Media Financial Management Association

MFM Focus 2020

Financial Reporting for Income Taxes

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Agenda

- CARES Act & tax accounting considerations
- Goodwill impairment testing and ASU 2017-04
- ASU Update 2019-12: Simplifying the Accounting for Income Taxes
- ASU Topic 740: Changes to the disclosure requirements for income taxes
- Business combinations
- Uncertain tax positions
- State income tax policy
- Altera Corp vs. Commissioner

CARES Act - Overview

- Net operating losses (NOLs) - (1) 5-year NOL carryback for 2018, 2019 or 2020 losses, (2) temporary removal of 80% NOL limitation, and, (3) modified pass-thru loss limitation;
- Acceleration of corporate AMT credit refunds;
- Section 163(j) - Increase 30% limitation to 50% for 2019 and 2020;
- 2017 Tax Reform Act technical corrections regarding qualified improvement property (QIP)
- Employee retentions credit - Temporary refundable 50% employee retention credit for employers subject to full or partial business suspension due to the COVID-19 emergency, or for employers whose gross receipts have significantly declined due to COVID-19.
- Payroll taxes - Delayed payment of applicable 2020 employer payroll taxes. Half of the deferred tax is to be paid by December 31, 2021, and the remainder by December 31, 2022.

CARES Act - NOL Carryback & Valuation Allowance Considerations

- Taxable income in prior carryback years is one of the four sources of taxable income provided by ASC 740 to support realization of deferred tax assets.
- Valuation allowances may no longer be necessary for existing NOL deferred tax assets if those NOLs can now be carried back to offset taxable income in prior years.
- Tax effect of releasing the valuation allowance on existing NOL deferred tax assets as a result of the CARES Act should be recorded discreetly in the period of enactment.
- Important to note that the Federal tax rate changed from 35% to 21% as of the 2017 TCJA. Thus, the tax rate differential should be considered for any NOLs that are expected to be carried back to a year before the tax rate change was effective.
    - The tax benefit for the rate differential related to losses recognized during the current year should be included in the annual ETR.

CARES Act - NOL Carryback Example

Assume a company with a December 31 year end expects to carry back any 2020 taxable loss to a pre-reform period when the tax rate was 35%. The company forecasts book losses of $250 each quarter, for a total book loss of $1,000 for the year. The company has unfavorable permanent differences of $60. The company expects net movement in its temporary differences during the year to reduce taxable income by $200. The composition of the movement in temporary differences is as follows:

Deductible/ (taxable) temporary differences	1/1/2020 (beginning of year)	Activity	12/31/2020 (end of year)
Temp Diff A (full reversal)	$100	($100)	$ -
Temp Diff B (partial reversal)	(500)	300	(200)
Temp Diff C (no reversal)	(300)	-	(300)
Temp Diff D (originating)	-	(400)	(400)
Total	**($700)**	**($200)**	**($900)**

CARES Act - NOL Carryback Example

- Temporary difference A is expected to fully reverse in the current year.
- Temporary difference B is expected to partially reverse in the current year.
- Temporary difference C is not expected to reverse in the current year (e.g., already fully amortized tax-deductible goodwill).
- Temporary difference D originates during the current year and will reverse in subsequent years.

Deductible/ (taxable) temporary differences	1/1/2020 (beginning of year)	Activity	12/31/2020 (end of year)
Temp Diff A (full reversal)	$100	($100)	$ -
Temp Diff B (partial reversal)	(500)	300	(200)
Temp Diff C (no reversal)	(300)	-	(300)
Temp Diff D (originating)	-	(400)	(400)
Total	**($700)**	**($200)**	**($900)**

CARES Act - NOL Carryback Example

Determine the tax provision for the year

- The total ***tax benefit is $357*** ($399 current benefit + $42 deferred expense).

Current provision	
Book loss	($1,000)
Perms	60
Temps	(200)
Taxable loss	(1,140)
Tax rate	35%
Current benefit	**($399)**

Deferred provision	
1/1/2020 deferreds	($700)
@ 21%	(147)
12/31/2020 deferreds	($900)
@ 21%	(189)
Deferred expense	**$42**

CARES Act - NOL Carryback Example

Determine discrete impact of remeasuring beginning of year deferreds that will reverse in the current year

Reversing temporary difference	Measured @ 21% (A)	Measured @ 35% (B)	Discrete amount (A) - (B)
Temp Diff A — ($100)	$21	$35	($14)
Temp Diff B — $300	(63)	(105)	42
Total	**($42)**	**($70)**	**$28**

Note that Temporary difference C is not included in the above calculation because there is no tax impact in the current year (i.e., the rate is 21% at both the beginning and end of the year). Temporary difference D is not included in the above calculation because it originates in the current year and is therefore captured in the next calculation.

CARES Act - NOL Carryback Example

Calculate the interim provision

	AETR
Estimated full year pre-tax loss	($1,000)
Estimated full year perms	60
Estimated full year pre-tax plus perms	(940)
Tax rate for current year loss	35%
Tax benefit on current year loss	(329)
AETR impact — originating differences[1]	(56)
Estimated full year income tax benefit	(385)
Estimated AETR	**38.5%**

Quarter	YTD loss x AETR	YTD benefit	YTD discrete expense	Total YTD provision
Q1	($250) x 38.5%	($96)	$28	($68)
Q2	($500) x 38.5%	($193)	$28	($165)
Q3	($750) x 38.5%	($289)	$28	($261)
Q4	($1,000) x 38.5%	($385)	$28	($357)

Temporary difference D, which originates in the current year, generates a permanent difference that impacts the rate. This is because the impact on the current provision will be recorded at the 35% carryback rate, but the temporary difference will reverse and impact the deferred provision at a 21% rate. This 14% rate differential, multiplied by the gross originating difference of $400, yields a permanent rate impact of $56.

CARES Act - Post Acquisition Considerations for NOL Carrybacks

- When a company has been acquired in recent years, NOLs attributable to the acquired company may be carried back to a consolidated tax filing group that is different than the one it currently belongs to.
  - Accounting for the acquirer's income tax impact of carrying back NOLs to a different consolidated tax filing group is similar to accounting for the federal tax rate differential except rather than remeasuring related DTAs to a 35% tax rate, the DTAs might instead be written off or remeasured to zero.
  - Both the buyer and seller should consider whether it would be appropriate to record an indemnification receivable or payable if the seller will reimburse the buyer for any portion of refunds received. The impact of recording the indemnification would generally be recorded through pre-tax book income rather than tax expense.

CARES Act - Section 163(j) Considerations

- For tax years beginning in 2019 and 2020, the CARES Act increases the adjusted taxable income (ATI) limitation from 30% to 50% and allows a taxpayer to elect to use 2019 ATI in determining the 2020 limitation.
    - Current year tax effects resulting from the increased ATI limitation and election to utilize 2019 ATI when determining the limitation for 2020 should be reflected in the current year AETR.
    - The income tax effects of changes in the prior year ATI limitation should be accounted for discretely in the interim period that includes the date of enactment. These effects might include changes in the valuation allowance and the knock-on effects from the change in taxable income as a result of the increased deduction. Examples include:
        - There might be a decrease in the valuation allowance because the increased ATI limitation results in less of a Section 163(j) carryforward from 2019; or
        - Credits that were originally claimed on the prior return (e.g., foreign tax credits, R&D tax credits) may now be carried forward and require a valuation allowance.

CARES Act - Other Considerations

- Other tax attributes that were utilized in carryback years (e.g. FTC, R&D Credits) may now be carried forward as DTAs that must be assessed for realizability.
- Other items with knock-on effects that are impacted by changes in taxable income including FDII, GILTI, BEAT, Section 199 deduction, and AMT may impact the amount of the rate differential (i.e., the carryback of a loss may result in a reported tax benefit that is less than the 14% rate differential between 35% and 21%).l
- Balance sheet presentation should reflect when the NOLs are expected to be monetized.
    - **Example:** A current tax receivable would be recorded if the NOL is expected to generate a cash tax refund within the current year. However, if an NOL is carried back to a toll charge year and will only result in a reduction to a future installment payment, the impact should instead be recorded as a reduction to the outstanding toll charge liability.

CARES Act - Qualified Improvement Property

- The CARES Act technical correction adds QIP to the list of property with a 15-year recovery period and a 20-year class life eligible for additional first-year (bonus) depreciation.
- The impact of the QIP technical correction on any position taken in a prior period should be recorded discreetly in the interim period that includes the date of enactment.
    - The technical correction constitutes new information that may allow for recognition of a tax position taken in a prior period that did not previously meet the more-likely-than-not recognition threshold under ASC 740-10-25-6. Any related changes to interest or penalties accrued for the tax position should be accounted for in the same period.
    - Companies may plan to file amended returns for prior periods to claim a benefit, which could result in a refund receivable or a reduction in a payable and a change in deferred taxes.
- Companies should consider the potential rate impact if additional deductions as a result of the QIP technical correction will create or increase NOLs that can be carried back to a year with a 35% tax rate.

CARES Act - Employee Retention Credit

- The credit is equal to 50% of qualified retention wages (wages and compensation paid by an eligible employer to employees after March 12, 2020 and before January 21, 2021) that an eligible employer pays in a calendar quarter with the maximum amount of qualified wages per employee capped at $10,000, so that the maximum amount of of the credit for wages paid to any employee is $5,000.
- Eligible Employers to receive the credit are employers that carry on a trade or business during calendar year 2020 and that either:
    - (1) Fully or partially suspend business operations during any calendar quarter in 2020 due to order from an appropriate governmental authority imposing restrictions upon the business operations by limiting commerce, travel, or group meetings due to COVID-19; or
    - (2) Experience a significant decline in gross receipts during the calendar quarter that are below 50% of the comparable quarter in 2019.
- Since the credit is calculated based on wages and reduces an employer's payroll tax, it is not considered a tax based on income and therefore should be accounted for outside of ASC 740 and would likely be treated as a grant.

CARES Act - Payroll Taxes

- Prior to the CARES Act, payroll taxes generally would have been deductible for income tax purposes in the same period that they were expensed for book purposes under the “recurring item exception” of the Internal Revenue Code.
- As a result of the CARES Act, if a company defers payment of its payroll taxes such that the recurring item exception no longer applies, accrued payroll taxes would not be deductible until the tax year in which they are actually paid.
- If the book expense and tax deduction are expected to occur in different periods, a deferred tax asset would need to be recorded for the deductible temporary difference related to the payroll tax accrual.
- For companies that are expecting to carry back current-period NOLs to a pre-tax reform year, there could be an unfavorable impact in the annual estimated effective tax rate related to this temporary difference.

Polling Question #1

Which area of the CARES Act has impacted your company the most?

A. NOL carryback

B. QIP

C. Employee retentions credit

D. Payroll tax deferral

E. N/A - The CARES Act did not have a material impact

Goodwill Impairment Testing

ASU 2017-04: Intangibles—Goodwill and Other (Topic 350)

- On January 26, 2017, the FASB issued Accounting Standards Update (ASU) No. 2017-04, Intangibles – Goodwill and Other (Topic 350).
    - The revised standard is effective for annual or interim goodwill impairment tests performed in ***fiscal years beginning after December 15, 2019.***
- Deferred tax impacts depend on whether a company has tax deductible goodwill
    - Non-deductible goodwill - No corresponding tax effect (permanent difference)
    - Tax deductible goodwill - Increase DTA or decrease the DTL
- Companies should keep in mind that COVID-19 may impact their projected cash flows due to a decrease in demand for their product, supply chain disruptions, or other events. In such situations, a company needs to consider whether the disruption in its business indicates that a "triggering event" has occurred and an impairment assessment is warranted.

ASU Update 2019-12: Simplifying the Accounting for Income Taxes

- On December 18, 2019, the FASB issued ASU 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (the ASU).
    - The standard is effective for public business entities for ***annual reporting periods beginning after December 15, 2020,*** and interim periods within those reporting periods.
    - For all other entities, it is effective for ***annual periods beginning after December 15, 2021,*** and interim periods within annual periods beginning after December 15, 2022.
    - Early adoption is permitted in any interim or annual period, with any adjustments reflected as of the beginning of the fiscal year of adoption.
        - If an entity chooses to early adopt, it must adopt all changes as a result of the ASU.

ASU Update 2019-12: Simplifying the Accounting for Income Taxes

Key provisions of the simplification include:

- Year-to-date losses in the interim periods
- Franchise taxes and other taxes partially based on income
- Intraperiod tax allocation
- Separate entity financial statements
- Deferred tax liabilities related to outside basis differences
- Step-up in tax basis goodwill

Polling Question #2

What is your Company's plan with respect to the ASU income tax simplification?

A. Already early adopted

B. Not planning to early adopt

C. Still deciding

D. Not sure

ASU Topic 740: Disclosure Framework

Changes to the Disclosure Requirements for Income Taxes

- On March 25, 2019 FASB issues a proposed ASU - Changes to the disclosure requirements for income taxes.
- The proposed ASU will affect financial statement disclosures of virtually all entities that apply US GAAP. Although many of the proposed disclosure requirements codify existing SEC disclosure requirements, certain of the new disclosures will make information public that was not previously available.
- Amendments would be applied prospectively. The effective date will be determined after the Board considers stakeholder feedback on the proposed amendments.
- Companies should monitor developments and expect an updated in 2020 with respect to the Disclosure Framework project.

Business Combinations

Goodwill Considerations: Component 1 vs. Component 2

Business Combinations

Goodwill considerations: Day one

- Excess financial reporting goodwill
  - No deferred tax recorded
  - As financial reporting goodwill changes (impaired or, if applicable, amortized), a "permanent difference" is recognized
- Excess tax goodwill
  - Tax-deductible goodwill with an initial tax-over-book basis (i.e., "excess tax goodwill") will result in an initial DTA, which is determined by using the following "iterative" formula:
  - **DTA = (Tax rate/(1 – Tax rate)) * Preliminary Temporary Difference**

Business Combinations

Goodwill considerations: Day two and forward

- When tax-deductible goodwill is amortized, adjust the deferred tax balance.
- When book goodwill is impaired:
  - If no tax-deductible goodwill exists, no deferred tax implications arise
  - If tax-deductible goodwill exists, and book goodwill exceeds tax goodwill, the impairment must be allocated pro rata to the 2 components of book goodwill to determine the deferred tax effect
    - The impairment is allocated pro rata to the 2 components based on the book carrying amounts.
  - If tax-deductible goodwill exceeds book goodwill, no allocation is necessary and the impairment will increase the DTA or reduce the DTL

Business Combinations

Change in control limitation on acquired tax attributes

- Section 382: restricts a utilization of NOLs after a corporation undergoes an ownership change.
  - Value of loss corporation's equity x long term tax-exempt interest rate = Annual Section 382 Limitation
  - Ownership change occurs if one or more "5% Shareholders" increase ownership in the corporation's stock, in the aggregate, by >50% during a testing period, generally the 3-year period preceding a testing date.
  - Section 382 limitation may be increased by recognized built-in gain ("RBIG") and recognized built-in loss ("RBIL") may be subject to the section 382 limitation.
- Section 383: restricts a utilization of excess credits (general business credit, MTC) in any post-change year determined on the basis of the tax liability which is attributable to so much of the taxable income as does not exceed the section 382 limitation for such post-change year to the extent available after application to annual limit to NOL utilization.

Business Combinations

Valuation Allowance Considerations

- Changes in the Acquirer's valuation allowance
  - At the date of acquisition, any changes in the Acquirer's valuation allowance are generally recognized in income tax expense.
  - Other "synergistic" tax impacts on an Acquirer are also recognized in income tax expense.
- Subsequent changes in judgment regarding the Acquired Enterprise's valuation allowance should be recognized as follows:
  - Within the measurement period - Goodwill
  - Outside the measurement period - Income tax expense

Uncertain Tax Positions

Recognition

- More-likely-than-not to be sustained on examination
- Assessment based on technical merits of the position
- No consideration of detection risk
- Consider administrative practices and precedents
- Uncertainties regarding valuations
- Interplay with valuation allowances

Measurement

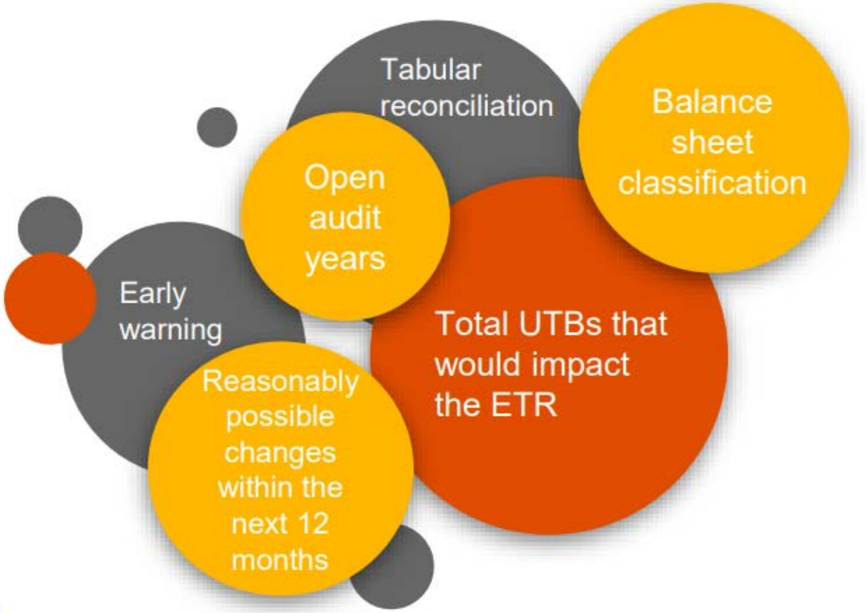
- Measured at the largest amount that has a cumulative probability of >50% of being the ultimate outcome
- Consider amounts and probabilities of various outcomes
- Highly certain tax positions
- Binary tax positions
- Interplay between recognition and measurement

Uncertain Tax Positions

Continual Assessment

- Positions are reassessed each period for new information
- Consider tax law changes and case law developments
- Effective settlement considerations
- Changes in judgement of a prior year UTP recorded on discrete basis

Disclosures



Polling Question #3

Which portion of today's training did you find most beneficial?

A. CARES Act

B. ASU 2019-12: Income tax simplification

C. Business combinations

D. Other

E. All of the above

State Income Tax Policy

- Moody's estimated a $160 billion decrease in state tax revenues for fiscal year 2021 due to COVID-19. As such, some states have enacted legislation in an attempt to raise revenue.
    - California
        - Suspend NOL deductions for any taxable year beginning on or after January 1, 2020, and before January 1, 2023, for taxpayers that have over $1 million in net business income.
        - Limit the utilization of business tax incentives to $5 million from January 1, 2020, to January 1, 2024.
    - District of Columbia
        - For tax years beginning after December 31, 2017, NOL utilization is limited to 80% of apportioned DC net income.
- Valuation allowance considerations

Altera Corp vs. Commissioner 145 T.C. 91 (2015)

- Altera Corporation (Altera) is a U.S. taxpayer that entered into a research and development cost sharing agreement (R&D CSA) with a foreign subsidiary. For tax years 2004-2007, Altera granted stock options and other SBC to certain employees, but did not include any SBC expenses in the pool of costs shared under the R&D CSA.
    - July 27, 2015 - U.S .Tax Court held that the SBC rule was invalid.
    - February 10, 2020 - Altera petitioned the U.S. Supreme Court for writ of certiorari.
    - June 22, 2020 - U.S. Supreme Court denied Altera's petition
- Uncertain tax position considerations
    - Taxpayers that participate in CSAs and incur SBC costs should consider whether the Supreme Court's denial of review affects their contractual obligations with respect to SBC costs and their accounting for the tax impact of the SBC issue in their financial statements.

Thank you!