TEI-SJSU High Tech Tax Institute
(34rd Annual)

Accounting for income taxes

Jesus Ochoa, PricewaterhouseCoopers LLP
JJ Schneider, Grant Thornton LLP
Matt Walton, Deloitte Tax LLP
Rachel Breen, Ernst & Young LLP
Thomas Sites, KPMG LLP

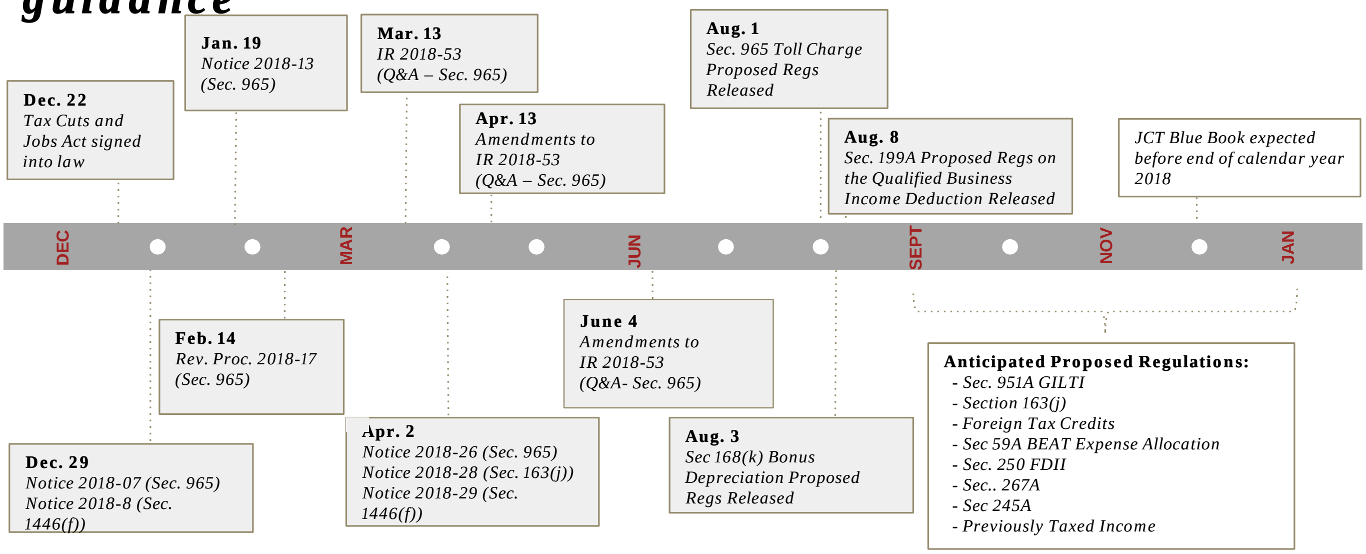
Notice

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

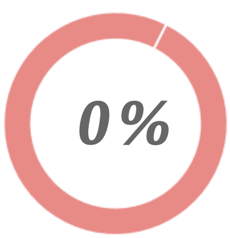
Accounting for US Tax Reform

US Tax Reform - Timeline of significant tax reform guidance

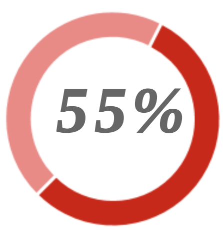


The current landscape

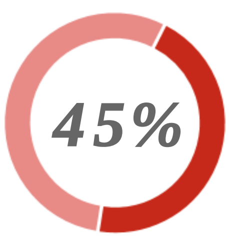
SEC Reporting: Q2 SAB 118 Disclosures - Dow 30



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



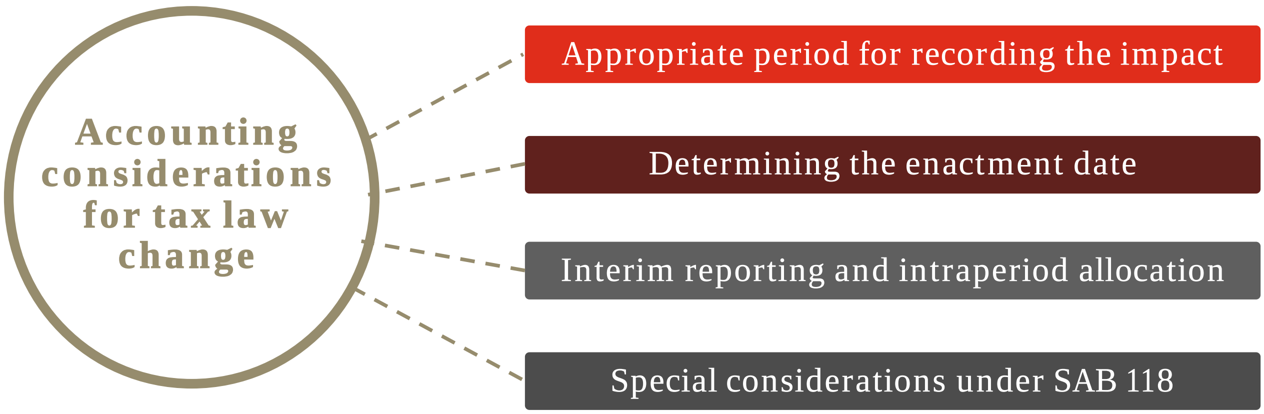
Of those who relied upon the SAB 118, 55% recorded adjustments to provisional estimates during either the first (25%) or second (35%) quarter



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).

Fiscal year-end company considerations

Section 245A and amended section 78

For companies with fiscal year foreign corporations, the overlapping effective dates between the new section 245A and amended section 78 means that deemed dividends attributable to the section 78 gross-up received by a domestic corporation from a fiscal year foreign corporation in fiscal year 2018 may be eligible for the benefit of the participation exemption under section 245A (including the section 78 gross-up as a result of section 965).

What factors should companies consider when assessing the financial statement impact of the overlapping effective dates?

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
  - 50% GILTI deduction (reducing to 37.5% after 12/31/2025)
- Recognition of deferred taxes would result in an impact on the ETR in the period that includes December 22, 2017
  - If SAB 118 provisional accounting was applied, adjustments to the provisional estimate would impact the ETR in the period of adjustment
- Consider impact these deferred taxes have on the recognition of other US deferred tax assets

Deferred tax accounting for GILTI

Valuation allowance considerations

- With and Without approach
  - Due to potential income inclusion with expected available FTC no or reduced incremental benefit may result from the utilization of NOL carryforwards
  - With – estimate tax due utilizing NOL against estimated taxable income including the GILTI
  - Without – estimate tax due on estimated taxable income including the GILTI, but assume no NOL available
  - Difference between with and without, after applying GILTI FTC, would be the incremental benefit available to recognize the NOL DTA
  - Requires forecasting of both future taxable income and GILTI inclusions

Deferred tax accounting for GILTI

Valuation allowance considerations

- Period approach
  - Where inclusion of GILTI supports realization of existing DTAs, no valuation allowance would be needed
  - FTC available to reduce GILTI would not be realized until NOL are utilized
  - Consider how this may impact future ETR where FTCs would reduce tax effect of GILTI inclusion
- Consider disclosures related to NOLs that will not reduce taxes payable

Deferred tax accounting for BEAT

- BEAT is akin to a minimum tax, therefore no deferred taxes should be recorded associated with BEAT
- Incremental effect of BEAT should be accounted for in the period incurred
- Impact of BEAT on valuation allowance
  - BEAT inclusion may result in no benefit for NOL utilization
  - Consider With and Without approach similar to as discussed in GILTI considerations

Valuation allowance considerations

Net operating losses (NOLs)

- Comparison of pre- and post-reform generated losses

	Pre-reform	Post-reform
Carryforward	20 years	Indefinite for NOLs generated in taxable years **ending after** 12/31/17
Carryback	2 years	Ineligible for NOLs generated in taxable years **ending after** 12/31/17
Limitations	100% of taxable income each year	80% of taxable income each year for NOLs generated in taxable years **beginning after** 12/31/17

- Realizability post-reform
  - Lack of expiration does not mean realizability
  - Limitations on usage and reversal pattern of taxable temporary differences
- Projections of future taxable income impacted by other reform changes (i.e. interest limitations)
- Realizability of existing foreign tax credit deferred tax assets in territorial system

Valuation allowance considerations (cont.)

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

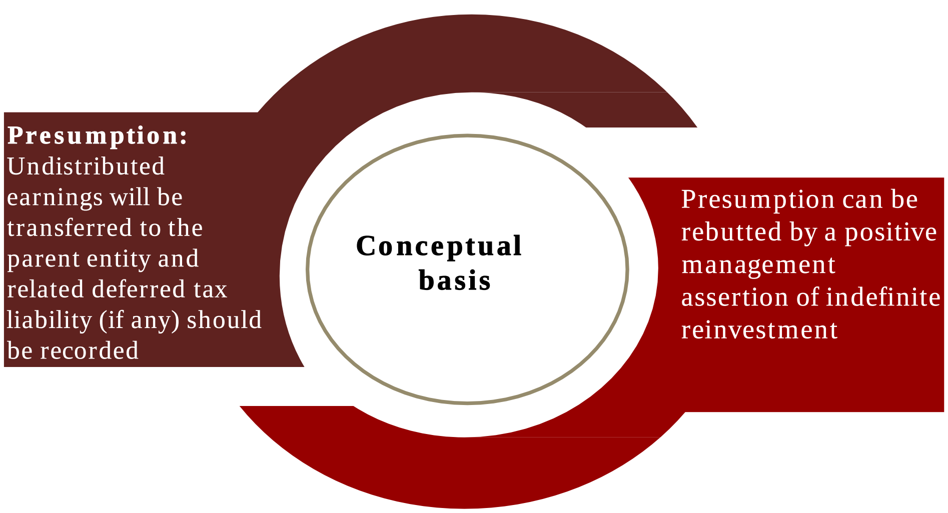
- Consider as source of income for NOLs generated after 12/31/17 that do not expire
- Consider as source of income for assessing the realizability of deferred tax assets that reverse into NOLs that do not expire

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 - Level setting on the basics



- Management must have <u>ability</u> and <u>intent</u> to indefinitely reinvest
- Parent entity needs <u>specific plans</u> for reinvestment which demonstrate that remittance is postponed indefinitely

Outside basis differences and indefinite reinvestment

- 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
- Tax reform ***does not eliminate*** the need for an entity (including a U.S. parent) to consider its assertion about the indefinite reinvestment of undistributed earnings when a taxable temporary difference exists
- 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 tax law ordering of future taxation in considering eligibility to assert
- Consider different intentions on the part of the operations of the business due to the potential accessibility of cash with limited tax cost

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:
  - It shall be presumed that all undistributed earnings of a subsidiary will be transferred to the parent entity. Accordingly, the undistributed earnings of a subsidiary included in consolidated income shall be accounted for as a temporary difference
- 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
Foreign taxable temporary differences

- 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
- ASC 740-30-25-17 and 25-18(a) provide the exception to the recognition of a deferred tax liability
  - Applies to all or a part of the excess of the financial reporting carrying amount over the tax basis of the investment
  - Not applicable to inside basis differences
  - Applicable only to foreign subsidiaries and certain foreign corporate joint ventures

Outside basis differences and indefinite reinvestment
Foreign taxable temporary differences

- For a U.S. parent entity evaluating its investment in foreign subsidiaries, the indefinite reversal criteria may be relevant for:
  - Foreign withholding taxes
  - State income taxes
  - Currency gains and losses on the distribution of previously taxed income
  - *Offset* previously taxed income (PTI) that doesn't have full tax basis (also referred to as zero basis PTI)

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 may be repatriated
- Impact of fixed dividend payments
- Foreign branches
- Not limited to US jurisdiction
- Plans to sell subsidiary

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
- 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

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 for 2017 was filed prior to end measurement period and new information is obtained or new notices are issued, companies may recognize different amount of enactment-date effects in its financial statements than it reported on return
  - Consider the effect of new information on previously filed tax return, remedies allowed for any resulting adjustments to positions taken on the return and any additional disclosures that may be required related to uncertain tax positions

After SAB 118… (ASC 250)

Change in accounting estimate

"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 in previously issued financial statements

"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."

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.

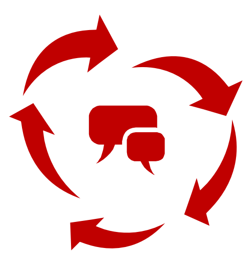
SAB 118 measurement period

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.

SEC and PCAOB on income taxes

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.



All parties need to ensure continuous communication with each other.

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

Standard setting updates

Highlights

Effective for calendar year public companies in 2019, private companies one year later

- Lessees
  - Balance sheet – recognize right-of-use asset and lease liability
  - Income statement – dual model retained (i.e. amortization and interest expense for finance leases; straight-line expense for operating leases)
- Lessors
  - Accounting model remains largely consistent with previous U.S. GAAP

Tax rules governing leasing transactions will not change

- ASC 842 may spotlight the company's existing treatment of leases for tax purposes
  - Double-check that it is correct
  - Consider risk mitigation if appropriate

Areas of focus for U.S. federal income tax purposes

- Lease classification
- Determining rent expense for true leases (i.e., operating leases) and interest expense/depreciation for sales or financings (i.e., finance leases)

Adoption

Public business entities, certain not-for-profit entities, and certain employee benefit plans	— Interim and annual periods in fiscal years beginning after December 15, 2018
All other entities	— Fiscal years beginning after December 15, 2019, and interim periods in fiscal years beginning one year later
Early adoption	— Early adoption permitted for all entities at any time after issuance
Date of initial application	— **Modified retrospective approach**: The first day of the earliest comparative period presented in the first annual financial statements post-effective date — *Or*, under the **optional transition approach:** The company's adoption date.

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

ASC 842: Book vs. tax considerations – Rent expense

	GAAP	Tax
Finance lease	— Amortization of right-of-use asset (straight-line over shorter of useful life or lease term) — Interest expense on lease liability (implicit rate in lease/lessee's incremental borrowing rate)	— Depreciation of tax asset (accelerated over recovery period) — Interest expense on lease liability (implicit rate in lease/AFR)
Operating lease	— Lease expense (straight-line over lease term)	— Lease expense (under IRC § 461 or 467)

Operating lease scenario

Facts:		Notes
Lease term (years)	10	
Interest rate	10 percent	
Total lease payments	$ 166,535	
Monthly lease payment	$ 14,527	in year 1 and escalating 3 percent per year
Present value	$ 100,000	
Tax rate	30 percent	
Tenant improvement allowance	$ 10,000	received at commencement; book sets up tenant allowance (liability) and reduces expense on a straight-line basis over the life of the lease

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

Tax:

Balance sheet	
Lease liability (Deferred rent)	Tenant incentive liability
-	-
-	-
-	-
-	-
-	-
-	-
-	-
-	-
-	-
-	-
-	-

Change in balance sheet		
Cash DR (CR)	Lease liability DR (CR)	Tenant incentive liability DR (CR)
10,000	-	-
(14,527)	-	-
(14,963)	-	-
(15,412)	-	-
(15,874)	-	-
(16,350)	-	-
(16,841)	-	-
(17,346)	-	-
(17,866)	-	-
(18,402)	-	-
(18,954)	-	-
(156,535)		

Income statement
Lease expense (income) DR (CR)
(10,000)
14,527
14,963
15,412
15,874
16,350
16,841
17,346
17,866
18,402
18,954
156,535

Current and deferred taxes
Today's treatment

Temporary difference (Tax – Books):

Balance sheet		Change in balance sheet			Income statement
Lease liability (Deferred rent)	Tenant incentive liability	Cash DR (CR)	Lease liability DR (CR)	Tenant incentive liability DR (CR)	Lease expense (income) DR (CR)
-	10,000				(10,000)
2,127	9,000	-	2,127	(1,000)	(1,127)
3,817	8,000	-	1,691	(1,000)	(691)
5,059	7,000	-	1,242	(1,000)	(242)
5,838	6,000	-	780	(1,000)	221
6,142	5,000	-	304	(1,000)	697
5,954	4,000	-	(188)	(1,000)	1,188
5,262	3,000	-	(693)	(1,000)	1,693
4,049	2,000	-	(1,213)	(1,000)	2,213
2,301	1,000	-	(1,749)	(1,000)	2,749
-	-	-	(2,301)	(1,000)	3,301
		-	-	-	-

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	Deferred tax expense (benefit) DR (CR)	Current tax expense (benefit) DR (CR)	Total income tax expense (benefit) DR (CR)
-	3,000	(3,000)	-	3,000	(3,000)	3,000	(4,696)
638	2,700	4,358	638	(300)	(338)	(4,358)	(4,696)
1,145	2,400	4,489	507	(300)	(207)	(4,489)	(4,696)
1,518	2,100	4,624	372	(300)	(72)	(4,624)	(4,696)
1,751	1,800	4,762	234	(300)	66	(4,762)	(4,696)
1,842	1,500	4,905	91	(300)	209	(4,905)	(4,696)
1,786	1,200	5,052	(56)	(300)	356	(5,052)	(4,696)
1,578	900	5,204	(208)	(300)	508	(5,204)	(4,696)
1,215	600	5,360	(364)	(300)	664	(5,360)	(4,696)
690	300	5,521	(525)	(300)	825	(5,521)	(4,696)
-	-	5,686	(690)	(300)	990	(5,686)	(4,696)
		46,961	-		-	(46,961)	(46,961)

Lease schedule (Book)
ASC 842 treatment

Book

	Lease schedule						
	Cash payment	Straight line lease expense	Principal paid	Interest accretion	Lease liability	ROU asset	Amortization on ROU asset
Commencement	10,000				100,000	90,000	
1	(14,527)	15,654	4,527	10,000	95,473	84,347	5,654
2	(14,963)	15,654	5,416	9,547	90,057	78,240	6,107
3	(15,412)	15,654	6,406	9,006	83,651	71,593	6,648
4	(15,874)	15,654	7,509	8,365	76,142	64,304	7,289
5	(16,350)	15,654	8,736	7,614	67,406	56,265	8,040
6	(16,841)	15,654	10,100	6,741	57,306	47,352	8,913
7	(17,346)	15,654	11,615	5,731	45,691	37,430	9,923
8	(17,866)	15,654	13,297	4,569	32,394	26,345	11,085
9	(18,402)	15,654	15,163	3,239	17,231	13,931	12,415
10	(18,954)	15,654	17,231	1,723	-	-	13,931
Subtotal	**(166,535)**	**156,535**	**100,000**	**66,535**			**90,000**

Book vs. tax
ASC 842 treatment

Book:

Balance sheet		Change in balance sheet			Income statement
Lease liability	ROU asset (net of lease incentive)	Cash DR (CR)	Lease liability DR (CR)	ROU asset DR (CR)	Lease expense (income) DR (CR)
(100,000)	90,000	10,000		(10,000)	
(95,473)	84,347	(14,527)	4,527	(5,654)	15,654
(90,057)	78,240	(14,963)	5,416	(6,107)	15,654
(83,651)	71,593	(15,412)	6,406	(6,648)	15,654
(76,142)	64,304	(15,874)	7,509	(7,289)	15,654
(67,406)	56,265	(16,350)	8,736	(8,040)	15,654
(57,306)	47,352	(16,841)	10,100	(8,913)	15,654
(45,691)	37,430	(17,346)	11,615	(9,923)	15,654
(32,394)	26,345	(17,866)	13,297	(11,085)	15,654
(17,231)	13,931	(18,402)	15,163	(12,415)	15,654
-	-	(18,954)	17,231	(13,931)	15,654
		(156,535)	100,000	(100,000)	156,535

Tax:

Balance sheet		Change in balance sheet	Income statement
Lease liability	ROU asset	Cash DR (CR)	Lease expense (income) DR (CR)
-	-	10,000	(10,000)
-	-	(14,527)	14,527
-	-	(14,963)	14,963
-	-	(15,412)	15,412
-	-	(15,874)	15,874
-	-	(16,350)	16,350
-	-	(16,841)	16,841
-	-	(17,346)	17,346
-	-	(17,866)	17,866
-	-	(18,402)	18,402
-	-	(18,954)	18,954
		(156,535)	156,535

Current and deferred
ASC 842 treatment

Temporary difference:

Balance sheet		Change in balance sheet			Income statement
Lease liability	ROU asset	Cash DR (CR)	Lease liability DR (CR)	ROU asset DR (CR)	Lease expense DR (CR)
100,000	(90,000)				(10,000)
95,473	(84,347)	-	(4,527)	5,654	(1,127)
90,057	(78,240)	-	(5,416)	6,107	(691)
83,651	(71,593)	-	(6,406)	6,648	(242)
76,142	(64,304)	-	(7,509)	7,289	221
67,406	(56,265)	-	(8,736)	8,040	697
57,306	(47,352)	-	(10,100)	8,913	1,188
45,691	(37,430)	-	(11,615)	9,923	1,693
32,394	(26,345)	-	(13,297)	11,085	2,213
17,231	(13,931)	-	(15,163)	12,415	2,749
-	-	-	(17,231)	13,931	3,301
		-	(100,000)	90,000	-

Current and Deferred Taxes:

Balance sheet		Change in balance sheet			Income statement		
Deferred tax asset (liability) – Lease liability	Deferred tax asset (liability) – ROU asset	Income taxes receivable (payable) DR (CR)	Deferred tax asset (liability) – Lease liability DR (CR)	Deferred tax asset (liability) – ROU asset DR (CR)	Deferred tax expense (benefit) DR (CR)	Current tax expense (benefit) DR (CR)	Total income tax expense (benefit) DR (CR)
30,000	(27,000)	(3,000)	30,000	(27,000)	(3,000)	3,000	-
28,642	(25,304)	4,358	(1,358)	1,696	(338)	(4,358)	(4,696)
27,017	(23,472)	4,489	(1,625)	1,832	(207)	(4,489)	(4,696)
25,095	(21,478)	4,624	(1,922)	1,994	(72)	(4,624)	(4,696)
22,843	(19,291)	4,762	(2,253)	2,187	66	(4,762)	(4,696)
20,222	(16,879)	4,905	(2,621)	2,412	209	(4,905)	(4,696)
17,192	(14,206)	5,052	(3,030)	2,674	356	(5,052)	(4,696)
13,707	(11,229)	5,204	(3,485)	2,977	508	(5,204)	(4,696)
9,718	(7,904)	5,360	(3,989)	3,325	664	(5,360)	(4,696)
5,169	(4,179)	5,521	(4,549)	3,724	825	(5,521)	(4,696)
-	-	5,686	(5,169)	4,179	990	(5,686)	(4,696)
		46,961	-	-	-	(46,961)	(46,961)

Comparison: ASC 840 vs. ASC 842

ASC 840 Current and Deferred Tax

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)	Current tax expense (benefit) DR (CR)	Total income tax expense (benefit) DR (CR)
–	3,000	(3,000)	–	3,000	(3,000)	3,000	–
638	2,700	4,358	638	(300)	(338)	(4,358)	(4,696)
1,145	2,400	4,489	507	(300)	(207)	(4,489)	(4,696)
1,518	2,100	4,624	372	(300)	(72)	(4,624)	(4,696)
1,751	1,800	4,762	234	(300)	66	(4,762)	(4,696)
1,842	1,500	4,905	91	(300)	209	(4,905)	(4,696)
1,786	1,200	5,052	(56)	(300)	356	(5,502)	(4,696)
1,578	900	5,204	(208)	(300)	508	(5,204)	(4,696)
1,215	600	5,360	(364)	(300)	664	(5,360)	(4,696)
690	300	5,521	(525)	(300)	825	(5,521)	(4,696)
–	–	5,686	(690)	(300)	990	(5,686)	(4,696)
		46,961	–		–	(46,961)	(46,961)

ASC 842 Current and Deferred Tax

Current and deferred Taxes:

Balance sheet		Change in balance sheet			Income statement		
Deferred tax asset (liability) – Lease liability	Deferred tax asset (liability) – ROU asset	Income taxes receivable (payable) DR (CR)	Deferred tax asset (liability) – Lease liability DR (CR)	Deferred tax asset (liability) – ROU asset DR (CR)	Deferred tax expense (benefit) DR (CR)	Current tax expense (benefit) DR (CR)	Total income tax expense (benefit) DR (CR)
30,000	(27,000)	(3,000)	30,000	(27,000)	(3,000)	3,000	(4,696)
28,642	(25,304)	4,358	(1,358)	1,696	(338)	(4,358)	(4,696)
27,017	(23,472)	4,489	(1,625)	1,832	(207)	(4,489)	(4,696)
25,095	(21,478)	4,624	(1,922)	1,994	(72)	(4,624)	(4,696)
22,843	(19,291)	4,762	(2,253)	2,187	66	(4,762)	(4,696)
20,222	(16,879)	4,905	(2,621)	2,412	209	(4,905)	(4,696)
17,192	(14,206)	5,052	(3,030)	2,674	356	(5,052)	(4,696)
13,707	(11,229)	5,204	(3,485)	2,977	508	(5,204)	(4,696)
9,718	(7,904)	5,360	(3,989)	3,325	664	(5,360)	(4,696)
5,169	(4,179)	5,521	(4,549)	3,724	825	(5,521)	(4,696)
–	–	5,686	(5,169)	4,179	990	(5,686)	(4,696)
		46,961	–	–	–	(46,961)	(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
  - Prohibition of backward tracing triggers stranded debits/credits in AOCI
- ASU 2018-02 gives the option to reclassify to retained earnings
  - Stranded tax effects related to the change in federal tax rate
  - Other stranded tax effects that relate to the Act
- Requires new disclosure on accounting policies on how a company releases the tax effects from AOCI
- Careful consideration on how ASU 2018-02 interacts with other accounting standards effective in Q1'18

Effective date of ASU 2018-02 for calendar year-ends		
	All Entities	Early adoption?
Elected retrospectively or in the period of adoption	2019	Yes

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-sale securities, employee benefits, cumulative translation adjustments, hedging items).

These entities can also elect to reclassify other stranded tax effects that relate to the Act but do not directly relate to the change in the federal rate (e.g., state taxes, changing from a worldwide tax system to a territorial system).

Tax effects that are stranded in OCI for other reasons (e.g., prior changes in tax law, a change in valuation allowance) may **not** be reclassified.

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

Disclosures required by **all** entities

- Entities will be required to disclose their policy for releasing the income tax effects from accumulated OCI.

Disclosures required by entities that **elect** to reclassify stranded effects

- In the period of adoption, entities that elect to reclassify the income tax effects of the Act from accumulated OCI to retained earnings must disclose that they made such an election. They must also disclose a description of other income tax effects related to the Act that are reclassified from accumulated OCI to retained earnings, if any.

Disclosures required by entities that **do not elect** to reclassify stranded effects

- In the period of adoption, entities that do not elect to reclassify the income tax effects of the Act from accumulated OCI to retained earnings must disclose that such an election was not made.

Disclosure example of adoption of ASU 2018-02

Additional disclosures are required for a company that adopts ASU 2018-02.

Income Taxes

In January 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from accumulated other comprehensive income (AOCI)*, which gives entities the option to reclassify to retained earnings tax effects resulting from the Act related to items in AOCI that the FASB refers to as having been stranded in AOCI.

The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized, or in the period of adoption. The Company must adopt this guidance for fiscal years beginning after 15 December 2018 and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including the period the Act was enacted. We elected to early adopt ASU 2018-02. As a result of adopting this standard, we reclassified $XXX from AOCI to retained earnings.

Additional disclosures are required for a company that adopts ASU 2018-02 and amounts may be provisional.

Income Taxes

In January 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from accumulated other comprehensive income (AOCI)*, which gives entities the option to reclassify to retained earnings tax effects resulting from the Act related to items in AOCI that the FASB refers to as having been stranded in AOCI.

The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized, or in the period of adoption. The Company must adopt this guidance for fiscal years beginning after 15 December 2018 and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including the period the Act was enacted. We elected to early adopt ASU 2018-02. As a result of adopting this standard, we reclassified $XXX from AOCI to retained earnings. The effect of the Act on temporary differences related to amounts initially recorded in AOCI are provisional (see footnote X for additional discussion). As we finalize the accounting for tax effects of the Act on the related temporary differences, additional reclassification adjustments may be recorded in future periods.

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 approaches
                b. Valuation allowance interplay
            3. BEAT
    b. Post reform impacts on valuation allowances
        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