TEI-SJSU High Tech Tax Institute (37th Annual - 2021)

ASC 740 Updates

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Agenda

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Tax accounting for business combinations

Tax accounting for business combinations

ASC 805 - Business Combinations

- Assets and liabilities acquired are accounted for at fair value
- Deferred taxes arising from the business combination are accounted for under ASC 740

Asset acquisition

- Fair value tax bases of assets and liabilities acquired
- Tax basis generally equals book basis on day one

Stock acquisition

- Historical tax bases of assets, liabilities and attributes carryover to buyer
- Tax basis may not equal book basis on day one

Book goodwill > Tax goodwill = No DTL

Tax goodwill > Book goodwill = DTA

Business combinations

Valuation allowance assessments

- Record a valuation allowance against acquired DTAs that are not "more likely than not" to be realized
- Valuation allowances will need to be assessed to determine whether they are:
  - Change in acquiree
  - Change in acquirer

Outside basis differences

- Recording of deferred taxes is based on buyer's intent related to acquired investments
  - Regardless of any assertions maintained by target before the acquisition

What to watch for

- **Deferred scheduling – attribute utilization limitations**
- **Valuation allowance release when both Target and Buyer have a valuation allowance**
  - Which assets are being recognized?
  - More complex post TCJA
- **State taxes**
  - Changes in apportionment
  - Separate v. combined
  - Instant unity
  - Attribute utilization limitations
- **Asset valuations by legal entity**

2 Goodwill impairment

Goodwill impairments

Key reminders:

- ASU 2017-04 became effective for calendar year SEC filers in 2020 and will be effective in 2023 for other entities
- Companies have the option of performing a qualitative assessment of goodwill impairment
- To the extent an entity bypasses or fails the qualitative assessment, a quantitative goodwill impairment test is performed

Deferred tax impacts depend on whether a company has tax deductible goodwill

What to watch for

- **Tracking tax goodwill by tax-paying component**
  - Foreign currency
  - Impacts of intra-entity transfers (ASU 2019-12)
- **Tax effects of Impairment**
  - Simultaneous equation

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Deferred tax accounting considerations for IRC 162(m)

Section 162(m) – $1 million dollar compensation deduction limit

Post-U.S. tax reform

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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 cumulative deductible amount of share-based compensation for tax purposes using the grant-date fair value and the cash compensation
- Policy election of treating stock compensation expense occurs first, last or pro rata
- 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
  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 to watch for

- **ARPA 2021 Application – Timing and Scheduling**
  - Covered employee categorization
  - Tracking, forecasting and scheduling especially with newly added 5 additional a8c42<.8(utache

4 Valuation allowances

Valuation allowances

Key reminders:

Valuation allowances (continued)

Common myths

Myth: A short term outlook forecast meets the all evidence criteria.

- Short-term outlook by management is generally not considered to be appropriate under ASC 740
- Uncertainty about the sustainability of taxable income

5 Tax accounting for U.S. legislative developments

U.S. legislative developments

U.S. legislative developments (continued)

Key reminders:

Enactment: the anticipated impact of tax reform **cannot** be recorded prior to enactment, which for US federal purposes is the date the president signs the bill into law.

Continuing operations: the total effects of the law changes on current and deferred taxes are accounted for as a component of continuing operations.

Other considerations

Accounting methods
- Timing of recognition
- Potential for impact to effective tax rate if reform is enacted

Annual elections
- Elections made each year with the tax return
- Best estimate as of each balance sheet date

Prepayments
- Accounting for the transaction for both the buyer and seller
  - Pre-tax accounting: sale & prepayment
  - Tax accounting: deferreds
- Valuation allowance considerations

IP transfers
- Determination of tax basis and method of recovery
- Timing of recognition of the current and deferred impacts

What to watch for

- **Prepayments**
  - Inventory - does ARB 51 apply?
  - Proper tax method to effectuate the planning?
  - State impacts
  - Unrecognized tax benefits for transfer pricing
- **AETR v. discrete impacts of tax law changes**
- **Impact on non-GAAP**

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SEC comment letters

Comment letter themes – Income tax

*% shown is out of total income tax related comments

54%

Omitted or inadequate disclosure

- indefinite reinvestment
- discrete events
- uncertain tax positions
- revenue recognition

Explain the nature of and amounts related to each of the discrete tax charge that resulted in the significant increase in your ETR…

29%

Other

- non-GAAP disclosures
- DC solar credits
- footing errors
- out of period adjustments

You present certain adjustments in your non-GAAP performance measures…net of income taxes. Please revise to present the effect of income taxes as a separate adjustment and expand your disclosure to clearly explain how the tax effects of non-GAAP adjustments are calculated.

17%

Valuation allowances

- weighting of evidence
- cumulative losses in recent years
- 2017 tax act

Thank you