TEI-SJSU High Tech Tax Institute
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Accounting for income taxes

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Notice

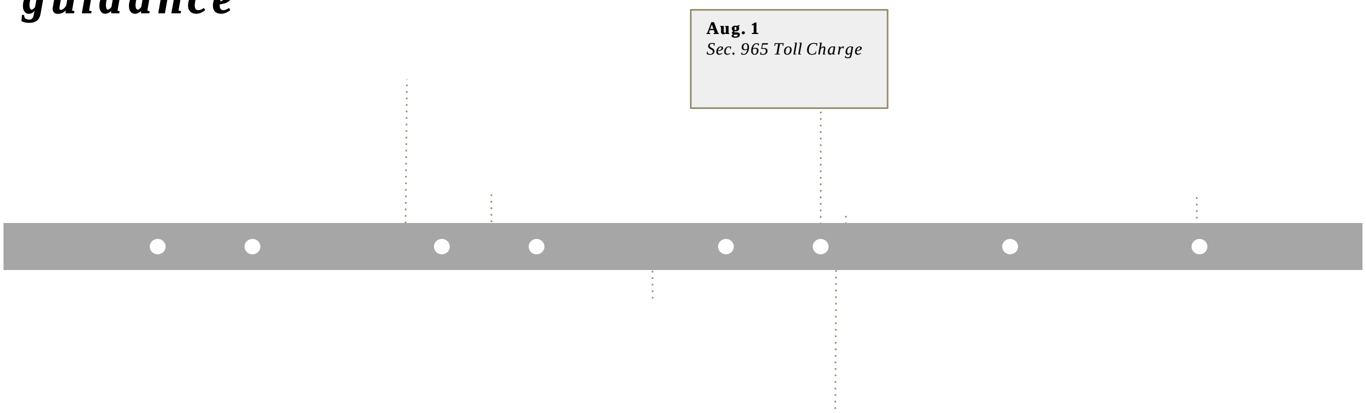
The following information is not intended to be “written advice

Outline of Topics

1. Accounting for US Tax Reform
   - Tax Reform considerations
   - Post Reform considerations
   - End of SAB 118
2. SEC and PCAOB on income taxes
   - 2017 AICPA National Conference on Current SEC and PCAOB developments
   - SEC comment letter trends
3. Standard settings update
   - Leasing standard
   - ASU 2018-02: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

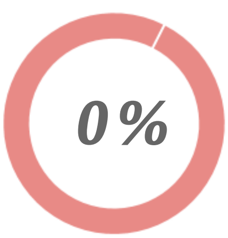
Accounting for US Tax Reform

US Tax Reform - Timeline of significant tax reform guidance

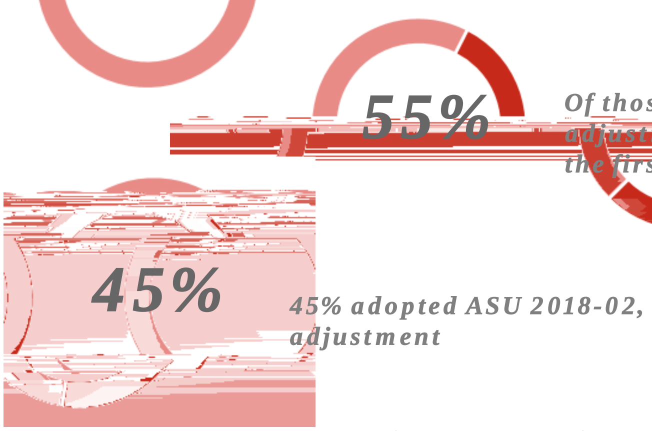


The current landscape

SEC Reporting: Q2 SAB 118 Disclosures - Dow 30



Of those who relied upon the SAB 118, 0% completed accounting for the 2017 ACT in the second quarter

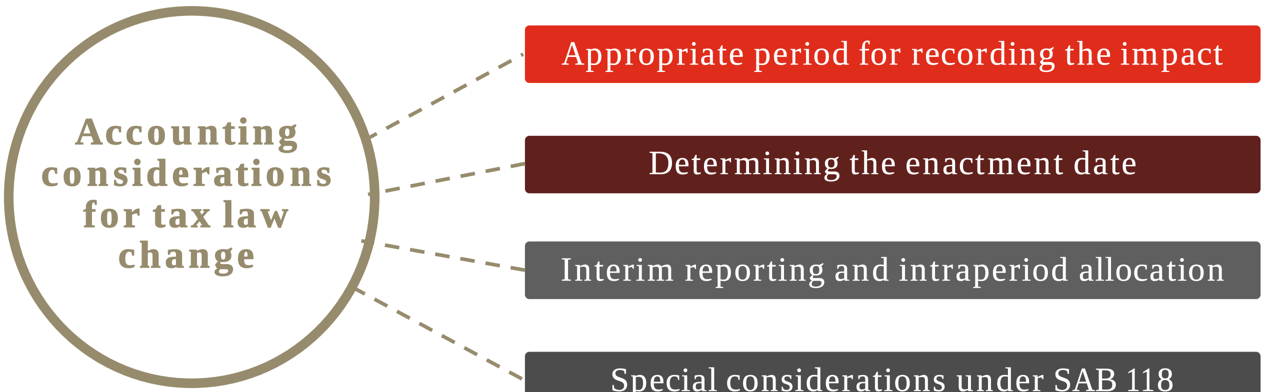


Of those who relied upon the SAB 118, 55% recorded adjustments to provisional estimates during either the first (25%) or second (35%) quarter

45% adopted ASU 2018-02, all of whom recorded a reclass adjustment

*** Based upon the 22 quarterly filings by the members of the Dow 30 with second quarter reports filed between 7/15/2018 and 8/23/2018*

Accounting for tax law changes



Section 965 proposed regulations

Issue	Provision	Impact
Treatment of withholding taxes imposed on the distribution of Section 965 PTI.	Prop. Treas. Reg. § 1.965-5(c)	• Domestic corporate shareholder's cannot claim a foreign tax credit for the applicable percentage of any withholding taxes imposed on distributions of section 965 PTI.
Treatment of taxes imposed on section 965(b) PTI	Prop. Treas. Reg. § 1.965-5(c)	• No foreign tax credit is allowed for any foreign income taxes that would have been deemed paid under section 960(a)(1) with respect to the portion of the section 965(a) earnings that is reduced by reason of a deficit offset.
Application of the basis reduction election	Prop. Treas. Reg. § 1.965-2(f)(2).	• US Shareholders will not get basis in section 965(b) PTI without making the election described in Prop. Treas. Reg. § 1.965-2(f)(2).
Treatment of disregarded transactions and location of E&P	Prop. Treas. Reg. § 1.965-4(f)	• E&P of payor is increased to the extent of any disregarded specified payment

Fiscal year-end company considerations

- Calculation of the blended corporate tax rate
- Repeal of corporate Alternative minimum tax (AMT)
- Net operating loss (NOL) modification effective dates
    - Losses arising in taxable years ending after December 31, 2017 vs. Congressional intent to provide modification effective arising in taxable years beginning after December 31, 2017.
- Aggregate foreign cash position of a U.S. shareholder is the greater of:
    - Cash at close of its SFCs' last tax year beginning before January 1, 2018 (i.e., closing cash of the inclusion year); or
    - Average of cash at (a) the close of the last taxable year of the SFCs ending before November 2, 2017 and (b) the preceding taxable year (i.e., the average of the prior two taxable years before the inclusion year).

Post Reform Considerations

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

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•

Deferred tax accounting for GILTI

Valuation allowance considerations

- With and Without approach
  -

Deferred tax accounting for GILTI

Valuation allowance considerations

- Period approach
    -

Valuation allowance considerations

Net operating losses (NOLs)

- Comparison of pre- and post-

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			

Internal control over financial reporting

- Whether annual and/or interim period financial statements are issued, make sure appropriate systems, processes and controls are in place to timely collect accurate data and to accurately perform calculations

- Monitor the issuance of the additional IRS regulatory guidance to determine its impact on positions taken in prior interim (or annual) periods

- A subsequent return-to-provision adjustment, if based on information that was reasonably available at the time that the prior financial statements were prepared, may constitute a correction of an error (and an internal control weakness)

Outside basis differences and indefinite reinvestment

- A company that does not assert indefinite reinvestment measures the deferred tax consequences based on the expected manner of recovery
- With respect to changes in recognized deferred tax balances:
  - Consider the intraperiod tax allocation in assessing the impact of Section 986(c) and changes in state taxes due to currency fluctuations
  - Changes in withholding taxes accrued as a result of currency fluctuations is considered a transaction gain or loss and recognized as a component of earnings

Outside basis differences and indefinite reinvestment
Foreign taxable temporary differences

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

Outside basis differences and indefinite reinvestment

Outside basis differences and indefinite reinvestment

Indefinite reinvestment considerations

- Policy may differ by subsidiary
- Treatment of Subpart F income (unrealized Subpart F)
- Continued reinvestment of prior earnings when future earnings

Outside basis differences and indefinite reinvestment

Indefinite reinvestment considerations

- A subsidiary should have a plan or use for unremitted earnings which may include acquisitions, expansions, funding for other group members or settlement of debt, amongst other potential uses that demonstrate the reversal of the outside basis difference will be postponed indefinitely
-

Outside basis differences and indefinite reinvestment

Post tax reform

Key takeaways

- The outside basis accounting model has ***not changed***
- Companies will need to ***continue to assess*** and evaluate their intentions with respect to outside basis differences
- Changes in US tax law may have ***impacted the assertion***

Facts & circumstances matter

Measurement based upon the facts at the balance sheet date

Tax law is relevant when measuring

END OF SAB 118

End of SAB 118 measurement period considerations

Year end considerations

- When accounting is considered complete for enactment-date effects of the Act or the measurement period ends, a company will no longer be able to apply the "reasonable estimate" guidance in SAB 118
- Regulatory or interpretative guidance issued after measurement period ends or after a company completes its accounting would constitute new information that could trigger changes in recognition and/or measurement of tax positions in the period in which change in judgment occurs

Uncertain tax positions

- Evaluate tax positions based on existing tax law and other sources of authority that exist at that time (i.e., tax law, Internal Revenue Code, regulations interpreting such statutes, IRS rulings)
- If return

Change in accounting estimate

Disclosure examples of completed accounting

Year-end income tax note for a calendar year-end company that completes its accounting in the fourth quarter.

The Tax Cuts and Jobs Act (the Act) was enacted in the US on 22 December 2017. The Act reduced the US federal corporate income tax rate to 21% from 35%, required companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and created new taxes on certain foreign-sourced earnings. In 2017 and the first nine months of 2018, we recorded provisional amounts for certain enactment-date effects of the Act by applying the guidance in SAB 118 because we had not yet completed our enactment-date accounting for these effects. In 2018 and 2017, the Company recorded tax expense related to the enactment-date effects of the Act that included recording the one-time transition tax liability related to undistributed earnings of certain foreign subsidiaries that were not previously taxed, adjusting deferred tax assets and liabilities and recognizing the effects of electing to account for GILTI in deferred taxes [if the company makes this policy election]. The changes to 2017 enactment-date provisional amounts increased the effective tax rate in 2018 by X.

SAB 118 measurement period

We applied the guidance in SAB 118 when accounting for the enactment-date effects of the Act in 2017 and throughout 2018. At 31 December 2017, we had not completed our accounting for all of the enactment-date income tax effects of the Act under ASC 740, Income Taxes, for the following aspects: remeasurement of deferred tax assets and liabilities, one-time transition tax, and tax on global intangible low-taxed income. At 31 December 2018, we have now completed our accounting for all of the enactment-date income tax effects of the Act. As further discussed below, during 2018, we recognized adjustments of $XXX to the provisional amounts recorded at 31 December 2017 and included these adjustments as a component of income tax expense from continuing operations.

2017 AICPA National Conference - *Conference theme*

This year's theme focused on the role that everyone (management, audit committee, auditors, regulators, and standard setters) has to play in providing investors with decision-useful information. The objectives of investor protection and capital formation are best accomplished when there is effective communications among all of the members of the financial reporting supply chain.

Internal control over financial reporting

- It's important for ICFR to be updated to reflect new accounting pronouncements and to allow sufficient time to design and test new controls
- The COSO Risk Assessment component directs companies to identify and assess changes that could significantly impact their system of internal control. This "adaptive mechanism" should be helpful in identifying changes necessary when adopting new accounting standards

SEC staff observations

- Capital formation and disclosure effectiveness are among the top priorities of the SEC's Division of Corporation Finance
- Guidance issued earlier this year allows non-EGCs to submit draft registration statements for non-public review and for that submission to exclude historical financial information that will not be required at the time of effectiveness
- Proposed rules were issued to streamline and reduce redundant disclosure requirements under Regulation S-K
- SEC staff will be looking at ways to potentially streamline requirements related to the financial statements of certain entities, including acquirees and guarantors, and the requirements related to mining disclosures, resource extraction, conflict minerals and Industry Guide 3

SEC staff observations (continued)

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

PCAOB update

- 2018 PCAOB inspection areas of focus include:
  - New accounting standards, including the firm's implementation and training
  - New auditing standards, including the auditor's reporting model
  - New technology, including cybersecurity and software auditing tools;
  - Specific risks, such as those related to mergers and acquisitions, natural disasters, tax reform

Highlights

Lease classification – Tax vs. Current & New GAAP

Test	Tax (sale/financing if test met)	Current GAAP (capital lease if test met)	New GAAP (finance lease if test met)
Ownership transfer by EOL	Yes	Yes	Yes
Lessee Purchase Option	Less than FMV/exercise reasonably likely	Bargain Purchase Option	Exercise reasonably certain
Useful Life	≥ 80 percent of asset's economic life	≥ 75 percent of asset's economic life	Term is for "major part" of asset's economic life
Residual Value	≤ 20 percent of asset's FMV	Lease pmts PV ≥ 90 percent of asset's FMV	Lease pmts PV ≥ "substantially all" of asset's FMV
Alternative Use	Limited-use property	N/A	No Alt Use at EOL

Lease schedule (Book)
Today’s treatment

Book:

	Lease schedule			**Incentive schedule**		
	Cash payment	**Straight line lease expense**	**Deferred rent**	**Cash receipt**	**Lease incentive expense (income)**	**Tenant incentive obligation**
Commencement				10,000		(10,000)
1	(14,527)	16,654	(2,127)		(1,000)	(9,000)
2	(14,963)	16,654	(3,817)		(1,000)	(8,000)
3	(15,412)	16,654	(5,059)		(1,000)	(7,000)
4	(15,874)	16,654	(5,838)		(1,000)	(6,000)
5	(16,350)	16,654	(6,142)		(1,000)	(5,000)
6	(16,841)	16,654	(5,954)		(1,000)	(4,000)
7	(17,346)	16,654	(5,262)		(1,000)	(3,000)
8	(17,866)	16,654	(4,049)		(1,000)	(2,000)
9	(18,402)	16,654	(2,301)		(1,000)	(1,000)
10	(18,954)	16,654	-		(1,000)	-
Subtotal	**(166,535)**	**166,535**			**(10,000)**	

Book vs. tax
Today’s treatment

Book:

Balance sheet	
Lease liability (Deferred rent)	**Tenant incentive liability**
	(10,000)
(2,127)	(9,000)
(3,817)	(8,000)
(5,059)	(7,000)
(5,838)	(6,000)
(6,142)	(5,000)
(5,954)	(4,000)
(5,262)	(3,000)
(4,049)	(2,000)
(2,301)	(1,000)
-	-

Change in balance sheet		
Cash DR (CR)	**Lease liability DR (CR)**	**Tenant incentive liability DR (CR)**
10,000		(10,000)
(14,527)	(2,127)	1,000
(14,963)	(1,691)	1,000
(15,412)	(1,242)	1,000
(15,874)	(780)	1,000
(16,350)	(304)	1,000
(16,841)	188	1,000
(17,346)	693	1,000
(17,866)	1,213	1,000
(18,402)	1,749	1,000
(18,954)	2,301	1,000
(156,535)	**-**	**-**

Income statement
Lease expense (income) DR (CR)
15,654
15,654
15,654
15,654
15,654
15,654
15,654
15,654
15,654
15,654
156,535

Temporary difference
(Tax –

Book vs. tax
ASC 842 treatment

Comparison: ASC 840 vs. ASC 842

Current and Deferred Taxes:

Balance sheet		Change in balance sheet			Income statement		
Deferred tax asset (liability) – Lease liability	Deferred tax asset (liability) – Tenant Incentive	Income taxes receivable (payable) DR (CR)	Deferred tax asset (liability) – Lease liability DR (CR)	Deferred tax asset (liability) – Tenant Incentive DR (CR)	Deferred tax expense (benefit) DR (CR)	CurrentRO	
–	3,000	(3,000)	–	3,000			
638	2,700	4,358	638	(300)			
1,145	2,400	4,489	507	(300)			
1,518	2,100	4,624	372	(300)			
1,751	1,800	4,762	234	(300)			
1,842	1,500	4,905	91	(300)			
1,786	1,200	5,052	(56)	(300)			
1,578	900	5,204	(208)	(300)			
1,215	600	5,360	(364)	(300)			
690	300	5,521	(525)	(300)			
–	–	5,686	(690)	(300)			
		46,961	–				

Key takeaways

- The adoption of ASC 842 will likely affect the calculation of deferred tax assets and liabilities
- The tax rules are not changing, but ASC 842 may put a spotlight on the company's historical tax treatment
- 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
- Rent or interest/depreciation expense
  - Does your company currently record any book/tax differences for rent expense (true leases) or interest expense (sales or financings)?
  - If not, does this signal a potential IRS exposure item?
- Consider state and local tax implications

ASU 2018 - 02

Accounting Standard Update (ASU) 2018-02

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

- The effect of new tax laws on deferred taxes initially recorded in OCI is recorded as tax expense related to continuing operations
  -

Accounting Standard Update (ASU) 2018-02 (cont.)

An entity that elects to reclassify these amounts must reclassify stranded tax effects related to the change in federal tax rate for **all** items accounted for in OCI (e.g., available-for-

Accounting Standard Update (ASU) 2018-

Disclosure example of adoption of ASU 2018-02

Thank You

TEI-SJSU High Tech Tax Institute

1. **Accounting for US Tax Reform**
    a. Tax reform considerations
        i. Current landscape and accounting
            1. High-level considerations
            2. Fiscal year taxpayer considerations
                a. Effective date considerations
                b. Corporate blended rate
                c. Cash balance determination
        ii. Deferred tax accounting
            1. GILTI overview
                a. Accounting policy election
            2. GILTI deferred taxes
                a. GILTI deferred a3edd ( )Tj /TT2 1 Tf -0.002 TcTc 6(y)8 aaxes
        i. Cumulative income/losses
        ii. Net operating losses
            1. Pre and Post reform generated losses
                a. Carryover periods
                b. Limitations
                c. Impact on tax strategies
        iii. Tax limitations
    c. Outside basis differences
        i. Deferred taxes related to outside basis differences
        ii. Changing an indefinite reinvestment assertion
        iii. Asserting indefinite reinvestment
    d. Internal control assessment
    e. End of SAB 118 measurement period considerations
        i. Year end considerations
        ii. Uncertain tax positions
        iii. Disclosures

2. **SEC and PCAOB on income taxes**
    a. 2017 AICPA National Conference on Current SEC and PCAOB developments
    b. SEC Comment Letters

3. **FASB Developments and Tax Impacts – New Standards**
    a. Leasing Standard
        i. Current vs. Revised Standard
        ii. Status, effective date and adoption method
        iii. Tax Implications
    b. ASU 2018-02: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income Status, effective date and adoption method