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Accounting Roundup — Special Edition

Annual Update on Accounting for Income Taxes

January 2015

Annual Update on Accounting for Income Taxes

by Deloitte & Touche LLP's Accounting Standards and Communications Group and Deloitte Tax LLP

Introduction

Welcome to this special tax edition of *Accounting Roundup*, which summarizes significant developments that have affected the accounting and financial reporting for income taxes over the past year. Topics covered in this publication include:

- The expiration of various federal tax credits at the end of 2014.
- The continuing efforts of state, local, and international tax authorities to reform tax law.
- Topics that the SEC focuses on when reviewing a registrant's income tax accounting and related disclosures.
- Recently issued ASUs that affect the presentation of unrecognized tax benefits, the accounting for certain types of investments in low-income housing tax credits, and the tax implications of the new goodwill accounting option for private companies.
- The FASB's simplification projects related to income taxes and share-based compensation.

In addition, this publication includes links to other resources that provide further insight into the topics discussed in the articles. You can also subscribe to receive by e-mail our *Accounting for Income Taxes — Quarterly Hot Topics* publication, which highlights certain recent tax and accounting developments that may affect the accounting for income taxes under U.S. GAAP.

We hope that this *Accounting Roundup — Special Edition* helps financial professionals stay up to date on current developments and plan for future changes. As always, we welcome your feedback. Please send questions and comments to accountingstandards@deloitte.com.

Sincerely,

Deloitte & Touche LLP and Deloitte Tax LLP

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Tax Policy and Other Developments

Federal Tax Changes

Affects: All entities.

Summary: Last year, Congress failed to reach an agreement on a long-term extension of numerous temporary business, individual, and energy tax incentives that expired at the end of 2013. Instead, in the closing days of the 113th Congress, lawmakers approved the Tax Increase Prevention Act of 2014, which retroactively extended the bulk of the expired provisions, but only through the end of 2014. President Obama signed the bill into law on December 19, 2014.

The expiration of these provisions will most likely affect calendar-year taxpayers and fiscal-year filers in different periods. In addition, taxpayers that are projecting tax rates for planning purposes may need to consider the potential impact of these changes. Under U.S. GAAP, the effects of new legislation are recognized upon enactment. The effect of a change in tax laws or rates on a deferred tax asset (DTA) or liability (DTL) is recognized as a discrete item in 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 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 effect of tax law or rate changes on taxes payable or refundable for a prior year (e.g., when the change has retroactive effects) is recognized upon enactment as a discrete item of tax expense or benefit for the current year.

Major business tax provisions that were renewed (only to lapse once more at the end of 2014) include the research and experimentation credit; the subpart F exemption for active financing income and look-through treatment for payments between related controlled foreign corporations; 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements; the new markets tax credit; and the work opportunity tax credit.

Expired energy incentives that were renewed include the production tax credit for wind; various tax credits for construction of energy-efficient new homes and energy-efficiency improvements to existing homes; and various incentives for biodiesel and renewable diesel, alternative fuel, and alternative fuel mixtures.

Expired provisions that were not renewed under the Tax Increase Prevention Act include the placed-in-service date for partial expensing of certain refinery property, the manufacturing credit for energy-efficient appliances, the credit for two- or three-wheeled plug-in electric vehicles, New York Liberty Zone tax-exempt bond financing, and the credit for health insurance costs for certain laid-off workers.

Implications and Next Steps: Entities should stay abreast of whether and, if so, when these "extenders" are renewed again. The path forward for extenders legislation is uncertain, in no small part because both of the congressional tax-writing committees are under new leadership. Rep. Paul Ryan (R-Wis.) has assumed control of the House Ways and Means Committee in the 114th Congress, replacing former chairman Dave Camp (R-Mich.), who has retired from Congress. And Sen. Orrin Hatch (R-Utah) has taken up the gavel in the Senate Finance Committee now that the GOP has gained the majority in the upper chamber. (Former chairman Ron Wyden (D-Ore.) is now the panel's ranking member.) Prospects for extenders are likely to become clearer as the new Congress gets under way and chairmen Ryan and Hatch lay out the agendas for their respective committees.

One potential development worth watching for is whether chairmen Ryan and Hatch seek to build on efforts begun last year by former Ways and Means Committee chairman Camp to move permanent or long-term extensions of certain significant extenders through Congress as a precursor to future tax reform. The House approved a number of individual bills in 2014 that would have permanently extended the research credit, bonus depreciation, and Internal Revenue Code (IRC) Section 179 expensing, among other provisions; however, those bills were never taken up in the Democrat-controlled Senate. A subsequent extenders agreement that Camp tried to broker with then Senate Majority Leader Harry Reid (D-Nev.) in late November of last year that reportedly called for making permanent 10 expired provisions — including the research credit and Section 179 expensing — was scuttled by the White House because it was, in the administration's view, too heavily skewed toward corporate taxpayers. President Obama has since indicated that he could consider long-term extensions of major business tax provisions if Congress also adopts a long-term fix for temporary provisions targeting families and middle-class taxpayers.

Other Resources: For more information about tax reform and extenders, see Deloitte's Tax News & Views page.

State and Local Tax Changes

Affects: All entities.

Summary: In recent years, many states have introduced or passed legislation that reduces their income tax rate applicable to individuals, corporations, or both, while attempting to increase tax revenue from consumption taxes. Generally, increased revenue from consumption taxes comes from an increase in the state's sales-and-use tax rate or an expansion of the sales-and-use tax base.

The table below summarizes some of the more significant domestic state tax law changes that occurred during 2014. For more information on a change that occurred in a specific tax jurisdiction, including the change's background, tax implications, and links to additional resources, click on that jurisdiction's link to go to the applicable Deloitte *Multistate Tax Alert*.

Select State and Local Tax Jurisdictions

Tax Jurisdiction	Summary
Alaska	In *Schlumberger Technology Corp. v. Alaska Department of Revenue*, the Alaska Supreme Court held that IRC Section 882(a)(1), which "requires a foreign corporation to report only income 'effectively connected with the conduct of a trade or business within the United States'" (often referred to as effectively connected income or ECI), has not been adopted by reference because it is inconsistent with the formula provided by the Alaska Net Income Tax Act (the "Alaska Act"). Instead, the court held that the Alaska Act limits the types of corporations that may be included in a water's-edge group but not the types of income to be included in apportionable income. In particular, the Alaska Act requires that a corporation filing that is part of a water's-edge combined return (whether the corporation is foreign or domestic) include 20 percent of dividends received from foreign corporations without regard to whether such dividends are ECI. For further discussion, see Deloitte's September 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
Indiana	Currently, Indiana's corporate tax rate is 7.5 percent and, under previous law, was scheduled to decrease to 7 percent after June 30, 2014, and to 6.5 percent after June 30, 2015. Effective July 1, 2014, a new law (S.B. 1) phases in revised state corporate tax rate reductions, eventually lowering the corporate tax rate to 4.9 percent after June 30, 2021. The corporate rates for subsequent periods will be reduced according to the following schedule: • After June 30, 2016, 6.25 percent. • After June 30, 2017, 6.0 percent. • After June 30, 2018, 5.75 percent. • After June 30, 2019, 5.5 percent. • After June 30, 2020, 5.25 percent. • After June 30, 2021, 4.9 percent. In addition, the new law phases in revised financial institution tax (FIT) rate reductions, eventually lowering the FIT rate to 4.9 percent for tax years beginning after December 31, 2022. Currently, Indiana's FIT rate is 8 percent and, under previous law, was scheduled to decrease to 7.5 percent for tax years beginning after December 31, 2014; to 7 percent for tax years beginning after December 31, 2015; and to 6.5 percent for tax years beginning after December 31, 2016. The FIT rates for subsequent periods will be reduced according to the following schedule: • After December 31, 2016, 6.5 percent. • After December 31, 2018, 6.25 percent. • After December 31, 2019, 6.0 percent. • After December 31, 2020, 5.5 percent. • After December 31, 2021, 5.0 percent. • After December 31, 2022, 4.9 percent. For further discussion, see Deloitte's June 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.

Select State and Local Tax Jurisdictions (continued)	
Tax Jurisdiction	**Summary**
Michigan	On July 14, 2014, in *International Business Machines (IBM) v. Michigan Department of Treasury*, the Michigan Supreme Court held that a taxpayer could elect to compute both the modified gross receipts tax and business income tax components of its 2008 Michigan business tax (MBT) liability by making the multistate tax compact (the "Compact") election in lieu of using the 100 percent sales-weighted apportionment formula under the MBT Act. By making this election (in Compact Article III), the taxpayer was allowed to use an equally weighted, three-factor apportionment formula (property, payroll, and sales). In August 2014, the Michigan Department of Treasury (the "Treasury") filed motions to appeal this decision. On September 11, 2014, while the Treasury's motions related to the IBM case were pending, Michigan Governor Rick Snyder signed into law Public Act (PA) 282 of 2014, which repeals, "retroactively and effective beginning January 1, 2008," the Compact provisions of Michigan law. On November 14, 2014, the Michigan Supreme Court denied the Treasury's motions and made no reference to PA 282 or its potential application. Accordingly, the Michigan Supreme Court decision of July 14, 2014, stands, and the matter has been remanded to the Michigan Court of Claims for entry of an order granting summary disposition in favor of IBM. The broader application of the IBM decision to other Michigan taxpayers is unclear in the absence of any reference or analysis by the Michigan Supreme Court in the IBM case to PA 282 or the amended law's retroactive application to January 1, 2008. On December 19, 2014, the Michigan Court of Claims granted summary disposition in favor of the Treasury in a number of pending Compact-based MBT refund cases. The court held that PA 282 retroactively bars MBT refund claims that had been based on an election to use a three-factor apportionment formula under the Compact. Meanwhile, the Michigan Court of Appeals is currently considering the Treasury's appeal of a taxpayer-favorable Compact decision in June 2013 from the Michigan Court of Claims in *Anheuser-Busch Inc. v. Michigan Department of Treasury*. The issue of PA 282's retroactive application may be addressed by the Michigan Court of Appeals in this case. For further discussion, see Deloitte's December 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
New Hampshire	The New Hampshire Department of Revenue Administration explains that as of July 1, 2014, any unused New Hampshire business enterprise tax (BET) credits from taxable periods ending before December 31, 2014, may be carried forward against the New Hampshire business profits tax (BPT) for five years from the taxable period in which it was paid. Further, any unused New Hampshire BET credits from taxable periods ending on or after December 31, 2014, may be carried forward against the BPT for 10 years from the taxable period in which it was paid. These tax reforms are based on legislative changes enacted during 2011 and further clarified via legislation enacted in 2014. For further discussion, see Deloitte's December 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
New Mexico	On March 10, 2014, New Mexico Governor Susana Martínez signed Senate Bill 106, which allows corporate taxpayers that generate net operating losses (NOLs) for tax years beginning on or after January 1, 2013, to carry the loss forward for 20 years. The carryforward period for losses generated before January 1, 2013, will continue to be five years. For further discussion, see Deloitte's June 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
New York	On March 31, 2014, New York Governor Andrew Cuomo signed the 2014–2015 Budget Act into law. The Budget Act *substantially* modifies and reforms various aspects of New York tax law. For instance, the act reduces the corporate franchise tax rate on entire net income from 7.1 percent to 6.5 percent, effective for taxable years beginning on or after January 1, 2016; eliminates the tax liability on entire net income for "qualified New York manufacturers" for taxable years beginning on or after January 1, 2014; and merges the banking corporation tax (Article 32) into the corporate franchise tax (Article 9-A). Furthermore, the act replaces the previous physical nexus standards with a new bright-line statutory nexus threshold; as a result, certain corporations now have a New York filing obligation. For additional information about the changes made by the Budget Act, see the following Deloitte publications: • March 2014 *Accounting for Income Taxes — Quarterly Hot Topics*. • "New York State Corporation Tax Reforms of 2014," an article published in the *Bloomberg BNA Weekly State Tax Report* (May 16, 2014).
New York City	A new law (A.B. 9462) signed on September 15, 2014, extends certain New York City general corporation tax (GCT) rate provisions — some of which have been in effect since 1978 and were set to expire by January 1, 2015 — through December 31, 2017. The current tax rate is the greater of (1) 8.85 percent on income, (2) 1.5 mills[1] on business and investment capital, (3) 8.85 percent of 15 percent of income plus the amount of salaries and other compensation paid to any person who at any time during the taxable year owned more than 5 percent of the taxpayer's capital stock, or (4) a minimum tax based on the amount of New York City receipts. There is also a 0.75 mill tax on subsidiary capital.[2] Note that this new law does not conform the New York City corporate tax regime to the New York corporate tax regime (which was significantly modified on March 31, 2014). For further discussion, see Deloitte's September 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.

[1] One mill is equal to $0.001.

[2] These rate provisions had been scheduled to drop on January 1, 2015, to (1) 6.7 percent, (2) 1 mill, (3) 6.7 percent, and (4) $25, respectively, and to 0.5 mill on subsidiary capital.

Select State and Local Tax Jurisdictions (continued)	
Tax Jurisdiction	**Summary**
North Carolina	On May 29, 2014, North Carolina Governor Pat McCrory signed House Bill 1050, which amends various provisions of the state corporate income tax, replacing the net economic loss with a state net loss and providing additional guidance on bonus depreciation and actual or deemed asset transfers. For further discussion, see Deloitte's September 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
Ohio	On December 19, 2014, Ohio Governor John Kasich signed Substitute House Bill No. 5 (H.B. 5), which creates uniform provisions applicable to more than 600 Ohio municipal income tax regimes (municipal net profits tax). The bill applies uniform standards to taxation of pass-through entities, NOL carryforwards, consolidated corporate returns, withholding for nonresident employees, and various procedural items. Unless otherwise specified, these changes will become effective on January 1, 2016. The following is a summary of changes that taxpayers should consider when preparing their financial statements: • *Pass-through entity* — Current law provides an option for municipalities to tax either the pass-through entity or its owners (on their respective distributive shares of income). Under H.B. 5, the municipal net profits tax is imposed on pass-through entities at the entity level. However, municipalities may continue to tax the income that passes through to a resident individual owner under applicable uniform rules. Note that financial statements that include an Ohio partnership should reflect deferred tax balances for the portion of the related temporary difference that will reverse in the future when the partnership is subject to an entity-level tax. • *NOLs* — H.B. 5 brings uniformity to Ohio municipal NOL carryforward provisions. Currently, 260 municipalities, including Columbus and its suburbs, do not allow for NOL carryforwards, while some municipalities permit a five-year carryforward and others offer varying lengths of carryforward. Under H.B. 5, for the jurisdictions that are not currently allowing NOL carryforwards, the amount of NOLs incurred for taxable years beginning after 2016 may be deducted to offset up to 50 percent of income generated in taxable years beginning in 2018 to 2022 and up to 100 percent thereafter. For jurisdictions that currently allow NOL carryforwards, the NOLs accumulated for periods before 2017 will be treated as deducted "first" and without the 50 percent limitation during the 2018–2022 phase-in period. • *Consolidated returns* — Ohio municipalities have generally permitted corporate consolidated filings when an affiliated business grouping filed a consolidated federal income tax return. The new law provides more detailed guidance on consolidated filings and potentially permits corporate entities to elect to deconsolidate. H.B. 5 also provides consolidated groups with an option to include an 80 percent or more owned pass-through entity's income and apportionment factors in, or exclude them from, the consolidated tax return. For further discussion, see Deloitte's June 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
Rhode Island	On June 19, 2014, Rhode Island Governor Lincoln Chafee signed into law the fiscal 2015 budget (H.B. 7133), which substantially modifies and reforms various aspects of Rhode Island tax law, including the following: • The law requires water's-edge combined reporting for members of a unitary group of affiliated business entities that are more than 50 percent commonly owned and controlled. Such combination may, by way of a five-year binding election, be done on an affiliated group basis. • The corporate income tax rate is reduced from 9 percent to 7 percent. • Single-sales factor apportionment is adopted, with market-based sourcing for sales of other than tangible personal property. Each unitary business group member's receipts will be included without regard to whether the member has nexus in the state (i.e., the "Finnigan" approach). • The related-party expense addback requirement is repealed. • The franchise tax is repealed. The tax law changes in H.B. 7133 are effective for tax years beginning on or after January 1, 2015. For further discussion, see Deloitte's June 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.

Select State and Local Tax Jurisdictions (continued)	
Tax Jurisdiction	**Summary**
Texas	The court of appeals for the 13th district of Texas recently upheld an assessment against a taxpayer, ruling that gains were required to be offset against losses from the sale of investments and capital assets in the determination of the franchise tax apportionment-factor denominator. The case involved the application of Section 171.105(b) of the Texas Tax Code (TTC), which states that "[i]f a taxable entity sells an investment or capital asset, the taxable entity's gross receipts from its entire business for taxable margin include only the net gain from the sale." The taxpayer argued that the proper interpretation of this statute was that gains only are included and losses are therefore disregarded. The court of appeals disagreed, siding with the Texas comptroller and concluding that gains are to be offset by losses from the sale of investments and capital assets. The taxpayer has not filed a petition for review with the Texas Supreme Court; however, the period during which such filing may be made remains open. For further discussion, see Deloitte's December 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
Wisconsin	Effective March 26, 2014, and applicable to taxable years beginning on or after January 1, 2014, net business losses may be carried forward 20 years (previously, 15 years) for state corporate income tax purposes. For further discussion, see Deloitte's June 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.

Implications and Next Steps: Income tax rates and laws are constantly changing, and such changes could meaningfully affect an entity's income tax accounting in its financial statements. To receive timely updates on changing tax rates, laws, and regulations, subscribe to receive Deloitte's *State Tax Matters* and *Accounting for Income Taxes — Quarterly Hot Topics*.

Changes in International Tax Rates, Laws, and Regulations

Affects: All entities.

Summary: Several international jurisdictions have been active recently in changing their tax rates and laws. The table below summarizes some of the more significant international tax law changes that occurred during 2014. For more information on a change that occurred in a specific tax jurisdiction, including the change's background, tax implications, and links to additional resources, click on that jurisdiction's link to go to the applicable *Global Tax Developments Quarterly* publication.

Select International Tax Jurisdictions	
Tax Jurisdiction	**Summary**
Ireland	On December 23, 2014, Ireland's Finance Act 2014 was enacted to bring into effect the 2015 budget published on October 23, 2014. The minister reaffirmed the government's commitment to the 12.5 percent corporate tax rate as settled tax policy and outlined measures for providing a competitive tax environment for multinationals to operate in the country. Measures relevant to multinationals include the following: (1) the grandfathering of "double Irish" structures created before January 1, 2015, and the change in tax residence rules for Irish companies incorporated after that date; (2) the enhancement of the Irish onshore intellectual property regime; and (3) the enhancement of the Irish research and development tax credit regime. For further discussion, see Deloitte's December 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
Italy	The Italian government enacted Law Decree No. 66 on June 18, 2014. This law became effective for fiscal years starting after December 31, 2013, and reduced the standard Italian regional tax on productive activities (IRAP) rate from 3.9 percent to 3.5 percent. The standard rates for financial institutions and insurance companies were reduced from 4.65 percent and 5.9 percent to 4.2 percent and 5.3 percent, respectively. However, Italy's 2015 budget, which was signed into law on December 29, 2014, repeals the reduction of the IRAP rates and restored the original rates (see above) as of January 1, 2014. Therefore, the reduced rates enacted in June 2014 will never be effective.

Select International Tax Jurisdictions (continued)	
Tax Jurisdiction	**Summary**
Russia	On November 24, 2014, fundamental changes were made to the taxation of foreign entities. The law, which became effective on January 1, 2015, introduces the concept of "beneficial ownership," a new definition of corporate residence, a controlled foreign-company regime, new rules on the indirect disposal of shares of Russian real-estate-rich companies, and requirements that Russian legal entities and individuals disclose information about their interests in foreign entities. For further discussion, see Deloitte's December 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.
Spain	Broad-based tax reform was enacted on November 28, 2014, and is effective for tax years beginning on or after January 1, 2015. The main change is a reduction of the general corporate income tax rate from 30 percent to 28 percent for 2015 and to 25 percent in taxable years starting in 2016. Other changes affect tax-deductible expenses, tax loss carryforwards, tax credits, the participation exemption, transfer pricing, nonresident income tax, and the tax consolidation regime. For further discussion, see Deloitte's December 2014 *Accounting for Income Taxes — Quarterly Hot Topics*.

Implications and Next Steps: Income tax rates and laws are constantly changing, and such changes could meaningfully affect an entity's income tax accounting in its financial statements. To receive timely updates on changing tax rates, laws, and regulations, subscribe to receive Deloitte's *Global Tax Developments Quarterly* and *Accounting for Income Taxes — Quarterly Hot Topics*.

Foreign Account Tax Compliance Act (FATCA)

Affects: All entities.

Summary: The purpose of FATCA is to identify U.S. taxpayers holding assets offshore. To that end, it obligates (1) foreign financial institutions (FFIs) to register with the IRS and agree to identify and report on their U.S. account holders to the IRS and (2) certain nonfinancial foreign entities (NFFEs) to identify substantial U.S. owners. Failure to comply with these requirements may result in the imposition of a 30 percent withholding tax on certain payments made by U.S. withholding agents (USWAs). USWAs, therefore, are also required to document and report all relationships with foreign entities to facilitate enforcement. These reporting and withholding requirements are in addition to the self-reporting requirements.

FATCA, codified as Chapter 4 of the IRC, was passed in March 18, 2010, as part of the Hiring Incentives to Restore Employment Act. In addition, the IRS issued final regulations related to FATCA on January 17, 2013, followed by technical corrections on February 20, 2014. The U.S. Treasury is also entering into intergovernmental agreements (IGAs) with foreign governments to facilitate the implementation of FATCA and enforce compliance.

After many delays, FATCA went live on July 1, 2014, and withholding commenced on certain payments made to noncompliant entities on January 1, 2015. The first FATCA reporting will be due in March 2015. As of January 2015, more than 147,000 institutions have registered with the IRS as FFIs and have agreed to do this reporting. Further, more than 100 countries have entered into, or are negotiating, IGAs to assist with this compliance.

Implications and Next Steps: All U.S. taxpayers holding assets in offshore accounts should be aware that their information will be reported by the foreign institutions through which they hold assets. Taxpayers with such holdings are also required to disclose their accounts in their tax returns and ensure that their reporting is consistent with their FFIs' reports.

Entities should also be aware of their requirements under FATCA. Such requirements include properly classifying their legal entities and non-U.S. employee benefit plans as FFIs or NFFEs. They should also ensure that any entities classified as FFIs are registered and prepared to comply with the new requirements. Further, U.S. entities should understand their obligations as withholding agents. The burden of determining whether withholding is required rests with the entity, and a failure to withhold will result in a liability for the USWA. To ensure compliance, USWAs must do the following:

- Identify all payees (e.g., clients, vendors, counterparties) receiving FATCA-withholdable payments.
- Obtain, validate, and retain required documentation and certifications from all payees.
- Establish a process for withholding on (1) nonparticipating FFIs or payees that have failed to provide appropriate documentation and report payments made to FFIs and (2) NFFEs that have identified substantial U.S. owners.

Failure to comply with these requirements can result in financial as well as reputational risk.

Other Resources: For more information about FATCA, see Deloitte's FATCA resource library.

SEC Developments

Tax-Related Themes of Recent SEC Staff Comments to Domestic Registrants and Foreign Private Issuers

Affects: Domestic SEC registrants and foreign private issuers.

Summary: The SEC staff's comments about income taxes continue to focus on (1) disclosure of potential tax and liquidity ramifications related to the repatriation of foreign earnings, (2) valuation allowances, (3) rate reconciliation disclosures, and (4) unrecognized tax benefits. More recently, the staff has asked registrants to support situations in which their valuation allowances were reduced or reversed. The staff continues to ask registrants to provide early-warning disclosures to help users understand these items and how they potentially affect the financial statements.

Repatriation of Foreign Earnings and Liquidity Ramifications

In accordance with ASC 740,[3] when the earnings of a foreign subsidiary are indefinitely reinvested, registrants should disclose the nature and amount of the temporary difference for which no DTL has been recognized as well as the changes in circumstances that could render the temporary difference taxable. In addition, registrants should disclose either (1) the amount of the unrecorded DTL related to that temporary difference or (2) a statement that determining that liability is not practicable.

The SEC staff continues to (1) ask for additional information when registrants claim that it is not practicable to determine the amount of the unrecognized DTL and (2) request that registrants expand their MD&A disclosures about indefinitely reinvested foreign earnings.

Disclosures in an MD&A liquidity analysis should include the following:

- The amount of cash and short-term investments held by foreign subsidiaries that would not be available to fund domestic operations unless the funds were repatriated.
- A statement that the company would need to accrue and pay taxes if the funds are repatriated.
- If true, a statement that the company does not intend to repatriate those funds.

Valuation Allowances

The SEC staff continues to focus on valuation risks related to DTAs, often commenting when registrants' filings indicate that no valuation allowance (or an insufficient one) has been recorded. The staff may also ask registrants about reversals of, or other changes in, their valuation allowances. The SEC staff has indicated that factors for registrants to consider in determining whether to reverse a previously recognized valuation allowance include (1) the magnitude and duration of past losses, (2) the magnitude and duration of current profitability, and (3) changes in factors (1) and (2) that drove losses in the past and those currently driving profitability.

The SEC staff has pointed out that registrants' disclosures should include a discussion of the factors or reasons that led to a reversal of a valuation allowance and that this discussion should effectively answer the question "Why now?" Such disclosures would include a comprehensive analysis of all available positive and negative evidence and how the entity weighted each piece of evidence in its assessment. The staff has also reminded registrants that the same disclosures would be expected when there is significant negative evidence and a registrant concludes that a valuation allowance is necessary.

The SEC staff has discouraged registrants from providing "boilerplate disclosures" and instead has recommended that they discuss registrant-specific factors (e.g., limitations on their ability to use NOLs and foreign tax credits). The SEC staff has also stated that it has asked registrants to disclose the effect of each source of taxable income on their ability to realize a DTA, including the relative magnitude of each source of taxable income.

Rate Reconciliation

The SEC staff has noted several issues related to registrants' tax rate reconciliation disclosures, including (1) unclear labeling of reconciling items and inadequate disclosures about the nature of material reconciling items, (2) a lack of MD&A disclosures about (a) each material foreign jurisdiction and its tax rate and (b) how each jurisdiction affects the amount in the tax rate reconciliation, (3) inappropriate aggregation of material reconciling items, (4) inconsistency with amounts disclosed elsewhere in a filing, and (5) inappropriate reflection of error corrections as changes in estimates.

[3] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

Unrecognized Tax Benefits

The SEC staff continues to comment when registrants fail to provide the disclosures required by ASC 740-10-50-15 and 50-15A about unrecognized tax benefits, including a tabular reconciliation of such benefits. In addition, the SEC staff expects registrants to provide more transparent disclosures about reasonably possible changes in unrecognized tax benefits. Because the guidance on the acceptable level of aggregation of information for these disclosures is not prescriptive and permits judgment, the SEC staff evaluates a registrant's level of disclosure on a case-by-case basis.

Implications and Next Steps: An entity should confirm that its financial statements include the required disclosures and that these disclosures enable users to understand the current and future tax consequences of the entity's transactions and related events. The entity should ensure that its recognition of the tax consequences of business transactions is consistent with the accounting requirements and that its disclosures about the tax consequences are transparent to financial statement users.

Other Resources: See the following Deloitte publications for additional guidance on the SEC staff's comments on income taxes:

- *SEC Comment Letters — Including Industry Insights: A Recap of Recent Trends (updated November 2014)*.
- *SEC Comment Letter Examples: Income Taxes*.

Tax-Related Themes Discussed at the 2014 AICPA Conference on SEC and PCAOB Developments

Affects: All entities.

Summary: The staff in the SEC's Division of Corporation Finance reiterated that it continues to comment on disclosures about (1) the potential tax and liquidity ramifications related to the repatriation of foreign earnings, (2) valuation allowances, (3) rate reconciliation, and (4) unrecognized tax benefits. In addition, the staff noted that registrants can improve their income tax disclosures, particularly disclosures related to tax provision amounts. In this regard, the staff stated that boilerplate language should be avoided and that more effective disclosure approaches may 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.
- Providing meaningful disclosures about known trends and uncertainties, including expectations regarding the countries where registrants operate.

Implications and Next Steps: The staff in the SEC's Office of the Chief Accountant (OCA) indicated that it is currently assessing the reporting of income taxes — in a manner similar to its focus on the statement of cash flows in 2014 — to better understand the causes of recent restatements. The staff further noted that the OCA will most likely be discussing its findings in 2015. Consequently, registrants can expect the SEC staff to increase its focus on income taxes.

Other Resources: For a comprehensive summary of topics discussed at the 2014 AICPA Conference, see Deloitte's December 15, 2014, *Heads Up*.

Effects of Standard-Setting Activities on Accounting for Income Taxes

Recently Issued ASUs

Revenue Recognition

Affects: All entities.

Summary: On May 28, 2014, the FASB and IASB issued their final standard on revenue from contracts with customers. The standard, issued as ASU 2014-09[4] by the FASB and as IFRS 15[5] by the IASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. While the ASU does not directly change the accounting for income taxes, entities should assess the related implications.

[4] FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*.
[5] IFRS 15, *Revenue From Contracts With Customers*.

Federal income tax law provides both general and specific rules for recognizing revenue on certain types of transactions (e.g., long-term contracts and arrangements that include advance payments for goods and services). These rules are often similar to the method a taxpayer uses for financial reporting purposes and, if so, the taxpayer employs the revenue recognition method it applies in maintaining its books and records (e.g., cash basis, U.S. GAAP, IFRSs). Although the IRC does not require entities to use any particular underlying financial accounting method to determine their taxable income (such as U.S. GAAP), entities must make appropriate adjustments (on Schedule M) to their financial accounting pretax income to determine taxable income under the IRC.

The ASU may change the timing of revenue recognition and, in some cases, the amount of revenue recognized for entities that maintain their books and records under U.S. GAAP or IFRSs. These changes may also affect taxable income. For example, under federal tax principles, income is generally recognized no later than when it is received. However, there are a few limited exceptions that allow a taxpayer to defer revenue recognition (one year or longer) for advance payments. Under one of these exceptions, a taxpayer can defer revenue recognition for advance payments for one year to the extent that the revenue is deferred under the method used for the taxpayer's applicable books and records.

The standard may affect the timing and measurement of revenue for certain contracts with advance payments and thus may accelerate revenue recognition for contracts with multiple performance obligations, which could have an impact on current taxable income.

In addition, a few of the concepts in the standard may give rise to or affect the measurement of certain temporary differences. These concepts include:

- Revenue recognition upon a transfer of control that results in changes in book revenue recognition (and related contract assets and contract liabilities).
- Potential changes in the timing of revenue recognition for contracts that include variable consideration or a significant financing component.
- Capitalization of certain costs incurred to obtain or fulfill a contract, some of which currently may be deductible for tax purposes.

The tax implications associated with implementing the standard will be based on an entity's specific facts and circumstances. Thus, it will be important for tax professionals to understand the detailed financial reporting implications of the standard so that they can analyze the tax ramifications and facilitate the selection of any alternative tax accounting methods that may be available.

Before a taxpayer can select a new tax accounting method, the taxpayer must obtain consent from the IRS commissioner. In addition to selecting alternative tax accounting methods, if a taxpayer is applying its book method and the book method changes, the taxpayer may have to secure the commissioner's consent to change to the new book method for tax purposes. Further, certain tax accounting method changes require the IRS to review an application before granting consent. Other tax accounting method changes provide automatic consent if the taxpayer complies with certain terms and conditions.

A taxpayer that chooses not to secure consent to change its tax accounting method may have to maintain its current tax accounting method and may need to keep additional records as a result. Additional record keeping will also be required when entities are not permitted to use the standard's revenue recognition method for tax purposes.

The following are a few questions for entities to consider in planning for the transition:

- Will potential changes to the timing or measurement of U.S. GAAP or IFRS revenue or expense recognition affect the timing of revenue or expense recognition for income tax purposes?
- If the financial statement modifications in revenue recognition methods under the standard are favorable and permissible for tax purposes, is an entity required to request a formal change in tax accounting method from the tax authorities?
- If the financial statement modifications are unfavorable or impermissible for tax purposes, will the entity need to maintain certain legacy U.S. GAAP or IFRS accounting method records (i.e., records in accordance with the revenue recognition guidance that will be superseded by the standard)?
- When the amount of revenue in a contract with multiple performance obligations is allocated to the separate performance obligations under the standard, are there specific contractual terms that may result in a difference between the allocations for tax and book accounting purposes?

- To the extent that tax accounting methods differ from financial reporting accounting methods, are there any new data or system requirements that need to be considered?
- Are there any cash tax implications related to foreign-controlled entities that, for example, maintain statutory accounting records under IFRSs?
- If there is a cumulative adjustment to the opening balance upon adoption of the standard at a foreign operation, should the U.S.-based parent entity reassess its indefinite reinvestment assertion and reevaluate the amount of DTLs established for the related outside basis difference, if any?
- What is the effect on a multinational entity's transfer pricing strategy, especially when the transfer pricing is based on the amount of revenue recognized for financial reporting?
- Should there be a change in the financial statement presentation for sales taxes collected that are remitted to a tax authority on the basis of the principal-versus-agent guidance in the standard?
- Although the impact on state taxable income generally is the same as that on federal taxable income, what other state tax implications should an entity consider?

In certain industries, the ASU may also have a significant impact on other taxes such as sales, excise, industry-specific gross receipts, telecommunications, utility, business and occupation, and other specialty taxes. For example, for an arrangement that includes discounted tangible personal property (TPP), the standard may require entities to change the manner in which they allocate revenue between the sale of the TPP and the sale of related services (as opposed to following the invoicing and contract treatment). In such cases, part of the amount historically recognized as service revenue over the life of the related service agreement most likely will be reallocated to product revenue. This reallocation of revenue could affect the amount of some taxes or fees collected or reported by the vendor.

Taxes or fees that are at risk for overcollection or underreporting are those that are based solely on either sales of services or sales of products (when the other category is generally excluded from the tax or fee base). For example, customer tax billing systems are often designed to automatically collect these taxes and fees on the basis of the billed amounts. If the legal base of the tax or fee is the amount recognized for services (and sales of TPP are excluded from the base), there is a risk that the tax/fee will be overcollected from customers if it is computed on the basis of the invoiced amounts. In contrast, if the legal base of the tax or fee is the amount billed, there is a risk that the tax/fee will be underreported if, after the adoption of the new standard, the vendor uses only the service revenue amount recognized for books as a source for tax base data.

Other Resources: For more information about the new revenue standard, see Deloitte's May 28, 2014, *Heads Up* and standards overview page.

Deferred Tax Considerations When Goodwill Becomes a Finite-Lived Asset

Affects: Entities other than public business entities.

Summary: Under ASU 2014-02, a private company can elect a simplified, alternative approach to subsequently account for goodwill (the "goodwill accounting alternative"). Under this approach, the company can amortize goodwill related to each business combination on a straight-line basis, generally over a period of 10 years.

Implications and Next Steps: A private company that 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:

- *Non-tax-deductible goodwill* — The accounting alternative does not change the prohibition on the recognition of a DTL for goodwill that is not deductible for tax purposes. The amortization of goodwill for financial reporting purposes will typically create a reconciling item related to the effective tax rate (i.e., an unfavorable permanent difference).
- *Tax-deductible goodwill* — The amortization of financial reporting goodwill will result in either an increase or a decrease to deferred taxes depending on how it compares with the related tax amortization in the period.

When both tax-deductible and non-tax-deductible goodwill are present, an entity must determine 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, should apply such a policy consistently. One method that is commonly

used in such circumstances 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 complexities arise when the goodwill in a reporting unit is associated with multiple acquisitions or spans multiple taxing jurisdictions.

In addition, an entity's post-acquisition tax amortization of 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, because of the recharacterization of goodwill as a finite-lived asset, the DTL could potentially be a source of taxable income supporting the recoverability of a DTA.

Other Resources: For more information on the goodwill accounting alternative, see Deloitte's January 27, 2014, *Heads Up*.

Accounting for Investments in Qualified Affordable Housing Projects

Affects: Entities that invest in limited liability entities that pass low-income housing tax credits (LIHTCs) through to their investors.

Summary: In January 2014, the FASB issued ASU 2014-01 in response to the EITF's final consensus on Issue 13-B. The ASU provides guidance on accounting for investments by a reporting entity in a flow-through limited liability entity that manages or invests in affordable housing projects that qualify for the LIHTC. Under the ASU, an investor can elect to apply the proportional amortization method described in ASC 323-740. Under that method, the cost of the investment is amortized in proportion to (and over the same period as) the total tax benefits expected to be allocated to investors, and both components are reported in the income tax expense/(benefit) line item. If a qualified affordable housing project does not meet the conditions for using the proportional amortization method, the investment should be accounted for under the equity method or the cost method.

Under the ASU, entities are permitted to apply the proportional amortization method's alternative measurement and presentation to LIHTC investments if the following conditions are met:

- "It is probable that the tax credits allocable to the investor will be available."
- "The investor does not have the ability to exercise significant influence[6] over the operating and financial policies of the limited liability entity."
- "Substantially all of the projected benefits are from tax credits and other tax benefits (for example, tax benefits generated from the operating losses of the investment)."
- "The investor's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive."
- "The investor is a limited liability investor in the limited liability entity for both legal and tax purposes, and the investor's liability is limited to its capital investment."

ASU 2014-01 does not prescribe whether an entity would record deferred taxes on the book and tax basis difference in LIHTC investments (e.g., outside basis difference). However, the ASU does not include deferred taxes[7] in the example illustrating the proportional amortization method, while it retains deferred taxes in the cost and equity method examples.

Under the ASU, an entity is required to:

- Evaluate its eligibility to use the measurement and presentation alternative in ASC 323-740 at the time of initial investment on the basis of facts and conditions that exist as of that date. The entity must reevaluate those conditions if either of the following occurs: (1) a "change in the nature of the investment (for example, if the investment is no longer in a flow-through entity for tax purposes)" or (2) a "change in the relationship with the limited liability entity that could result in the reporting entity no longer meeting the conditions" described in ASC 323-740.
- Test a LIHTC investment accounted for under the proportional amortization method for impairment when it is more likely than not that the investment will not be realized and measure an impairment loss as the amount by which the investment's carrying amount exceeds its fair value.

[6] In determining whether a LIHTC investor has significant influence, the investor may be required to evaluate the facts and circumstances of each investment.

[7] In certain circumstances, an entity should consider whether it is appropriate to record deferred taxes on a temporary difference resulting from proportional amortization accounting (e.g., when LIHTC investments report taxable income, the taxable losses associated with LIHTC investments exceed the original investment, or the alternative amortization method under the practical expedient is applied).

- "[D]isclose information that enables users of its financial statements to understand the nature of its investments in qualified affordable housing projects, and the effect of the measurement of its investments in qualified affordable housing projects and the related tax credits on its financial position and results of operations."

Implications and Next Steps: For public entities, the ASU is effective for annual periods beginning after December 15, 2014, and interim periods therein. For nonpublic entities, the ASU is effective for annual periods beginning after December 15, 2014, and interim and annual periods thereafter. Early adoption is permitted.

Entities that applied the effective yield method to account for LIHTC investments under the alternative in ASC 323-740 are permitted to continue to do so, but only for investments already accounted for under that method. Otherwise, the guidance in the ASU must be applied retrospectively to all periods presented.

Other Resources: See Deloitte's December 2013 *Accounting for Income Taxes — Quarterly Hot Topics* for a discussion of the criteria an entity must meet to use the proportional amortization method to account for a LIHTC investment.

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

Affects: Entities with unrecognized tax benefits that also have tax loss or tax credit carryforwards in the same tax jurisdiction as of the reporting date.

Summary: On July 18, 2013, the FASB issued ASU 2013-11 in response to a consensus reached at the EITF's June 11, 2013, meeting. The ASU provides guidance on financial statement presentation of an unrecognized tax benefit when an NOL carryforward, a similar tax loss, or a tax credit carryforward exists. The FASB's objective in issuing this ASU is to eliminate diversity in practice resulting from a lack of guidance on this topic in current U.S. GAAP.

Under the ASU, an entity must present an unrecognized tax benefit, or a portion of an unrecognized tax benefit, in the financial statements as a reduction to a DTA for an NOL carryforward, a similar tax loss, or a tax credit carryforward except when:

- An NOL carryforward, a similar tax loss, or a tax credit carryforward is not available as of the reporting date under the governing tax law to settle taxes that would result from the disallowance of the tax position.
- The entity does not intend to use the DTA for this purpose (provided that the tax law permits a choice).

If either of these conditions exists, an entity should present an unrecognized tax benefit in the financial statements as a liability and should not net the unrecognized tax benefit with a DTA. New recurring disclosures are not required because the ASU does not affect the recognition or measurement of uncertain tax positions under ASC 740. This amendment does not affect the amounts public entities disclose in the tabular reconciliation of the total amounts of unrecognized tax benefits because the tabular reconciliation presents the gross amounts of unrecognized tax benefits.

Implications and Next Steps: The ASU's amendments are effective for public entities for fiscal years beginning after December 15, 2013, and interim periods within those years. Nonpublic entities may wait until fiscal years, and interim periods within those years, beginning after December 15, 2014, to adopt the amendments. Early adoption is permitted for all entities.

The amendments should be applied to all unrecognized tax benefits that exist as of the effective date. Entities may choose to apply the amendments retrospectively to each prior reporting period presented.

Other Resources: For more information, see Deloitte's July 22, 2013, *Heads Up* and June 2013 *EITF Snapshot*.

FASB Projects

Leases

Affects: All entities.

Summary: At its August 27, 2014, meeting, the FASB redeliberated certain U.S. GAAP matters related to the leases project, including whether to eliminate leveraged-lease accounting.[8] The FASB reaffirmed its decision to eliminate leveraged-lease accounting, as had been proposed in the May 2013 exposure draft (ED), but tentatively decided to allow entities to continue to apply the current leveraged-lease guidance to arrangements that exist as of the final standard's effective date. The Board's decision to grandfather existing leveraged leases acknowledges stakeholder concerns about the cost and complexity of revising the accounting for these transactions upon transition.

[8] Leveraged leases allow a lessor to secure the tax benefits of equipment ownership (i.e., depreciation) with an investment that is significantly less than the cost of the equipment.

Implications and Next Steps: This decision remains tentative until the release of a final ASU on leases, which is expected later this year.

Other Resources: For a comprehensive update on the leases project, see Deloitte's project overview.

Accounting for Financial Instruments — Classification and Measurement

Affects: All entities.

Summary: In connection with its project on the classification and measurement of financial instruments, the FASB has debated how to determine whether a valuation allowance on a DTA related to debt securities classified as available for sale should be recognized. In current practice, there are different approaches to such recognition. According to the SEC staff, there are two acceptable views on evaluating the need for a valuation allowance on a DTA when the DTA is recognized as a result of an unrealized loss on a debt security recorded in other comprehensive income (OCI) and an entity has the intent and ability to hold the debt security until recovery:

- *View 1* — DTAs related to available-for-sale securities are excluded from other DTAs being evaluated for realization because the DTA recognized for unrealized losses of a debt security included in OCI does not require a source of future taxable income for realization (since the accounting assertions imply that the unrealized loss will never be realized and that no tax loss will therefore ever be reported on any tax return).
- *View 2* — DTAs related to available-for-sale securities are combined with the other DTAs in the assessment of the realizability of the total DTAs of a given tax-paying component of the entity. If the future income (including the expected recovery of value related to the debt securities) is not sufficient to realize the DTAs, a valuation allowance is required.

In a 2014 meeting, the FASB tentatively decided that its final standard on the classification and measurement of financial instruments would require entities to apply the guidance in View 2.

Implications and Next Steps: The FASB's final ASU on the classification and measurement of financial instruments is expected to be issued later this year. Entities currently applying View 1 would not be required to revise their accounting policies until adoption of the ASU, which is most likely several years away. An entity that is considering changing its accounting policy before then may be required to conduct a preferability analysis under ASC 250.

Other Resources: For a comprehensive update on the Board's financial instruments projects, see Deloitte's project overview.

Simplification Initiatives

Accounting for Income Taxes

Affects: All entities.

Summary: As part of its simplification initiative, the FASB has issued proposed ASUs on the following topics:

- *Intra-entity asset transfers* — This proposal removes the requirement under which the income tax consequences of intra-entity asset transfers are deferred until the assets are ultimately sold to an outside party. The tax consequences of such transfers would be recognized in tax expense when the transfers occur. This treatment is consistent with IAS 12.[9] The Board acknowledged that the elimination of this exception in ASC 740 might not reduce the cost entities incur by having to track book-tax differences. However, the Board believes that the change would better depict the economic effect (e.g., a cash tax payment) of those transfers and would make it easier to apply the general guidance in ASC 740. The proposal would require a modified retrospective transition with a cumulative catch-up adjustment to opening retained earnings in the period of adoption. Since the period of adoption would not be comparable to the prior periods presented, entities would need to disclose the nature of and reason for the accounting change and the quantitative effects of the accounting change on the financial statements for the period of adoption.
- *Balance sheet classification of deferred taxes* — Under this proposal, all deferred taxes would be classified as noncurrent, with prospective application of this accounting change. Jurisdictional netting would still be required. The proposed ASU asks constituents who disagree with the proposed change to identify alternatives for presenting deferred taxes in a classified balance sheet and the conceptual basis for those alternatives.

[9] IAS 12, *Income Taxes*.

For public business entities, the proposed ASU would be effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption would not be permitted. Entities other than public business entities would have a one-year deferral and would be permitted to early adopt the standard as long as such adoption is no sooner than the effective date for public business entities.

Implications and Next Steps: Comments on the two proposals are due by May 29, 2015.

Other Resources: For more information, see Deloitte's project page.

Share-Based Compensation

Affects: All entities.

Summary: On October 8, 2014, the FASB added to its agenda a project to improve the accounting for employee share-based payments and began deliberating certain potential improvements, including the following items related to the accounting for income taxes:

- *Excess tax benefits/deficiencies upon vesting or settlement of awards* — The Board decided to remove the requirement to defer recognition of an excess tax benefit until the benefit is realized. Further, entities would be required to recognize all excess tax benefits and tax deficiencies in income tax expense as opposed to recognizing some of those amounts in additional paid-in capital.
- *Presentation of excess tax benefits in the statement of cash flows* — The Board decided to remove the requirement to present excess tax benefits in the cash flow statement as a cash inflow from financing activities and an offsetting cash outflow from operating activities.

Implications and Next Steps: The FASB has not yet indicated how soon it may issue a proposed ASU but is expected to do so sometime in 2015.

Other Resources: For more information, see Deloitte's project page.

Disclosure Framework — Income Taxes

Affects: All entities.

Summary: At its January 7, 2015, meeting, the FASB staff discussed its disclosure review — income taxes project,[10] specifically its potential enhancements to the ASC 740 disclosure requirements related to taxes on foreign earnings. The staff discussed potentially requiring entities to disclose the following information:

- Foreign earnings for each jurisdiction that is individually significant.
- Domestic tax expense recognized for taxes on foreign earnings and earnings that, during the current period, are no longer asserted to be indefinitely reinvested; such disclosures may be required in the aggregate as well as for each jurisdiction that is individually significant.
- DTLs for unremitted foreign earnings for each jurisdiction that is individually significant.
- The estimated unrecognized DTL for unremitted foreign earnings, if any, as calculated on the basis of "simplified assumptions."
- The accumulated amount of indefinitely reinvested foreign earnings for any jurisdiction for which the amount is significant.
- Past events or current conditions that have changed management's plans on undistributed foreign earnings.

The FASB discussed the nature of these potential disclosure requirements. Although no decisions were made at this meeting, various views were shared on the potential benefits of these disclosures to investors and on the complexities of preparing them.

[10] The primary impetus for this project was the FAF's post-implementation review of FASB Statement No. 109, *Accounting for Income Taxes*, which concluded that users desire more information that will allow them to analyze (1) "the cash effects associated with income taxes, particularly current period taxes paid by jurisdiction (e.g., U.S. and foreign), and estimate future tax payments" and (2) "earnings determined to be indefinitely reinvested in foreign subsidiaries."

Implications and Next Steps: The FASB staff will be conducting further outreach and analysis related to this project in the coming months. In addition to more closely evaluating the potential disclosure requirements described above, the FASB intends to explore other opportunities for improving the effectiveness of the disclosure requirements in ASC 740. The FASB is expected to further deliberate (and expose for comment) any revised disclosure requirements it proposes as a result of this project.

IFRSs

Proposed Amendments to IAS 12

Affects: All entities.

Summary: On August 20, 2014, the IASB issued an ED[10] to reduce the diversity in practice related to the recognition of a DTA associated with a debt instrument measured at fair value. The proposed amendments would clarify that unrealized losses on debt instruments measured at fair value and measured at cost for tax purposes can give rise to a deductible temporary difference. In addition, the ED would specify that the carrying amount of an asset does not limit the estimation of probable future taxable profits and that, when an entity compares deductible temporary differences with future taxable profits, the future taxable profits would exclude tax deductions resulting from the reversal of those deductible temporary differences. Further, an entity would assess whether to recognize the tax effect of a deductible temporary difference as a DTA in combination with other DTAs of the same type (e.g., ordinary or capital); this provision would be consistent with the recent decision regarding the recognition of a valuation allowance that the FASB made as part of its project on the classification and measurement of financial instruments.

Comments on the ED were due by December 18, 2014.

Implications and Next Steps: The ED does not specify an effective date. In addition, the proposal indicates that although an entity may apply the amendments retrospectively, full retrospective adoption is not required.

Other Resources: For additional information about this proposal, see Deloitte's August 20, 2014, *IFRS in Focus*.

Hot Topics

Carve-Out Financial Statements

Affects: All entities.

Summary: As entities refocus on their core strategies to sustain future growth, many are finding that divestitures of parts of their businesses, including spin-off transactions, have become larger and more complex. Entities will often need to prepare carve-out financial statements in conjunction with a divestiture. Determining the information related to tax provisions (e.g., balance sheets, expenses and benefits) is typically one of the most complex aspects of preparing such financial statements.

Up-front planning can ease the burden on entities and increase the likelihood of a successful divestiture transaction. For entities that will prepare carve-out financial statements, such planning should include the involvement of tax professionals and advisers in the earliest stages so that tax matters can be appropriately addressed before the substantive work begins. Some of the more complex aspects of carve-out financial statements include:

- Deciding the most appropriate approach for determining deferred taxes (i.e., a top-down or bottom-up approach).
- Determining the tax effect of certain accounting carve-out adjustments (e.g., corporate overhead and reserves).
- Developing an acceptable systematic and rational method, such as the separate-return method, to recalculate certain consolidated tax adjustments on a carve-out basis.
- Assessing certain tax-specific carve-out adjustments, including the build-up and use of tax attributes, unrecognized tax benefits, and the need for a valuation allowance.
- Calculating the amount of federal and state taxes payable in the carve-out financial statements, since this is likely to be different from the amount previously booked and paid by the entities that are part of the carve-out operations.

[10] IASB Exposure Draft ED/2014/3, *Recognition of Deferred Tax Assets for Unrealised Losses* — proposed amendments to IAS 12.

- Recalculating the apportionment for the carve-out operations on a stand-alone basis to determine a reasonable blended state statutory tax rate.
- Considering international tax implications, including, but not limited to, the following: (1) the need to extract carve-out operations from an existing foreign consolidated group or single legal entity, (2) identification and use of foreign-specific tax attributes and NOLs, and (3) intercompany transactions that may be eliminated on a carve-out basis.
- Preparing a comprehensive tax footnote as part of the carve-out financial statements.

Other Resources: For more information, see Deloitte's *Carve-Out Financial Statements: Tax Considerations and Complexities*.

Internal Control

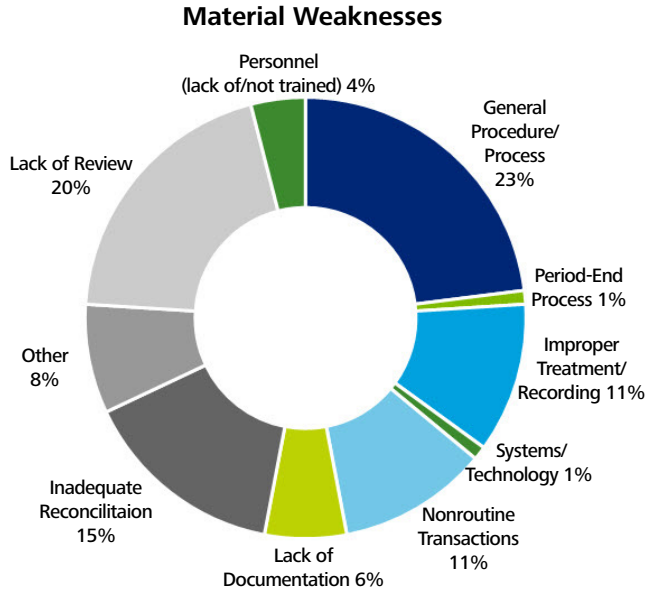
Affects: All entities.

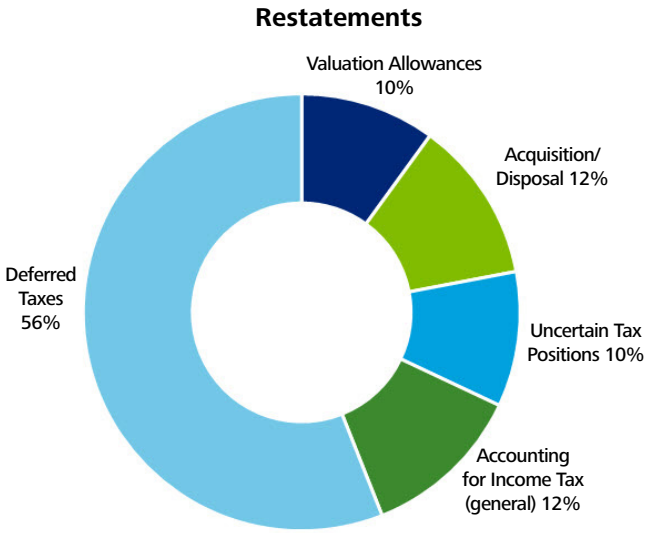
Summary: At the 2014 AICPA Conference on Current SEC and PCAOB Developments, the staff in the SEC's Office of the Chief Accountant (OCA) questioned whether all material weaknesses in internal controls are being properly identified, evaluated, and disclosed. The staff attributed inadequate identification and disclosure of material weaknesses to either (1) not identifying deficiencies initially or (2) not appropriately evaluating the severity of the deficiencies.

In a discussion about COSO's *Internal Control — Integrated Framework* (the "2013 Framework"), the OCA staff reminded participants that COSO no longer supports the 1992 Framework as of December 15, 2014. The SEC staff indicated during a Q&A session that it does not expect to question companies about why they did not use the 2013 Framework. As time passes, however, others (e.g., the staff in the SEC's Division of Corporation Finance) may ask a company why it would use an outdated framework. The staff also remarked that it is important for companies to disclose to investors which framework they used.

As companies work their way through implementing the 2013 Framework, some may resort to a checklist approach. To truly unlock the value that can be achieved by adopting the 2013 Framework, management should take a step back and evaluate how it is addressing the risks to its organization in light of the company's size, complexity, global reach, and risk profile. There is a difference between doing the minimum to address the framework's principles and doing the right thing to effectively address the principles. Companies that choose to do the right thing will unlock the value, reduce fraud risk, avoid financial reporting surprises, and support sustained business performance over the long term.

The design and effectiveness of controls over the accounting for income taxes deserve significant attention, since errors in the accounting for income taxes remain a leading cause of restatements. In 2013, errors specific to the accounting for income taxes were the fourth most common cause of restatements as a percentage of total restatements.[12] Deloitte's further analysis of restatements related to income tax accounting in 2013 examined the source of the restatements and, when applicable, the nature of the internal control failure that caused a material weakness.





[12] *2013 Financial Restatements: A Thirteen Year Comparison, Audit Analytics.*

Implications and Next Steps: In implementing the 2013 Framework, entities will need to take a fresh look at their internal controls in many key areas, including the accounting and reporting for income taxes. In particular, the increased use of technology, including data management and analytics, may lead to improved efficiency in the tax function. However, it could also create additional technology risks that need to be identified and addressed in accordance with the 2013 Framework.

Other Resources: See Deloitte's September 5, 2014, and December 15, 2014, *Heads Up* newsletters for additional information on implementation of the 2013 COSO Framework and internal control.

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