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# Annual Conference Scottsdale, AZ

FASB/Financial Reporting Update

*October 25, 2022*

*4:45PM – 5:45PM*



**Moderator**



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## Standard Setting Update



## Pillar II

- Refresher
- OECD Official Timeline
- Process Considerations
- Effective Tax Rate



## Recent Tax Legislation

- Overview
- Accounting for Changes in Tax Law
- Corporate Alternative Minimum Tax
- Refundable Credits
- Transferable Credits
- Stock Buyback Tax
- Accounting for ITCs

# Standard Setting Update

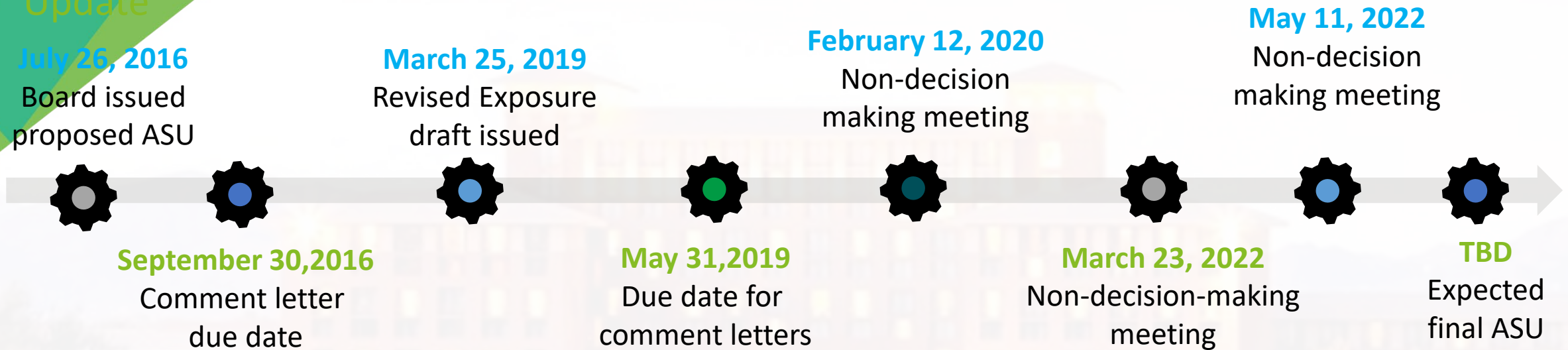


# Standard Setting Update

## Overview

- Identifiable intangible assets and subsequent accounting for goodwill
  - Removed from technical agenda
- Income tax disclosure project
- Accounting for investments in tax credit structures using the proportional amortization method
- ASU 2021-10 *Disclosures by Business Entities about Government Assistance*

# FASB Income Tax Disclosure Project



## During the May 11, 2022 meeting, the Board discussed:

- Income taxes paid - Three potential types of disaggregation to be applied to the disclosure:
  - Jurisdiction Approach - top jurisdictions based on metric determined by the Board, or application of a quantitative threshold
  - Time Period Approach – amount paid for the current period vs. amount paid for prior periods
  - Payment Nature Approach – by type (e.g., general corporate tax payments, GILTI, BEAT, etc.), or by frequency of occurrence
- Rate reconciliation disclosure, including the application of a threshold to disclose individual reconciling items and/or prescription of a list of specific categories requiring separate disclosure.
- **Next steps:** The Board directed the staff to perform outreach and research to further explore potential disclosure improvements to income taxes paid and the rate reconciliation.

# Standard Setting Update

Accounting for investments in tax credit structures using the proportional amortization method

- On August 22, 2022, the FASB issued the proposed ASU.
- The amendments in this proposed update would permit reporting entities to elect to account for their tax equity investments, regardless of the program from which the income tax credits are received, using the proportional amortization method if certain conditions are met.
- Proposed transition methods include both the modified prospective and the retrospective approach.



## Status

- Effective date is TBD.
- The due date for comment letters was October 6, 2022.



FASB EXPOSURE DRAFT

*Proposed Accounting Standards Update*

Issued: August 22, 2022  
Comments Due: October 6, 2022

Investments—Equity Method and Joint Ventures  
(Topic 323)

Accounting for Investments in Tax Credit Structures  
Using the Proportional Amortization Method

a consensus of the Emerging Issues Task Force



# ASU 2021-10 Disclosures Regarding Government Assistance

## Key Provisions of the ASU

- Created ASC 832 which requires business entities to provide certain disclosures when they
  - (1) have received government assistance and
  - (2) use a grant or contribution accounting model by analogy to other accounting guidance.
- **Effective for all entities for fiscal years beginning after December 15, 2021.**
- Requires the following disclosures for annual periods about transactions that are within scope:
  - The nature of the transactions, including a general description of the transactions and the form in which the assistance has been received
  - The accounting policies used to account for the transactions
  - The line items on the balance sheet and income statement that are affected by the transactions, and the amounts applicable to each financial statement line item in the current reporting period
  - Information about the significant terms and conditions of transactions with a government



# Pillar II

# Refresher of Pillar Two rules

- OECD two-pillar solution was agreed by 137 countries and endorsed by the G20 Finance Ministers and Leaders in October 2021.
- The Pillar Two Model rules were approved by member countries on December 14, 2021 and released on December 20, 2021.
- These rules outline a system of taxation intended to ensure large groups pay a minimum level of tax on the income arising in each country where they operate.
- The rules have been drafted to provide a template that jurisdictions can translate into domestic law.
- Countries are expected to bring the Pillar Two rules into domestic legislation in 2023 and be effective from 2024.

The OECD two-pillar solution to address the challenges arising from the digitalization of the economy

## Pillar I

### **Reallocation of taxing rights**

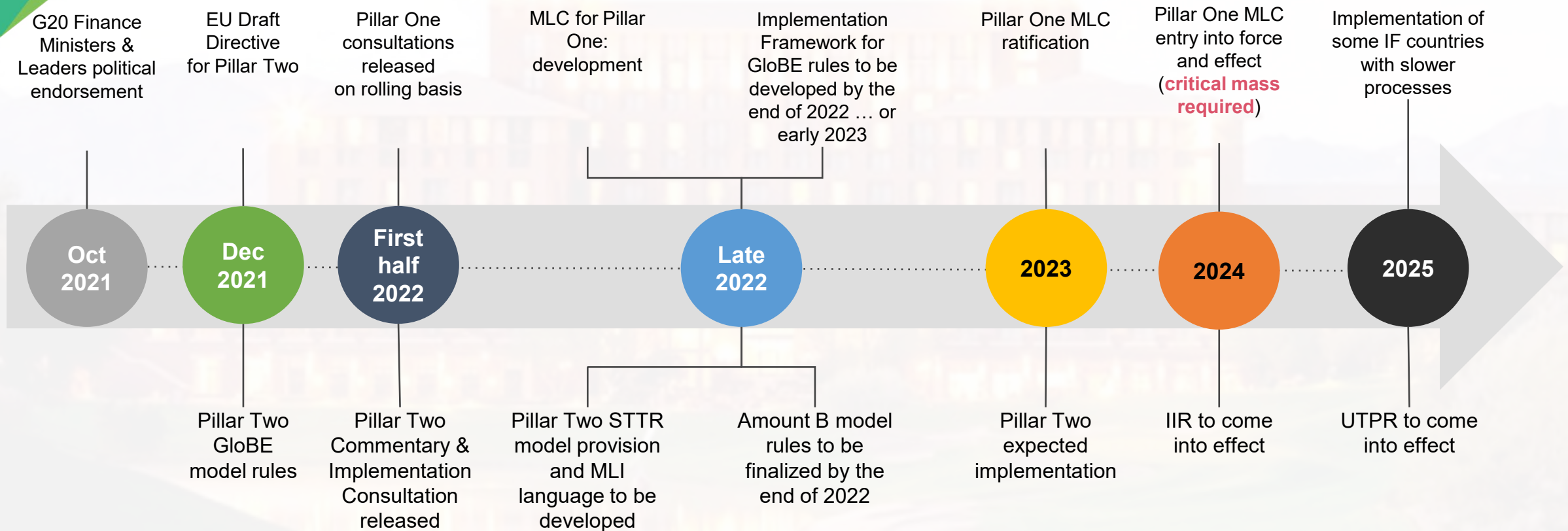
Allocates a portion of the group consolidated financial profits to market jurisdictions

## Pillar Two

### **Global minimum effective tax rate**

Creates a system where multinational groups are subject to a minimum effective tax rate on income arising in low tax jurisdictions

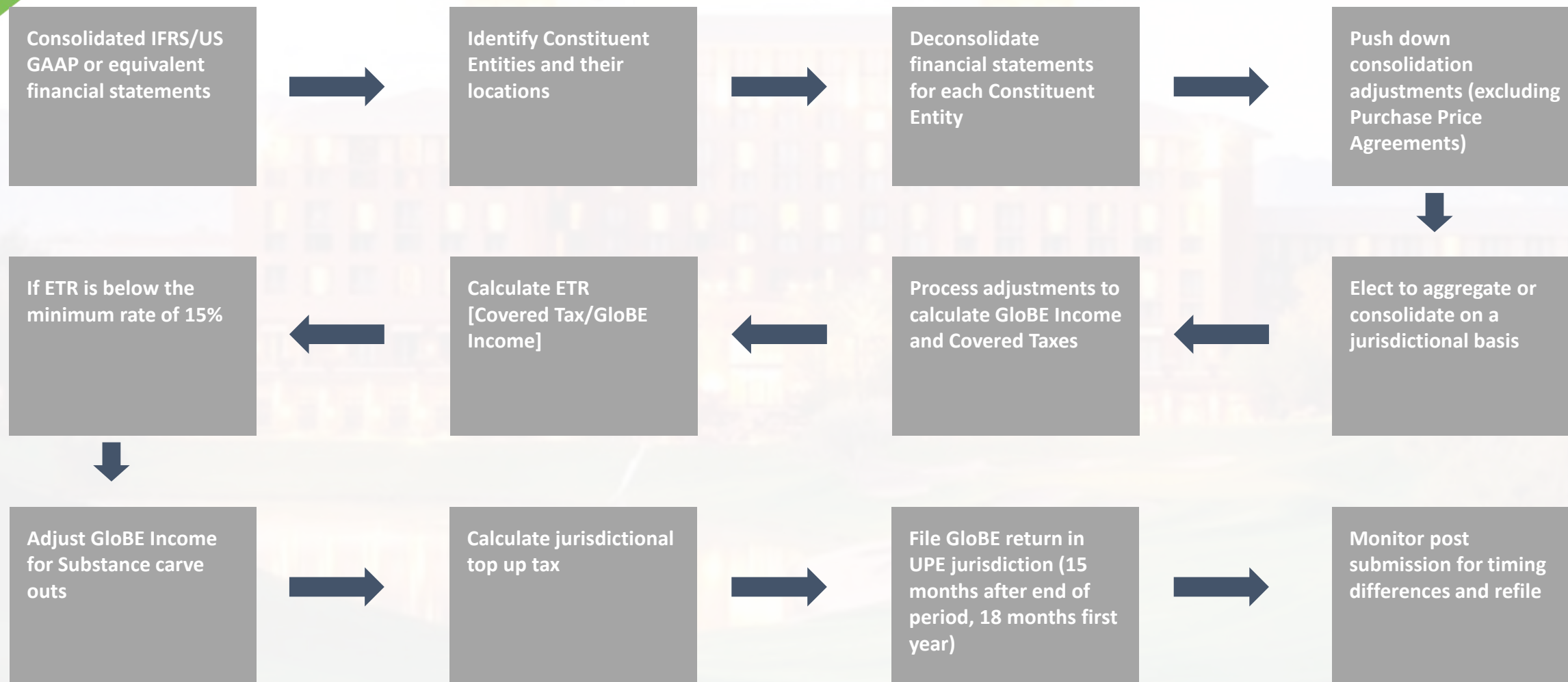
# Pillars 1 & 2: OECD Official timeline



Interim period where signatory countries will not introduce any newly enacted DSTs



# Refresher of Pillar Two rules – Illustrative process for GloBE calculations



# Consolidation process considerations



Are there multiple ERP systems?



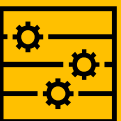
What is the basis of the local ledger reporting?



What accounting standard are the local ledgers maintained in?



What accounting entries are maintained in consolidation ledgers and/or top-side ledgers?



What are the intercompany transactions of the company and how are they eliminated within the consolidation process?

# Pillar Two Effective Tax Rate

Step	Reference	Summary
1	A	Calculate <b>Pillar Two income</b> on jurisdictional basis
2	B	<b>Covered Taxes</b> calculated on jurisdictional basis
3	$C = B/A$	<b>Jurisdiction level ETR = Covered Taxes/Pillar Two Income</b>
4	$D = 15\% (-) C$	Top up tax percentage = Minimum ETR - <b>Jurisdiction level ETR</b>
	E	Tangible assets plus payroll
	$F = E * 5\%$	<b>Substance based carve-out</b>
5	$G = A (-) F$	<b>Excess Profit</b> (e.g., the tax base for top up tax) = <b>Pillar Two income - Substance based carve out</b>
6	$H = D * G$	Top up tax



# Recent Tax Legislation

# Recent Tax Legislation

## Highlights of recent U.S. tax law changes

### Legislation:

- Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act of 2022
  - signed into law on August 9, 2022
- Inflation Reduction Act (“IRA”)
  - signed into law on August 16, 2022

**New  
Corporate  
AMT**



**Tax credits  
Direct-Pay  
option**



**Transferable  
tax credits**



**Stock  
buyback  
excise tax**



# Recent Tax Legislation

## Effect of changes in tax laws or rates

### Current income taxes

- The tax effect of an enacted change in tax laws or rates on taxes currently payable or refundable is reflected in the estimated annual effective tax rate in the first interim period that includes the enactment date\*

### Deferred income taxes

- Deferred tax balances are adjusted for the effects of change tax laws or rates in the period that includes the enactment date
  - Valuation allowance may also be required to be reevaluated

\* Prior to amendment by ASU 2019-12, ASC 740-270-25-5 required that the effects of an enacted change in tax law on taxes currently payable or refundable for the current year be reflected in the computation of the annual effective tax rate (AETR) in the first interim period that includes the effective date of the new legislation.



# Corporate Alternative Minimum Tax

# Corporate AMT

## Overview

- The corporate AMT imposes a **15% minimum tax** on the **adjusted financial statement income ("AFSI")** of an **applicable corporation**
- An applicable corporation's corporate **AMT** is:

$$\text{Corporate AMT} = \text{Tentative Minimum Tax ("TMT")} - \text{Regular tax (plus any BEAT)}$$

- An applicable corporation's **TMT** is:

$$\text{TMT} = \left[ \text{AFSI} - \text{MIN} \left\{ \text{FS NOL}, 80\% \times \text{AFSI} \right\} \right] \times 15\% - \text{Corporate AMT foreign tax credit ("AMT FTC")}$$

- AFSI is the net income or loss set forth on the taxpayer's **applicable financial statement ("AFS")**, subject to certain adjustments
- A corporation is eligible to claim a **credit against regular tax** (plus any BEAT) for corporate AMT paid in prior years
- General business credits including R&D may generally offset up to approximately **75% of the sum of a corporation's regular tax and AMT**
- Applies to tax years beginning after **12/31/2022**

# Corporate AMT

## Definition of applicable corporation

- **General rule:**

- An **applicable corporation** is any corporation (other than an S corporation, a RIC, or a REIT) which meets the **average annual AFSI test (“AFSI test”)** for one or more preceding tax years that end after December 31, 2021
- The AFSI test is met for a tax year if the average annual AFSI (determined without regard to financial statement net operating losses (“NOL”) for the three-year period ending with such year **exceeds \$1 billion**

- **Exception:**

- An otherwise applicable corporation will not be treated as an applicable corporation if:
  - it has a change in ownership or a specified number (*to be determined by the Secretary taking into account the facts and circumstances of the taxpayer*) of consecutive tax years, including the most recent tax year, in which the corporation does not meet the AFSI test, and
  - the Secretary determines that it would not be appropriate to continue to treat such corporation as an applicable corporation
- However, if the corporation meets the AFSI test for a subsequent tax year, then it will again be treated as an applicable corporation



# Corporate AMT

## US GAAP and IFRS definitions

**AFSI** means, “with respect to any corporation for any tax year, the **net income or loss of the taxpayer** set forth on the taxpayer’s applicable financial statements for such tax year, adjusted as provided in this section”

### US GAAP Accounting Standard Codification Master Glossary



#### Net Income

- A measure of financial performance resulting from the aggregation of revenues, expenses, gains, and losses that are not items of other comprehensive income. A variety of other terms such as net earnings or earnings may be used to describe net income.

### International Financial Reporting Standards Glossary



#### Income

- Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

#### Profit or Loss

- Total of income less expenses, excluding components of other comprehensive income.

# Corporate AMT

## Adjusted Financial Statement Income

### Sec. 56A Adjusted financial statement income

(a) In general. For purposes of this part, the term “Adjusted financial statement income” means, with respect to any corporation for any taxable year, the **net income or loss of the taxpayer** set forth on the taxpayer's applicable financial statement for such taxable year, adjusted as provided in this section.

[...]

(c) General adjustments.

[...]

(5) Adjustments for certain taxes. Adjusted financial statement income shall be appropriately adjusted to **disregard any Federal income taxes, or income, war profits, or excess profits taxes** (within the meaning of section 901) **with respect to a foreign country or possession of the United States**, which are taken into account on the taxpayer's applicable financial statement. To the extent provided by the Secretary, the preceding sentence shall not apply to income, war profits, or excess profits taxes (within the meaning of section 901) that are imposed by a foreign country or possession of the United States and taken into account on the taxpayer's applicable financial statement if the taxpayer does not choose to have the benefits of subpart A of part III of subchapter N for the taxable year. **The Secretary shall prescribe such regulations or other guidance as may be necessary and appropriate to provide for the proper treatment of current and deferred taxes for purposes of this paragraph**, including the time at which such taxes are properly taken into account.

[...]

# Corporate AMT

## Accounting considerations

- Corporate AMT has many similarities to the since-repealed, pre-2018 U.S. AMT system applicable to corporations. ASC 740 addressed that tax law and provided:
  - applicable tax rate [for measuring U.S. federal deferred taxes] is the regular tax rate
  - deferred tax asset (DTA) would be recognized for AMT credit carryforwards available under the law which would then be assessed for realization
- Accordingly, under this approach:
  - No remeasurement of existing DTAs and DTLs needed in period of enactment
  - Reflect tax effects of corporate AMT in financial statements after law is effective
  - Considered AMT in determining entity's AETR in such future years
  - Consider impact on valuation allowance for perpetual corporate AMT taxpayers



# Corporate AMT

## Perpetual AMT Taxpayers & VA assessment

When assessing the realizability of regular tax system DTAs for perpetual corporate AMT taxpayers, we believe two acceptable approaches exist :

***Approach 1*** – Future corporate AMT should be considered in the VA assessment for regular tax system deferred tax assets.

- ASC 740 requires all positive and negative evidence to be considered.
- If use of a deductible temporary difference or attribute will result in incremental corporate AMT, a valuation allowance would be required to reflect the actual amount of tax benefit that will be realized with respect to the associated DTA.

***Approach 2*** – Future corporate AMT should NOT be factored into the VA assessment for regular tax system deferred tax assets.

- ASC 740-10-55-15(c) states that the AMT tax law and rate should only be considered when assessing an AMT tax credit carryforward for VA.
- any incremental impact of the corporate AMT would be accounted for in the period the corporate AMT is incurred.

Represents an accounting policy choice that must be consistently applied.



# Corporate AMT

## Valuation Allowance

### Assumptions:

- Entity A has a \$1,000 pre-2018 NOL carryforward as of year-end and no corporate AMT credit or NOL carryforward
- Entity A expects sufficient future income to fully utilize the NOL before it expires
- Entity A expects to perpetually pay AMT and will need to record a valuation allowance against any future corporate AMT credit DTAs
- For simplicity, assume no permanent or temporary differences

**Question:** How much valuation allowance would be required under each approach as of yearend?

	Regular Tax	AMT
Future AFSI & taxable income before NOL c/f <b>A</b>	\$ 1,000	\$ 1,000
NOL deduction	(1,000)	0
Taxable income/AFSI <b>B</b>	\$ 0	\$ 1,000
Tax rate <b>C</b>	21%	15%
Taxes payable with NOL carryforward ( <b>B × C</b> )	\$ 0	\$ 150
Taxes payable without NOL carryforward ( <b>A × C</b> )	\$ 210	\$ 150

### Approach 1

*Tax benefit equals \$60*

*Valuation allowance equals \$150*

### Approach 2

*No valuation allowance required*

# Refundable Credits

# Refundable Credits

## General overview

- The CHIPS Act allows for a direct pay election whereby a taxpayer may elect to treat the amount of section 48D tax credits they are entitled to as a direct payment against tax.
- A similar provision exists for a number of “applicable credits” contained in the Inflation Reduction Act
- If an entity has the ability to elect to treat the credit as a direct payment of tax and receive a refund of such payment even in the absence of any taxable income (i.e., the entity is otherwise in a loss), we believe the tax credit represents a refundable credit that **would be accounted for outside the scope of ASC 740**.
- U.S. GAAP has **no specific authoritative guidance on the recognition and measurement of government assistance** received by business entities. Accordingly, diversity in practice exists and multiple models under U.S. GAAP with respect to accounting for government assistance may be acceptable.

# Transferable Credits



# Transferable Credits

## General overview

- The Inflation Reduction Act adds a transferability provision, for taxable years beginning after December 31, 2022, for a number of "eligible credits".
- The transferability provision would allow an "eligible taxpayer" to elect to transfer (i.e., sell) the credit, or some portion thereof, to an unrelated taxpayer.
- Potential Views:
  - View A – As credit not refundable by the government, Seller always assesses credit initially in ASC 740 model.
  - View B – As Seller does not need an income tax liability to monetize, credit always outside scope of ASC 740.
  - View C – Determination of scope dependent upon intent of Seller.
- We expect the accounting for transferable credits to be the subject of additional discussion within the profession.



**Diversity in practice exists, therefore consultation with your attest firm is recommended**

# Transferable Credits

## Transferee Considerations

- The entity that purchases a transferable credit should generally record a deferred tax asset for the amount of tax credits purchased and a **deferred credit for the difference between the amount paid and the deferred tax asset recognized** in accordance with ASC 740 (such deferred credit does not represent a deferred tax liability).
- The deferred credit will be reversed and recognized as an income tax benefit in proportion to the deferred tax expense recognized on realization of the associated deferred tax asset (i.e., as the credits are utilized on the tax return).

# Transferable Credits

## Example

- **Assumptions – 20X1**

- Jurisdiction X provides a transferable income tax credit for certain qualifying investments related to the production of clean energy.
  - Taxpayers can elect to transfer the credit to an unrelated taxpayer.
  - The consideration paid for the credits is not deductible by the transferee.
  - The difference between the reduction in tax for use of the credits and consideration paid for them is not taxable to the transferee.
- Company A engages in the production of clean energy in Jurisdiction X which qualifies for a tax credit of \$10M.
- In 20X1, Company A is a loss company and enters into an agreement to transfer the credit to Company B for \$8M.
- Company A has a full valuation allowance on its net deferred tax assets (DTAs).
- The statutory tax rate in Jurisdiction X is 21%
- Assume company A accounts for the transferable credit as within the scope of ASC 740 (View A)



# Transferable Credits

## Example (cont.)

### Analysis:

Company A would record the following entries with respect to the credit generated and sold in 20X1:

Company A		
DR Deferred tax asset	\$10.0M	
CR Valuation allowance		\$10.0M
To record initial measurement of DTA for credit		
DR Cash	\$8.0M	
DR Valuation allowance	\$10.0M	
CR Deferred tax asset		\$10.0M
CR Gain		\$8.0M
To record sale of credit and related DTA		

Company B would record the following entries with respect to the credit purchased in 20X1:

Company B		
DR Deferred tax asset	\$10.0M	
CR Deferred credit <sup>[1]</sup>		\$2.0M
CR Cash		\$8.0M
To record purchase of credit and related DTA		

<sup>[1]</sup> The deferred credit will be reversed and recognized as an income tax benefit in proportion to realization of the tax benefit of the DTA (i.e., as the credits are utilized on the tax returns filed in Jurisdiction X). If B would have \$2.0M of taxable income on use of the credits a deferred tax liability would be required.



Diversity in practice exists, therefore consultation with your attest firm is recommended



# Stock Buyback Tax

# Stock Buyback Tax

## General overview

- The Inflation Reduction Act adds a new **1-percent excise tax on stock repurchases** by publicly traded companies that occur **after December 31, 2022**.
- A covered corporation would be subject to a tax equal to 1 percent of:
  - (1) the fair market value of any stock of the corporation that is repurchased by such corporation (or certain affiliates) during any taxable year, with limited exceptions, less
  - (2) the fair market value of any stock issued by the covered corporation (or certain affiliates) during the taxable year (including compensatory stock issuances).
- As the tax is not based on an element of taxable income it is **not within the scope of ASC 740**.
- It is generally acceptable to account for an excise tax obligation that results from the repurchase of common stock classified within permanent equity as a cost of the treasury stock transaction.

# Accounting for ITCs

# Investment Tax Credits

## General overview

**ASC 740-10-25-46** specifies that an entity can use one of two methods to account for the receipt of an ITC (e.g., upon purchase or upon the placement of a purchased or constructed asset in service) as an item of income in the financial statements:

### Deferral Method<sup>[1]</sup>

Reduction to income taxes payable or an increase in a DTA that is recognized as either:

- a reduction to the carrying value of the related asset
- deferred credit (i.e., credit is treated as deferred income)<sup>[2]</sup>

### Flow-through method

Reduction to income taxes payable or an increase in a DTA for the year in which the credit arises is recognized as an **immediate reduction to income tax expense**

The following two approaches are acceptable for recording the tax effect of temporary differences created by ITCs:

### Gross-up approach

- no immediate income statement recognition
- Simultaneous equations method is used to calculate the final book basis of the acquired property and the DTA or DTL.

### Income statement approach

- the DTA/DTL is recorded with an offset to income tax expense.

[1] - Preferable view, as indicated in ASC 740-10-25-46

[2] - We are also aware of an alternative view under which the deferred credit would be reversed through the income tax provision in accordance with paragraph 3 of APB Opinion 4.



# Investment Tax Credits

## Example

### Assumptions:

- Jurisdiction X provides a tax credit equal to 25% of the cost basis of a qualifying asset placed in service. Taxpayers are only required to reduce tax basis of the qualifying asset by 50% of the tax credit.
- Company A places in a qualifying asset of \$40M in service during the year.
  - Tax credit = \$10M; tax basis reduction = \$5M
- Company A's tax rate is 25%

**Difference in approach  
impacts book basis**

### Methods to Account for ITCs:

Deferral Method				
	Book	Tax	Difference	DTA/(DTL)
Asset	\$30.0M	\$35.0M	\$5.0M	\$1.25M
Gross-up	(1.67M)*			
Adjusted Basis	\$28.33M	\$35.0M	\$6.67M	\$1.67M

Flow-through Method				
	Book	Tax	Difference	DTA/(DTL)
Asset	\$40.0M	\$35.0M	(\$5.0M)	(\$1.25M)
Gross-up	1.67M*			
Adjusted Basis	\$41.67M	\$35.0M	(\$6.67M)	(\$1.67M)

**\*Note:** Under the gross-up approach, A applies a simultaneous equation on the initial temporary difference:  $\$1.25M * 25\% \div [1 - 25\%] = .42M$

Questions



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