Technology Industry Accounting Guide

Other Accounting and Financial Reporting Topics:
Income Taxes

March 2023

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Current Expected Credit Losses

Debt

Distinguishing Liabilities From Equity

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Equity Method Investments and Joint Ventures

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Foreign Currency Matters

Guarantees and Collateralizations — SEC Reporting Considerations

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Preface

We are pleased to present the inaugural edition of Deloitte's *Technology Industry Accounting Guide* (the "Guide").

The technology industry ecosystem encompasses a wide array of entities, from enterprise software and software-as-a-service (SaaS) providers to hardware and semiconductor manufacturers. The technology industry has also experienced convergence with other types of businesses, creating subsectors such as fintech, health tech, energy tech, education tech, and auto tech, to name a few. Many entities have fueled the significant growth of the technology industry by embracing emerging technologies such as artificial intelligence (AI) and machine learning, everything as a service (XaaS) powered by the cloud, robotics, the Internet of Things (IoT), blockchain, and edge computing. Continuous innovation by technology entities produces novel business models while introducing potentially complex accounting and financial reporting matters.

Finance and accounting professionals in the technology industry face complex issues and must exercise significant judgment in applying existing rules to matters such as revenue recognition, software-related costs, acquisitions and divestitures, consolidation, stock-based compensation, leases, financial instruments, income taxes, digital assets, initial public offerings (IPOs), and disclosures of non-GAAP measures and metrics. To help technology entities work through some of the more difficult accounting and financial reporting issues related to these and other relevant topics, this Guide includes interpretive guidance, illustrative examples, and discussion of recent standard-setting developments (through February 28, 2023).

Appendix A lists the titles of standards and other literature we cited, and Appendix B defines the abbreviations we used.

We hope this Guide is helpful in navigating the various accounting and reporting challenges that technology entities face. We encourage clients to contact their Deloitte team for additional information and assistance.

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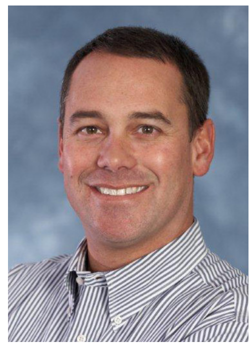

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Chapter 5 — Other Accounting and Financial Reporting Topics

5.7 Income Taxes

The accounting for income taxes under ASC 740 is sometimes very specific and can be complex. The overall objective of accounting for income taxes is to reflect (1) the amount an entity currently owes to tax authorities and (2) deferred tax assets (DTAs) and deferred tax liabilities (DTLs) for the tax effects of transactions or events that have occurred but that have not yet been reflected in a tax return or vice versa (also referred to as “basis differences” or “temporary differences”). A DTA will be recorded for items that will result in future tax deductions (sometimes referred to as a benefit or a deductible temporary difference), and DTLs are recorded for items that will result in the inclusion of future taxable income in an entity’s tax return (taxable temporary difference). This balance sheet approach is used to calculate temporary differences and, in effect, takes into account the total tax that would be payable (or receivable) if all of an entity’s assets and liabilities were realized at their carrying value at a specific time (the reporting date).

In accordance with ASC 740, the critical event for recognition of a DTA is the event that gives rise to the deductible temporary difference, tax credit, or net operating loss (NOL) carryforward. Once that event occurs, those tax benefits should be recognized, subject to a realizability assessment. In effect, earning taxable income in future years is treated as a confirmation of realizability and not as a prerequisite to asset recognition. At the same time, management should consider future events to record those DTAs at amounts that are more likely than not to be realized in future tax returns. In the case of DTLs, ASC 740 requires an entity to include in its balance sheet an obligation for the tax consequences of taxable temporary differences, even when losses are expected in future years.

For more information, see Deloitte’s Roadmap *Income Taxes*.

5.7.1 Scope Considerations

The scope of ASC 740 is limited to “taxes based on income” when income is determined after revenues and gains are reduced by some amount of expenses and losses allowed by the jurisdiction. Therefore, a tax based on gross receipts, revenue, or capital should be accounted for under other applicable literature (e.g., ASC 450). In contrast, a tax whose base takes into account both income and expense is within the scope of ASC 740.

A common question for technology entities to consider is whether certain investment tax credits and R&D credits are within the scope of ASC 740. Credits whose realization ultimately depends on taxable income are generally recognized as a reduction of income tax expense under ASC 740. However, tax credits whose realization does not depend on the entity’s generation of taxable income or the entity’s ongoing tax status or tax position (e.g., refundable credits) are not considered an element of income tax accounting under ASC 740 regardless of whether the credit claims are filed in connection with a tax return. When determining the classification of these credits, an entity may consider them to be a form of government grant or assistance. If so, the entity may consider the guidance in IAS 20 by analogy.

For more information, see Section 2.7 of Deloitte's Roadmap *Income Taxes*.

5.7.2 Intra-Entity Transfers of IP

Technology entities often develop IP such as software, know-how, and other proprietary information. This IP may be developed in one jurisdiction but subsequently transferred to a subsidiary in another jurisdiction. Such transfers are often tax-motivated, and both the initial and subsequent accounting for them has historically been complex. An entity should record the current and deferred tax effects of intra-entity transfers of assets other than inventory, including the tax consequences of intra-entity asset transfers involving IP. For more information, see Section 3.3 of Deloitte's Roadmap *Income Taxes*.

5.7.3 Transfer Pricing

Many technology entities are global and operate legal entities in multiple countries. The global nature of these entities gives rise to income tax accounting issues regarding the use of transfer pricing for intra-entity and related-party transactions. Generally, transfer pricing is the pricing used for transfers of tangible property, intangible property, services, or financing between affiliated entities in different tax jurisdictions. The general transfer pricing principle is that the pricing of a related-party transaction should be consistent with the pricing of similar transactions between independent entities under similar circumstances (i.e., an arm's-length transaction).

An entity's exposure to transfer pricing primarily occurs when the entity includes in its tax return the benefit received from a related-party transaction that was not conducted as though it was at arm's length. An unrecognized tax benefit results when one of the related parties reports either lower revenue or higher costs than it can sustain under examination by the tax authority (depending on the type of transaction). While a benefit is generally more likely than not to result from such a transaction (e.g., some amount will be allowed as an interest deduction, royalty expense, or cost of goods sold), the amount of benefit is often uncertain because of the subjectivity of valuing the related-party transaction.

For more information, see Section 4.6.3 of Deloitte's Roadmap *Income Taxes*.

5.7.4 Research and Development

For many technology entities, R&D activities represent a significant focus and expenditure. Beyond the above-mentioned scope considerations related to refundable R&D tax credits, these activities may result in various income tax accounting impacts that should be accounted for in accordance with ASC 740. For example, R&D cost-sharing agreements may affect an entity's accounting for the income tax effects of stock-based compensation. In addition, an entity may acquire R&D assets in a business combination that result in the creation of temporary differences. For more information, see the next section and Section 11.3.4.3 of Deloitte's Roadmap *Income Taxes*.

5.7.5 Cost-Sharing Arrangements

Related entities that operate in different tax jurisdictions may enter into cost-sharing (or recharge) agreements under which one party is reimbursed for a portion of certain costs it incurred in undertaking shared development activities associated with intangible property. A jurisdiction may permit or require the resident entity to include stock-based compensation cost in the joint cost pool that is reimbursed (commonly referred to as the "all costs rule").

Under U.S. tax regulations, entities may generally use one of two methods in determining the appropriate amount and timing of stock-based compensation cost that is included in the joint cost pool: (1) the exercise method, under which the amount and timing are based on the award's intrinsic value as of the exercise date; or (2) the grant method, under which entities determine the amount and timing by using the award's grant-date fair-value-based measure (which, in turn, is based on U.S. GAAP compensation costs).

A technology entity should consider the impact of cost-sharing arrangements when measuring, on the basis of the tax election it has made or plans to make, the initial and subsequent deferred tax effects associated with its stock-based compensation costs. If regulations in a particular jurisdiction vary significantly from those in the U.S. federal tax jurisdiction, the entity should consult with its accounting advisers regarding the appropriate accounting treatment. For more information, see Section 10.5 of Deloitte's Roadmap *Income Taxes*.

When a parent company grants stock-based compensation awards to its subsidiary's employees and the subsidiary reimburses the parent company for the awards, the subsidiary will need to account for its intercompany recharge agreement if it files stand-alone financial statements. Depending on the facts and circumstances, the subsidiary's financial statements may reflect the reimbursement as a reduction in contributed capital or a distribution, either of which could result in an intercompany payable depending on the timing.

5.7.6 Valuation Allowances

Technology entities, particularly emerging growth entities, frequently incur losses over an extended period to invest in R&D and marketing as well as reward employees with stock-based compensation. A technology entity that has recurring losses or other negative evidence must consider all available evidence, both positive and negative, to determine whether a valuation allowance against its DTAs is needed. This analysis can be quite complex depending on the entity's facts and circumstances. Significant judgment is often required, and it is difficult to assert that the entity will have future taxable income exclusive of reversing taxable temporary differences when it has cumulative losses in recent years. Further, tax-planning strategies must meet certain criteria to be treated as a source of taxable income, and evaluation of those criteria is often not straightforward. For more information, see Chapter 5 of Deloitte's Roadmap *Income Taxes*.

5.7.7 IRC Section 382 Limitations on NOL Carryforwards

Because of the significant up-front costs required for entities to bring new technologies to market, it is common for entities in the technology industry to generate losses in the early stage of development. Entities can generally benefit from these losses in the form of NOL carryforwards that offset future taxable income.

However, IRC Section 382 provides that loss corporations may be subject to a limitation on the amount of the NOL carryforward that can be realized in periods after a change in ownership (the "Section 382 limitation"). While ownership changes can result from a business combination or an IPO transaction, they can also be driven by a new round of equity financing that affects the company's ownership structure when certain thresholds are met.

The determination of a Section 382 limitation involves a high degree of complexity and requires careful evaluation. An assessment of potential limitations on NOL carryforwards should be included as part of an entity's ongoing tax-planning and tax-forecasting strategies, and the impacts of such limitations on potential funding, exit plans, or acquisition portfolio strategies should also be considered.

5.7.8 SEC Comment Letter Trends

SEC staff comments frequently focus on (1) valuation allowances, (2) disclosures related to the income tax rate, (3) tax effects of significant or unusual transactions that occurred during the period, and (4) noncompliance with disclosure requirements (e.g., omission of required disclosures).

The SEC staff may ask a registrant to provide early-warning disclosures to help financial statement users understand key estimates and assumptions that the registrant made in recording items related to income taxes and how changes to those estimates and assumptions could potentially affect the financial statements in the future. The SEC staff also may issue comments on non-GAAP measures with a particular focus on the income tax impact of the adjustments made to the GAAP measures.

Historically, the SEC staff has stated that boilerplate language should be avoided with respect to income tax disclosures within MD&A and that approaches more conducive to effective disclosure would include:

- Using the income tax rate reconciliation as a starting point and describing the details of the material items.
- Discussing significant foreign jurisdictions, including statutory rates, effective rates, and the current and future impact of reconciling items and uncertain tax positions.
- Providing meaningful disclosures about known trends and uncertainties, including expectations regarding the countries where registrants operate.

For more information, see Section 2.12 of Deloitte's Roadmap *SEC Comment Letter Considerations, Including Industry Insights*.

Appendix A — Titles of Standards and Other Literature

AICPA Literature

Accounting and Valuation Guide

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Audit and Accounting Guide

Revenue Recognition

Practice Aid

Accounting for and Auditing of Digital Assets

FASB Literature

ASC Topics

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 235, *Notes to Financial Statements*

ASC 260, *Earnings per Share*

ASC 270, *Interim Reporting*

ASC 275, *Risks and Uncertainties*

ASC 310, *Receivables*

ASC 320, *Investments — Debt Securities*

ASC 321, *Investments — Equity Securities*

ASC 323, *Investments — Equity Method and Joint Ventures*

ASC 325, *Investments — Other*

ASC 326, *Financial Instruments — Credit Losses*

ASC 330, *Inventory*

ASC 340, *Other Assets and Deferred Costs*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 405, *Liabilities*

ASC 450, *Contingencies*

ASC 460, *Guarantees*

ASC 470, *Debt*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 505, *Equity*

ASC 605, *Revenue Recognition*

ASC 606, *Revenue From Contracts With Customers*

ASC 610, *Other Income*

ASC 705, *Cost of Sales and Services*

ASC 710, *Compensation — General*

ASC 712, *Compensation — Nonretirement Postemployment Benefits*

ASC 715, *Compensation — Retirement Benefits*

ASC 718, *Compensation — Stock Compensation*

ASC 720, *Other Expenses*

ASC 730, *Research and Development*

ASC 740, *Income Taxes*

ASC 805, *Business Combinations*

ASC 808, *Collaborative Arrangements*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 825, *Financial Instruments*

ASC 840, *Leases*

ASC 842, *Leases*

ASC 845, *Nonmonetary Transactions*

ASC 848, *Reference Rate Reform*

ASC 860, *Transfers and Servicing*

ASC 940, *Financial Services — Brokers and Dealers*

ASC 944, *Financial Services — Insurance*

ASC 946, *Financial Services — Investment Companies*

ASC 985, *Software*

ASUs

ASU 2014-01, *Investments — Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*

ASU 2016-08, *Revenue From Contracts With Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*

ASU 2016-10, *Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing*

ASU 2016-12, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers*

ASU 2018-07, *Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

ASU 2018-11, *Leases (Topic 842): Targeted Improvements*

ASU 2018-15, *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract* — a consensus of the FASB Emerging Issues Task Force

ASU 2019-08, *Compensation — Stock Compensation (Topic 718) and Revenue From Contracts With Customers (Topic 606): Codification Improvements — Share-Based Consideration Payable to a Customer*

ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*

ASU 2020-06, *Debt — Debt With Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*

ASU 2021-02, *Franchisors — Revenue From Contracts With Customers (Subtopic 952-606): Practical Expedient*

ASU 2021-04, *Earnings per Share (Topic 260), Debt — Modifications and Extinguishments (Subtopic 470-50), Compensation — Stock Compensation (Topic 718), and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options* — a consensus of the FASB Emerging Issues Task Force

ASU 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities From Contracts With Customers*

ASU 2022-06, *Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848*

Concepts Statements

No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

No. 8, *Conceptual Framework for Financial Reporting — Chapter 4,* Elements of Financial Statements

Proposed ASU

No. 2022-ED300, *Business Combinations — Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*

IRC

Section 382, "Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change"

Section 409A, "Inclusion in Gross Income of Deferred Compensation Under Nonqualified Deferred Compensation Plans"

IFRS Literature

IFRS 15, *Revenue From Contracts With Customers*

IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

SEC Literature

FRM

Topic 7, "Related Party Matters"

Topic 10, "Emerging Growth Companies"

Interpretive Release

No. 33-10751, *Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations*

Regulation S-K

Item 10(e), "General; Use of Non-GAAP Financial Measures in Commission Filings"

Item 103, "Business; Legal Proceedings"

Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Regulation S-X

Rule 3-13, "Filing of Other Financial Statements in Certain Cases"

Rule 5-03, "Statements of Comprehensive Income"

Rule 11-01, "Presentation Requirements"

SAB Topics

No. 1, "Financial Statements"

- No. 1.B, "Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity"
- No. 1.M, "Materiality"

No. 5.Y, "Miscellaneous Accounting; Accounting and Disclosures Relating to Loss Contingencies"

Securities Exchange Act of 1934

Section 13, "Periodical and Other Reports"

Section 15(d), "Registration and Regulation of Brokers and Dealers; Supplementary and Periodic Information"

Superseded Literature

AICPA Technical Practice Aid

Section 5100.68, "Revenue Recognition: Fair Value of PCS in Perpetual and Multi-Year Time-Based Licenses and Software Revenue Recognition"

EITF Abstract

Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease*

FASB Concepts Statement

No. 6, *Elements of Financial Statements* — a replacement of FASB Concepts Statement No. 3 (incorporating an amendment of FASB Concepts Statement No. 2)

Other Literature

FASB TRG Agenda Papers

TRG Agenda Paper 23, *Incremental Costs of Obtaining a Contract*

TRG Agenda Paper 41, *Measuring Progress When Multiple Goods or Services Are Included in a Single Performance Obligation*

TRG Agenda Paper 44, *July 2015 Meeting — Summary of Issues Discussed and Next Steps*

TRG Agenda Paper 57, *Capitalization and Amortization of Incremental Costs of Obtaining a Contract*

TRG Agenda Paper 59, *Payments to Customers*

TRG Agenda Paper 60, *November 2016 Meeting — Summary of Issues Discussed and Next Steps*

Appendix B — Abbreviations

Abbreviation	Description
AI	artificial intelligence
AICPA	American Institute of Certified Public Accountants
ASC	FASB Accounting Standards Codification
ASR	accelerated share repurchase
ASU	FASB Accounting Standards Update
BC	Basis for Conclusions
BCF	beneficial conversion feature
C&DI	SEC Compliance and Disclosure Interpretation
CAM	critical audit matter
CAQ	Center for Audit Quality
CCF	cash conversion feature
CECL	current expected credit loss
CIMA	Chartered Institute of Management Accountants
CPM	cost per mille
CRM	customer relationship management
DLOM	discount for lack of marketability
DTA	deferred tax asset
DTL	deferred tax liability
EBITDA	earnings before interest, taxes, depreciation, and amortization
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval System
EGC	emerging growth company
EITF	FASB Emerging Issues Task Force
EPS	earnings per share

Abbreviation	Description
ERP	enterprise resource planning
ex-TAC	excluding traffic acquisition costs
Exchange Act	Securities Exchange Act of 1934
FASB	Financial Accounting Standards Board
FAST Act	Fixing America's Surface Transportation Act
FIFO	first in, first out
FinREC	AICPA Financial Reporting Executive Committee
FRM	SEC Financial Reporting Manual
GAAP	generally accepted accounting principles
GAAS	generally accepted auditing standards
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IC	independent contractor
ICFR	internal control over financial reporting
IFRS	International Financial Reporting Standard
IoT	Internet of Things
IP	intellectual property
IPO	initial public offering
IPR&D	in-process research and development
IRC	Internal Revenue Code
IT	information technology

Abbreviation	Description
JOBS Act	Jumpstart Our Business Startups Act
KPI	key performance indicator
LIBOR	London Interbank Offered Rate
LIFO	last in, first out
LLC	limited liability company
M&A	merger and acquisition
MD&A	Management's Discussion and Analysis
NFT	nonfungible token
NOL	net operating loss
OCA	SEC's Office of the Chief Accountant
OEM	original equipment manufacturer
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PCS	postcontract customer support
Q&A	question and answer
R&D	research and development
RMN	retail media network
ROU	right-of-use

Abbreviation	Description
S&P 500	Standard & Poor's 500 stock market index
SaaS	software as a service
SAB	SEC Staff Accounting Bulletin
Sarbanes-Oxley	Sarbanes-Oxley Act of 2002
SEC	U.S. Securities and Exchange Commission
Securities Act	Securities Act of 1933
SG&A	selling, general, and administrative
SKU	separate stock-keeping unit
SPAC	special-purpose acquisition company
SRC	smaller reporting company
SSP	stand-alone selling price
TMT	Technology, Media, & Telecommunications
TPA	AICPA Technical Practice Aid
TRG	FASB/IASB transition resource group for revenue recognition
VIE	variable interest entity
XaaS	everything as a service