Notice

- *The following information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.*
- *The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.*

Outline of Topics

1. SEC and PCAOB on income taxes
    - 2015 and 2014 AICPA National Conference on Current SEC and PCAOB developments
    - SEC Comment Letters
    - Non-GAAP measures
2. Recently issued and Proposed ASUs
    - ASUs
    - Disclosure framework
3. New accounting pronouncements
    - ASU 2016-09: Employee share-based payment accounting improvements
    - ASU 2016-16: Intra-entity asset transfers

5. State Aid update
    - Accounting and reporting

SEC and PCAOB on income taxes

2015 AICPA National Conference

-

2015 AICPA National Conference (continued)

- Division of corporation finance (continued)
    -

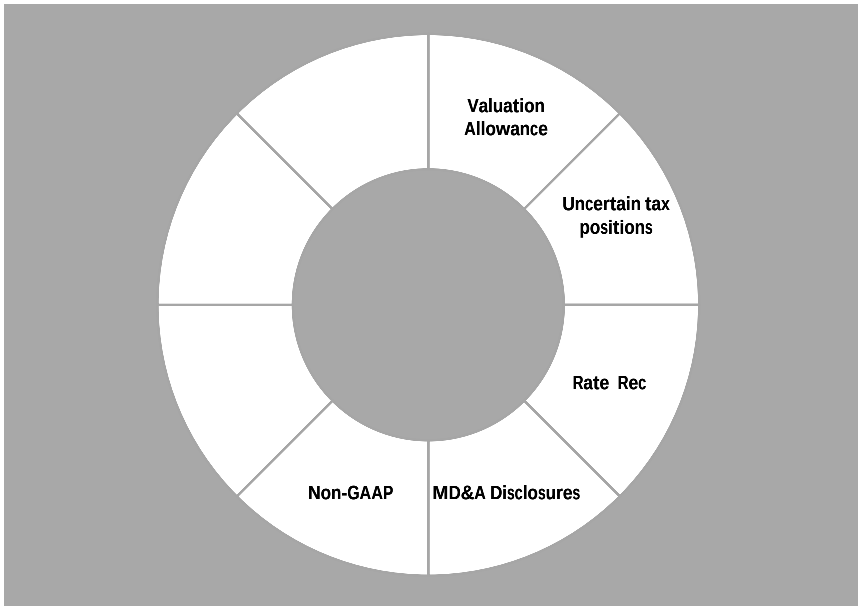
2014 AICPA National Conference

- At the 2014 AICPA National Conference on Current SEC and PCAOB Developments, representatives of the SEC indicated the trend of frequent comments on income taxes has continued
- The Division of Corporation Finance Staff discussed circumstances where there could be improvements in income tax disclosures, including situations in which there are:
    - Significant differences between the expected income tax expense and the actual income tax expense
    - Significant changes in the annual effective income tax rate or materially volatile but offsetting components
    - Material components in the rate reconciliation that .6(d)-0.6(i)a3(n)-0.b.4(f)6(f)12.7(s)-1..6(e)-1( )-cseils

2014 AICPA National Conference (continued)

- Division of Corporation Finance Staff have been and will continue to be focused on foreign income and related taxes
- The Staff observed that they continue to see registrants making generic disclosures about changes in foreign taxes that are not sufficient for investors to understand the material risks and uncertainties associated with an entity's foreign taxes

SEC Comment Letter Themes



SEC Comment Letter Trends

- SEC comment letters continue to highlight:
- Foreign earnings unremitted to the US and the tax impact of their potential repatriation
- Judgments around the need for a valuation allowance
- The components of companies' effective tax rate reconciliation
- Uncertain tax positions

SEC Comments

MD&A – General observations

Enable users to see the company through the eyes of management. MD&A disclosures should be:

- Transparent in providing relevant information
- Tailored to the company's facts and circumstances
- Consistent with financial statements and other public communications
-

SEC Comments

MD&A – Results of operations

Highlight and explain activities driving material changes period-over-period.

- Disclosing known trends - disclose events that have occurred and how those events were a positive or negative indicator of future performance
- Drivers behind fluctuations – disclose significant fluctuations between periods, including quantification of factors
- Consistency of information – staff may question why information disclosed on earnings calls and press releases are not included in the MD&A discussion
- Segment discussion – staff comments have encouraged the use of segment analysis to provide more in-depth explanation

> *"When you identify multiple factors contributing to the changes in the line items comprising income from continuing operations, please quantify each factor in accordance with the guidance in Item 303(a)(3) of Regulation…"*

SEC Comments

Income Tax – Other specific areas

- Discussion of underlying factors included in the effective tax rate reconciliation
- Provide support for the recognition or release of a valuation allowance
- Uncertain tax positions
- Indefinite reinvestment of foreign earnings and liquidity constraints
- Disclosures regarding pre-tax income from U.S. and foreign jurisdictions

SEC Comments

Effective tax rates

- Volatility of effective tax rates
- Effective tax rates do not change because material changes in components are offsetting
- Tax rates that appear unusual relative to the expected statutory rate

"We note that your effective tax rate is substantially different than the U.S. Statutory tax rate of 35%. With reference to your reconciliation of United States statutory rates to the effective rates, please revise future filings to expand your discussion to thoroughly address all items impacting your effective tax rates for each period, including foreign taxes and valuation allowances."

SEC Comments

“We note the evidence you considered for the release of the majority of your valuation allowance against your U.S. federal and state deferred tax assets in the fourth quarter of 201X. Based on your historical operating results, it appears that the realization of your deferred tax assets is dependent on material improvement over present levels of pre-tax income, including the impact of acquired entities. Given the significant portion of U.S. operating loss carryforwards expiring between 202Y and 202Z, tell us in detail the material assumptions underlying your determination of the expected U.S. pre-tax income amount needed to realize your deferred tax

SEC Comments

Uncertain tax positions

- Better understanding of changes in positions and potential changes
- Variability in the effective tax rate reconciliation caused by uncertain tax positions
- Significant prior year position changes
- Justification for changes in measurement of uncertain tax positions in a particular period
- Disclose reasonably possible significant changes within the next 12 months

SEC Comments

Foreign earnings unremitted to the US and the tax impact of their potential repatriation:

- What level of evidence is maintained and disclosed by management for specific plans on reinvesting earnings
-

SEC Comments

Foreign earnings unremitted to the US and the tax impact of their potential repatriation:

"Given your significant foreign operations, please enhance your liquidity disclosures to address the following:

· Disclose the amount of foreign cash and cash equivalents you have as compared to your total amount of cash and cash equivalents as of the latest balance sheet date;

· Discuss the fact that if the foreign cash and cash equivalents are needed for your

Non-GAAP measures

- Chair Mary Jo White observed the following in respect to non-GAAP financial measures:
  - Used extensively
  - Can be a source of confusion in some instances
  - Deserve close attention (to make sure that the rules are being followed)
  - Consider whether existing rules are sufficient
- Asked preparers to carefully consider the following questions when they use non-GAAP measures:
  - Why is the measure being used?
  - How does it provide investors with useful information?
  - Is the explanation accurate and complete rather than boilerplate?
  - Is it being given greater prominence than GAAP measures?
  - Are there appropriate controls over the calculation?

SEC Compliance & Disclosure Interpretations

•CD&I Question 102.11, Prior to May 17, 2016

•*Question: May a registrant present an adjustment "net of tax" when reconciling a non-GAAP performance measure to the most directly comparable GAAP measure?*

•*Answer: Yes, provided that the tax effect of each reconciling item is disclosed parenthetically or in a footnote to the reconciliation. Alternatively, the company can present the tax effect in one line in the reconciliation. Regardless of the format of the presentation, registrants should disclose how the tax effect was calculated.*

What happened?

- New/updated CD&I's issued May 17, 2016
- Previously, CD&I's had not been updated since July 2011

SEC Compliance & Disclosure Interpretations

CD&I Question 102.11, Updated as of May 17, 2016

Question: *How should income tax effects related to adjustments to arrive at a non-GAAP measure be calculated and presented?*

Answer: *A registrant should provide income tax effects on its non-GAAP measures depending on the nature of the measures. If a measure is a liquidity measure that includes income taxes, it might be acceptable to adjust GAAP taxes to show taxes paid in cash. If a measure is a performance measure, the registrant should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability. In addition, adjustments to arrive at a non-GAAP measure should not be presented "net of tax." Rather, income taxes should be shown as a separate adjustment and clearly explained. [May 17, 2016]*

Non-GAAP Measures - Disclosures

- Different Measures = Different Tax Calculations

- May result in a tax rate applied that is different from a company's effective tax rate.

  - If a measure is a liquidity measure that includes income taxes, it might be acceptable to adjust GAAP taxes to show taxes paid in cash

  - If a measure is a performance measure, the registrant should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability

- Separate adjustment and, clearly explained

Non-GAAP measures –

PCAOB findings on income taxes

- 2016 staff inspection brief
    - The most frequently selected financial reporting areas in 2015 included revenue and receivables, non-financial assets, inventory, financial instruments, the allowance for loan losses, income taxes, benefit related liabilities and equity transactions
    - Key areas of insuons

Recently issued and Proposed ASUs

Recently issued ASUs

- ASU 2015-

Recently issued ASUs (continued)

- ASU 2016-01: Recognition and measurement of financial assets and financial liabilities
    - Includes guidance that clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available for sale debt securities in combination with the entity's other deferred tax assets
    - Effective for periods beginning after December 15, 2017 for public business entities and for annual periods beginning after December 15, 2018 and interim periods beginning after December 15, 2019 for all other entities

Proposed ASUs

- Technical corrections and improvements
    - Proposed amendment would revise the wording in paragraph ASC 852-740-43-3 for tax benefits as of the date of quasi-reorganizations, consistent with that in paragraph ASC 852-740-55-2
    - No transition is required and the guidance would be effective upon issuance of a final ASU
    - Comments were due July 5, 2016 and the project is in the redeliberations stage
- Accounting for goodwill impairment
    - Proposal to simplify the subsequent measurement of goodwill by removing step two of the

ASC 740 Forthcoming Developments & Other Hot Topics

Current FASB Topics - Income Tax Accounting

- ASU 2015

FASB projects

- The board's potential project on accounting for income taxes: presentation of tax expense/benefit is in the research stage

Income taxes disclosures

-

Income taxes disclosures (continued)

- Additional disclosure requirements for all entities
  - The following additional disclosures would be required by ASC 740
    - Description of an enacted change in tax law that is probable to have an effect on the reporting entity in a future period
    - Income (loss) from continuing operations before income tax expense (benefit) disaggregated between domestic and foreign*
    - Income tax expense (benefit) from continuing operations disaggregated between domestic and foreign*
    - Income taxes paid disaggregated between domestic and foreign, and the amount of

Income taxes disclosures (continued)

- Additional disclosure requirements for all entities (continued)
  - Requires an entity to disclose the description of a legally enforceable agreement with a government, including the duration of the agreement and the commitments made with the government under that agreement and the amount of benefit that reduces (or may reduce) its income tax burden
    - Government would determine whether an entity will receive assistance or how much assistance an entity will receive even if the entity meets applicable eligibility requirements
    - Disclosure would not apply to circumstances in which the entity meets the applicable eligibility requirements that are broadly available to taxpayers without specific agreement between the entity and the government

Income taxes disclosures (continued)

- Additional disclosure requirements for public business entities
  - The following additional disclosures would be required by ASC 740
    - An explanation of the year-to-year changes in rate reconciling items
    - The amount and explanation of the valuation allowance recognized and released during the reporting period
    - Within the rollforward of unrecognized tax benefits at the beginning and end of the period, settlements using existing deferred tax assets separate from those that have been or will be settled in cash
    - The line items in the statement of financial position in which the unrecognized tax benefits are presented and the related amounts of such unrecognized tax benefits. If the unrecognized tax benefits are not presented in the statement of financial position, those amounts should be disclosed separately
    - The total amount of unrecognized tax benefits that offsets the deferred tax assets for carryforwards

Income taxes disclosures (continued)

- Modification of existing disclosure requirements for all entities
  - Current disclosures requirements would be modified by ASC 740 as follows
    - Eliminate the requirement for all entities to disclose the nature and estimate of the range of the reasonably possible change in the unrecognized benefits balance in the next 12 months or make a statement that an estimate of the range cannot be made
    - Disclose the amounts of federal, state and foreign carryforwards (not tax effected) by time period of expiration

Income taxes disclosures (continued)

- Modification of existing disclosure requirements for public business entities
  -

Income taxes disclosures (continued)

- Effective date and transition
  - An entity would apply the proposed changes prospectively
  -

Income taxes disclosures (continued)

- Reporting and disclosure
  - If and when a final ASU is issued, disclosure is required of the impact that recently issued accounting standards will have on the financial statements of the Registrant when adopted in a future period (SAB 74)
    - Brief description of the new standard, the date adoption is required and the date the registrant plans to adopt (if earlier application is permitted)
    - Discussion that adoption of the standard is applied on a prospective basis
    - Disclosure of the potential impact of other significant matters that the Registrant believes might result from the adoption of the standard

ASU 2016-09: Improvements to employee share-based payment accounting

Share-based payments

- Guidance prior to the adoption of ASU 2016-09
    - Accounting for Income Taxes upon Settlement of an Award
        - Excess tax benefits are recognized in the period in which the tax deduction is realized through a reduction of taxes payable
        - Net operating loss carryforwards related to excess tax benefits do not result in deferred tax assets (maintained off-balance sheet)
        - Excess tax benefits are recognized as Additional Paid-in Capital in the period the benefit is realized
        - Deficiencies are recognized as reductions to Additional Paid-in Capital to the extent of prior realized excess tax benefits with any residual recorded as income tax expense
    - Presentation of Excess Tax Benefits on the Statement of Cash Flows
        - Excess tax benefits are presented as a cash inflow from financing activities and a cash outflow from operating activities

Share

Share-based payments (continued)

- Effective date and transition
  - Public Business Entities: Annual periods, and interim periods within such years, beginning after December 15, 2016
  - All Other Entities: Annual periods beginning after December 15, 2017, and interim periods in annual periods beginning after December 15, 2018
  - Early adoption is permitted for all entities as of the beginning of any interim or annual reporting period that is not yet issued
  - An entity that elects to early adopt the new guidance must adopt all of the amendments of the ASU in the same period
  - Adoption of the amendments will occur as of the beginning of the year for the issues adopted by the cumulative-effect and prospective methods
    - Any adjustments to previously reported interim periods of that fiscal year should be included in the year-to-date results
    - If any previously reported interim results appear in any future filings, they are reported on a revised basis

Share-based payments (continued)

- Reporting and disclosure (continued)
    - In the first interim and annual period of adoption, a public business entity shall disclose the following
        - The nature of and reason for the change in accounting principle
        - The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption
        - A statement that prior periods were restated and the impact of such restatement if an entity elects to adopt on a retrospective basis
        - A statement that prior periods were not restated if an entity elects to adopt on a prospective basis
    - All other entities shall make the above disclosures in the first annual period after the entity's adoption date, unless the entity elects to early adopt in an interim period, in which case the entity also shall make those disclosures in the interim periods within the first annual period after the entity's adoption date

Share-based payments (continued)

•

Share-based payments (continued)

PRE-ASU 2016-09 GUIDANCE				

Share-based payments (continued)

PRE-ASU 2016-09 GUIDANCE (continued)				
Year	**DR (CR)**	**Account description**	**Amount**	
20X6: Tax effect of pretax income (loss)				
20X6	DR	Current tax expense (benefit)	$80,000	$200,000 pretax income x 40%
20X6	CR	Current taxes payable	(80,000)	
20X6: Reversal of the deferred tax asset due to the exercise of the share options				
20X6	DR	Deferred tax expense (benefit)	$80,000	(100,000 options x $2 per share) x 40%
20X6	CR	Deferred tax asset	(80,000)	
20X6: Impact of stock compensation deduction on current income taxes				
20X6	DR	Current taxes payable	$80,000	$200,000 reversal of deferred tax asset x 40%
20X6	CR	Current tax expense (benefit)	(80,000)	

Share-based payments (continued)

Share-based payments (continued)

POST-ASU 2016-09 GUIDANCE				
Year	DR (CR)	Account description		

Share-based payments (continued)

POST-ASU 2016-09 GUIDANCE (continued)				
Year	DR (CR)	Account description	Amount	
20X6: Tax effect of pretax income (loss)				
20X6	DR	Current tax expense (benefit)	$80,000	$200,000 pretax income x 40%
20X6	CR	Current taxes payable	(80,000)	
20X6: Reversal of the deferred tax asset due to the exercise of the share options				
20X6	DR	Deferred tax expense (benefit)	$80,000	(100,000 options x $2 per share) x 40%
20X6	CR	Deferred tax asset	(80,000)	
20X6: Current tax effect of the reversal of the deferred tax asset due to the exercise of the share options				
20X6	DR	Income taxes payable	80,000	(100,000 options x $2 per share) x 40%
20X6	CR	Current tax expense (benefit)	(80,000)	
20X6: Recognition of $400,000 excess tax benefit to reflect the deferred tax asset on NOL carryforwards				
20X6	DR	Deferred tax asset	$160,000	nP3(x)8.CP /MCDDeferred(e)13(x)8(pe)3(da)13.u(o8nt/MCoJEnTw 3.437 Td[(I)-1(100,)64/v

Share-based payments (continued)

POST-ASU 2016-				

ASU 2016-16: Intra-entity transfers of assets other than inventory

Intra-entity asset transfers

- Existing guidance
    - Current guidance under ASC 810, Consolidation, provides that intra-entity balances, transactions, and profit or loss on assets remaining within the group should be eliminated
    - ASC 810-10-45-8 provides that if income taxes have been paid on intra-entity profits on assets remaining within the consolidated group, those taxes shall be deferred or the intra-entity profits to be eliminated in consolidation shall be appropriately reduced
        - Results in the deferral of the net tax expense (benefit) to the seller which is generally reflected as a deferred charge (credit) as an other asset (liability) on the consolidated balance sheet
    - Further, ASC 740-10-25-3(e) provides an exception to the recognition of deferred taxes in the buyer's jurisdiction noting there is a prohibition on recognition of a deferred tax asset for the intra-entity difference between the tax basis of the assets in the buyer's tax jurisdiction and their cost as reported in the consolidated financial statements
        - Deferred tax effects of assets subject to depreciation or amortization generally should be amortized over an appropriate period
    - Current guidance under U.S. GAAP is an exception to the accounting model for comprehensive recognition of income taxes in ASC 740

Intra-

Intra-entity asset transfers (continued)

Example – CoA and CoB are wholly owned subsidiaries of the same parent. CoA sells equipment to CoB for $150. Profit of $50. Seller's tax rate is 40%. Buyer's tax rate is 30%.

Current US GAAP

Deferred charge (balance sheet)	$20
Income tax payable	($20)
Income tax expense	$2
Deferred charge (balance sheet)	($2)
Income tax payable	$1.5
Current tax expense	($1.5)

New US GAAP

Current tax expense	$20
Income tax payable	($20)
Deferred tax asset	$15
Deferred tax expense	($15)
Income tax payable	$1.5
Current tax expense	($1.5)
Deferred tax expense	$1.5
Deferred tax asset	($1.5)

Intra-entity asset transfers (continued)

- Effective date and transition guidance
  - Public Business Entities: Annual periods, and interim periods within such years, beginning after December 15, 2017
  - All Other Entities: Annual periods beginning after December 15, 2018, and interim periods in annual periods beginning after December 15, 2019
  - Early adoption is permitted as of the beginning of an annual reporting period
  - The amendments are applied on a modified retrospective basis with a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption

Intra-entity asset transfers (continued)

- Reporting and disclosure
  - Disclosure is required of the impact that recently issued accounting standards will have on the financial statements of the registrant when adopted in a future period (SAB 74)
    - Brief description of the new standard, the date adoption is required and the date the registrant plans to adopt (if earlier)
    - Discussion of the methods of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined
    - Discussion of the impact of adoption or a statement that it is not known or reasonably estimable
    - Disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the standard

State Aid Update

Impact on Financial Accounting Reporting Considerations

State Aid Update

- Overview – What is State Aid?
    - Assistance directed by governments to individual companies that is not normally available to the general population.
        - Enacted by specific state agency
        - Advantage is selective to specific group or company
        - Potential to distort competition among other member states or government agencies

State Aid Update

-

State Aid Update

- Recent Findings on State Aid
    - The European Commission commented that:

"Tax rulings cannot use methodologies, no matter how complex, to establish transfer prices with no economic justification and which unduly shift profits to reduce the taxes paid by the company. It would give that company an unfair competitive advantage over other companies that are taxed on their actual profits because they pay market prices for the goods and services they use."

State Aid Update

- Overview – How is a State Aid Investigation Processed?
    - After initial investigation, EU Commission will issue its "Provisional Finding" on tax ruling's compatibility with EU State Aid rules.
        - The member state, taxpayer, and competitors have 30 day window to submit comments / provide additional support to Commission.

State Aid Update

- Accounting for Income Taxes considerations
  - Although an evolving tax topic, the underlying principles of accounting for uncertain tax positions apply.
  - To