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TEI-SJSU High Tech Tax Institute (35th Annual)

Accounting for Income Taxes

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Outline of Topics

1. Accounting for Income Taxes (ASC 740)
   - Permanent Differences
   - Valuation Allowances
   - Outside Basis Differences
   - Accounting Changes and Error Corrections
2. FASB Developments and New Standards
   - FASB Disclosure Framework Income Taxes - Update
   - Leasing Standard – ASC 842
3. Additional Considerations
4. Appendix
   - 2018 AICPA National Conference on Current SEC and PCAOB developments

Accounting for Income Taxes (ASC 740)

Permanent Differences

International Tax Provisions

While tax reform intended to move us from a worldwide to a territorial tax system, certain new provisions might result in current U.S. taxes on foreign earnings.

What are the new international provisions?

- Global Intangible Low-Taxed Income (GILTI)
- Base Erosion Anti-abuse Tax (BEAT)
- Foreign-Derived Intangible Income (FDII)

International Tax Provisions

Fundamental accounting question: should these items be recorded in the period as they are incurred, or should they somehow be considered in the tax rate used when measuring deferred taxes?

One question, three different answers!

- Global Intangible Low-Taxed Income (GILTI) → *period cost OR deferred*
- Base Erosion Anti-abuse Tax (BEAT) → *period cost*
- Foreign-Derived Intangible Income (FDII) → *special deduction*

International Tax Provisions

Complexities in Forecasting

Overview

- The Tax Cuts and Jobs Act (the Act) targets erosion of the US tax base with the introduction of the 'base erosion and anti abuse tax' (BEAT) and a tax on 'global intangible low taxed income' (GILTI). Alternatively, the Act attempts to provide an incentive for US companies to produce goods and services domestically and sell them abroad by allowing a deduction for 'foreign-derived intangible income' (FDII). These provisions are complex and will require detailed modeling in order to estimate the tax effect for the year.
- Example – GILTI
  - As an example, in order to quantify the amount of GILTI subject to US tax, companies will need a significant amount of data, such as the CFCs tested income or loss computed on US tax principles, quarterly average tax basis in trade or business tangible assets, and available US tax attributes.
  - In order to model the amount of Section 250 deduction allowable to offset a US shareholder's GILTI inclusion, taxpayers will need to forecast US taxable income (including consideration of permanent and temporary differences and the utilization of net operating loss (NOL) carryforwards).
  - These inputs will then need to be analyzed to determine the current year GILTI impact.

GILTI Overview

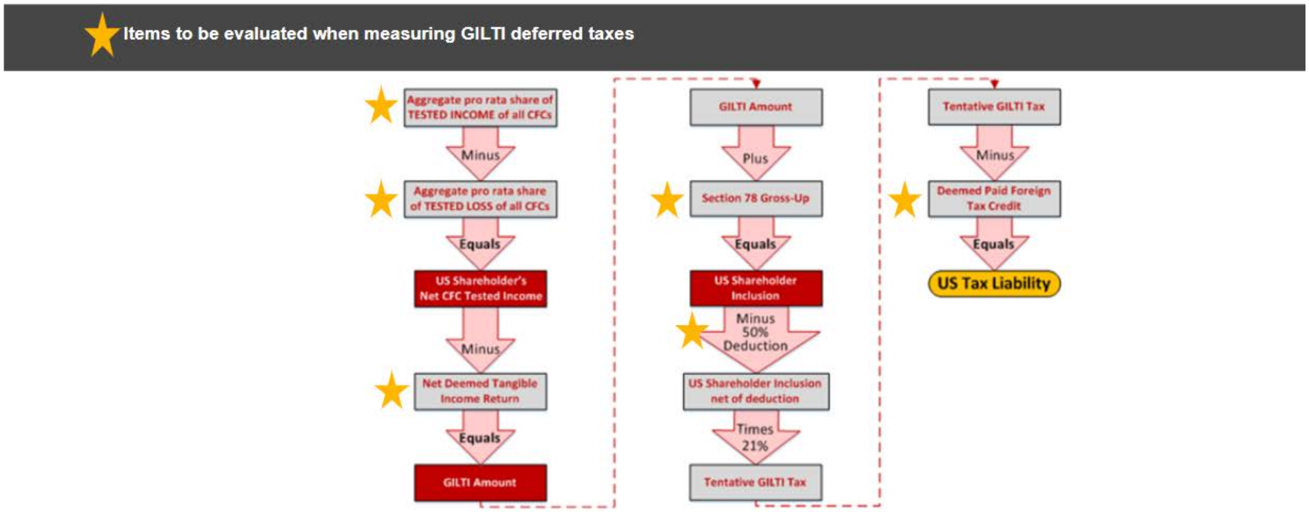
A US Shareholder of a CFC shall include in gross income its "Global Intangible Low-Taxed Income ("GILTI") in a manner similar to Subpart F income (§951A).

- This rule generally subjects a US Shareholder to tax on the combined net income of its CFCs that:
  - is not otherwise taxed in the US on a current basis (e.g., not ECI, not Subpart F) or specifically excluded (e.g., related dividends); and
  - exceeds a fixed, routine return on the CFCs tangible depreciable assets
- Accounting policy election - record GILTI tax effect as a period cost or record deferred tax impacts

Book	*Tax*	*Permanent Difference - increasing income*
Not in pre-tax income	US taxable income	• If no permanent reinvestment assertion, consider impact on outside basis difference • If permanent reinvestment assertion, consider impact on assertion

GILTI Overview (Cont.)

Mechanics



Deferred Tax Accounting for GILTI

Accounting policy election

- FASB Staff Q&A, Topic 740, No. 5: Accounting for global intangible low-taxed income ("GILTI"), a company can make an accounting policy election to account for the deferred tax effects of GILTI in the future period as the tax arises or to recognize them as part of deferred taxes (to the extent temporary differences, upon reversal, would impact the GILTI calculation)

- **Considerations in making the election**
  - Impact on ETR
  - Impact on Valuation Allowance
  - Impact on Disclosures

Deferred Tax Accounting for GILTI (cont.)

GILTI Deferred Approach

- Provide for deferred taxes associated with the difference between US-GAAP and US tax basis of assets held in CFCs
  - Required to determine the tax basis in assets based on US tax law GILTI basis
- Considerations of the applicable tax rate applied to the deferred taxes
  - Deduction for return on tangible property
  - 50% GILTI deduction (reducing to 37.5% after 12/31/2025)
- Consider impact these deferred taxes have on the recognition of other US deferred tax assets
- Consider impact on valuation allowance

BEAT Overview

Framework

- The base erosion anti-abuse tax ("BEAT") is essentially a 10% minimum tax (5% for tax years beginning in 2018) calculated on a base equal to the taxpayer's income determined without the tax benefits arising from base erosion payments and base erosion percentage of any NOL allowed for the tax year.
- **Base erosion minimum tax amount:** equal to 10% (5% in the case of taxable years beginning in calendar year 2018 and 12.5% for tax years beginning after December 31, 2025) of the *modified taxable income* over the regular tax liability, reduced (but not below zero) by the excess of credits allowed under Chapter 1 over the sum of:
  - Credits allowed under §38 which are properly allocable to the research credit under §41, plus
  - The portion of the *applicable §38 credits* not in excess of 80% of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to the applicable §38 credits).
- **Modified taxable income:** taxable income determined without regard to:
  - any base erosion tax benefit with respect to any base erosion payment, or
  - the base erosion percentage of any NOL allowed for the tax year.

BEAT Overview (cont.)

Framework, continued

- Base erosion payment: any amount paid or accrued by the taxpayer to a foreign person that is a related party and with respect to which a deduction is allowed. Also includes:
  - any amount paid or accrued to a related foreign person in connection with the acquisition of depreciable or amortizable property
  - any premium or other consideration paid or accrued to a related foreign person for reinsurance payments
  - any amount paid or accrued to a surrogate foreign corporation or a member of the expanded affiliated group which results in a reduction of the gross receipts of the taxpayer.
- Base erosion payments exclude:
  - Any amount paid for services if the services are eligible for using the services cost method (without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure) and the amount constitutes the total services cost with no markup component.
  - Any qualified derivative payment, i.e., a payment made pursuant to a derivative with respect to which the taxpayer marks to market, treats any gain/loss as ordinary, and treats gain/loss on any payment made under the derivative as ordinary.

BEAT Overview (cont.)

Framework, continued

Base erosion tax benefit: any deduction allowed with respect to a base erosion payment for the taxable year.

- Cost of goods sold is a reduction in gross receipts, not a deduction, by definition, not included as a base erosion tax benefit.

Tax accounting impact

- FASB has indicated that BEAT should be recorded as a period cost
- FASB has indicated that companies would not need to evaluate the effect of the interaction of BEAT with its deferred tax assets, but we believe that companies may *elect* to do so

FDII Overview

Deduction Allowance

- US domestic corporation may deduct an amount which is the lesser of:
  - the sum of 37.5% of its foreign-derived intangible income (“FDII”) plus 50% of its GILTI inclusion; or
  - its taxable income.
- Allowable deduction percentage decreases to 21.875%for FDII and 37.5% for GILTI for tax years beginning after December 31, 2025.
- Treated as a special deduction (similar to the former §199 deduction).

FDII defined

Foreign derived intangible income is the amount which bears the same ratio to the corporations deemed intangible income as its foreign-derived deduction eligible income (“FDDEI”) bears to its deduction eligible income (“DEI”).

Foreign-Derived Intangible Income = Deemed Intangible Income x FDDEI / DEI

FDII Overview (Cont.)

Deduction eligible income

Deduction eligible income is the excess, if any, of:

• The gross income of a domestic corporation, excluding:
- Subpart F income
- GILTI inclusion
- Any financial services income (defined in §904(d)(2)(D))
- any dividend received from a CFC by its US shareholder
- any domestic oil and gas income of the corporation, and
- any foreign branch income (as defined in §904(d)(2)(J))

• **Over** the deductions (including taxes) properly allocable to such gross income.

Eligible Gross Income - Allocable Deductions (including taxes) = Deduction Eligible Income

FDII Overview (Cont.)

Foreign-derived deduction eligible income

Foreign-derived deduction eligible income is any deduction eligible income of the taxpayer that is derived in connection with:

- **property** sold by the taxpayer to any person who is not a US person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use, or
- **services** provided by the taxpayer that it establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States.

Foreign Branches - Income

Overview

The income of a foreign branch of the US or disregarded foreign entity owned by the US is generally included in US taxable income

- US inclusion of foreign branch is computed under US law, which is likely different than amount computed under foreign law
- There may be limitations on use of losses, such as dual consolidated losses (§1503(d))
- §901 foreign tax credit may be available subject to new US FTC branch limitation

Book	*Tax*	
Usually not in pre-tax income (Note: some companies record intercompany distributions in income then eliminate in a separate accounting entity or unit)	**US taxable income**	***Permanent Difference - Increasing/decreasing taxable income by activity of foreign branch***

Foreign Branches – Deferred Accounting

As ***foreign branch*** earnings are subject to taxation in both the US and foreign jurisdictions, deferred taxes should be recorded for both jurisdictions.

- The deferred taxes recorded in the US should also include the US tax effects of the foreign temporary differences, similar to the federal tax effect on state deferred taxes (often referred to as ***"mirror image deferreds"*** if it is expected foreign taxes are fully credible).

	Book-tax difference	Tax Rate	DTA / (DTL)
PP&E (Country X)	(1,000)	30%	(300)
PP&E (U.S.)	(1,000)	21%	(210)
U.S. DTA on branch temporary differences*			210
Total DTA / (DTL)			**(300)**

* The foreign deferred tax liability of $300 will increase foreign taxes paid when settled, resulting in an increase in future FTCs in the US. In this case, the FTCs will be limited based on the tax rate because the US tax rate is lower than the tax rate of Country X (i.e., 70%=21%/30%, 70%*300=210).

Foreign Branches – Other Considerations

Dual consolidated losses

- When the foreign branch incurs a loss, a deferred tax asset would arise in the foreign jurisdiction for that loss if it can be carried forward to offset future foreign taxable income
- Generally, a foreign-branch loss would also be deductible under current US tax law. If that were the case, should a "double" tax benefit (i.e., current US deduction and foreign deferred tax asset) be recognized
- A DTL should be reported in the US jurisdiction because the future foreign taxable income necessary for the realization of the foreign deferred tax asset will also be reported as US income in future years, with no foreign tax credits available to offset the US tax in the year during which the foreign income is earned
  - The tax liability for this taxable temporary difference would generally be based on the foregone foreign tax credits that would otherwise have been available to the company had cash taxes been paid

Section 162(m)-$1 Million Dollar Compensation Deduction Limit

Pre-U.S. Tax Reform

- Covered employees were the CEO and next three highest compensated named executives, **excluding CFO**, as of the **last day** of the tax year
- Exception for **qualified performance-based** compensation

Post-U.S. Tax Reform

- Expanded scope and repeals exception
- “Covered employee” definition expanded to **include CFO**
- Extended application to both **current and former covered employees**-applies to any payments made after retirement or death
- Anyone serving as a **CEO or CFO during the year**, not just as of the last day of the tax year, is also subject to Section 162(m).
- Public companies within the purview of Section 162(m) also includes foreign companies traded through ADRs.
- **Repealed exception for performance-based** compensation
- Transition rule provides for “**grandfathering**” such that expanded provisions do not apply to **written, binding contracts in effect on November 2, 2017** (and not materially modified on or thereafter).

Section 162(m)-$1 Million Dollar Compensation Deduction Limit

Tax Accounting Considerations and Accounting Policy Election

- The amount of deductible temporary differences associated with an executive’s compensation should be based on the combination of the estimated deductible amount of share-based compensation for tax purposes using the grant-date fair value and the cash compensation
- Amounts that are expected to be subject to the §162(m) limitation are not considered deductible and therefore are not deductible temporary differences
- It is not appropriate to gross up the deferred tax asset and valuation allowance
- Policy choice of assuming whether stock compensation expense occurs last or pro rata
- Estimates around §162(m) can change from year to year
  - The executives subject to §162(m) limitations and the amount of total compensation, amongst other estimates may result in a change
  - An entity should reflect its best estimates at each reporting date and account for changes in estimates if and when necessary
  - Changes in estimates to recognize or eliminate a portion or all of a deferred tax asset for awards subject to §162(m) limitations are recognized as income tax expense (benefit)

What is an Income Tax?

ASC 740 applies to all federal, foreign, state and local (including franchise) taxes that are **based on income**.

Example scenarios	Generally within the scope of ASC 740?
Tax based on company's revenues, less cost of sales and operating expenses	?
Net worth tax levied based on equity	?
Tax based on the value of purchases	?
Tax levied based on 5% revenue earned for services performed	?
Tax levied on distribution of income	?

What is not an income tax?

Taxes and government assistance programs that are NOT within the scope of income tax accounting generally are either a non-income based tax or a government grant.

Non-income-based tax	Government grant
Revenue, payroll, use taxes (accounted for under ASC 450, Contingencies and Concepts Statement No. 6, Elements of Financial Statements)	International Accounting Standards 20, *Accounting for Government Grants and Disclosure of Government Assistance* (collectible from government regardless of taxable income)

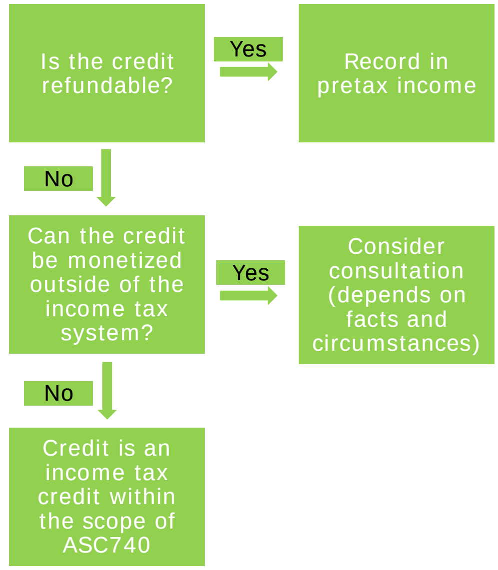
Is a credit an income tax item?

Determining whether credits are within the scope of ASC 740 may not always be clear, generally

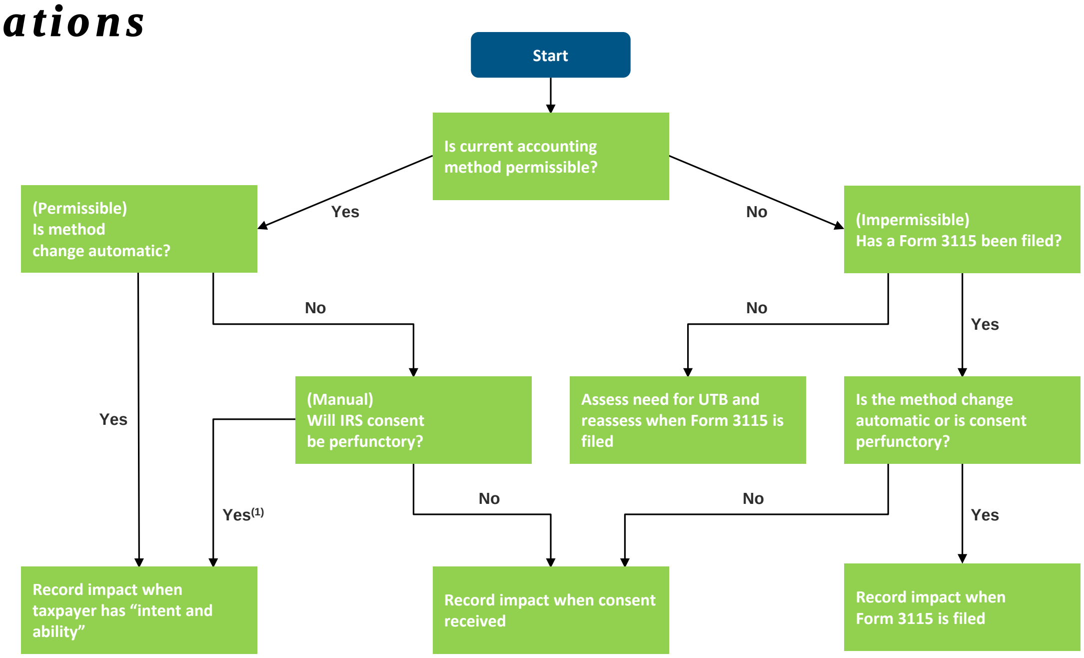
- Refundable credits are accounted for outside the scope of ASC 740 since monetizing the credits is not dependent upon taxable income, whereas nonrefundable credits are in the scope of ASC 740

Should consider

- Purpose of the credit
- Impact on tax basis
- How the credit is computed
- How and when the credit is monetized



Voluntary Method Changes & Unrecognized Tax Benefit Implications



(1) No earlier than the year the Form 3115 will be filed.

Accounting for Income Taxes (ASC 740)
Valuation Allowances

Valuation Allowance Considerations

Cumulative income/losses

- Look back period to consider depends on facts
- What is included in “income/loss”?

Scheduling of temporary difference reversals

- Expectations with respect to temporary differences on the balance sheet date
  - DTAs that will turn into NOL with 80% limitation
  - Should not consider originating temporary differences

Valuation Allowance Considerations (cont.)

Scheduling of temporary difference reversals

- Net operating losses (NOLs)
  - Comparison of pre- and post-reform generated losses
  - Lack of expiration does not mean realizability
  - Indefinite lived assets DTL with indefinite carryforward NOL DTA
  - Limitations on usage and reversal pattern of taxable temporary differences
  - IRC 382 limitations and DTL on identifiable intangibles
- IRC 163(j) disallowed interest
  - Allowable amount can be impacted by other reversing temporary differences

Valuation Allowance Considerations (cont.)

Indefinite-lived intangible asset ("naked credit") considerations

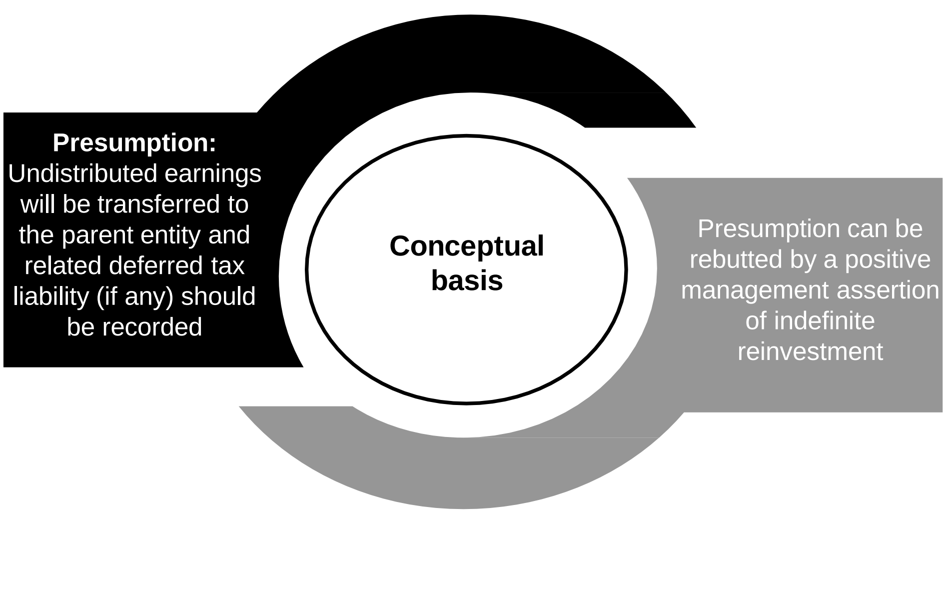
- Consider as source of income for NOLs generated after 12/31/17 that do not expire
- Consider as source of income for assessing the realizability of deferred tax assets that reverse into NOLs that do not expire

Description	Tax Effected Balance	2018	2019	2020
Other deferred tax assets	2,310,000	(770,000)	(770,000)	(770,000)
Tax goodwill	(1,680,000)			
Net operating losses	10,500,000	770,000	770,000	770,000
Total temporary differences	**11,130,000**			
Valuation allowance (before indefinite-lived DTL)	**(12,810,000)**			
Total tax effected temporary difference	**(1,680,000)**			
Valuation allowance release (after indefinite-lived DTL)	**1,344,000**			
Adjusted total tax effected temporary difference	**(336,000)**			
Amount of reversals into indefinite NOL	2,310,000			
Maximum utilization of indefinite NOL (80% of DTL)	1,344,000			
Valuation allowance release (lesser of the 2)	1,344,000			

Accounting for Income Taxes (ASC 740)
Outside Basis Differences

Outside Basis Differences and Indefinite Reinvestment
The presumption…

ASC 740-30 provides a presumption for undistributed earnings of a subsidiary:



Outside Basis Differences and Indefinite Reinvestment
The exception…

- Exception to the recognition of deferred taxes:
  - If the indefinite reversal criteria is met, a deferred tax liability shall not be recognized for an excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary unless it becomes apparent that the temporary difference will reverse in the foreseeable future
- The indefinite reversal criteria:
  - The presumption that all undistributed earnings will be transferred to the parent entity may be overcome, and no income taxes shall be accrued by the parent entity, if sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation
  - A parent entity shall have evidence of specific plans for reinvestment of undistributed earnings of a subsidiary which demonstrate that remittance of the earnings will be postponed indefinitely
  - Experience of the entities and definite future programs of operations and remittances are examples of the types of evidence required to substantiate the parent entity's representation of indefinite postponement of remittances from a subsidiary

Outside Basis Differences and Indefinite Reinvestment
Reminders

- Tax reform ***did not eliminate*** the need for an entity to consider its assertion about the indefinite reinvestment of undistributed earnings when a taxable temporary difference exists
- A company should consider its expected manner of recovery in determining to what extent, if any, a taxable temporary difference exists with respect to a subsidiary
  - Temporary differences may exist with respect to Section 986(c) currency gains (losses) on previously tax income (PTI), section 965(b) PTI, withholding taxes, and state taxes
- Continue to evaluate the ability to assert indefinite reinvestment to avoid recognizing deferred tax consequences associated with taxes that would become due once an actual distribution is made
- Consider different intentions on the part of the operations of the business due to the potential accessibility of cash with limited tax cost
- As economic conditions change or as new transactions are planned as a result of changing economic conditions, an entity may reevaluate its global cash needs and revise its plans for repatriating or reinvesting foreign earnings

Accounting for Income Taxes (ASC 740)
Accounting Changes and Error Corrections

ASC 250 – accounting changes and error corrections *(ASC 250-10-20)*

Change in estimate (defined)

“A change that has the effect of adjusting the carrying amount of an existing asset or liability or altering the subsequent accounting for existing or future assets or liabilities.

A change in accounting estimate is a necessary consequence of the assessment, in conjunction with the periodic presentation of financial statements, of the present status and expected future benefits and obligations associated with assets and liabilities.

Changes in accounting estimates result from new information.”

Error (defined)

“An error in recognition, measurement, presentation, or disclosure in financial statements resulting from mathematical mistakes, mistakes in the application of generally accepted accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared.

A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error.”

Examples – change in estimates

Change in judgment or new info

- Change in judgment resulting from new information regarding
  - sustainability of a tax position
  - need for valuation allowance
- New information not reasonably knowable as of prior period
  - on basis of other taxpayer's experience with similar circumstances
  - not readily accessible from entity's books/records at prior reporting date
- Issuance of a new administrative ruling

Other changes in estimates

- Developing additional technical insight, with the assistance of advisors, into application of complex or technical tax issues
- Retroactive tax election that affects positions on prior tax returns due to factors occurring after balance sheet date
- Deciding to pursue a tax deduction or credit retroactively that was previously considered not to be economical but that becomes prudent due to change in facts and circumstances

Examples – errors

Errors

- Misstatement of a tax accrual
- Mathematical error in a prior year tax provision
- Oversight or misuse of facts or failure to use information "reasonably knowable" and "readily accessible" at balance sheet date
- Misapplying a rule or requirement or provisions of GAAP
- Adjusting an amount for information readily accessible at prior reporting period

Accounting for and reporting a change in estimate or an error (i.e., when to record)

Change in accounting estimate

"A change in accounting estimate shall be accounted for in the period of change if the change affects that period only or in the period of change and future periods if the change affects both.

A change in accounting estimate shall not be accounted for by restating or retrospectively adjusting amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods."

(ASC 250-10-45-17)

Correction of an error

"Any error in the financial statements of a prior period discovered after the financial statements are issued or are available to be issued, shall be reported as an error correction, by restating the prior-period financial statements."

(ASC 250-10-45-23)

Restatements – material versus immaterial

ASC 250-10-20 defines a restatement as a revision of previously issued financial statements to reflect correction of an error

Material restatement

- Considered material if error(s) being corrected is **material**
- For public companies, generally results in additional filings, disclosures, and language in audit report and use of special financial statement column headings (e.g., "as previously reported," "adjustments," "as restated")

Immaterial restatement

- Considered immaterial if error(s) being corrected is **not material**
- Prior period amounts are updated and footnote disclosure describing effect of immaterial restatement is typically required
- Sometimes referred to as "little r" restatement

! **CONSULTATION WITH YOUR ATTEST FIRM IS RECOMMENDED**

Error correction – internal control considerations

Management's assessment (auditor-detected errors)

- Management is required to consider misstatements the auditor detects by performing substantive procedures as a possible indication of a control failure when they are assessing operating effectiveness of related controls
- Management's assessment of nature and cause of misstatement may include considering whether misstatement arose as a result of
  - absence of one or more necessary controls
  - improperly designed or implemented controls
  - breakdown in operating effectiveness of implemented controls
  - potential that management overrode one or more established controls over financial reporting
- Control deficiencies that rise to the level of significant deficiencies or material weaknesses need to reported by the auditor to those charged with corporate governance (e.g., audit committee)

Impact of error on internal controls – classification of deficiency

"A **deficiency** in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis."

"A **material weakness** is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis."

"A **significant deficiency** is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting."

FASB Developments and New Standards

FASB Disclosure Framework Income Taxes - Update

FASB Disclosure Framework: Income Taxes

As part of its disclosure framework project, the FASB proposed improvements to income taxes disclosures to test the effectiveness of its framework

- July 2016 – Exposure Draft issued
- November 2018 – Began actively re-deliberating comments on the exposure draft and effects of tax reform
- March 2019 – Revised Exposure Draft issued
- Proposed amendments would:
  - Replace the term *public entity* in Topic 740 with the term *public business entity* (PBE)
  - Be applied prospectively
- Effective date – To be determined

FASB Disclosure Framework: Income Taxes

Proposed Additional Disclosures – All Entities

- Income (or loss) from continuing operations before intra-entity eliminations and income tax expense (or benefit) disaggregated between domestic and foreign
- Disaggregate the following between federal, state and foreign*:
  - Income tax expense (or benefit) from continuing operations; and
  - Income taxes paid
  - For interim periods, total income taxes paid.

* Amounts imposed by the country of domicile on foreign earnings would be included in federal.

FASB Disclosure Framework: Income Taxes

Proposed Additional Disclosures – PBEs Only

- The ending balance of unrecognized tax benefits by balance sheet line item
- The amount and explanation of the valuation allowance recognized and released

FASB Disclosure Framework: Income Taxes

Proposed Modifications to Disclosures – PBEs Only

Current

- Amounts and expiration dates of carryforwards shown on the income tax return

Proposed

- Amounts of federal, state and foreign carryforwards (tax effected) before valuation allowance; disaggregated by expiration for the first 5 years, total for any remaining years and total for those that do not expire
- Amount of valuation allowance recognized for federal, state and foreign carryforward deferred tax assets
- Total amount of unrecognized tax benefits that reduces deferred tax assets for carryforwards

FASB Disclosure Framework: Income Taxes

Proposed Modifications to Disclosures – PBEs Only

Current

- A reconciliation (using percentages or dollar amounts) of the reported income tax expense to the income tax expense that would result from applying the domestic federal rate to pretax income

Proposed

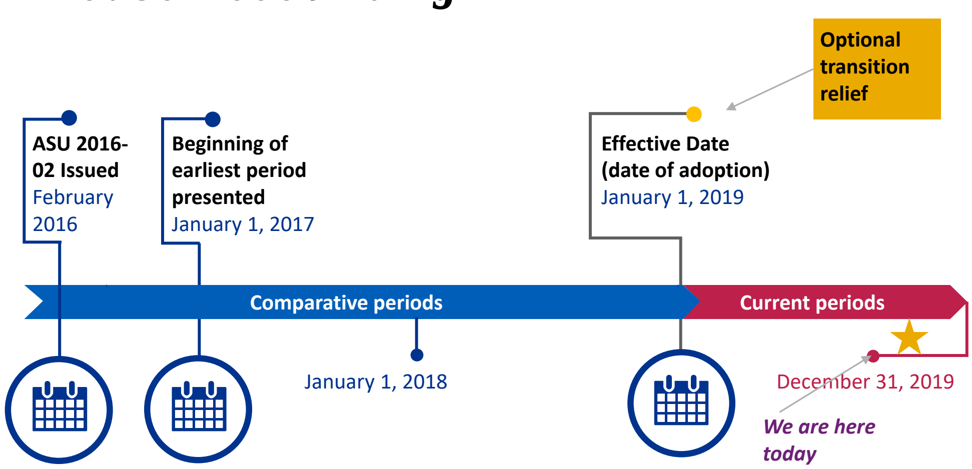
- Disclosure would be aligned with the SEC requirement to:
  - Identify the 'domestic' rate as the federal income tax rate in its country of domicile;
  - Explain the basis for using rate other than the federal rate; and
  - Separately disclose reconciling items that are more than five percent of the amount computed by multiplying income before tax by the applicable statutory federal income tax rate
  - Public business entities would also be required to explain year-to-year changes in those items

FASB Disclosure Framework: Income Taxes

Proposed Removal of Disclosures – All Entities

- The nature and estimate of possible changes in unrecognized tax benefits for the next 12 months.
- The cumulative amount of each type of temporary difference not recognized because of the exception to recognizing deferred taxes related to subsidiaries and corporate joint ventures.

ASC 842 – Lease Accounting



— **Public entities**: effective for annual and interim periods in fiscal years beginning after December 15, 2018

— **All other entities**: effective for annual periods in fiscal years beginning after December 15, 2019, and interim periods in fiscal years beginning after December 15, 2020

ASC 842 – Lease Accounting

Tax rules governing leasing transactions will not change, however, the adoption of ASC 842 will likely affect the calculation of deferred tax assets and liabilities

ASC 842 may spotlight the company's historical tax treatment of leases

- Double-check that it is correct
- Consider risk mitigation, if appropriate

Lease classification

- Is your company "just following books" to distinguish true leases from tax ownership?
- If so, develop a game plan for assessing and managing potential IRS audit exposure

Capitalized costs

- Tax generally capitalizes different lease acquisition costs than those required for financial accounting purposes

Rent or interest / depreciation expense

- Does your company currently record any book/tax differences for rent expense (for true leases) or interest expense (for capital leases)?
- If not, does this signal a potential IRS exposure item?

Consider state and local tax implications

Additional Considerations

Altera Case Accounting Considerations

June 7, 2019 decision by the U.S. Court of Appeals for the Ninth Circuit in Altera Corporation & Subsidiaries v. Commissioner of Internal Revenue

- 3-judge panel of the Ninth Circuit upheld the validity of the 2003 regulations overturning a Tax Court decision that held the regulations were invalid
- Ninth Circuit sided with IRS with respect to application of regulations requiring stock-based compensation costs to be included in the pool of costs shared in a cost-sharing arrangement

FIN 48 considerations:

- Assume positions will be examined
- Impact on Ninth Circuit resident Taxpayers
- Impact for taxpayers residing outside of the Ninth Circuit

Altera Case Next Steps

Panel rehearing

• Any judge can ask the three-judge panel if it wants to rehear the case itself (grant panel rehearing). The panel has up to 90 days (from the date of the government's latest response to the court) to respond.

Rehearing en banc

• Assuming panel rehearing is rejected, then any judge could call for en banc vote. The judges have two weeks to call for a vote. If no judge calls for a vote, the petition is denied. If a judge calls for a vote, the judges have three weeks to debate whether to grant rehearing en banc, then two weeks to vote.

• If the court grants rehearing en banc, the panel decision is vacated and an 11-judge panel is drawn to rehear the case

State Aid Case Updates

The following European Commission (EC) state aid cases have either had rulings or are still in process:

Country	Company	Case Status/Outcome
Luxemburg	Amazon	Ongoing
Ireland	Apple	Ongoing
Luxemburg	Fiat	EC decision upheld
Netherlands	Ikea	Ongoing
Luxemburg	McDonald's	Ongoing
Netherlands	Nike	Ongoing
Netherlands	Starbucks	EC decision overruled

Appendix

2018 AICPA National Conference - *Conference Theme*

This year's theme was consistent with prior years focused on collaboration and transparency. All participants in the financial reporting supply chain need to work together to provide investors with transparent and decision-useful information.

All parties should be aligned in their objective – to present investors with high-quality, decision-useful reporting that supports efficient capital markets.

Internal Control Over Financial Reporting

- In assessing internal controls, management should focus on both the operation of controls as designed (which is built on the premise that the controls are adequately designed to address risks) and considering the level of evidence required to evaluate the control.
- Control deficiencies. In determining whether the identified deficiency, either alone or in combination with other identified control deficiencies, rises to the level of a material weakness, management should evaluate the level of detail and assurance needed to support their conclusions by considering what the views of a "prudent official" would be in conducting their own affairs. Management must focus on a holistic assessment of that deficiency, not just the identified misstatement.

SEC Staff Observations

- Capital formation and disclosure effectiveness are among the top priorities of the SEC's Division of Corporation Finance
- The SEC staff has worked to streamline its rules, including making amendments to eliminate, modify, or integrate into other SEC requirements certain disclosure rules, and proposing rules to simplify certain disclosure requirements
- The SEC staff is also looking into whether the auditor attestation on ICFR continues to be beneficial for certain smaller reporting entities
- Key message simpler is better

SEC Staff Observations (continued)

- Frequent SEC comment letter trends include
  - Revenue recognition
  - Business combinations
  - Goodwill and intangible assets
  - Income taxes
  - Non-GAAP measures
  - MD&A
  - Fair value disclosures
  - Segments

PCAOB Update

- 2019 PCAOB inspection areas of focus include:
  - System of Quality Control – increase focus on the design and operating effectiveness of firms system of quality control.
  - Independence – continue focus on firm independence matters, including how firms maintain their independence in fact and appearance, educate their professional on independence requirements, monitor compliance and assess the impact on independence of non-audit services.
  - New auditing standards, including the auditor's reporting model.
  - New technology, cybersecurity risk, software auditing tools and response to digital assets.
  - Plan to consider how firms may be using Audit Quality Indicators (AQIs) to monitor their audit work and staff development and whether firms are discussing AQI results with audit committees.

Thank You