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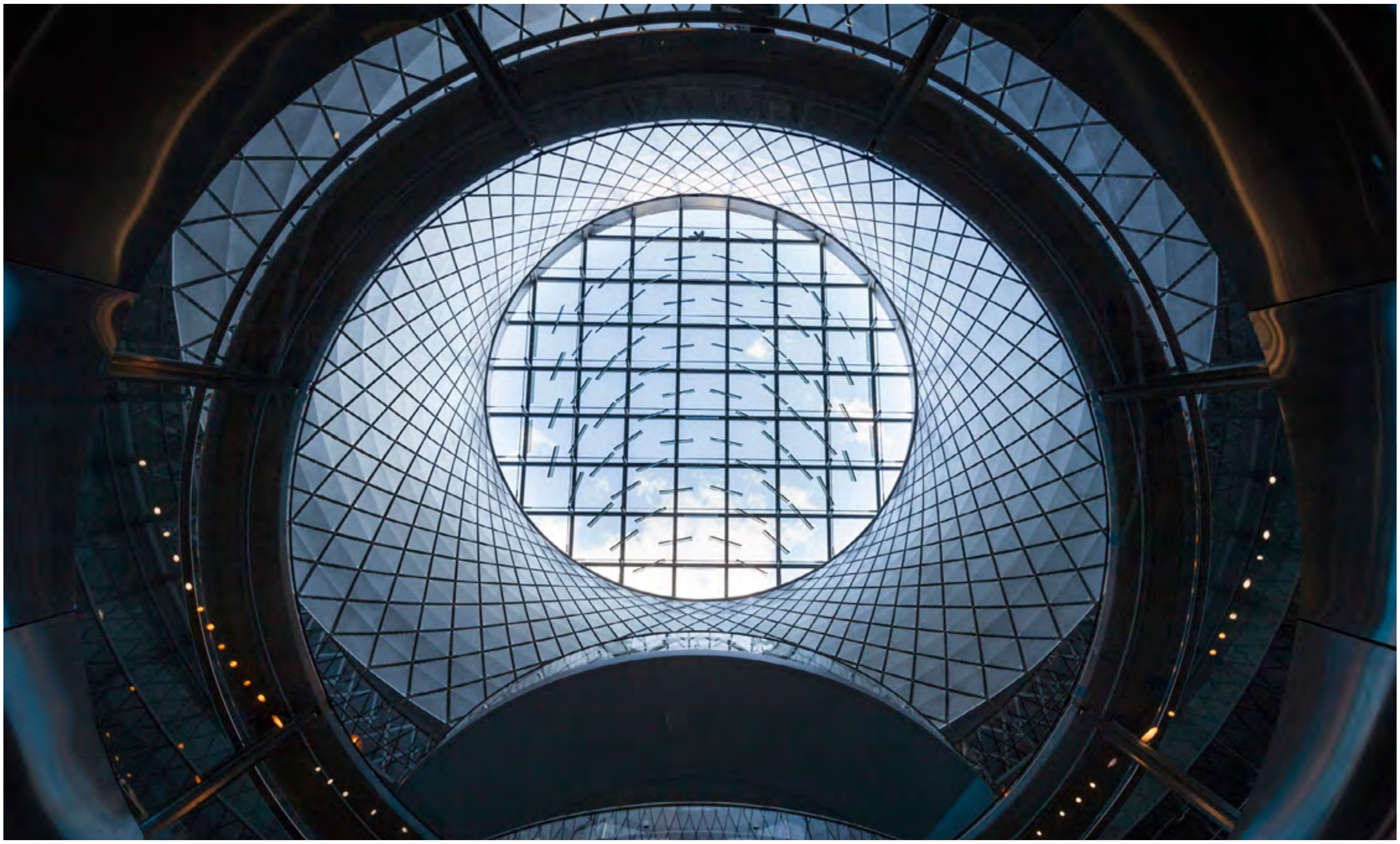

In This Issue

FASB Simplifies Accounting for Intra-Entity Asset Transfers

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Introduction

On October 24, 2016, the FASB issued ASU 2016-16,[1] which removes the prohibition in ASC 740[2] against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The ASU, which is part of the Board's simplification initiative, is intended to reduce the complexity of U.S. GAAP and diversity in practice related to the tax consequences of certain types of intra-entity asset transfers, particularly those involving intellectual property (IP).

Editor's Note

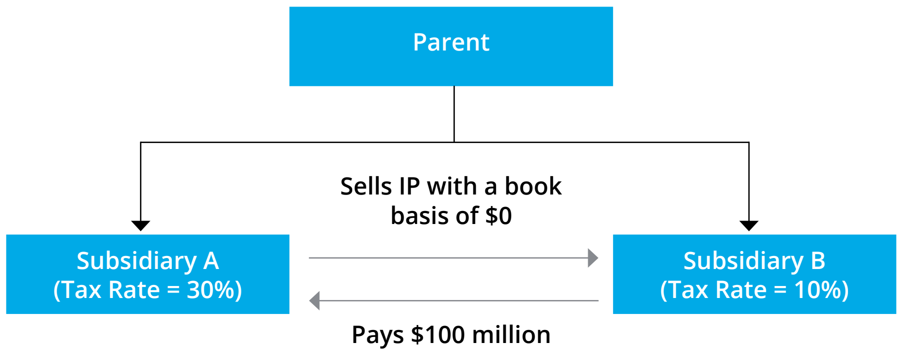
The FASB decided to exclude transfers of inventory from the new guidance because of some constituents' concerns about the costs and complexity of applying it to taxes related to intra-entity inventory transactions. The Board noted that such application would run counter to its simplification initiative. Accordingly, entities will continue to be prohibited from recognizing the current and deferred tax effects of intra-entity transfers of inventory.

[1] FASB Accounting Standards Update No. 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*.
[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

Key Provisions of the ASU

Under the ASU, the selling (transferring) entity is required to recognize a current tax expense or benefit upon transfer of the asset. Similarly, the purchasing (receiving) entity is required to recognize a deferred tax asset (DTA) or deferred tax liability (DTL), as well as the related deferred tax benefit or expense, upon receipt of the asset. The resulting DTA or DTL is measured by (1) computing the difference between the tax basis of the asset in the buyer's jurisdiction and its financial reporting carrying value in the consolidated financial statements and (2) multiplying such difference by the enacted tax rate in the buyer's jurisdiction.

The example below compares the income tax accounting for intra-entity transfers of assets other than inventory under current GAAP with that under the ASU.



Under Current U.S. GAAP

In the transaction above, Subsidiary A recognizes a gain of $100 million on the sale of IP to Subsidiary B, which is equal to the proceeds received ($100 million) less the financial reporting carrying value of the IP (zero). However, in accordance with ASC 740-10-25-3(e), A is prohibited from recognizing the current tax expense associated with that $100 million gain. Therefore, upon the sale, A would record the following journal entry for the tax effects:

Prepaid taxes	30,000,000	
Current taxes payable		30,000,000

Further, B receives a tax basis in the IP of $100 million, which is equal to the amount that it paid to A. This tax basis is greater than the carrying value of the IP in the consolidated financial statements (zero), which would generally result in a DTA. However, in accordance with ASC 740-10-25-3(e), B is prohibited from recognizing the DTA (benefit) associated with its tax-over-book basis difference. Therefore, B would not record any tax entries associated with this transaction.

Under the ASU

Under the ASU, since the exception to recognizing current and deferred taxes on intra-entity transfers of assets other than inventory is removed, A is required to recognize the current tax expense associated with the gain on the sale of the IP by recording the following journal entry:

Current tax expense	30,000,000	
Current taxes payable		30,000,000

In addition, B is required to recognize the deferred tax effects associated with its purchase of the IP by recording the following journal entry:

DTA	10,000,000	
Deferred tax benefit		10,000,000

Interim Reporting Considerations

The ASU does not explicitly state whether the tax effects of intra-entity transfers of assets other than inventory should be recognized as discrete items or included in the estimated annual effective tax rate for interim reporting purposes. The ASU's Basis for Conclusions states, in part:

> Because of the variety of intra-entity asset transfers, the Board did not want to preclude an entity from making its own assessment about how to treat an intra-entity asset transfer for purposes of the estimate. The Board also agreed with stakeholders who indicated that if the Board had decided that all intra-entity asset transfers should be treated similarly for purposes of the estimate, it would have created an exception to the model in Topic 740. The Board's view is that it would not be unusual for entities following the guidance to conclude that many intra-entity transfers of assets other than inventory would be treated as discrete items for purposes of the computation. However, the Board understands from stakeholders' input that because the nature of, frequency of, and ability to estimate these transfers vary among entities, there are circumstances in which an entity could conclude that the transaction should be included in the computation of the estimated annual effective tax rate. The Board understands that an entity will need to apply judgment on the basis of the facts and circumstances to conclude whether the tax consequences of an intra-entity asset transfer other than inventory should be included in the computation of the estimated annual effective tax rate or treated as a discrete item in the interim period in which the transfer occurs.

In accordance with the paragraph above, reporting entities should carefully consider *all* the provisions and exceptions in ASC 740-270 to determine whether the tax effects of intra-entity asset transfers are appropriately treated for interim reporting.

Effective Date and Transition

For public business entities, the ASU is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods. For all other entities, the ASU is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. Early adoption is permitted for all entities as of the beginning of a fiscal year for which neither the annual or interim (if applicable) financial statements have been issued. If an entity chooses to early adopt the amendments in the ASU, it must do so in the first interim period of its annual financial statements (if the entity issues interim financial statements). That is, an entity cannot adopt the amendments in the ASU in a later interim period and apply them as if they were in effect as of the beginning of the year.

Entities should apply the ASU's amendments on a modified retrospective basis, recognizing the effects in retained earnings as of the beginning of the year of adoption.

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