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	Asset acquisition	Stock acquisition
• Assets and liabilities acquired are accounted for at fair value • Deferred taxes arising from the business combination are accounted for under ASC 740	• Fair value tax bases of assets and liabilities acquired • Tax basis generally equals book basis on day one	• 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

3

Deferred tax accounting considerations for IRC 162(m)

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

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).

American Rescue Plan Act of 2021 (“ARPA”)

- Expands scope of Section 162(m) to include 5 additional individuals as covered employees
- Changes take effect for tax years beginning after December 31, 2026
  - House bill proposes to accelerate the 5 additional individuals to tax years beginning after December 31, 2021

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 individuals
  - Getting the right data and system or tool
- **TCJA Grandfathered Rule Application**
  - Performance based plan criteria
  - Modification: Employee agreement phase out/evergreen period
  - RSU vs. NQ
  - Publicly traded entity definition and short period

4 Valuation allowances

Valuation allowances

Key reminders:

Assess realizability at **each** reporting date	Consider ALL evidence available – **Both** positive and negative
Weight evidence based on extent it is objectively verifiable	Cumulative income or loss position

Valuation allowances (continued)

Common myths

Short term outlook

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 due to general business and macroeconomic risk factors is not a valid reason to use a short-term outlook
- Consider consistency of the forecasts with those used for other accounting estimates

Indefinite-lived DTA/DTLs

Myth: An indefinite-lived DTL can simply be netted against an indefinite-lived NOL to determine the amount of valuation allowance.

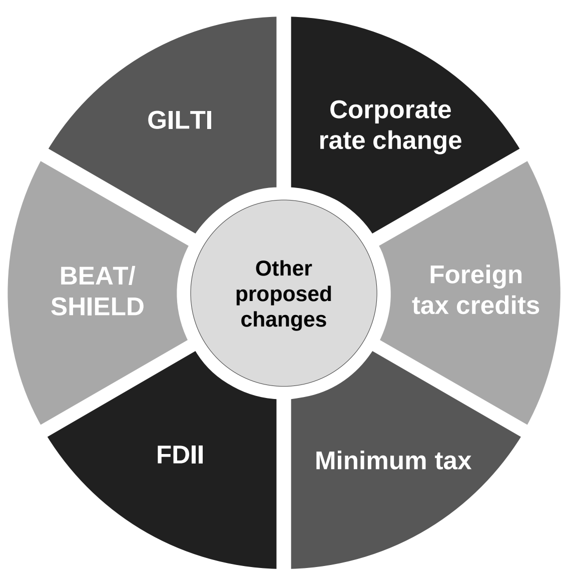
- Consider tax law ordering and limitations
- Scheduling is often necessary to determine the amount of valuation allowance required
- If only a portion of the DTL can be used to offset the NOL, a company may end up with a partial valuation allowance and a net DTL
- Aligning with the Company's policy choice

What to watch for

- **Forecasting future taxable income**
  - Impact of share-based compensation on forecasted future income
  - Impact of GILTI, FDII
- **Scheduling**
  - Accuracy regarding when deferreds will reverse
  - Attribute utilization limitations
  - Properly understanding the character of each deferred upon reversal
  - State taxes

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**

6 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

29%

Other

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

17%

Valuation allowances

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

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

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.

Thank you