

TEI-SJSU High Tech Tax Institute  
(33<sup>rd</sup> Annual)

# Accounting for Income Taxes

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## Notice

- *The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.*
- *The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.*

# Outline of Topics

1. Tax reform considerations
  - Corporate tax
  - Evaluation/Planning
2. SEC and PCAOB on income taxes
  - 2016 and 2015 AICPA National Conference on Current SEC and PCAOB developments
  - SEC comment letters
  - Non-GAAP measures
3. Standard settings update
  - Revenue standard
  - Leasing standard
  - Intra-entity transaction - ASU 2016-16
  - Proposed disclosures
4. Additional considerations

## Tax reform considerations

## Corporation tax

- Current proposed change in rate: from 35% to 20%
  - Rate adjustment on existing DTA & DTL should be recorded
  - Reporting time frame: Upon enactment (when President signs legislation)
  - Interim period: treat as a discrete item
- Modification of net operating loss deduction
  - Indefinite carryover
- Modification of definition of covered officer

## Permanent reinvestment assertion

- Proposed one time tax on repatriation with participation exemption regime
  - Reporting time frame: Upon enactment
  - Consider need for a DTL and/or current payable for the amount of tax upon deemed repatriation
  - Interim period: treat as a discrete item
- Consider modeling now the potential liability to be recorded
- Inside/Outside basis considerations

## Permanent reinvestment assertion (Cont.)

- Foreign tax credit considerations:
  - Valuation allowance assessment on FTC carry forwards
  - "Unborn" Tax Credit – No DTA until actual repatriation occurs
- Foreign dividend withholding tax:
  - Consider need for DTL on withholding tax related to unrepatriated earnings
  - No Impact on foreign jurisdiction

## Accounting method change

- Taxpayers might request accounting method change to defer income and accelerate deductions by filing Form 3115
- DTL should be booked for unfavorable adjustments in period identified
- Reporting time frame varies for favorable adjustments:
  - Advanced consent
  - Automatic change

## Possible impacts on state income tax

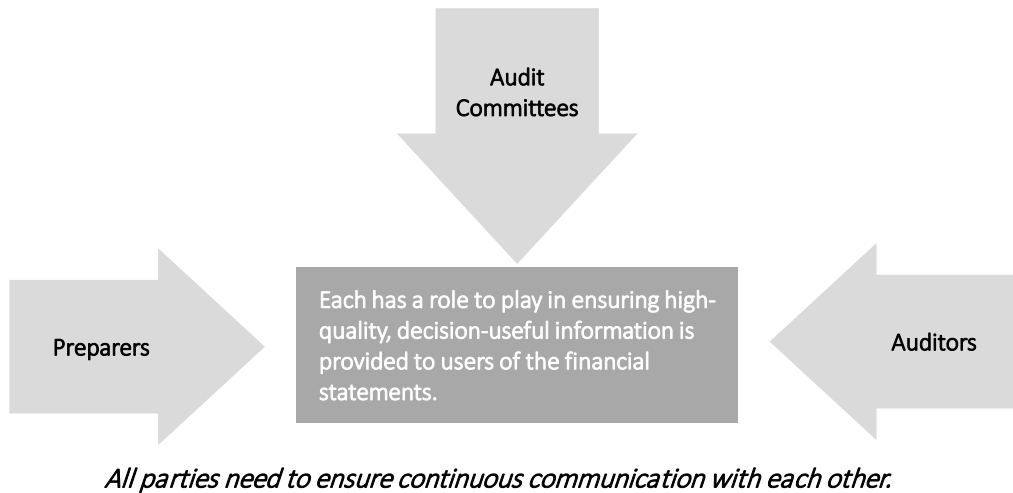
- Effect on Federal income base
- State tax value against Federal deduction
  - Impact on state audits => DTA for future state tax deduction and DTL for future state tax income
- Worldwide basis vs. Water's-edge election

SEC and PCAOB on income taxes

## 2016 AICPA National Conference

### Key Themes

- ***Preparers, audit committee members, and auditors all have important roles to play in providing high quality financial information to the users of the financial statements.***



## SEC observations

### *New accounting pronouncements (SAB 74 disclosures)*

- Several new accounting pronouncements were recently issued (e.g., revenue, leases, and credit losses)
  - SEC staff expects enhancements to quantitative and qualitative disclosures in 2016 and 2017 filings on the impacts of the recently issued standards
  - Disclosures should be used to facilitate discussions among the audit committee, preparers, and auditors to assess the design and implementation status
  - Disclosures are important to investors and to assist them in assessing the impacts the new standards will have on the financial statements when adopted
  - Presenters reiterated the SEC Observer's announcement at the September EITF meeting emphasizing the need to disclose the expected qualitative impact when the quantitative information is not yet known.
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## SEC observations (continued)

### *Segments*

- Continue to focus on criteria used of segment aggregation
  - Economic characteristics (quantitative, qualitative and the overall principle) should be considered rather than only looking at the quantitative characteristics, which may be coincidental
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### *Income taxes*

- Continue to be an area of focus
  - Presentation of the income tax rate reconciliation
  - Disclosures regarding changes in valuations allowances
  - Disclosures related to changes in unrecognized tax benefits
  - Indefinite reinvestment assertions
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## SEC observations (continued)

### *Income taxes – MD&A*

- Registrants should address:
    - Reasons for changes in the statutory and effective tax rates (ETR)
    - Extent to which the historical ETR is indicative of the future tax rate
    - Effect of taxes on liquidity
    - Uncertainties related to the company's tax positions
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## PCAOB rulemaking and inspection

### *PCAOB observations*

- Worked to re-establishing the profession's solid footing
- Building constructive relationships with firms is beneficial for audit firms, investors, and preparers

### *Inspection results and findings*

- **2017 areas of focus**
  - 2016 observations
    - Audit areas impacts by economic trends and higher financial reporting risk
    - Risk assessment (identification of risks and testing approach)
- **2016 observations**
  - Management review controls
  - Assessing and responding to risk of material misstatement
  - Accounting for estimates, including the fair value
  - Related parties

## PCAOB findings on income taxes

- 2017 staff inspection brief
  - The most frequently selected financial reporting areas in 2016 included revenue and receivables, non-financial assets, inventory, financial instruments, the allowance for loan losses, **income taxes**, benefit related liabilities and equity transactions
  - Key areas of inspection focus in 2017 include, amongst other areas, the evaluation of income tax accounting and disclosures
    - Evaluation and testing of management's assertion regarding the indefinite reinvestment of earnings when issuers have large and growing undistributed earnings in foreign jurisdictions, including the impact of events, such as significant cash transfers from a foreign subsidiary to the U.S. parent.
    - Evaluation of the design and operating effectiveness of controls related to income taxes
    - Often involves testing and evaluation of prospective financial information which may involve a high degree of subjectivity by management



## 2015 AICPA National Conference

- Mary Jo White, Chair of the SEC
  - The SEC staff's initiative to make disclosure more effective is about not only reducing volume and complexity, but also considering whether investors need more information in certain areas
  - In certain circumstances (foreign tax disclosure is one) the staff believes that more disclosure would help investors
  - Encouraged companies to continue to undertake individual efforts to enhance disclosures for the benefit of investors
- Division of corporation finance
  - Continue to focus on clear disclosure of income tax activity and positions, especially for multinational corporations
  - One area that needs continued improvement is the disclosure of overseas profits, taxes and cash
  - Recommended to use the rate reconciliation as a starting point for clear, comprehensive income tax disclosures (either in the footnotes or within MD&A) aimed at describing material information about what is happening, why, and its susceptibility to change

## 2015 AICPA National Conference (continued)

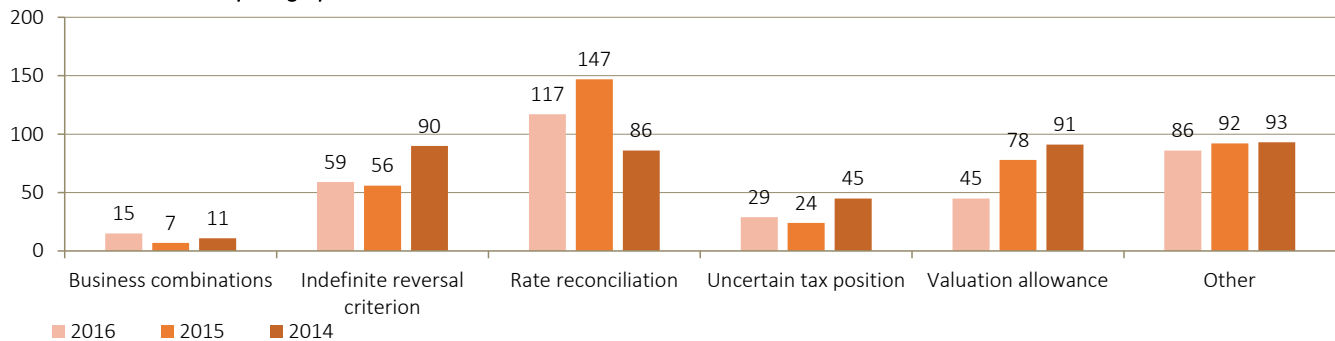
- Division of corporation finance (continued)
  - Examples of insufficient disclosures related to income taxes
    - Insufficient details describing the foreign tax rate differential, especially when many foreign tax jurisdictions are grouped together
    - Aggregation of individually significant tax transactions or outcomes with recurring transactions in rate reconciliation line items, such as a nondeductible goodwill impairment charge
    - Unclear linkage between amounts in the qualitative discussion and the information in the rate reconciliation
    - Use of boilerplate disclosure to describe changes in tax estimates, such as changes in valuation allowances or reinvestment decisions
    - Unclear description of what is included in Other
  - To remediate these problems, the staff encouraged companies to use a disaggregated, tabular rate reconciliation by country
- SEC Office of Chief Accountant
  - The three most commonly identified restatement areas are debt/equity, statement of cash flows and accounting for income taxes

## SEC comment letter trends

SEC comment letters continue to highlight:

- The components of companies' effective tax rate reconciliation
- Foreign earnings unremitted to the US and the tax impact of their potential repatriation
- Uncertain tax positions
- Judgments around the need for a valuation allowance
- Other (i.e., Non-GAAP financial measures, errors related to income taxes, Omission of required disclosures).

Comment letters issued by category



## SEC comments

### Effective tax rates

- Tax rates that appear unusual relative to the expected statutory rate
- Effective tax rates do not change because material changes in components are offsetting
- The presentation and disclosure of foreign items within the rate reconciliation

*“We note that your effective tax rate is substantially different than the U.S. Statutory tax rate of 35%. With reference to your reconciliation of United States statutory rates to the effective rates, please revise future filings to expand your discussion to thoroughly address all items impacting your effective tax rates for each period, including foreign taxes and valuation allowances.”*

*“Please expand the disclosure to disclose the foreign jurisdictions that impact your tax provisions such as the foreign tax rate differential, foreign tax credits, foreign withholding taxes and deferred foreign tax credit offset.”*

## SEC comments

### Valuation allowance

- Inquiries on positive and negative evidence considered in company's assessment. Particularly in situations where there has been a return to profitability
- Information about valuation allowance movement when cumulative profitability evidence is inconsistent

*"We note the evidence you considered for the release of the majority of your valuation allowance against your U.S. federal and state deferred tax assets in the fourth quarter of 201X. Based on your historical operating results, it appears that the realization of your deferred tax assets is dependent on material improvement over present levels of pre-tax income, including the impact of acquired entities. Given the significant portion of U.S. operating loss carryforwards expiring between 202Y and 202Z, tell us in detail the material assumptions underlying your determination of the expected U.S. pre-tax income amount needed to realize your deferred tax assets. Tell us how you weighted all of the positive and negative evidence, including to the extent to which it can be objectively verified, in reaching your conclusion to reverse the valuation allowance...."*

## SEC comments

### Foreign earnings unremitted to the US and the tax impact of their potential repatriation:

- What level of evidence is maintained and disclosed by management for specific plans on reinvesting earnings
- Details on repatriation of some current earnings while others remain indefinitely reinvested
- The SEC has sought to gain a more comprehensive understanding of the registrant's ability and intent to support its unremitted earnings assertion by inquiring about:
  - Specific countries of which indefinitely reinvested foreign earnings are located
  - Amount of investments and other liquid assets held by foreign subs
  - Portion of cash held by foreign subs and amount of cash available for use in the US without repatriation

## SEC comments

Foreign earnings unremitted to the US and the tax impact of their potential repatriation:

*“Given your significant foreign operations, please enhance your liquidity disclosures to address the following:*

- Disclose the amount of foreign cash and cash equivalents you have as compared to your total amount of cash and cash equivalents as of the latest balance sheet date;*
- Discuss the fact that if the foreign cash and cash equivalents are needed for your operations in the U.S., you would be required to accrue and pay U.S. taxes to repatriate these funds but your intent is to permanently reinvest these foreign amounts outside the U.S. and your current plans do not demonstrate a need to repatriate the foreign amounts to fund your U.S. operations, if true; and*
- Disclose the nature and extent of any legal or economic restrictions on the ability of your subsidiaries to transfer funds to you in the form of cash dividends, loans or advances and the impact such restrictions have had or are expected to have on your ability to meet cash obligations.”*

## SEC comments

Foreign repatriation of current earnings while others remain indefinitely reinvested:

*“You state on page 41 that it is your intention to permanently reinvest the undistributed earnings associated with your foreign subsidiaries; however, your tax rate reconciliation on page 75 reflects a foreign repatriation benefit for each period presented. In addition, you appear to have repatriated earnings in each of the last five years. Therefore, please clarify your policy regarding foreign earnings, and tell us whether your assertion that foreign earnings are indefinitely reinvested relates to all or only a portion of total foreign earnings. If the former is true, please explain to us how you evaluated the criteria for the exception to recognition of a deferred tax liability in accordance with ASC 740-30-25-17 and 18. If the latter is true, please tell us how you determine which earnings to repatriate and tell us the impact on your effective tax rate and income tax expense recorded during the period.”*

## Non-GAAP measures

- Non-GAAP measures continue to be a discussion item
- Appropriateness and undue prominence continue to be areas where more progress is needed
- Audit committees should understand the non-GAAP measures used by management and the controls surrounding their preparation
- “Acceptable” non-GAAP measures were discussed during a panel specifically focused on non-GAAP measures
- Outreach underway to conclude on the appropriateness of adjustments for pensions and derivatives
- Non-GAAP measures are on the “radar” of international standard-setting and regulatory organizations as well
- PCAOB looking to focus on the auditor’s approach to non-GAAP measures to potentially inform future standard setting

## Non-GAAP measures - disclosures

- Different Measures = Different Tax Calculations
- May result in a tax rate applied that is different from a company’s effective tax rate.
  - If a measure is a liquidity measure that includes income taxes, it might be acceptable to adjust GAAP taxes to show taxes paid in cash
  - If a measure is a performance measure, the registrant should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability
- Separate adjustment and, clearly explained

## Non-GAAP financial measures

### *"Future Change in Non-GAAP Measures of Adjusted Net Income and Adjusted Diluted Earnings per Share*

*Beginning the third quarter of 2016, in response to the SEC's Compliance and Disclosure Interpretations published on May 17, 2016 pertaining to non-GAAP measures, the Company will revise its presentation of two non-GAAP measures, Adjusted Net Income and Adjusted Diluted Earnings per Share. The reduction in income taxes payable previously included in the determination of Adjusted Net Income will no longer be included, but will be provided separately including the per-share amount of the reductions. Table 2 of this earnings release displays the current presentation of Adjusted Net Income and Adjusted Diluted Earnings per Share. Table 3 of this earnings release displays the revised presentation of Adjusted Net Income and Adjusted Diluted Earnings per Share."*

## Non-GAAP financial measures

### *Q2 2017 Letter to Shareholders*

*"Beginning this quarter, we are changing how we calculate our non-GAAP provision for income taxes in accordance with the SEC guidance on non-GAAP financial measures. In order to assist investors to better understand the change, we are providing the calculations under our prior method and the new method in the Reconciliation of GAAP to Non-GAAP Financial Measures section of the Appendix. The "New Method" consists of current and deferred income tax expense commensurate with the non-GAAP measure of profitability using our blended US statutory tax rate (which was 37%). The "Prior Method" consists of current and deferred income tax expense on a GAAP basis excluding the income tax effects related to acquisitions. This change will not affect our non-GAAP income before income taxes, actual cash tax payments, or cash flows, but will result in significantly higher non-GAAP provision for income taxes. We, however, do not expect to pay substantial taxes on a GAAP basis in the US and certain other foreign jurisdictions for the foreseeable future due to our net operating loss carryforward balances."*

## Standard setting updates

### Standard setting reminders

#### **Intra-entity asset transfers (ASU 2016-16)**

Effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017 (for non-public entities: one year later for annual periods, two years later for interim periods, i.e. FYs beginning after December 15, 2019)

#### **Revenue recognition (ASU 2014-09)**

Effective for public entities for annual reporting periods beginning after December 15, 2017; one year later for nonpublic entities

#### **Leasing (ASU 2016-02)**

Effective for calendar periods beginning on January 1, 2019 and interim periods therein (public companies); one year later for all other entities

# Revenue recognition standard

## New revenue guidance Transition options



UPDATE: Practical expedient for contract modifications (FASB & IASB)

### Full retrospective approach

- Restate prior periods in compliance with ASC 250
- Optional practical expedients

### Modified retrospective approach

- Apply revenue standard to contracts not completed as of effective date and record cumulative catch-up

### Required disclosures for modified retrospective adopters

- Amount of each FS line item affected in current period
- Explanation of significant changes

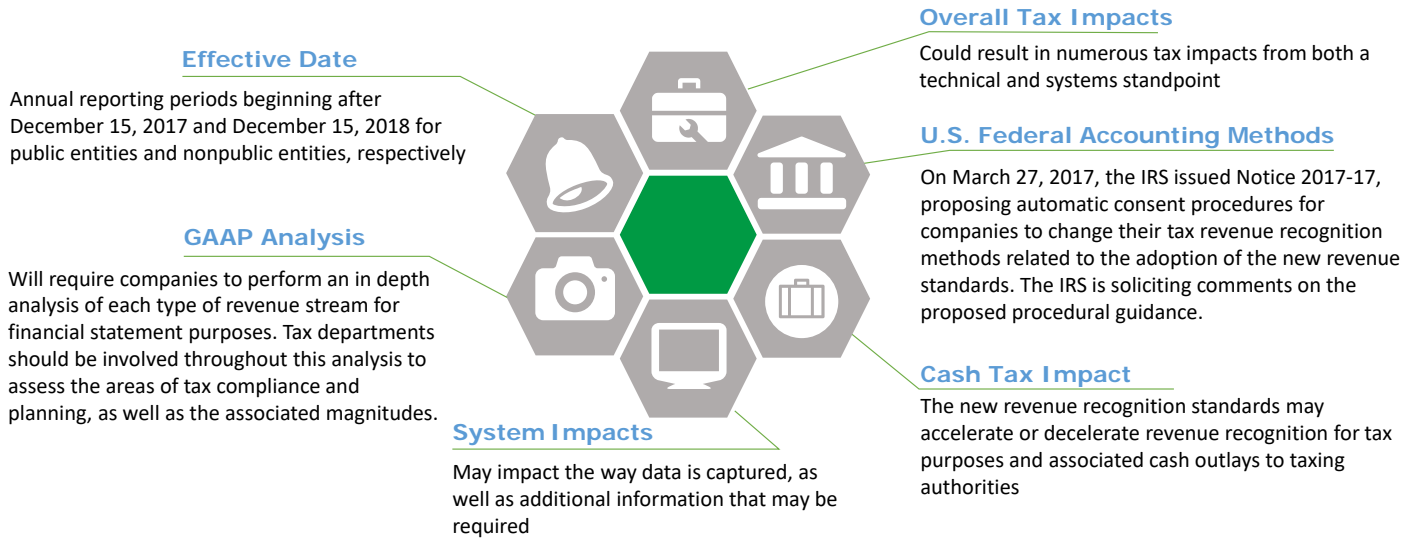
January 1, 2018 Initial application year	2018 Current year	2017 Prior year 1	2016 Prior year 2
New contracts	New ASU		
Existing contracts	New ASU +cumulative catch-up		
Completed contracts		Legacy GAAP	Legacy GAAP

Cumulative catch-up



# Introduction

## Key points — Adoption of ASC 606 / IFRS 15\*

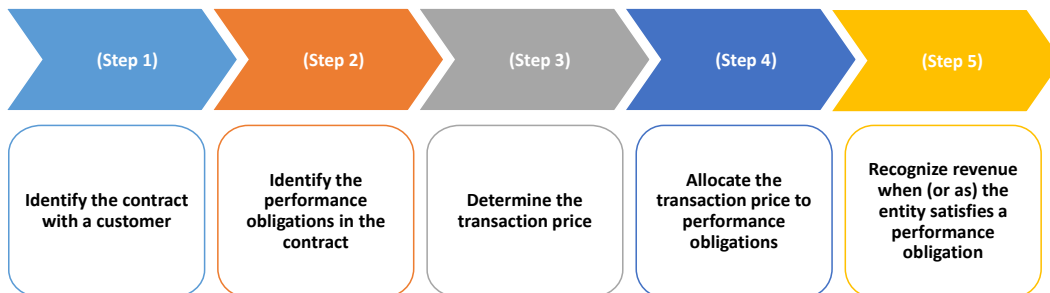


\*Although the FASB and IASB revenue recognition standards are nearly fully converged, there are some differences between ASC 606 and IFRS 15. After the FASB and IASB issued ASU 2014-09 and IFRS 15, respectively, the boards decided to amend certain aspects of the new revenue standard. In some cases, the amendments retained convergence; in other cases, however, the FASB decided on a solution that differs from the IASB's.

# New revenue standard

## The five-step model

**Core principle:** Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled in exchange for those goods or services.



This revenue recognition model is based on a control approach, which differs from the risks and rewards approach applied under current US GAAP.

## New Revenue Recognition Guidance Transition

### Full retrospective approach

- Restate prior periods as required by ASC 250
  - Generally prior two comparative years (potentially three) required to be restated
  - Cumulative catch-up adjustment recorded through equity

### Modified retrospective approach

- Apply revenue standard to contracts not completed as of effective date and record cumulative catch-up
  - Required disclosures:
    - Amount of each F/S line item affected in current period
    - Explanation of significant changes

January 1, 2018 Initial Application Year	2018 Current Year	2017 Prior Year 1	2016 Prior Year 2
New contracts	New ASU		
Existing contracts	New ASU + cumulative catch-up	Legacy GAAP	Legacy GAAP
Completed contracts		Legacy GAAP	Legacy GAAP

cumulative catch-up

↓

## Retrospective application

Accounting guidance — ASC 250-10-45-8

“Retrospective application shall include only the direct effects of a change in accounting principle, including any related income tax effects. Indirect effects that would have been recognized if the newly adopted accounting principle had been followed in prior periods shall not be included in the retrospective application. If indirect effects are actually incurred and recognized, they shall be reported in the period in which the accounting change is made.”

### Glossary terms

**Direct effects:** Those recognized changes in assets or liabilities necessary to effect a change in accounting principle. An example of a direct effect is an adjustment to an inventory balance to effect a change in inventory valuation method. Related changes, such as an effect on deferred income tax assets or liabilities or an impairment adjustment resulting from applying the subsequent measurement guidance in [ASC] 330-10 to the adjusted inventory balance, also are examples of direct effects of a change in accounting principle.

**Indirect effects:** Any changes to current or future cash flows of an entity that result from making a change in accounting principle that is applied retrospectively. An example of an indirect effect is a change in a nondiscretionary profit sharing or royalty payment that is based on a reported amount such as revenue or net income.

# Leasing standard

## Lessee accounting model

What does the lessee model look like?

- Most leases (both financing and operating) are recorded on the balance sheet using a right-of-use asset approach\*:

Initial Measurement	<ul style="list-style-type: none"> <li>• <u>Lease obligation</u>: PV of lease payments not yet paid</li> <li>• <u>ROU asset</u>: lease obligation + initial direct costs – lease incentives + prepaid lease payments</li> </ul>
Subsequent Measurement	<ul style="list-style-type: none"> <li>• <u>Lease obligation</u>: amortized using the effective interest method</li> <li>• <u>ROU asset</u>: depends upon lease classification</li> <li>• Expense recognition pattern:               <ul style="list-style-type: none"> <li>– Finance lease — front-loaded</li> <li>– Operating lease — generally straight-line</li> </ul> </li> </ul>

**\*Short-term leases:** A lessee can elect, by asset class, not to record on its balance sheet a lease with a lease term of 12 months or less and which does not include a purchase option that the lessee is reasonably certain to exercise

# Lessee accounting model

## Illustrative example

A lessee enters into a three-year lease and agrees to make the following annual payments at the end of each year: \$10,000 in year 1, \$15,000 in year 2, and \$20,000 in year 3. The initial measurement of the right-of-use (ROU) asset and liability to make lease payments is \$38,000 at a discount rate of 8%.

This table highlights the differences in subsequent measurement of the right-to-use asset for a finance lease vs. an operating lease.

Year	Finance & Operating		Finance lease			Operating lease		
	Lease liability	Interest expense <X>	Amortization expense <Y>	Total lease expense <X + Y>	ROU asset	Lease expense <Z>	Reduction in ROU asset <Z - X>	ROU asset
0	\$38,000				\$38,000			\$38,000
1	31,038 (a)	\$3,038	\$12,666	\$15,704	25,334	\$15,000	\$11,962	26,038
2	18,519 (b)	2,481	12,667	15,148	12,667	15,000	12,519	13,519
3	- (c)	1,481	12,667	14,148	-	15,000	13,519	-
Total		\$7,000	\$38,000	\$45,000		\$45,000	\$38,000	

(a) =  $38,000 - (10,000 - 3,038)$

(b) =  $31,038 - (15,000 - 2,481)$

(c) =  $18,519 - (20,000 - 1,481)$

## Effective date and transition

### Effective date

#### Public business entities

Effective for calendar periods beginning on January 1, 2019, and interim periods therein

#### All other entities

Effective for calendar periods beginning on January 1, 2020, and interim periods thereafter

Early adoption will be permitted

### Transition


Lessees and lessors are required to use a modified retrospective transition method for all existing leases


Would apply the new model for the earliest year presented in the financial statements


Application of approach linked to current lease classification and new lease classification


An entity can use hindsight when evaluating lease term

## Overview of income tax implications

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Lease characterization for federal income tax purposes *has not changed* (e.g., true lease vs. sale) as a result of Topic 842. For tax, the focus remains on which party bears the benefits and burdens of ownership.
- 

Topic 842 *does not contain tax accounting guidance* and only includes minor, conforming amendments to ASC Topic 740, *Accounting for Income Taxes*, that do not change the basic requirements of current accounting.
- 

Topic 842 will create book/tax differences consistent with current GAAP. However, since the new standard may result in the recognition of more assets and liabilities, ASC 842 *may require entities to record new or adjust existing DTAs and DTLs*.
- 

Topic 842 *may also impact the computation of state and local income-based taxes* as a result of changes to the apportionment formula.

## Leases — Modified retrospective transition approach

### Illustration — Lessee accounting — Existing operating lease

#### Assumptions

##### **On January 1, 20X1, Company A, a calendar year taxpayer, enters into a five-year lease of an asset**

- Lease is accounted for as an operating lease for both financial reporting and tax purposes
- Lease payments are \$31,000/year for the first two years and \$33,000/year for the remaining three years
- Company A defers \$500 of initial direct costs at lease commencement, to be amortized over five years
- At January 1, 20X2, Company A has accrued a rent liability of \$1,200 related to rent expense recognized but not yet paid (i.e., because rent expense is recognized on a straight-line basis over the life of the lease)

#### Assumptions (cont'd)

##### **On January 1, 20X4, Company A adopts ASC 842**

- Applies modified retrospective method as of January 1, 20X2 (beginning of earliest period presented)
- Elects all practical expedients
- No new leases in year of adoption
- The tax rate is 40%

## Leases — Modified retrospective transition approach

Illustration — Lessee accounting — Existing operating lease (cont'd)

### Application

January 1, 20X2	Current GAAP	ASC 842
Accrued rent liability	(\$1,200)	
Unamortized initial direct costs [3]	\$ 400	
Lease liability[1]		(\$112,462)
Right-of-use asset[2]		\$111,662
Deferred tax asset	\$ 480	\$ 44,985
Deferred tax liability	(\$ 160)	(\$ 44,665)

Notes:

[1] PV of remaining lease payments discounted at 6%, Company A's incremental borrowing rate

[2] Lease liability of \$112,462 minus \$1,200 accrued rent liability plus \$400 unamortized initial direct costs

[3] Assumes the initial direct costs were immediately deducted for tax purposes.

## Leases — Modified retrospective transition approach

Illustration — Lessee accounting — Existing operating lease (cont'd)

### Cumulative catch-up at January 1, 20X2

	DR	CR
Accrued rent liability	\$ 1,200	
Unamortized initial direct costs		\$ 400
Lease liability		\$112,462
Right-of-use asset	\$111,662	
Deferred tax asset	\$ 44,505	
Deferred tax liability		\$ 44,505

## Intra-entity transactions - ASU 2016-16

### ASU 2016-16 - Intra-entity asset transfers other than Inventory Accounting guidance

Entity	Current	New
Seller	ASC 810-10-45-8 provides “If income taxes have been paid on intra-entity profits on assets remaining within the consolidated group, those taxes shall be <b>deferred</b> or the intra-entity profits to be <b>eliminated</b> in consolidation shall be appropriately reduced”	The final ASU removes the prohibition on recognition of income tax expense for taxes paid for intra-entity transactions except for transfers of inventory
Buyer	ASC 740-10-25-3(e) <b>prohibits</b> recognition of a deferred tax asset for the intra-entity difference between the tax basis of the assets in the buyer’s tax jurisdiction and their cost as reported in the consolidated financial statements	The final ASU removes the prohibition on recognition of deferred tax assets on intra-entity differences between the tax basis of the assets in a buyer’s tax jurisdiction and their cost as reported in the consolidated financial statements except for transfers of inventory

## ASU 2016-16 - Intra-entity asset transfers

### Transition guidance

Modified retrospective with a cumulative catch-up adjustment to opening retained earnings as of the beginning of the period of adoption

### Effective date

Public business entities – annual periods, including interim periods within those annual periods, beginning after December 15, 2017 (for non-public entities: one year later for annual periods, 2 years later for interim periods – i.e. FYs beginning after 12/15/19)

Early adoption is permitted for all entities as of the beginning of an annual period

## Intra-entity Transactions

### Example disclosures ASU 2016-16

#### •Example 1

- In October 2016, the FASB issued guidance which requires an entity to recognize the income tax consequences of intra-entity transfers of assets, other than inventory, at the time of transfer. Assets within the scope of the guidance include intellectual property and property, plant and equipment. The guidance is effective January 1, 2018 and early adoption is permitted. The company adopted the guidance on January 1, 2017 using the required modified retrospective method. At adoption, \$X million and \$X million were reclassified from investments and sundry assets and prepaid expenses and other current assets, respectively into retained earnings. Additionally, net deferred taxes of \$X million were established in deferred taxes in the Consolidated Statement of Financial Position, resulting in a cumulative-effect net credit to retained earnings of \$X million. In January 2017, the company had one transaction that generated a \$X million benefit to income tax expense, income from continuing operations and net income and a benefit to basic and diluted earnings per share of \$0.XX and \$0.XX per share, respectively, for the three months ended March 31, 2017. The ongoing impact of this guidance will be dependent on any transaction that is within its scope.

#### •Example 2

- In the first quarter of 2017, the Company adopted ASU No. 2016-16, “Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory.” Under previous guidance, the tax effects of intra-entity asset transfers (intercompany sales) were deferred until the transferred asset was sold to a third party or otherwise recovered through use. The new guidance eliminates the exception for all intra-entity sales of assets other than inventory. Upon adoption, a cumulative-effect adjustment is recorded in retained earnings as of the beginning of the period of adoption. The net impact upon adoption is a reduction to retained earnings of \$X million. The Company does not expect any material impact on its future operations as a result of the adoption of this guidance.



# Proposed disclosures

## Proposed income tax disclosures

### Overview

#### Disclose (all)

- Domestic and foreign components of pretax income or loss
- Indefinitely reinvested foreign earnings
- Disaggregation of income taxes paid by country
- Other disclosures

#### Disclose (public business entities)

- Unrecognized tax benefits
- Reason for changes in realizability estimates of deferred tax assets
- Government assistance
- Other disclosures

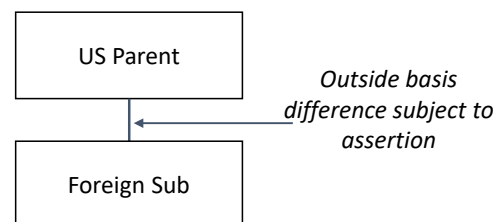


## Proposed income tax disclosures

### Indefinitely reinvested foreign earnings

#### Disclose (all entities)

- Amount of undistributed foreign earnings for which there is a change in assertion during period regarding indefinite reinvestment of such earnings and explain circumstances that caused such assertion change\*
- Aggregate of cash, cash equivalents, and marketable securities held by foreign subsidiaries\*



#### Example disclosure (change in assertion)

Prior to fiscal year 20XX, we asserted that undistributed earnings of our foreign subsidiaries were [indefinitely] reinvested. **Primarily due to the increase in our U.S. debt service obligations resulting from issuance of additional unsecured senior notes in aggregate principal amount of \$XXX during the current fiscal year and issuance of additional unsecured senior notes in aggregate principal amount of \$XXX in current year, management concluded that the ability to access certain amounts of foreign earnings would provide greater flexibility to meet domestic cash flow needs** without constraining foreign objectives. Accordingly, in fourth quarter of fiscal year 20XX, **we withdrew the [indefinite] reinvestment assertion on \$XXX of earnings** generated by certain of our foreign subsidiaries through fiscal year 20XX. We provided for U.S. income taxes on \$XXX of undistributed foreign earnings, resulting in recognition of a deferred tax liability of approximately \$XXX. We recognized additional deferred income tax expense of \$XXX related to the impact of fluctuations in foreign currency exchange rates during fiscal year 20XX on the portion of the \$XXX of unremitted earnings generated prior to fiscal year 20XX.

**Note:** \* Commonly requested in SEC comments



## Proposed income tax disclosures

### Unrecognized tax benefits

#### Disclose (public business entities)

- In tabular reconciliation, disaggregate settlements between those using attributes versus those using cash
- “Map” unrecognized tax benefit total in tabular reconciliation to balance sheet lines where recorded
- Eliminates requirement to provide details of positions for which it is reasonably possible that total UTBs will significantly increase/decrease in next 12 months

#### Example disclosure (immediately below tabular reconciliation table)

At December 31, ending balance of unrecognized tax benefits presented by statement of financial position line item is as follows:

	20X7	20X6
Taxes payable	\$ 30,000	\$ 40,000
Deferred tax liability	120,000	180,000
Unrecognized tax benefits presented on statement of financial position	150,000	220,000
Unrecognized tax benefits not presented on statement of financial position	160,000	150,000
<b>Total unrecognized tax benefits</b>	<b>\$ 310,000</b>	<b>\$ 370,000</b>

# Proposed income tax disclosures

## Realizability estimates of deferred tax assets for carryforwards

### Disclose (public business entities)

- Total federal/state/foreign operating loss and tax credit CFs disclosed by expiration period (first five years after reporting date and total for all remaining years)
- Total federal/state/foreign DTAs for operating loss and tax credit CFs before valuation allowances; amounts further disaggregated by expiration period (first five years after reporting date and total for all remaining years)
- Total UTBs that offset DTAs related to operating loss and tax credit CFs

### Example Disclosure

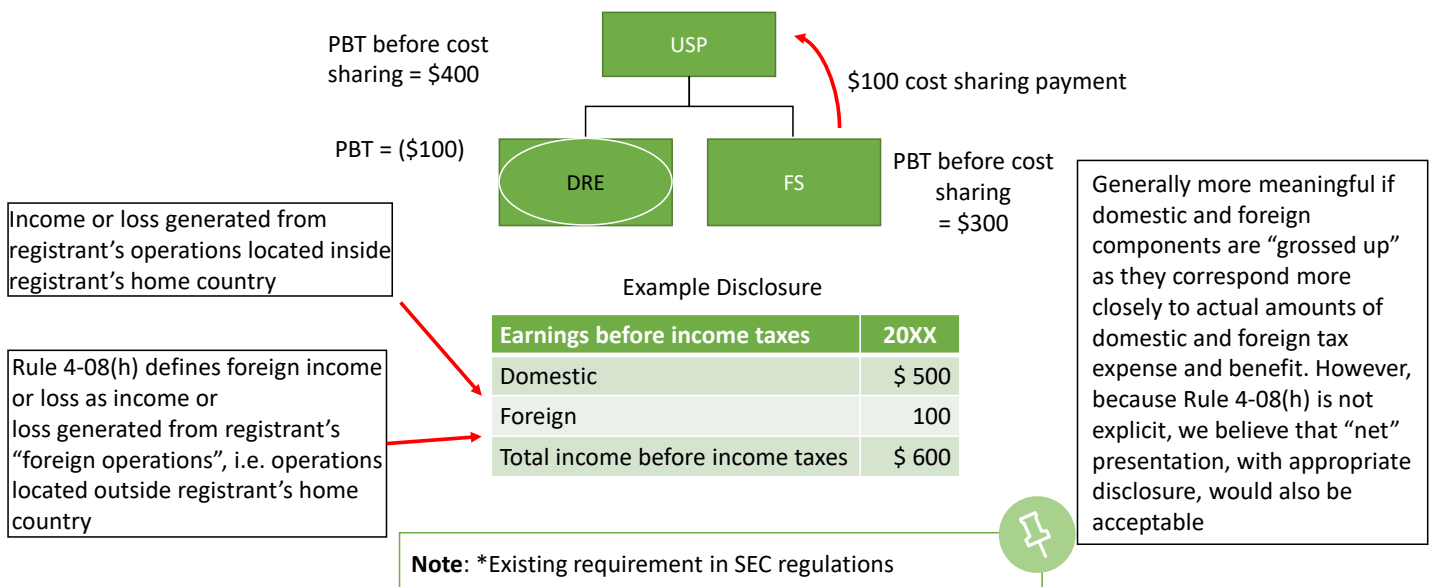
Expires during FY	Loss carryforwards (not tax effected)			Deferred Tax asset for loss carryforwards before valuation allowance (tax effected)			
	Federal	State	Foreign	Federal	State	Foreign	Total
20X2	\$ 1,800	\$ 1,550	\$ 1,900	\$ 720	\$ 155	\$ 570	\$ 1,445
20X3	1,200	1,050	1,100	480	105	330	915
20X4	850	700	900	340	70	270	680
20X5	800	600	550	320	60	165	545
20X6	500	300	400	200	30	120	350
Thereafter	1,450	1,200	550	580	120	165	865
Total							4,800
Unrecognized tax benefits at December 31, 20X1							(2,000)
Total tax effect of carryforwards after unrecognized tax benefits							\$ 2,800

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# Proposed income tax disclosures

## Domestic and foreign components of pre-tax income or loss

(All entities) disclose pretax earnings from continuing operations disaggregated by domestic and foreign\*



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## Proposed income tax disclosures

### Disaggregation of income taxes paid between countries

#### Disclose (all entities)

Disclose foreign income taxes paid further disaggregated for any country significant to total

#### Example disclosure

The domestic and foreign income taxes paid were as follows

	20X5	20X4	20X3
United States	\$650	\$ 565	\$775
United Kingdom	167	157	143
Ireland	120	100	80
Other countries	100	50	230
<b>Total income taxes paid</b>	<b>\$ 1,037</b>	<b>\$ 872</b>	<b>\$ 1,228</b>

## Proposed income tax disclosures

### Other disclosures and government assistance

#### Other disclosures (public business entities)

- Disaggregation of income tax expense (benefit) between foreign and domestic jurisdictions\*
- Separately present reconciling items > 5% of the tax at statutory rate in effective tax rate reconciliation\*
- Enacted tax law change, if probable that change will affect entity in future period
- Explanation of nature and amounts of valuation allowance recognized or released
- Explanation of year-over-year change in separately presented reconciling items (i.e., > 5% above)

#### Disclose (all entities) (Proposed ASC 740-10-50-23)

- Description of legally enforceable agreement with a government\*\*, including
  - Duration of agreement
  - Commitments made with government under that agreement
  - Amount of benefit that reduces, or may reduce, its income tax burden

**Note:** \* Existing requirement in SEC regulations

**\*\*Notes**  
 (1) Applies where government determines whether entity receives assistance (and how much) based on eligibility  
 (2) Does not apply when entity meets eligibility requirements broadly available to taxpayers without agreements

## Additional considerations

### Research credit directive

On September 22, 2017, the Large Business and International Division of the IRS issued a new directive providing for an optional safe harbor for taxpayers to compute and support credit claims based on a simplified book-basis method. Safe harbor available to any open tax years.

#### **Considerations**

- Can be used/elected immediately
- Evaluate period of adjustment, if any
- Evaluate impact on existing reserves

## Notice 2017-57

On October 2, 2017, Treasury and the IRS issued Notice 2017-57, indicating their intention to amend the regulations delaying the 'applicability dates' of the final Section 987 regulations and certain of the temporary regulations by one year.

Note that the applicability date of Temp. Treas. Reg. sec. 1.987-12T (and a few others), which is currently applicable has not been altered. Taxpayers may rely on the Notice prior to Treasury and the IRS amending the regulations.

The Notice changes the applicability date to taxable years beginning on or after two years after the first date of the first taxable year following December 7, 2016.

### **Considerations**

Assess in the financial reporting period that includes October 2, 2017, whether the Company intends to rely on the Notice to defer the applicability date of the regulations.

- Companies intending to rely on the Notice should account for any impact the deferral of the applicability date will have in the financial reporting period that includes October 2, 2017.

## State Aid Update

Overview – What is State Aid?

- Assistance directed by governments to individual companies that is not normally available to the general population.
  - Enacted by specific state agency
  - Advantage is selective to specific group or company
  - Potential to distort competition among other member states or government agencies

## State Aid Update

- State aid investigations continued to draw a lot of attention recently
- Notable investigations / decisions
  - Spanish goodwill
  - Belgian excess profits ruling system
  - Starbucks
  - McDonalds
  - Fiat
  - Apple
  - GDF Suez group (now Engie)
  - Gibraltar corporate tax system

## State Aid Update

### State Aid - Financial reporting considerations

- Management controls
- Understand State aid facts and circumstances
- Consider technical position of State aid scenario based on the latest cases
- Determine GAAP framework and risk assessment
- Disclosure considerations

## State Aid Update

- Accounting for Income Taxes considerations
  - The underlying principles of accounting for uncertain tax positions apply.
  - To the extent the State Aid was presented as a reduction in income taxes, the matter should be treated the same as any uncertain income tax position.
    - Determine if technical merits are MLTN.
    - If MLTN, measure and recognize the largest amount of tax benefit greater than 50% likely to be realized upon settlement.
    - Subsequent changes in judgment that lead to changes in measurement should result from evaluation of new information.
    - Consider disclosure requirements for the unrecognized benefits and timing.