Accounting for Income Taxes Update

Bank & Capital Markets Tax Institute
Companies should be aware of proposed changes to accounting for income taxes under U.S. GAAP as well as ongoing and expected developments in U.S. and international tax law.

- FASB Exposure Draft: Disclosures
- Ongoing Considerations for U.S. Tax Reform
- On the Horizon: International Developments
- FASB Exposure Draft: Simplification
FASB Exposure Draft: Disclosures
FASB - Disclosure Framework Project

Timing

- Exposure Draft Issued: March 25, 2019
- Comment Period Ended: May 31, 2019
- Final ASU: TBD
- Effective Date: TBD

Once finalized, transition is expected to be on a **prospective basis**.

FASB will decide whether **early adoption** will be permitted based on feedback.

These developments do NOT impact current reporting requirements!
FASB - Disclosure Framework Project

Highlights

**Disaggregation of items by jurisdictions for all entities as follows**

- **Pre-tax book income/(loss)** from continuing operations before *intra-entity eliminations* between **domestic** and **foreign**
- **Tax expense/(benefit)** from continuing operations between **federal**, **state**, and **foreign**
- **Income taxes paid** between **federal**, **state**, and **foreign**

**Effective tax rate reconciliation for public business entities (PBEs)**

- Disclosure of effective tax rate reconciling items **greater than 5%** of statutory federal rate
- Explanation of the **year-to-year change** in amounts/percentages of reconciling items
FASB - Disclosure Framework Project
Highlights

**Uncertain tax positions**

- **New requirement for PBEs** to disclose the *line item in the statement of financial position* in which unrecognized tax benefits are presented along with related amounts
- **Removed** existing requirement to disclose unrecognized tax benefits *that could change in the next 12 months*

**Outside basis differences for all entities**

- **Removed** existing requirement to disclose *gross temporary difference* when indefinite reinvestment assertion is made
- Requirement to disclose *unrecorded deferred tax liability (tax-effected)* (or a statement that it’s impracticable to do so) **still exists**
FASB - Disclosure Framework Project

Highlights

Carryforwards for PBEs

• New requirement to disclose tax-effected federal, state, and foreign carryforwards disaggregated by time period of expiration for (1) each of the first five years after the reporting date, (2) a total for any remaining years, and (3) a total for carryforwards that do not expire

• New requirement to disclose valuation allowance and any offsetting unrecognized tax benefits associated with the carryforwards

Carryforwards for other than PBEs

• New requirement to disclose total (federal, state, and foreign) credit carryforwards and other non-tax-effected carryforwards separate from those that do not expire along with a range of expiration dates
Other

• **New requirement for PBEs** to disclose amount and explanation of *valuation allowance recognized or released* during the period

• **New requirement** to disclose **interim taxes paid for all entities** that file interim financial statements

• **No additional** disclosures for any provisions of the *Tax Cuts and Jobs Act* (e.g., GILTI, BEAT, FDII)
FASB - Simplification Project

Timing

- Exposure Draft Issued: May 14, 2019
- Comment Period Ended: June 28, 2019
- Final ASU: TBD
- Effective Date: TBD

Mix of **prospective, modified retrospective**, and **full retrospective** transition guidance.

FASB has decided **early adoption** will be permitted based on feedback.

**Public business entities:** Fiscal years beginning on or after December 15, 2020, and interim periods within those fiscal years.

**All others:** Fiscal years beginning on or after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022.

These developments do NOT impact current reporting requirements!
FASB - Simplification Project

Highlights

Removal of certain ASC 740 exceptions

• Removes the *exception to intraperiod tax allocation* when there is a loss in continuing operations and income in other components, such as discontinued operations or other comprehensive income (prospective application proposed)

• If a *foreign subsidiary becomes an equity method investment*, the amount of outside basis difference for which deferred taxes were not provided for would no longer be considered “frozen” and a deferred tax liability would be recorded in the period of change (modified retrospective application proposed)

• If an *equity method investment becomes a foreign subsidiary*, the deferred tax liability for the amount of the outside basis difference would no longer be frozen and an entity could assert that the undistributed earnings are indefinitely reinvested and eliminate the deferred tax liability (modified retrospective application proposed)

• If an entity’s year-to-date loss exceeds the anticipated loss for the year, there will no longer be a *limitation on the amount of benefit* that can be recorded in an interim period (prospective application proposed)
FASB - Simplification Project

Highlights

**Simplification**

- Requires that the *portion of franchise tax based on income* be recognized in accordance with ASC 740 and any incremental amount (based on items such as capital or revenue) be accounted for as a non-income-based tax (retrospective application proposed)

- Requires an entity to evaluate whether a *step up in tax basis of goodwill* should be considered part of the initial recognition of book goodwill or a separate transaction (prospective application proposed)

- For separate company financial statements, specifies that an entity is *not required to allocate consolidated income taxes to legal entities not subject to tax* (e.g., partnerships, single member LLCs), but may elect to do so (retrospective application proposed)

- For interim periods, *requires the annual effective tax rate to reflect changes in enacted tax laws or rates*, beginning with the period of enactment (prospective application proposed)
Ongoing Considerations for U.S. Tax Reform
U.S. Tax Reform
Ongoing considerations

**Same framework, different considerations:**

- Indefinite reinvestment assertion & outside basis differences
- Uncertain tax positions
- Valuation Allowances
- GILTI, BEAT, FDII
U.S. Tax Reform

Ongoing considerations – indefinite reinvestment assertion

**Indefinite reinvestment assertion**

- Requirement to assess and evaluate intentions with respect to outside basis differences remains
- Impact of change in assertion should be reflected in tax expense
- If not asserting, the tax liability should include the tax effects based upon the expected manner of reversal
- The following are examples of items that should be considered:
  - withholding taxes
  - state taxes
  - local taxes
  - currency gains and losses
- Movement in withholding tax DTL on unremitted earnings from year to year caused by currency fluctuations should be recorded to the income statement
U.S. Tax Reform

Ongoing considerations – uncertain tax positions

**Tax law changes and uncertainty in income taxes**

New information related to tax positions should be evaluated each reporting period based on the two-step model under ASC 740

<table>
<thead>
<tr>
<th>1</th>
<th>Recognition</th>
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<td>• Recognize the financial statement effects of a tax position when it is <strong>more-likely-than-not</strong>, based on the <strong>technical merits</strong>, that the position will be sustained upon examination</td>
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<tr>
<td>- No consideration of detection risk</td>
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<td>- Evaluate without consideration of the possibility of offset or aggregation with other positions</td>
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<td>- Consider past administrative practices and precedents of the taxing authority</td>
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<th>2</th>
<th>Measurement</th>
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<td>• After concluding that a position has met the recognition threshold, the amount of benefit recognized should be measured using a <strong>cumulative probability methodology</strong> (i.e., the amount of benefit recorded represents the largest amount of tax benefit that is greater than 50% likely to be realized upon settlement with a taxing authority that has full knowledge of all relevant information)</td>
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U.S. Tax Reform

Ongoing considerations – uncertain tax positions

**Tax law changes and uncertainty in income taxes**

- Enacted tax law changes and interpretations of tax law should be accounted for in the *period of enactment* or issuance
- Consider the **weight of the authority** that is being relied upon to support the position
  - Final regulations - enacted tax law
  - Proposed regulations
    - Not enacted tax law unlike final and temporary regulations, but they do provide indication of Treasury’s current thinking
    - May be relied upon in some cases before they are finalized under the law
    - Consult with tax specialists to determine whether early reliance is appropriate
- Additional **final regulations** expected to be issued throughout 2019
U.S. Tax Reform

Ongoing considerations – valuation allowance

Valuation allowances

A holistic evaluation of how tax reform impacts valuation allowance assessments will be needed – below are examples of potential valuation allowance considerations:

- Policy elections for GILTI & BEAT
- New net operating loss rules
- Revised interest limitations
- “Naked credit” (indefinite-lived) DTLs as a source of income
U.S. Tax Reform

Ongoing considerations – GILTI, BEAT, FDII

Anti-base erosion and related provisions

**GILTI**
- Inclusion of “global intangible low-taxed income” of CFCs
- Policy election to:
  1. recognize deferred taxes for basis differences expected to reverse as GILTI or
  2. account for GILTI as period costs if and when incurred

**BEAT**
- Parallel tax-system imposing a minimum tax on adjusted tax base
- Measurement of deferred taxes should be at the statutory tax rate under the regular tax system, not the BEAT rate.

**FDII**
- Deduction for “foreign-derived intangible income”
- Accounted for as a special deduction
On the Horizon: International Developments
The international tax landscape is changing quickly!

- EU’s Anti-Tax Avoidance Directives (ATAD I & II)
- OECD and unilateral digital tax proposals
- Various international tax reform proposals
- What’s next?

- Tax law changes should be closely monitored but should not be anticipated from an accounting standpoint — they should be accounted for in the period of enactment.
- EU directives and OECD proposals that require legislation at the individual country level should not be accounted for until legislation is enacted within that country.
- As new international taxes are proposed, be mindful of whether the taxes fall within the scope of ASC 740.