite-lived asset, the reversal of the DTL could potentially support the recoverability of a DTA.

FASB removes income taxes convergence project from agenda

On January 29, 2014, the FASB voted to reorganize its agenda to focus more closely on the issues most important to FASB stakeholders, as guided by recent outreach. Several projects were removed from the FASB's technical agenda, including income taxes. This project was a joint, FASB-IASB convergence project that originated in 2002 and sought to eliminate the differences between International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (U.S. GAAP) in this area. Under the project, the International Accounting Standards Board (IASB) issued an exposure draft in 2009 but, on the basis of the joint FASB-IASB deliberations that followed, the IASB decided not to finalize the exposure draft, but instead undertake some limited scope amendments to IAS 12.

Despite the elimination of this project, the FASB is expected to continue its research in response to the findings of the post-implementation review of FASB Statement No. 109, as described in last quarter's newsletter. In response to the report, the FASB indicated that it would focus on concerns regarding (1) intraperiod tax allocation, (2) intercompany transfers of assets, (3), earnings indefinitely reinvested in foreign subsidiaries, and (4) cash flows from income taxes. The FASB's outreach in this regard could lead to initiatives to make focused improvements to ASC 740. Separately, the IASB has identified income taxes as a possible longer term research project, although preliminary work on the research project is not expected to commence until after the 2015 agenda consultation.

Tax law developments

The topics below highlight what we believe are significant tax law developments that should be considered during the preparation of the financial statements. Note that this is not a complete list of all recent tax law changes.

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 DTL or DTA is recognized as a discrete item in

[1]For further discussion of the allocation considerations affecting the deferred tax effects of a goodwill impairment, see 11.110 – 11.114 of Deloitte's **A Roadmap to Accounting for Income Taxes**.

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.

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.

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.

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.

International

Brazil: Brazil's National Treasury Attorney's Office recently issued a significant opinion, in which it revisited the tax authorities' long-standing position on the interpretation of the business profits article in Brazil's tax treaties with respect to payments made abroad for services that do not involve an accompanying transfer of technology. The opinion provides a general tax treaty rule whereby payments made abroad for technical services and technical assistance without an accompanying transfer of technology are treated as business profits and may be subject to the treatment in the royalties article and, therefore, will not be subject to withholding tax. For additional details on this new position in Brazil, see Deloitte's February 27, 2014, **Global Tax Alert**.

Finland: Finland enacted changes to its corporate tax law on November 17, 2013, which took effect in 2014, including a reduction in the corporate income tax rate from 24.5 percent to 20 percent for tax years ending in 2014. Also, deductions of interest paid on intragroup loans are further restricted from 30 percent to 25 percent of earnings before interest, taxes, depreciation, and amortization.

France: The French president signed both the Finance Law for 2014 and the amended Finance Law for 2013, which were enacted on December 31, 2013. The finance law includes a temporary tax, levied at a rate of 50 percent on high remuneration paid by companies in 2013 and 2014, a restriction on the deduction of interest paid between related parties where the interest is not subject to a certain level of taxation at the level of the recipient, and an increase of the corporate tax surcharge for companies with gross revenue exceeding EUR 250 million (calculated on a consolidated basis when a French consolidated group is in place) from 5 percent to 10.7 percent. The restriction on interest deductions is applicable to fiscal years ending on or after September 25, 2013. For additional details on the tax law changes in France, see Deloitte's January 24, 2014, **World Tax Advisor**.

Italy: The Italian parliament passed the 2014 Budget Law on December 27, 2013 (and the law was published in the official gazette on the same date), which includes some important changes in the tax rules applicable to multinational companies with activities in Italy. The new provisions apply from January 1, 2014, unless otherwise noted. Among other provisions, the law provides for increased tax rates for the notional interest deduction for FY 2014-2016; a one-time step-up opportunity for tangible and intangible property, as well as for some qualifying participations booked in the stand-alone financial statements as of December 31, 2012; making permanent the tax step-up optional regime for goodwill, trademarks, and other IP booked in consolidated financial statements; an opportunity for Italian individuals and nonresident entities to step up the tax base of unlisted participations2 (and land); and changes to the local tax on productive activities (IRAP), such as a deduction for newly hired employees and an option for Italian entities to convert IRAP DTAs into tax credits. For additional details on the tax law changes in Italy, see Deloitte's January 10, 2014, **World Tax Advisor**.

Slovakia: Parliament approved a corporate tax rate decrease from 23 percent to 22 percent on December 3, 2013. Also, tax loss carryforwards were further restricted to utilization evenly over four years.

Switzerland: The Swiss Federal Tax Administration (SFTA) has provided the cantonal tax authorities with revised guidance on how to apply rules that affect the taxation of principal companies, which will impact both existing and new principal company rulings. Swiss principal companies can allocate a fixed percentage of trading profits abroad (an international tax allocation), which renders those profits exempt from the Swiss tax base for direct federal tax purposes. Swiss principal structures often are established to benefit from Switzerland's favorable tax rates, advance tax ruling practice, and business-friendly climate. For additional details on these updated guidelines for taxation in Switzerland, see Deloitte's February 22, 2014, **Global Tax Alert**.

Vietnam: A decree issued by the Vietnamese government on December 26, 2013, includes a reduction in the corporate income tax rate from 25 percent to 22 percent, as well as guidance on various tax incentives in the Corporate Income Tax Law and the Amended Law ratified by the National Assembly in 2013. For additional details on the tax law changes in Vietnam, see Deloitte's February 14, 2014, **World Tax Advisor**.

Multistate

Michigan: The State of Michigan has recently adopted into law Senate Bill 337, amending Michigan law with respect to various procedural tax provisions of the Michigan Revenue Act. These amendments include: the addition of deadlines by which certain events must occur within an audit, changes regarding how an audit or other events affect the statute of limitations, the addition of a deemed-denied appeal option for certain refund claims, and changes to various responsible person and successor liability provisions. For additional details on the new Michigan tax law, see Deloitte's **Michigan Multistate Tax Alert**.

New Jersey: Beginning on March 15, 2014 and running through May 15, 2014, companies that own intangible assets and derive income from the use of those assets in New Jersey will have the opportunity to come forward and voluntarily comply with their corporation business tax filing requirements, according to a recent New Jersey Division of Taxation announcement. The New Jersey Division of Taxation explains that it continues to discover non-filing companies that have nexus with New Jersey as a result of having derived income from the use of intangible assets in New Jersey. For additional details on the New Jersey voluntary disclosure program, see Deloitte's February 28, 2014, **State Tax Matters Issue 2014-08**.

New York: On December 30, 2013, New York Governor Cuomo signed legislation that allocated $74 million to provide a nonrefundable veteran hiring credit for taxable years beginning on or after January 1, 2015 and before January 1, 2017. To qualify for the credit, businesses must hire and employ certain post-9/11 veterans who commence employment on or after January 1, 2014 and before January 1, 2016. The amount of the tax credit is capped at $5,000 for each qualified *non-disabled* post-9/11 veteran and at $15,000 for each qualified *disabled* post-9/11 veteran. For additional details on the New York veteran hiring credit, see Deloitte's **New York Multistate Tax Alert**.

[2] Ownership in a non-publicly traded Italian company.

Texas: On January 15, 2014, a Texas District Court denied a taxpayer's motion to use the Compact[3] three-factor formula election to compute the Texas Franchise Tax. Taxpayers that have made or are considering making an election to use the Compact three-factor apportionment formula may wish to consider the effect that this case could have if the District Court's Order is final and not appealed. For additional details on the Texas District Court case, see Deloitte's **Texas Multistate Tax Alert**.

Texas: The Texas Third Court of Appeals held on December 31, 2013, that for purposes of calculating the Texas Franchise Tax a taxpayer may deduct as Costs of Goods Sold (COGS) certain costs related to real property services. On January 16, 2014, the Texas Comptroller filed a motion for rehearing in the Court of Appeals, stating that it "accepts the Court's opinion and reasoning, but moves for rehearing to request . . . [clarification of] two areas of the opinion . . ." Taxpayers that have excluded costs otherwise eligible for the COGS deduction on the basis that the costs were incurred by an affiliate that only provided services may wish to reconsider such treatment and whether a refund claim may be appropriate. The statute of limitations for refunds involving Franchise Tax reports filed in 2010 may expire as early as May 15, 2014. For additional details on the Texas Court of Appeals case, see Deloitte's **Texas Multistate Tax Alert**.

Looking forward

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

Camp releases comprehensive tax reform discussion draft

The comprehensive tax reform discussion draft that House Ways and Means Committee Chairman, Dave Camp, R-Mich., released February 26 achieves, at least nominally, the goals he set in 2011 of reducing the top income tax rate for corporations and individuals to 25 percent and moving the United States toward a territorial system for taxing domestic multinational corporations. But to accomplish those objectives – plus keep the legislation revenue neutral and ensure that the reformed tax code would retain the levels of progressivity in place under current law – the draft proposal includes an array of base broadening provisions that would have a significant impact on corporations, passthrough entities, individual taxpayers, and tax-exempt organizations. Like the previous discussion drafts Camp unveiled in 2011 and 2013, this latest draft is not an introduced bill, but it does contain legislative language. For additional details on the discussion draft, see Deloitte's February 27, 2014, **Tax News & Views**.

White House releases FY 2015 budget proposal

President Obama released a fiscal year 2015 budget blueprint on March 4, 2014 that includes tax increases primarily targeting multinational corporations and high-income individuals to pay for lower- and middle-class tax relief, increased spending on transportation infrastructure, and deficit reduction. The majority of the revenue proposals in the budget blueprint — such as proposals to implement the "Buffett Rule,"[4] tax income from carried interests as ordinary income, reform the tax treatment of large financial institutions, repeal long-standing tax provisions benefiting the oil and gas industry, and tighten international tax rules — have been carried over from previous years. Likewise, a variety of previously proposed tax incentives to encourage domestic manufacturing and infrastructure development and provide relief to small businesses and middle-class individuals make another appearance this year. However, this latest plan also includes several

[3] Compact refers to the Multistate Tax Compact, which Texas adopted in its entirety in 1967.
[4] The Buffett Rule "requires that millionaires pay no less than 30 percent of income — after charitable contributions — in taxes, preventing high-income households from using tax preferences to reduce their tax bills to less than what many middle class families pay." – White House 2015 Budget.

significant new proposals to tighten the tax rules for corporations and individuals, a handful of new tax incentives, and discrete proposals to address certain temporary tax provisions that expired at the end of last year. For additional details on the White House FY 2015 budget, see Deloitte's March 7, 2014, **Tax News & Views**.

Organization for Economic Cooperation and Development (OECD) discussion draft

The OECD on January 30 released a discussion draft on transfer pricing documentation and country-by-country reporting as part of its work on base erosion and profit shifting (BEPS). The discussion draft sets out revised guidance on transfer pricing documentation requirements in the form of a new draft Chapter V of the OECD's transfer pricing guidelines, and includes a common template for the reporting of detailed global information to tax authorities on a country-by-country basis, focusing on the global allocation of income, economic activity, and taxes paid.

The discussion draft addresses Action 13 in the July 2013 BEPS Action Plan, which promised to "[d]evelop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into account the compliance costs for business." However, many of the proposed requirements need further refinement and balancing to achieve this goal. The proposed rules, if implemented, will likely increase the cost of compliance for multinationals. For additional details on the OECD discussion draft, see Deloitte's February 3, 2014, **Arm's Length Standard**.

New York State 2014-15 budget outlines tax reform proposals

On January 21, 2014, the Honorable Andrew Cuomo, Governor of New York State, submitted an Executive Budget to the NY legislature, which includes significant tax reforms and tax reductions. The Governor has proposed reducing the corporate franchise tax rate on entire net income from 7.1 percent to 6.5 percent, to be effective for taxable years beginning on or after January 1, 2016. In addition, the tax on entire net income would be eliminated for upstate manufacturers, to be effective for taxable years beginning on or after January 1, 2014. The Governor's Executive Budget also includes many of the tax reforms recommended by the Governor's Tax Reform and Fairness Commission, including merging the Banking Corporation Tax (Article 32) into the Corporate Franchise Tax (Article 9-A), which would be effective for taxable years beginning on or after January 1, 2015. We highlight below certain additional significant corporate tax proposals, which generally would be effective for taxable years beginning on or after January 1, 2015, if enacted:

- Adopting an apportionment formula based on a single receipts factor using customer sourcing rules;
- Adopting full water's-edge unitary combined reporting with an ownership test of more than 50 percent and providing for a new combined group seven-year election for certain commonly owned groups;
- Expanding the application of economic nexus in determining whether corporations are subject to tax so that corporations with sales to New York customers of $1 million or more would be subject to tax;
- Eliminating the additional tax on subsidiary capital and certain existing exclusions for income from subsidiaries while retaining an exemption for dividends from unitary subsidiaries;
- Using federal tax law effectively connected income concepts (without regard to tax treaties) as the starting point in determining New York entire net income;
- Requiring that all captive insurance companies be subject to unitary combination;
- Repealing the "tax treaty" exception to the royalty addback provisions;
- Repealing the alternative minimum tax, but increasing caps on the alternative taxes based on New York source gross receipts and on allocated business capital;
- Modifying the Metropolitan Transportation Authority (MTA) Surcharge to provide an economic nexus standard, increase the MTA Surcharge rate to 24.5 percent;
- Creating a real property tax credit for qualified New York manufacturers, which would permit a manufacturer to claim a refundable tax credit under either the corporation franchise tax or the personal income tax equal to 20 percent of such manufacturer's real property tax paid on property used for manufacturing (this would take effect as of January 1, 2014); and

- Reforming the eligibility criteria for the investment tax credit (ITC) by restricting the credit to qualified New York manufacturers and qualified New York agricultural and mining businesses for property used to produce goods for sale or research and development (this would take effect as of January 1, 2014).

The Governor's budget also provides for the development of a Compliance Assurance Process (CAP), similar to that used by the Internal Revenue Service. Under this program, corporate taxpayers would be able to work with the Department's audit division to resolve issues prior to filing their tax returns. For additional details on the proposed New York Executive Budget, see Deloitte's **New York Multistate Tax Alert**.

Learn more

Financial Reporting for Taxes Training: Professionals continue to face significant challenges in financial accounting and reporting for income taxes. Deloitte's 2014 training programs can help you stay informed. Two five-day programs with multiple course offerings that allow the participant to choose the appropriate courses for his or her needs are set for May 19 – 23 in Orlando, Florida, and December 8 – 12 in Las Vegas, Nevada. For course descriptions, pricing, and additional information, please register **here**.

FASB issued ASU 2014-01: In January 2014, FASB issued **ASU 2014-01** 'Accounting for Investments in Qualified Affordable Housing Projects.' We have previously addressed the criteria an entity must meet in order to account for the Low-Income Housing Tax Credit (LIHTC) investment using the proportional-amortization method in our December 2013, **Accounting for Income Taxes Hot Topics Newsletter** and Deloitte's January 24, 2014, **Accounting Roundup: Special Edition — Annual update on accounting for income taxes**. Furthermore, on March 14, 2014, there was a Dbriefs webcast which addressed:

- Criteria to qualify for the accounting alternatives available under the ASU.
- Comparison of the proportionate amortization and the practical expedient methods.
- Presentation under both the proportionate amortization and practical expedient methods.
- Transition considerations.

A recording of this webcast can be found **here**. Note webcasts are archived for only 180 days after the live broadcast.

Accounting Roundup: Special Edition — Annual update on accounting for income taxes: This special edition of Accounting Roundup summarizes significant developments that have affected the accounting and financial reporting for income taxes over the past year. A copy of this publication can be found **here**. Topics covered in this publication include:

- The expiration of various federal tax credits at the end of 2013.
- The deferred tax considerations related to the issuance of the final tangible property regulations.
- A summary of the 2013 state and international tax law changes.
- Areas that the U.S. Securities and Exchange Commission (SEC) focuses on when reviewing a registrant's income-tax-related disclosures.
- EITF standard setting affecting the presentation of unrecognized tax benefits and the accounting for certain types of investments in LIHTCs.
- The FASB's and IASB's joint convergence projects that are nearing completion and the related tax implications, particularly those related to the revenue recognition project. (Note that the revenue recognition final standard is expected to be issued in the first half of 2014.)

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 March 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**.

Additional resources that you may find helpful:

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

1633 Broadway
New York, NY 10019-6754
United States