FEI Professional Development: Tax and Accounting

February 11, 2019

Notices

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The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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Wayfair: The Case and What it Means

Quill – and how we got here

In *Quill v. North Dakota* (1992), the U.S. Supreme Court ruled that a state cannot require a business to collect use tax from in-state customers if the business has no physical presence in the state

— In the 26 years since *Quill* was decided, states have been increasingly aggressive in their efforts to narrow *Quill's* effect and expand what constitutes a physical presence

- Initial efforts focused on representational nexus – states asserting that the physical presence of a third-party or an affiliate in the state created nexus for the out-of-state seller
- This required a showing that the in-state person was engaging in activities that were "significantly associated with the seller's ability to establish and maintain a market for sales"

— Most recently, several states have adopted "economic nexus" standards that require sellers with no physical presence to collect sales and use tax if they exceed certain bright-line sales or transaction thresholds

- Many of these state statutes specifically acknowledged that the economic nexus standards and thresholds conflicted with the Court's holding in *Quill*

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South Dakota v. Wayfair

Background

— In 2016, South Dakota passed Senate Bill 106, which adopted an economic nexus standard for sales and use tax purposes

- Under the revised law, any seller with sales exceeding an annual threshold of $100,000 or 200 separate transactions in South Dakota was required to collect and remit effective May 1, 2016
- The law was quickly challenged; as was expected

— On September 14, 2017, the South Dakota Supreme Court held that the state is bound to follow established U.S. Supreme Court precedent

- A law imposing economic nexus standards on remote retailers could not be enforced in light of *Quill*

On January 12, 2018, the U.S. Supreme Court granted certiorari and oral arguments were held April 17, 2018

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South Dakota v. Wayfair

On June 21, 2018, the Court ruled in a 5-4 decision in favor of South Dakota

— The Court concluded that the physical presence rule set forth in *Quill* is overruled as it is "unsound and incorrect"

— The physical presence rule "has been the target of criticism over many years from many quarters"

- "*Quill* is flawed on its own terms. First, the physical presence rule is not a necessary interpretation of the requirement that a state tax must be applied to an activity with a substantial nexus with the taxing state. Second, *Quill* creates rather than resolves market distortions. Third, *Quill* imposes the sort of arbitrary, formalistic distinction that the Court's modern Commerce Clause precedents disavow"

— While multistate business may be faced with significant compliance costs, the Court suggested that other aspects of constitutional analysis, can "better and more accurately address any potential burdens on interstate commerce"

— The four dissenters followed varied lines of reasoning, including decrying the lack of a record and that the issue was better left to Congress; none defended the physical presence rule

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South Dakota v. Wayfair (cont.)

The physical presence rule has been overturned, but it is not clear how the Court's holding will be applied in every other state

— It's important to keep in mind that the Court did not hold that South Dakota's law would be permissible under every circumstance in every state

- The Court held that the taxpayers at issue had the requisite virtual and economic contacts with South Dakota to meet the "substantial nexus" requirement
  - There might be a different result for different sellers in other states

— Also, under the Court's rationale, the laws, as applied to the sellers, ***cannot discriminate or place undue burdens on interstate commerce***

- The South Dakota statute, in the Court's view, appeared to do neither
  - The South Dakota law included a safe harbor for those sellers who transacted only limited business in South Dakota; ensured that no obligation to remit the sales tax may be applied retroactively; and, South Dakota is one of more than 20 States that have adopted the Streamlined Sales and Use Tax Agreement

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What has happened since *Wayfair*

The majority of states with a sales tax have now adopted economic nexus standards similar to South Dakota's

— Some have enacted legislation, others have promulgated regulations, and a large number of state revenue departments have simply announced new economic nexus standards (based on broad "doing business" statutes already in place)

- There has been no legal challenge to a state revenue department creating an economic nexus standard via announcement or guidance
- The large majority of economic nexus standards mirror South Dakota's, but some differ in important ways (e.g., higher threshold, no transaction threshold, etc.)

— The remaining states that have not yet adopted an economic nexus standard are likely to address this in the 2019 legislative session (and some have already announced their intention to do so).

No state has attempted to enforce an economic nexus standard retroactively (i.e., to periods prior to the *Wayfair* decision), including states that had provisions in effect prior to the decision.

— Two states, Massachusetts and Ohio, have standards requiring economic nexus plus a software-related presence, that these states will enforce pre-*Wayfair*

- These are not "pure" economic nexus standards and therefore, in the state's view, can be enforced prior to *Quill* being overturned

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Reactions to *Wayfair* – 1/29/2019

A. Economic nexus with effective date

Effective Prior to 1/1/2019			Effective 1/1/2019	Effective After 1/1/2019
AL – 10/1/2018	MD – 10/1/2018	NV – 10/1/2018	DC – 1/1/2019	CA – 4/1/2019**
CT – 12/1/2018	MI – 10/1/2018	SC – 11/1/2018	IA – 1/1/2019	CO – 6/1/2019***
HI – 7/1/2018	MN – 10/1/2018	SD – 11/1/2018	NE – 1/1/2019	LA – TBD 2019
IL – 10/1/2018	MS – 9/1/2018	VT – 7/1/2018	NY – 1/15/2019*	PA – 7/1/2019
IN – 10/1/2018	NJ – 11/1/2018	WA – 10/1/2018	UT – 1/1/2019	TX – 10/1/2019
KY – 10/1/2018	NC – 11/1/2018	WI – 10/1/2018	WV – 1/1/2019	WY – 2/1/2019
ME – 7/1/2018	ND – 10/1/2018			

B. Other

AR	AZ	FL	GA (collect-or-report)	ID
KS	MA (software nexus)	MO	NM	OH (software nexus)
OK (collect-or-report)	PR (report)	RI (collect-or-report)	TN (enjoined; needs legislative approval)	VA

* New York guidance, issued 1.15.2019, indicated that existing statutory thresholds became effective "immediately" after *Wayfair* (6.21.2018) and vendors meeting the thresholds should register "immediately." The guidance did not indicate whether the Department intended to enforce the thresholds back to 6.21.2018.

** The California legislature introduced AB 147, which would modify the CDTFA's economic nexus thresholds, effective upon being enacted

*** Colorado's economic nexus rule was to go into effect December 1, 2018, but the Department announced a grace period through May 31, 2019

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Economic nexus

As of January 29, 2019

State	Threshold	Effective Date
Alabama	$250,000	October 1, 2018
California	$100,000 or 200 transactions	April 1, 2019
Colorado	$100,000 or 200 transactions	June 1, 2019 (grace period from December 1, 2018)
Connecticut	Regular or systematic solicitation of sales, plus $250,000 and 200 transactions	December 1, 2018
District of Columbia	$100,000 or 200 transactions	January 1, 2019
Hawaii	$100,000 or 200 transactions	July 1, 2018
Illinois	$100,000 or 200 transactions	October 1, 2018
Indiana	$100,000 or 200 transactions	October 1, 2018
Iowa	$100,000 or 200 transactions	January 1, 2019
Kentucky	$100,000 or 200 transactions	October 1, 2018
Louisiana	$100,000 or 200 transactions	DoR aiming for sometime in 2019
Maine	$100,000 or 200 transactions	July 1, 2018

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Economic nexus, continued

As of January 29, 2019

State	Threshold	Effective Date
Maryland	$100,000 or 200 transactions	October 1, 2018 (effective date of emergency regulation)
Michigan	$100,000 or 200 transactions	October 1, 2018
Minnesota	Regular or systematic solicitation of sales, plus either 100 transactions or 10 or more transactions totaling over $100,000	October 1, 2018
Mississippi	$250,000 plus purposeful or systematic exploitation of the Mississippi market	September 1, 2018
Nebraska	$100,000 or 200 transactions + meet "doing business" definition	January 1, 2019
Nevada	$100,000 or 200 transactions	October 1, 2018
New Jersey	$100,000 or 200 transactions	November 1, 2018
New York	$300,000 **and** 100 transactions	January 15, 2019*
North Carolina	$100,000 or 200 transactions	November 1, 2018
North Dakota	$100,000 or 200 transactions	October 1, 2018

* New York guidance, issued 1.15.2019, indicated that existing statutory thresholds became effective "immediately" after *Wayfair* (6.21.2018) and vendors meeting the thresholds should register "immediately." The guidance did not indicate whether the Department intended to enforce the thresholds back to 6.21.2018.

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Economic nexus, continued

As of January 29, 2019

State	Threshold	Effective Date
Pennsylvania	$100,000	July 1, 2019
South Carolina	$100,000	November 1, 2018
South Dakota	$100,000 or 200 transactions	November 1, 2018
Tennessee	$500,000 and regular or systematic solicitation	TBD (pending resolution of state litigation regarding TN economic nexus rule and approval by legislature)
Texas	$500,000 and solicitation for taxable items	October 1, 2019
Utah	$100,000 or 200 transactions	January 1, 2019
Vermont	Regular, systematic, or seasonal solicitation of sales, plus either $100,000 or 200 transactions	July 1, 2018
Washington	$100,000 or 200 transactions	October 1, 2018
West Virginia	$100,000 or 200 transactions	January 1, 2019
Wisconsin	$100,000 or 200 transactions	October 1, 2018
Wyoming	$100,000 or 200 transactions	February 1, 2019

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Economic threshold + software-related presence

As of January 29, 2019

State	Threshold	Effective Date
Massachusetts	$500,000 and 100 transactions for retailers with software in state (apps, cookies, etc.)	October 1, 2017
Ohio	$500,000 for retailers with software or content distribution networks in state	January 1, 2018

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Issues – remote sellers generally

Besides having to register and collect in new states, what are the other issues?

- Determining taxability of goods in new states where the seller has a collection obligation
  - Not always easy- even when selling tangible personal property
    - A number of states have exemptions for clothing, farm equipment, durable medical equipment, etc.
    - Determining what does and does not fall within the scope of an exemption may not be simple and will be subject to audit
  - Does the state have sales tax holidays that need to be addressed for online sales?
  - Does the seller have a process for collecting and storing exemption certificates for sales to exempt organizations?
- Determining the tax base upon which sales tax is charged
  - Are delivery/shipping costs subject to sales tax in each state?
  - Are there ancillary services being provided as part of the sale that would be taxable under a true-object analysis?

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Issues – foreign sellers

Wayfair does not provide different rules or carve-out foreign sellers making sales to customers in the U.S.

- No states limit the scope of their economic nexus laws to U.S.-based sellers.
  - Under plain reading, foreign sellers are required to collect and remit on sales made to in-state customers if they meet the state's economic threshold
- Note that economic nexus thresholds in many states apply to gross sales, not just taxable sales

State laws that impose burdens on interstate commerce that are clearly excessive in relation to local benefits may be unconstitutional

- Under Foreign Commerce Clause jurisprudence, a heightened standard applies to foreign commerce and there may be arguments that as applied to foreign sellers, state economic nexus laws discriminate or are unduly burdensome
  - Would be a facts and circumstances analysis

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Issues – foreign sellers and enforcement

The Revenue Rule

- — A general legal principle that the courts of one country will not enforce the tax laws of another country
- — US courts generally do not enforce foreign tax judgments against U.S. companies
  - The U.S. Supreme Court has held that U.S. courts are prohibited from enforcing a foreign court's tax judgment, unless otherwise permissible under U.S. statutes or treaties
  - The 2006 U.S. Model Income Tax Convention does not allow the enforcement of foreign tax judgments U.S. courts (and doesn't apply to state taxes in any event)
    - — Of the newer US-foreign tax treaties that have some enforcement reciprocity, none apply to state taxes
  - State statutes generally reflect the federal approach to foreign tax judgments
    - — 31 states have adopted a model law that excludes tax judgments from enforceable foreign judgments
- — Therefore, it is unlikely that any foreign court will enforce state sales tax judgments against foreign sellers

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Issues – foreign sellers and enforcement

General procedure for enforcing sales tax collection

— If a seller fails to collect and remit tax or fails to reply to audit notices, the state can issue a jeopardy assessment and seek a tax judgment against the seller in the state's court

— If the seller is based in another state, per the U.S. constitution's full faith and credit clause, the other state must enforce this judgment from a "sister state"

Foreign sellers

— If a foreign seller has in-state property, a state court may order it seized to satisfy the judgment

— If not, the state would have to rely on the courts in the seller's home jurisdiction to enforce the judgment. Per the "revenue rule," foreign courts are not likely to enforce the judgment

Alternative enforcement tools (as identified by the Multistate Tax Commission)

— Impose collection obligations on marketplace facilitators who provide a platform for foreign sellers

— Obtain purchase data from U.S. Customs and deduct unpaid use tax from state income tax refunds

— Pursue non-tax civil actions against sellers that collect but do not remit (i.e. tort of conversion)

— Impose reporting requirements on sellers that do not collect and remit, with penalties for failure to comply (presumably the revenue rule will not apply to collection of penalties)

— Impose collection obligations on U.S.-based entities that provide credit card and payment processing services

— CAVEAT: States cannot discriminate against foreign commerce (constitutional issue)

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Issues – technology companies

Does the decision disproportionately affect technology companies?

— Perhaps
  - Because of how technology-related services are delivered, many technology companies likely contained their nexus footprint to a few jurisdictions

— Also, determining the taxability of Internet-based/technology-related services can be challenging
  - Right now, about half the states impose sales/use tax on software-as-a-service and a number of states impose tax on electronically downloaded software and associated technology-related services
  - The guidance around which technology products and services are taxable is far from clear in many states and often involves an analysis to ascertain the "true-object" or primary purpose of the transaction
  - In certain states, there may not be clear answers and rulings will need to be obtained

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Issues – exempt/non-taxable sales

Does the decision affect sellers that make only tax-exempt sales (e.g., sales for resale, or exempt sales)?

- Yes – in many states, the economic nexus thresholds are based on gross revenues from sales or total sales, not necessarily total taxable sales or sales at retail
  - There are a few exceptions – need to read laws carefully
- If the standard is based on gross revenues or total sales, affected sellers would need to register, collect exemption certificates from customers, and file zero returns in these states
  - Certain states may have annual filing requirements for sales and use tax, as well
- If a seller has not been collecting exemption certificates because they had no nexus in the customer's state, they will likely need to do so now to prove the sale is not taxable AND be able to present the certificate on audit
- Note that each state has different non-filing penalties and/or administrative practices around obtaining exemption certificates after a sale transaction has been completed, rather than contemporaneously

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Issues – purchase side

Does the decision affect companies that purchase a lot of goods/services for use in their business?

— Yes, the holding means that more sales tax will be collected at point-of-sale on purchases, rather than remitted as use tax
  - Companies will need to ensure that use tax is not being remitted when sales tax is collected
  - Will also need to ensure that sales tax is not erroneously being charged on exempt sales or sales where the purchaser holds a direct pay permit
  - In sum, processes need to be put in place to ensure that the correct rate of tax is being charged and is reported to the proper jurisdictions

— Companies that have central purchasing entities will need to consider the implications of the decision

— Nature of audits will shift over time from use tax audits to sales tax audits

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Income tax consequences

The repeal of the Quill physical presence standard has corporate income tax implications, as well

— Although many states assert economic nexus for corporate income tax purposes, not all states have specific or bright-line economic nexus authority

— States may well re-evaluate their economic position in light of the overturn of Quill

Steps to consider

— To the extent *Quill* was relied on for a non-filing position, that should likely be re-evaluated and nexus documentation updated

— Reserves may need to be increased in jurisdictions with pre-Wayfair economic nexus position if entity is not fully reserved

— Consider the impact of registering for sales/use tax on possibility of nexus questionnaire or other income tax inquiry by state

— Consider possible pursuit of a VDA if non-filing position is questionable

— Monitor state announcements carefully

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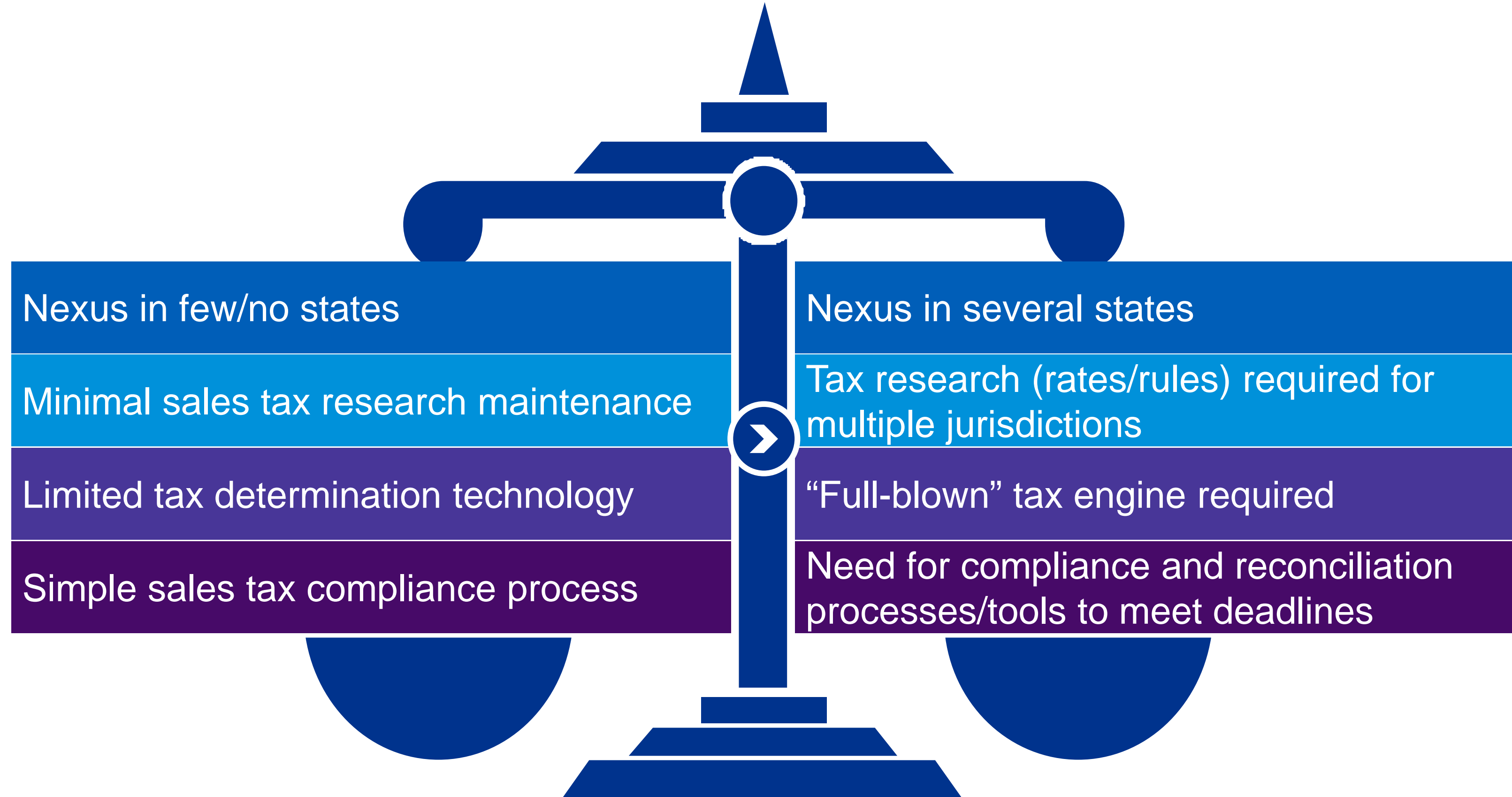
Next steps

Infrastructure needs change overnight!



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Navigating a world without *Quill*

Step 1 – Review Existing and Post-*Quill* Nexus Footprint

— Existing filing obligations – consider VDA/amnesty programs

— Assess post-*Quill* filing obligations

Step 2 – Consider the Overall Business Implications

— Communicate with all stakeholders in the organization

— Involve legal, marketing, supply chain, technology, direct tax, finance

Step 3 – Review Product/Service Mix

— Develop taxability determinations

— Examine bundled items

Step 4 – Review and Consider Technology Needs

— What do you have and what are your options?

— Consider tax engine upgrades or outsourcing compliance processes

Step 5 – Filing Compliance and Initial Registration

— Register in new jurisdictions

— Ensure that all returns and remittances are timely filed

Step 6– Monitor Tax Updates and Handle State Audits

— Stay abreast of tax updates (nexus, rates, exemptions, etc.)

— Prepare for increased audit activity with new jurisdictions

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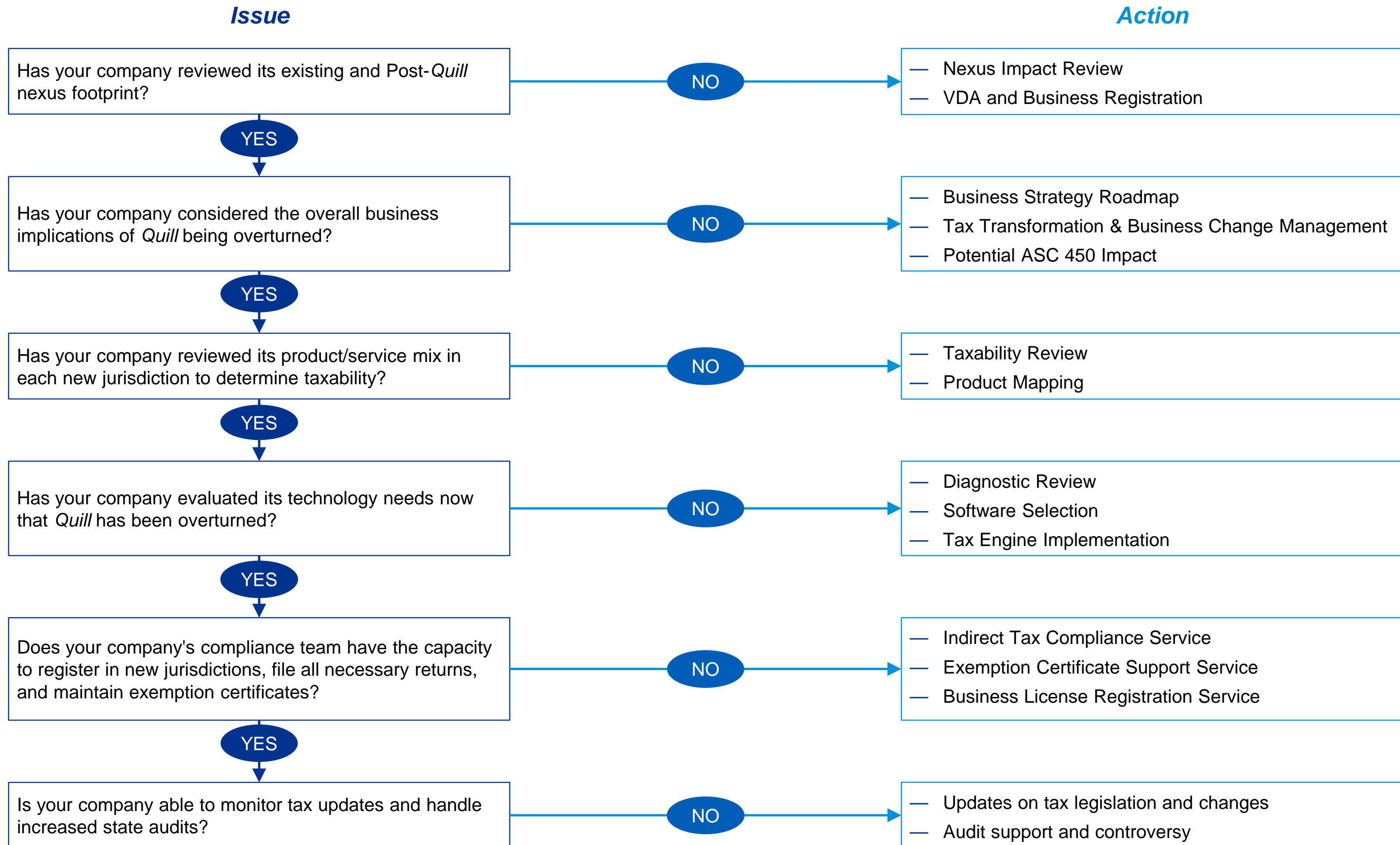
Post-*Quill* readiness checklist



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States and Federal Tax Reform

State conformity to IRC – Three Methods

Rolling
(a.k.a. Moving)

Conforms with IRC in effect for current year, keeping state current with federal changes

Fixed-Date
(a.k.a. Static)

Adopts IRC as of a specific date. State periodically updates conformity date to incorporate federal changes

Selective

State conforms to select IRC provisions and does not incorporate all of the provisions of the IRC as of a certain date

Caution: A state may adopt different methods for different taxpayer types

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General state conformity to the IRC

No general corporate income tax

Rolling conformity or conformity to current IRC (Alaska, D.C.)

Fixed Date or static conformity (Hawaii)

State conforms only to specific sections of the IRC (Arkansas, California, Hawaii, Mississippi)

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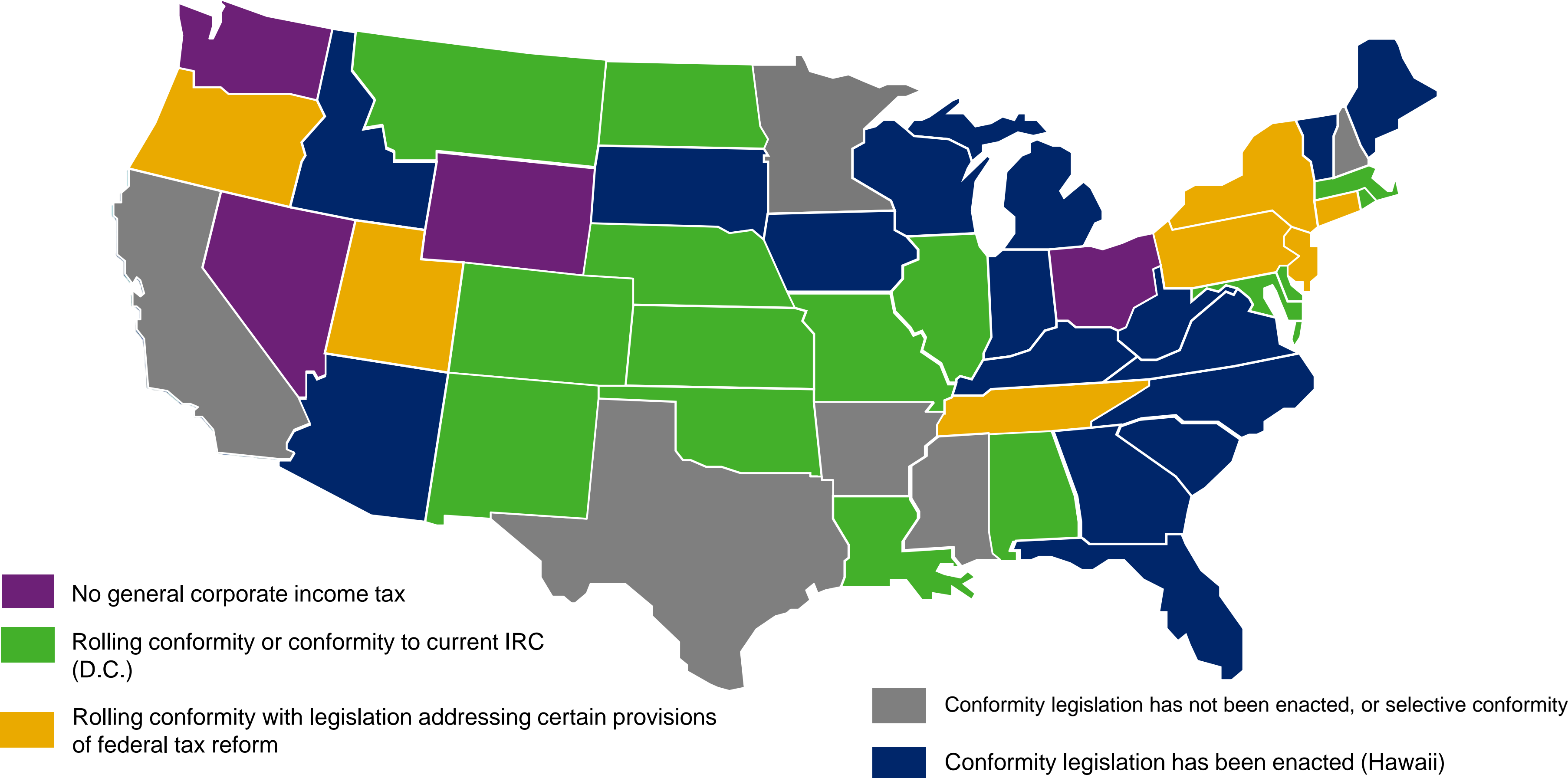
Legislation conforming to the Internal Revenue Code at the end of 2018



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State responses to federal tax reform

1. Blind adoption of the Code after tax reform
2. Adopting a conformity date after tax reform, but decoupling from certain (in some cases, many) tax reform provisions
3. Adopting a conformity date **prior to** tax reform, or not picking up 2018 changes

Minnesota's Governor vetoed two conformity bills; South Carolina failed to pass legislation during the regular sessions, but finally adopted conformity during a late special session

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Key changes affecting corporations

Few conformity issues	Complex conformity issues
Corporate rate reduction to 21 percent	Mandatory repatriation
Repeal of corporate AMT	New GILTI inclusion/ Foreign Derived Intangible Income
Repealing/revising certain miscellaneous deductions	Limits on net interest deduction
Changes to IRC section 1031 like kind exchanges	100 Percent bonus depreciation
Base Erosion Anti-abuse Tax or BEAT	Limits on use of NOLs
	Taxation of state/local contributions to capital

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State conformity to post-reform IRC §163(j)

as of 1/20/19

Conformity starting in TY2019

Decouples starting in TY2020

Conform - rolling or fixed to a post-reform date

Has not updated conformity or has selective conformity and does not adopt

Decouple – specifically decoupled from post-reform 163(j)

Decouple – updated fixed conformity but not for 2018 aspects of tax reform

No general corporate income tax

Alaska

District of Columbia

Hawaii

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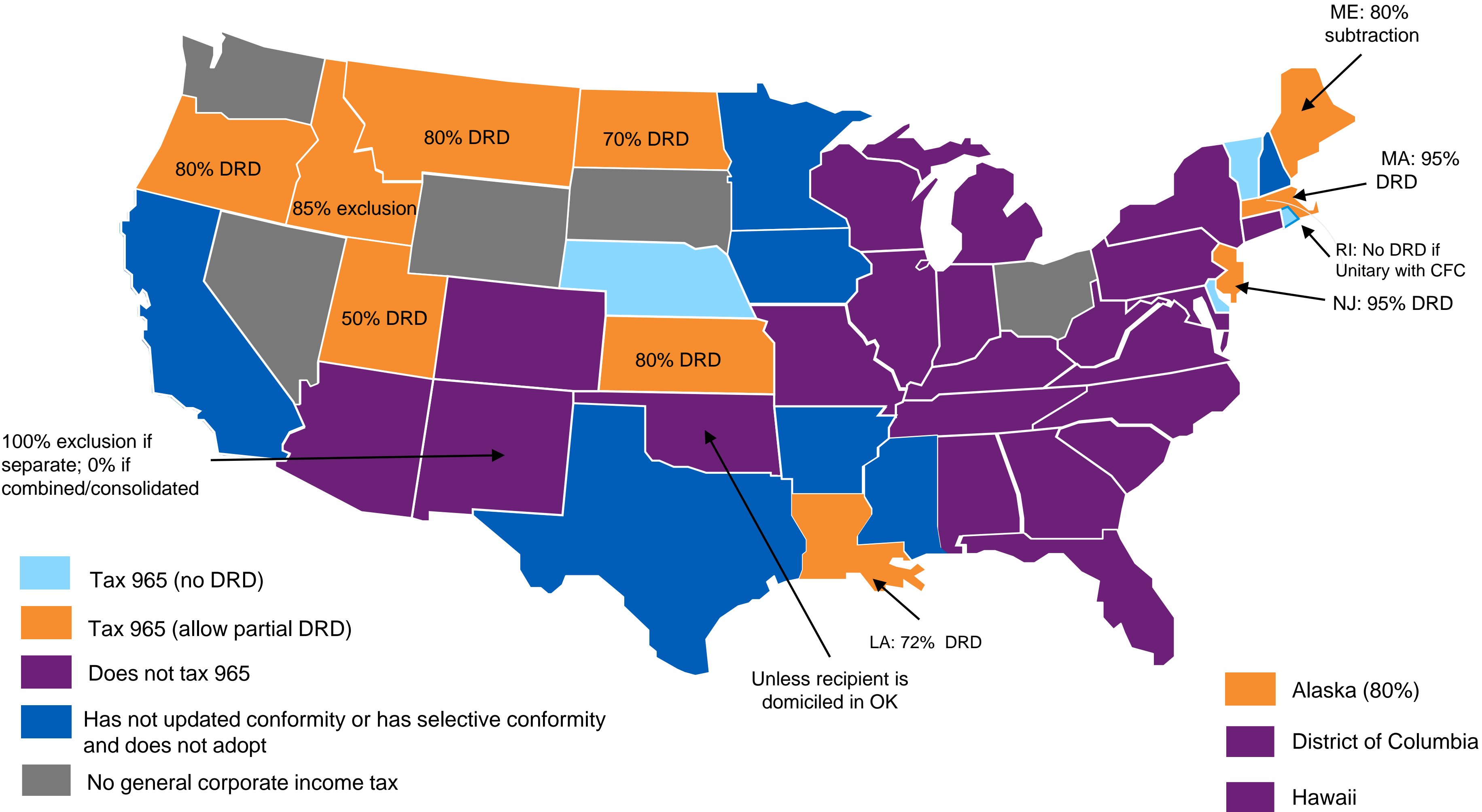
State responses to 965 (as of 1/20/2019)

Not considering FCC and assuming 100% ownership of DFIC



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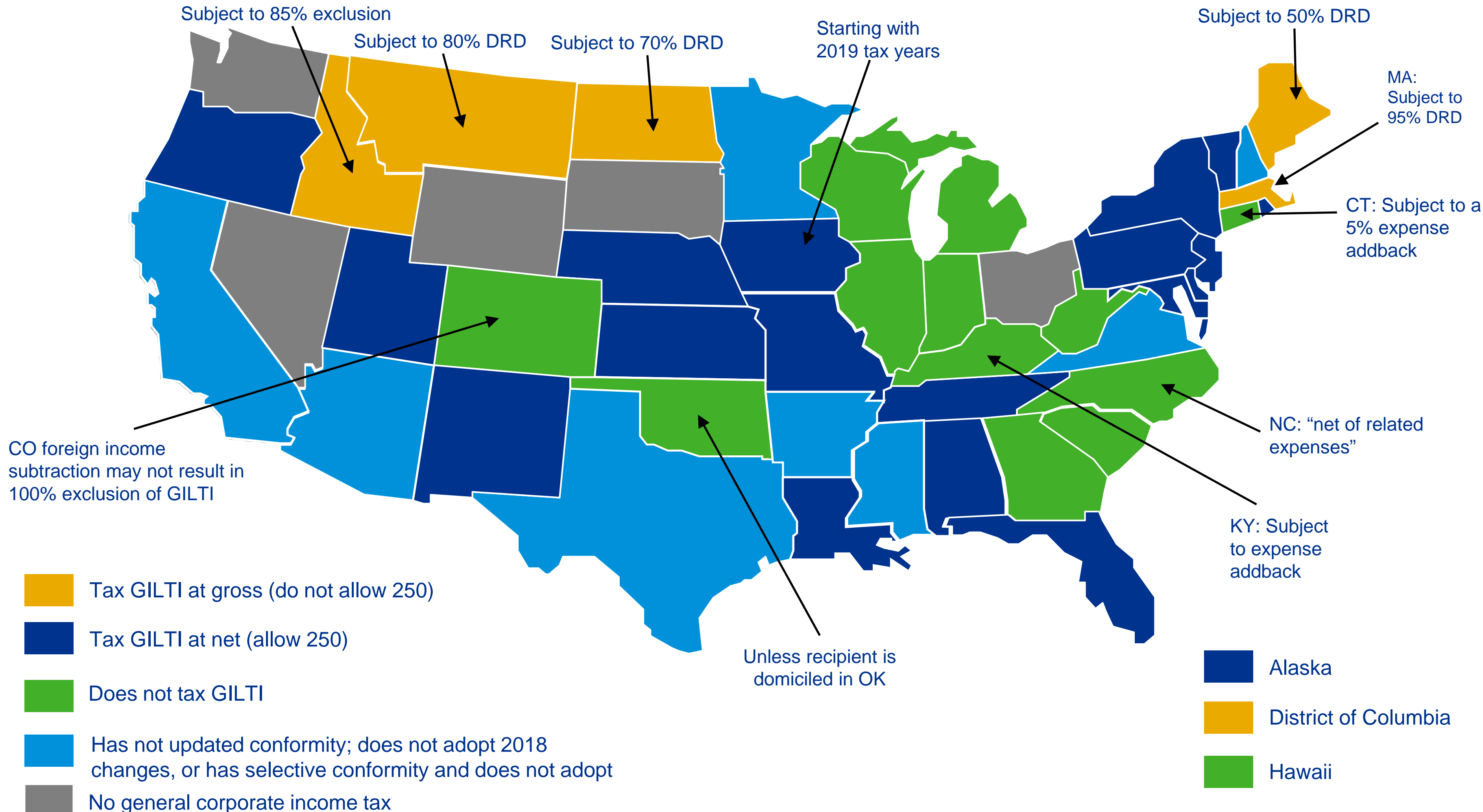
State taxation of GILTI (as of 1/20/2019)

Not considering Foreign Commerce Clause and assuming 100 percent ownership



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Looking ahead

Legislation

- In the states that have not updated their conformity, or that updated their conformity to the Code without addressing tax reform, we can expect state lawmakers to debate tax reform during the 2019 sessions
  - May not be a quick process in certain states (e.g., California)
  - Post-mid-term political situation may change state's approach
  - Budget situation will likely play a role

2018 Compliance

- State income tax compliance will be significantly more challenging when filing 2018 returns, as taxpayers will have to address 163(j) limits and GILTI, as well as a host of other changes
- Filing in non-conforming states (e.g., California and Minnesota) will also be much more time-consuming
- State guidance on mandatory repatriation came often days before returns were due
  - Not clear if or when states will issue guidance on 2018 tax reform provisions

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Accounting for income taxes considerations of tax reform

Corporate tax rate reduction

- Reduction of corporate tax rate to 21 percent
- Effective January 1, 2018 for calendar year end entities
- Blended rate for fiscal year end entities

Accounting for income taxes considerations

— Return to provision adjustments

Evaluate whether each adjustment (or expected adjustment) results from new information or information that existed and was reasonably knowable at the balance sheet date

If the adjustment arose from new information, it generally will represent a change in estimate recognized discretely in the period of the change

If the adjustment arose from information that existed and was reasonably knowable at the balance sheet date, it represents a correction of an error

- — Material errors are corrected through restatements of prior period financial statements
- — Immaterial errors are generally corrected discretely in the period identified

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Excessive executive compensation

- Changes covered employees to principal executive officer, principal financial officer and three other highest compensated officers
- Removes exceptions for commissions and performance based compensation
- Employees that are covered persons remain covered persons for all future years

Accounting for income taxes considerations

— Current tax impact

Increase in nondeductible compensation may increase taxable income and the effective tax rate

— Deferred tax impact

§162(m) limitations should be considered in measuring deferred tax assets on share-based compensation

— Two most common methods used in practice to determine which compensation amounts are deductible are pro rata or stock compensation last

Consider impact to other compensation related deferred taxes

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Interest expense limitation

- Disallows interest expense in excess of 30 percent of adjusted taxable income (generally without regard to activity not associated with a trade or business, interest income or expense, and net operating losses, amongst other adjustments)
- For taxable years beginning after December 31, 2017 and before January 1, 2022, adjusted taxable income also excludes deductions for depreciation, amortization, or depletion
- Disallowed interest may be carried forward indefinitely

Accounting for income taxes considerations

— Current tax impact

May result in an increase in taxable income and the effective tax rate

— Valuation allowance judgment

Consider amount and character limitations for utilization of disallowed interest carryforward, including ordering rules

Support of indefinite life deferred tax assets with indefinite life deferred tax liabilities

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Net operating losses

- Limits utilization to 80 percent of taxable income for losses arising in tax years beginning after December 31, 2017
- Repeals ability to carryback net operating losses, except for certain farming losses, for losses in years ending after December 31, 2017
- Permits indefinite carryforward of losses in years ending after December 31, 2017
- Special rules for property and casualty insurance companies

Accounting for income taxes considerations

— Net operating loss carryforwards arising in tax years ending after December 31, 2017 may be supported with reversing taxable temporary differences differently than older losses

— Valuation allowance judgment

Scheduling may be required for net operating loss limitation in determining the amount of deferred tax assets supported by reversing deferred tax liabilities

Support of indefinite life deferred tax assets with indefinite life deferred tax liabilities

We believe tax-planning strategies are required to be considered for carryforwards with an indefinite life

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Base erosion and anti-abuse tax

- Imposes a base erosion minimum tax amount based on the taxpayer's modified taxable income (taxable income excluding base erosion payments) for the year, over an amount equal to the pre-credit regular income tax liability reduced by certain tax credits
- The tax rate is 5% (2018), 10% (2019-2025) and 12.5% (after 2025) except for banks and registered securities dealers that have rates of 6% (2018), 11% (2019-2025) and 13.5% (after 2025)

Accounting for income taxes considerations

— Deferred tax impact

Measure deferred taxes based upon the regular tax rate

Amounts payable in excess of the regular tax liability will be treated as a periodic cost in the period incurred

Companies would not need to consider whether they expect to pay BEAT when assessing the realizability of deferred tax assets under the regular tax system

We believe companies may elect to consider whether they expect to pay BEAT when assessing the realizability of deferred tax assets as an accounting policy election that should be consistently applied

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Global intangible low-taxed income

- Include a U.S. shareholder's pro rata share of its CFC global intangible low-taxed income (GILTI) in taxable income
- Allows deduction for a deemed return on tangible assets
- Allows deduction equal to 50 percent (2018-2025) or 37.5 percent (after 2025) of GILTI but capped at taxable income (the Section 250 deduction)
- Provides an 80 percent foreign tax credit and separately baskets the foreign taxes with no carryforward or carryback

Accounting for income taxes considerations

— Deferred tax impact

Consider and explicitly disclose policy on whether U.S. federal deferred taxes are recognized for GILTI inclusions

If deferred taxes are recognized, we believe the net deemed tangible income return for GILTI may be akin to a special deduction; however, we would also accept consideration in the rate used to measure deferred taxes

If deferred taxes are recognized, we believe that if a company believes it will have a section 250(a) deduction, the deduction should be considered in the rate used to measure deferred taxes

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Global intangible low-taxed income

- Valuation allowance

An entity accounting for GILTI as a period cost should consider its expected GILTI when assessing the need for a valuation allowance by electing one of the following policies and applying it in a consistent manner

- With and without approach: Deferred tax assets not supported by taxable temporary differences consider the potential displacement of one benefit by another (for instance, the foregone Section 250 deduction or foreign tax credits that would be utilized if a net operating loss carryforward did not exist)
- Tax law ordering approach: Consider how benefits would be reflected in the tax return in order to determine which would be recognized (generally, net operating losses will be benefited prior to the Section 250 deduction or foreign tax credits, resulting in recognition of the full net operating loss deferred tax asset)

Entities may not have the same policy election if recognizing GILTI deferred taxes

- When GILTI deferreds are measured at less than 21 percent, we believe an entity should use the with and without approach
- When GILTI deferreds are measured at 21 percent, we believe an entity should use the tax law ordering approach

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Other tax reform considerations

— AMT credit carryforwards

Continue to assess the balance sheet classification to the extent AMT credit carryforwards are presented as income taxes receivable

To the extent an income taxes receivable is reflected, sequestration doesn't apply based on recent IRS guidance

— Deemed repatriation

Assess the balance sheet classification of remaining income taxes payable if electing to pay over the eight year period

— Foreign derived intangible income

We believe the foreign derived intangible income (FDII) deduction is akin to a special deduction because the amount is contingent on the future deemed tangible income return

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ASU 2018-02

Reclassification of Certain Tax Effects from Accumulated OCI

- Permits a reclassification from accumulated OCI to retained earnings for stranded tax effects resulting from the application of U.S. federal tax reform

The requirement to reflect the impact of the change in tax laws or rates directly to income tax expense (benefit) from continuing operations remains unchanged

Includes effects of the change in the U.S. federal income tax rate on the gross deferred tax amounts and related valuation allowances at the date of enactment (excludes the effect of the change on gross valuation allowances that were originally charged to continuing operations)

Companies also have the option to reclassify other income tax effects of the law

- Requires disclosure for all entities (including those that do not elect to reclassify) of the accounting policy for releasing income tax effects from accumulated OCI
- If an entity elects to reclassify, disclose a statement that an election was made to reclassify the income tax effects from accumulated OCI to retained earnings and a description of other income tax effects of the law change that are reclassified, if any
- If an entity elects to not reclassify, a statement to that effect is required to be disclosed
- Effective for all entities for years beginning after December 15, 2018 and interim periods within those years with early application permitted for any interim periods for which financial statements have not been issued or made available for issuance
- Retrospective or modified retrospective application

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SEC Tax Reform Relief (SAB 118)

Relief issued by the SEC staff

— Similar to measurement period used when accounting for business combinations

— In accordance with SAB 118, entities are required to:

Record the effects of H.R. 1 (the Act) for which the accounting is complete

Report provisional amounts (or adjustments to such amounts) for the effects of the Act for which the accounting is not complete, but for which a reasonable estimate can be determined

To the extent that all information necessary is not available, prepared or analyzed to determine a reasonable estimate for a specific effect of the Act, the company should not record a provisional amount and should continue to apply ASC 740 based on tax law in effect just before the enactment

— Provisional amounts are adjusted when entities obtain, prepare or analyze additional information about facts and circumstances that existed at the enactment date

— Measurement period ends when a company has obtained, prepared and analyzed the information necessary to finalize its accounting, not to extend beyond one year

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SEC Tax Reform Relief (SAB 118)

Relief issued by the SEC staff

— The following disclosures should be included in the notes to the financial statements:

Qualitative disclosures of the income tax effects of the Act for which the accounting is incomplete

Disclosures of items reported as provisional amounts

Disclosures of existing current or deferred tax amounts for which the income tax effects of the Act have not been completed

The reason that the initial accounting is incomplete

The additional information that needs to be obtained, prepared or analyzed to complete the accounting requirements under ASC 740

The nature and amount of measurement period adjustments recognized during the reporting period

The effect of measurement period adjustments on the effective tax rate

When the accounting for the income tax effects of the Act have been completed

— We would generally expect that adjustment to provisional amounts during the measurement period would have been disclosed as areas of potential adjustment in previous periods

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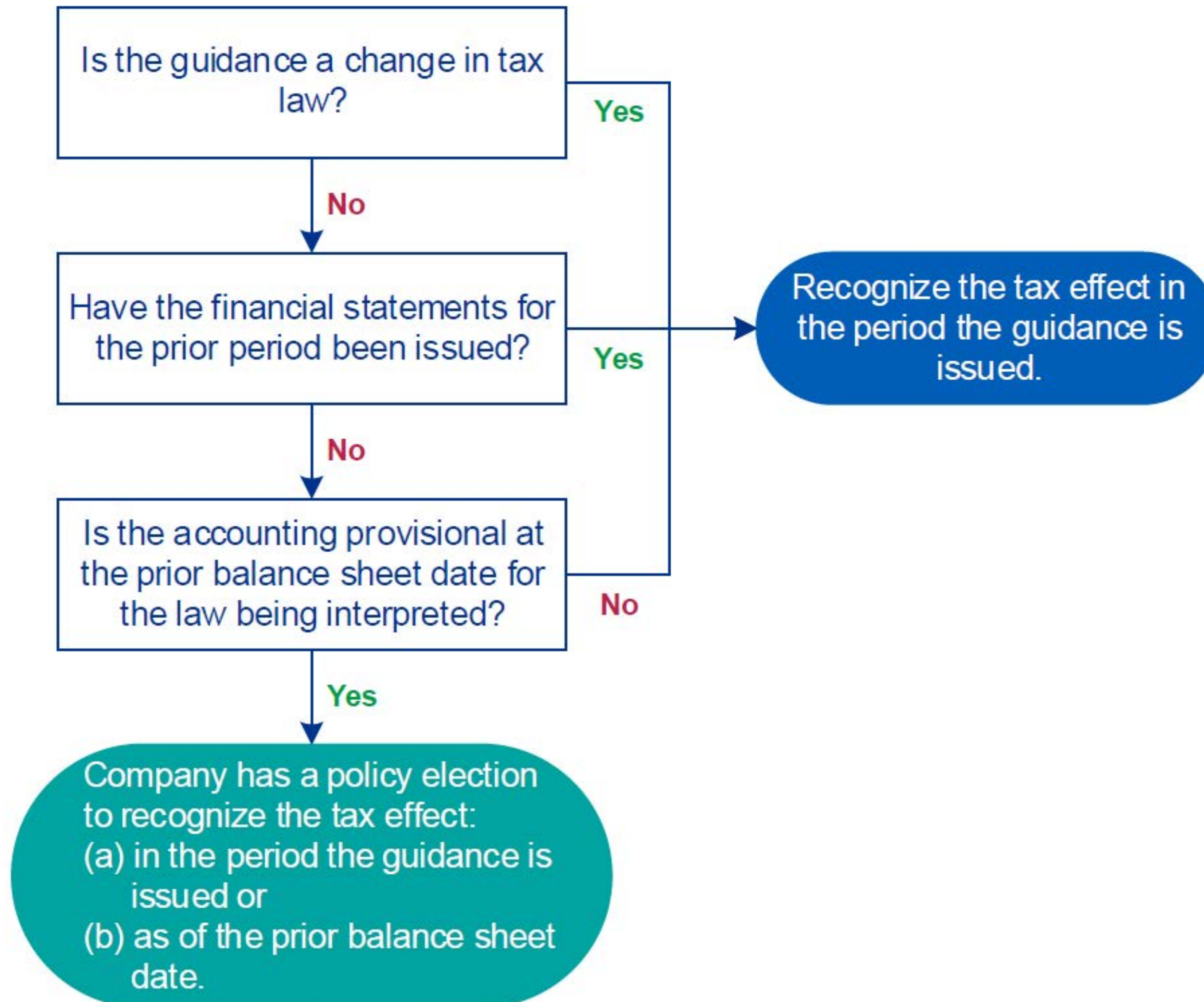
Consideration of Treasury Guidance



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Recently issued ASUs and other forthcoming developments

Recently issued ASUs

ASU 2016-16: Intra-entity Transfers of Assets other than Inventory

Requires an entity to recognize the income tax consequences of an intra-entity asset transfer, other than an intra-entity asset transfer of inventory, when the transfer occurs

For intra-entity transfers of inventory, the existing exception in US GAAP is retained which requires an entity to recognize the income tax consequences of the transaction when the inventory has been sold outside of the consolidated group

Effective for periods beginning after December 15, 2017 for public business entities and for annual periods beginning after December 15, 2018 and interim periods beginning after December 15, 2019 for all other entities

Early adoption is permitted as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance

Early adoption should be in the first interim period if an entity issues interim financial statements

The amendments in the ASU are to be applied on a modified retrospective basis with a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption

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Recently issued ASUs

ASU 2016-16: Intra-entity Transfers of Assets other than Inventory

In the first annual reporting period after adoption, and the interim reporting periods within that first annual reporting period, all entities are expected to disclose the following:

— The nature of and reason for the change in accounting principle

— The effect of the change on income from continuing operations, net income, any other affected financial statement line items and any affected per-share amounts

— Cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the periods of adoption

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Recently issued ASUs

ASU 2018-09: Codification Improvements (related to Income Taxes)

Removes the phrase taxes not payable in cash and directly reflects guidance that an appropriate example of the recognition of tax benefits directly in equity is related to deductible temporary differences and carryforwards arising from quasi-reorganizations [ASC 220-10-45-10B(b)(2)]

Clarifies that excess tax benefits or deficiencies are recognized in the income statement when the amount of the deduction is determined [ASC 718-740-35-2]

Removes guidance that requires an entity that purchases tax benefits directly from a government that result from intra-entity transfers of inventory between members of a consolidated entity to apply an exception [ASC 740-10-25-55 and 55-203]

Removes the three methods of allocating income tax expense to separate company financial statements of an acquired entity after a business combination and conform to methods available for intercorporate allocations as included in ASC 740 [ASC 805-740-25-13]

Generally applied on a modified retrospective basis

The above generally have effective dates for annual periods beginning after December 15, 2018 for public business entities, except the guidance around purchases of tax benefits directly from a government, which typically follows ASU 2016-16 adoption

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AICPA positions

Q&A Section 7200.09: Tax Accounting Considerations Under Partnership Audit Regime

Issued in response to Bipartisan Budget Act of 2015 rules for audits of partnerships that allow the IRS to asses and collect underpayments of tax from the partnership rather than pursuing payment from the partners

Asks how a partnership accounts for amounts it pays to the IRS for previous underpayments of tax, interest, and penalties

It notes the collection of tax from the partnership is merely an administrative convenience on the part of the government from partners in previous periods

It concludes the income taxes on partnership income, regardless of when paid, should continue to be attributed to the partners and, therefore, the partnership would not apply the ASC 740 accounting model to account for amounts it pays to the IRS for previous underpayments of tax, interest, and penalties

It further notes a payment made by the partnership under the IRS partnership audit regime should be treated as a distribution from the partnership to the partners in the financial statements of the partnership

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Selected recently issued non-tax ASUs

Fiscal years beginning after December 15, 2017

ASU 2014-09: Revenue from Contracts with Customers

ASU 2016-01: Recognition and Measurement of Financial Assets and Financial Liabilities

Fiscal years beginning after December 15, 2018

ASU 2016-02: Leases

ASU 2017-12: Targeted Improvements to Accounting for Hedging Activities

Fiscal years beginning after December 15, 2019

ASU 2016-13: Measurement of Credit Losses on Financial Instruments

Upon adoption of these ASUs, any direct tax effect of the financial reporting change is taken into consideration as part of the adoption of the new standard

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SEC comments on income taxes: AICPA national conference on current SEC developments

2018 AICPA National Conference

Non-GAAP financial measures

Non-GAAP financial measures may play an important role for investors in making investment decisions; as such, the same diligence in preparing non-GAAP financial measures should be given as in preparing audited financial statements

DCF staff observed the challenges to differentiate between an acceptable non-GAAP financial measure and an individually tailored accounting principle

Income taxes may impact non-GAAP financial measures and may result in questions from management or audit committees to determine if the non-GAAP financial measure reflects part, but not all, of the income taxes impacts of a transaction

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2017 AICPA National Conference

Tax Reform

Recognition and disclosures in the current year

Preparing for new accounting standards

Develop and implement strong policies, procedures, and internal controls to apply the new accounting standards

Consider impact of accounting for income taxes upon adoption of the new standards and any impacts on the tax compliance process

Transparency in financial communications

Align financial statement disclosures, discussions in other parts of SEC filings (including MD&A), and investor communications made outside of SEC filings (for instance, investor presentations and press releases)

Disclosure framework project

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SEC comments on income taxes

Areas of common questions

— Valuation allowance

Reasons for the lack of a valuation allowance when a cumulative loss exists, including the analysis of positive and negative evidence and the extent to which the evidence is objectively verifiable

Additional detail as to why a valuation allowance exists when the entity does not have a three year cumulative loss

Additional detail as to why a change in tax law resulted in a partial release of a valuation allowance

— Effective tax rate

Reasons on why an entity is reconciling to a rate different from the statutory rate of the parent company's country of domicile

Additional detail on why *adjustments of prior years* reflected within the rate reconciliation are considered changes in estimates as opposed to corrections of errors

Detail as to whether material items within the rate reconciliation are recurring or non-recurring

Further insight on the rate reconciling items included within the *effect of foreign operations* line of the rate reconciliation

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SEC comments on income taxes

Areas of common questions

— Investments in subsidiaries

Reasons for the ability to assert indefinite reinvestment when a history of domestic losses and distributions exists

Additional detail as to why a deferred tax liability exists when an entity asserts it is indefinitely reinvested and why it is not practicable to determine the unrecognized deferred tax liability

Detail as to whether a change in judgment was reflected in the appropriate period and if the measurement of the liability was accurate

— Unrecognized tax benefits

Reasons as to why an unrecognized tax benefit exists even though the tax position is more likely than not of being realized

Additional detail as to why no current year layer of unrecognized tax benefits exists when the issue is continuously reflected in the same manner on the return

Reasons why the required disclosures related to unrecognized tax benefits are omitted

— Tax Reform

Reasons why no liability for transition tax was recognized as a result of tax reform

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SEC comments on income taxes

Areas of common questions

— Omitted disclosures

Domestic and foreign components of income (loss) from continuing operations

Amounts and expiration dates of net operating loss carryforwards

Unrecognized deferred tax liability on indefinitely reinvested earnings, or a statement that it is not practicable to determine

Per share effects of tax holiday

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Presenter's Contact Details

Clifford M. Crockett

Partner, Business Tax Services

KPMG LLP

Dallas, Texas

ccrockett@kpmg.com

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Accounting for income taxes considerations of tax reform

Corporate tax rate reduction

- Reduction of corporate tax rate to 21 percent
- Effective January 1, 2018 for calendar year end entities
- Blended rate for fiscal year end entities

Accounting for income taxes considerations

— Return to provision adjustments

Evaluate whether each adjustment (or expected adjustment) results from new information or information that existed and was reasonably knowable at the balance sheet date

If the adjustment arose from new information, it generally will represent a change in estimate recognized discretely in the period of the change

If the adjustment arose from information that existed and was reasonably knowable at the balance sheet date, it represents a correction of an error

- — Material errors are corrected through restatements of prior period financial statements
- — Immaterial errors are generally corrected discretely in the period identified

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Excessive executive compensation

- Changes covered employees to principal executive officer, principal financial officer and three other highest compensated officers
- Removes exceptions for commissions and performance based compensation
- Employees that are covered persons remain covered persons for all future years

Accounting for income taxes considerations

— Current tax impact

Increase in nondeductible compensation may increase taxable income and the effective tax rate

— Deferred tax impact

§162(m) limitations should be considered in measuring deferred tax assets on share-based compensation

— Two most common methods used in practice to determine which compensation amounts are deductible are pro rata or stock compensation last

Consider impact to other compensation related deferred taxes

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Consider amount and character limitations for utilization of disallowed interest carryforward, including ordering rules

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Companies also have the option to reclassify other income tax effects of the law

— Requires disclosure for all entities (including those that do not elect to reclassify) of the accounting policy for releasing income tax effects from accumulated OCI

— If an entity elects to reclassify, disclose a statement that an election was made to reclassify the income tax effects from accumulated OCI to retained earnings and a description of other income tax effects of the law change that are reclassified, if any

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Relief issued by the SEC staff

— The following disclosures should be included in the notes to the financial statements:

Qualitative disclosures of the income tax effects of the Act for which the accounting is incomplete

Disclosures of items reported as provisional amounts

Disclosures of existing current or deferred tax amounts for which the income tax effects of the Act have not been completed

The reason that the initial accounting is incomplete

The additional information that needs to be obtained, prepared or analyzed to complete the accounting requirements under ASC 740

The nature and amount of measurement period adjustments recognized during the reporting period

The effect of measurement period adjustments on the effective tax rate

When the accounting for the income tax effects of the Act have been completed

— We would generally expect that adjustment to provisional amounts during the measurement period would have been disclosed as areas of potential adjustment in previous periods

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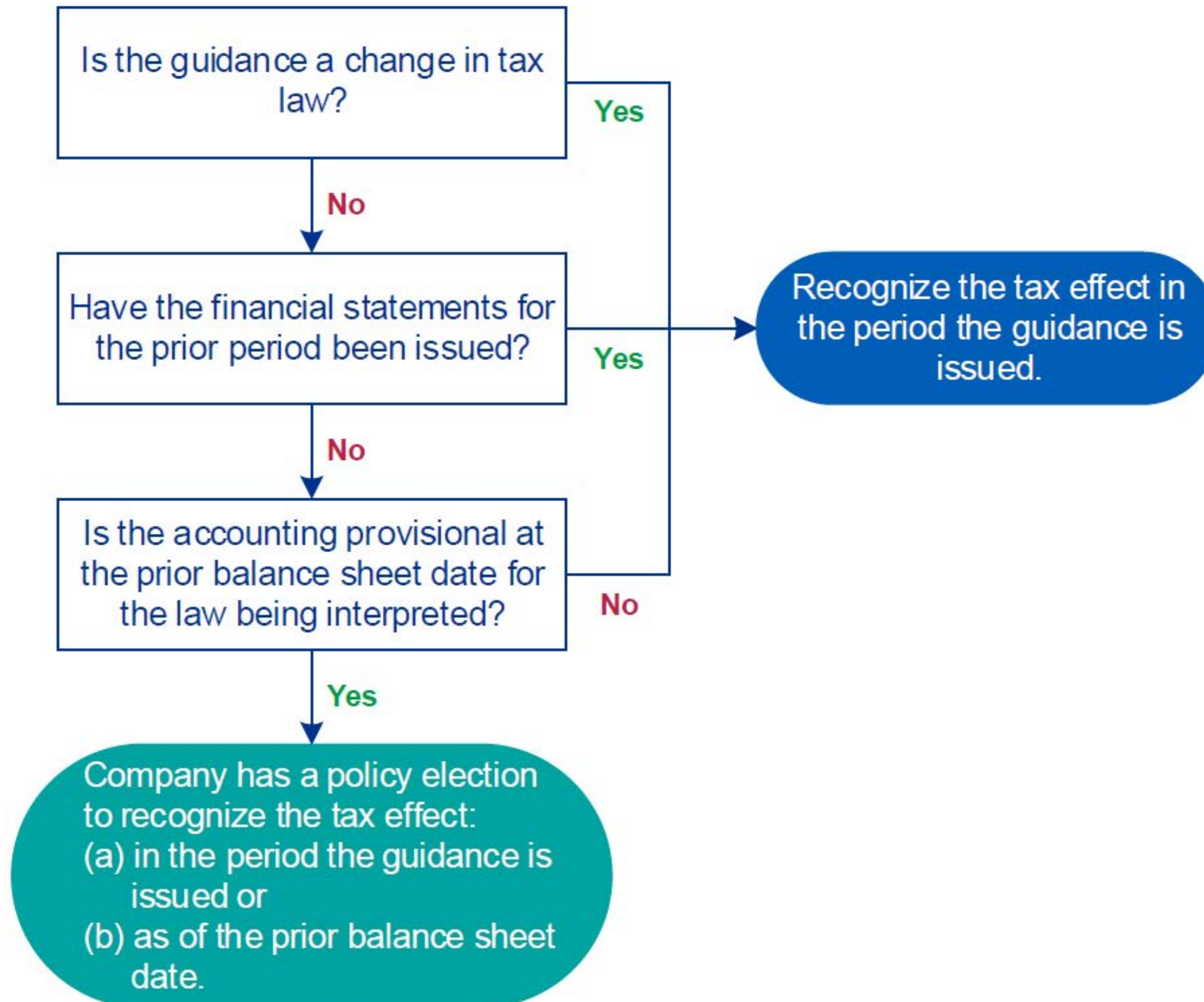
Consideration of Treasury Guidance



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Recently issued ASUs and other forthcoming developments

Recently issued ASUs

ASU 2016-16: Intra-entity Transfers of Assets other than Inventory

Requires an entity to recognize the income tax consequences of an intra-entity asset transfer, other than an intra-entity asset transfer of inventory, when the transfer occurs

For intra-entity transfers of inventory, the existing exception in US GAAP is retained which requires an entity to recognize the income tax consequences of the transaction when the inventory has been sold outside of the consolidated group

Effective for periods beginning after December 15, 2017 for public business entities and for annual periods beginning after December 15, 2018 and interim periods beginning after December 15, 2019 for all other entities

Early adoption is permitted as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued or made available for issuance

Early adoption should be in the first interim period if an entity issues interim financial statements

The amendments in the ASU are to be applied on a modified retrospective basis with a cumulative effect adjustment directly to retained earnings as of the beginning of the period of adoption

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Recently issued ASUs

ASU 2016-16: Intra-entity Transfers of Assets other than Inventory

In the first annual reporting period after adoption, and the interim reporting periods within that first annual reporting period, all entities are expected to disclose the following:

— The nature of and reason for the change in accounting principle

— The effect of the change on income from continuing operations, net income, any other affected financial statement line items and any affected per-share amounts

— Cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the periods of adoption

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Recently issued ASUs

ASU 2018-09: Codification Improvements (related to Income Taxes)

Removes the phrase taxes not payable in cash and directly reflects guidance that an appropriate example of the recognition of tax benefits directly in equity is related to deductible temporary differences and carryforwards arising from quasi-reorganizations [ASC 220-10-45-10B(b)(2)]

Clarifies that excess tax benefits or deficiencies are recognized in the income statement when the amount of the deduction is determined [ASC 718-740-35-2]

Removes guidance that requires an entity that purchases tax benefits directly from a government that result from intra-entity transfers of inventory between members of a consolidated entity to apply an exception [ASC 740-10-25-55 and 55-203]

Removes the three methods of allocating income tax expense to separate company financial statements of an acquired entity after a business combination and conform to methods available for intercorporate allocations as included in ASC 740 [ASC 805-740-25-13]

Generally applied on a modified retrospective basis

The above generally have effective dates for annual periods beginning after December 15, 2018 for public business entities, except the guidance around purchases of tax benefits directly from a government, which typically follows ASU 2016-16 adoption

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AICPA positions

Q&A Section 7200.09: Tax Accounting Considerations Under Partnership Audit Regime

Issued in response to Bipartisan Budget Act of 2015 rules for audits of partnerships that allow the IRS to asses and collect underpayments of tax from the partnership rather than pursuing payment from the partners

Asks how a partnership accounts for amounts it pays to the IRS for previous underpayments of tax, interest, and penalties

It notes the collection of tax from the partnership is merely an administrative convenience on the part of the government from partners in previous periods

It concludes the income taxes on partnership income, regardless of when paid, should continue to be attributed to the partners and, therefore, the partnership would not apply the ASC 740 accounting model to account for amounts it pays to the IRS for previous underpayments of tax, interest, and penalties

It further notes a payment made by the partnership under the IRS partnership audit regime should be treated as a distribution from the partnership to the partners in the financial statements of the partnership

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Selected recently issued non-tax ASUs

Fiscal years beginning after December 15, 2017

ASU 2014-09: Revenue from Contracts with Customers

ASU 2016-01: Recognition and Measurement of Financial Assets and Financial Liabilities

Fiscal years beginning after December 15, 2018

ASU 2016-02: Leases

ASU 2017-12: Targeted Improvements to Accounting for Hedging Activities

Fiscal years beginning after December 15, 2019

ASU 2016-13: Measurement of Credit Losses on Financial Instruments

Upon adoption of these ASUs, any direct tax effect of the financial reporting change is taken into consideration as part of the adoption of the new standard

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SEC comments on income taxes: AICPA national conference on current SEC developments

2018 AICPA National Conference

Non-GAAP financial measures

Non-GAAP financial measures may play an important role for investors in making investment decisions; as such, the same diligence in preparing non-GAAP financial measures should be given as in preparing audited financial statements

DCF staff observed the challenges to differentiate between an acceptable non-GAAP financial measure and an individually tailored accounting principle

Income taxes may impact non-GAAP financial measures and may result in questions from management or audit committees to determine if the non-GAAP financial measure reflects part, but not all, of the income taxes impacts of a transaction

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2017 AICPA National Conference

Tax Reform

Recognition and disclosures in the current year

Preparing for new accounting standards

Develop and implement strong policies, procedures, and internal controls to apply the new accounting standards

Consider impact of accounting for income taxes upon adoption of the new standards and any impacts on the tax compliance process

Transparency in financial communications

Align financial statement disclosures, discussions in other parts of SEC filings (including MD&A), and investor communications made outside of SEC filings (for instance, investor presentations and press releases)

Disclosure framework project

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SEC comments on income taxes

Areas of common questions

- Valuation allowance

Reasons for the lack of a valuation allowance when a cumulative loss exists, including the analysis of positive and negative evidence and the extent to which the evidence is objectively verifiable

Additional detail as to why a valuation allowance exists when the entity does not have a three year cumulative loss

Additional detail as to why a change in tax law resulted in a partial release of a valuation allowance

- Effective tax rate

Reasons on why an entity is reconciling to a rate different from the statutory rate of the parent company's country of domicile

Additional detail on why *adjustments of prior years* reflected within the rate reconciliation are considered changes in estimates as opposed to corrections of errors

Detail as to whether material items within the rate reconciliation are recurring or non-recurring

Further insight on the rate reconciling items included within the *effect of foreign operations* line of the rate reconciliation

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SEC comments on income taxes

Areas of common questions

— Investments in subsidiaries

Reasons for the ability to assert indefinite reinvestment when a history of domestic losses and distributions exists

Additional detail as to why a deferred tax liability exists when an entity asserts it is indefinitely reinvested and why it is not practicable to determine the unrecognized deferred tax liability

Detail as to whether a change in judgment was reflected in the appropriate period and if the measurement of the liability was accurate

— Unrecognized tax benefits

Reasons as to why an unrecognized tax benefit exists even though the tax position is more likely than not of being realized

Additional detail as to why no current year layer of unrecognized tax benefits exists when the issue is continuously reflected in the same manner on the return

Reasons why the required disclosures related to unrecognized tax benefits are omitted

— Tax Reform

Reasons why no liability for transition tax was recognized as a result of tax reform

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SEC comments on income taxes

Areas of common questions

— Omitted disclosures

Domestic and foreign components of income (loss) from continuing operations

Amounts and expiration dates of net operating loss carryforwards

Unrecognized deferred tax liability on indefinitely reinvested earnings, or a statement that it is not practicable to determine

Per share effects of tax holiday

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2018 AICPA Conference on Current SEC and PCAOB Developments

AICPA Conference – Key messages

High-quality financial reporting and reliable audits are a shared responsibility among all participants in the financial reporting architecture.

- **Preparing for new accounting standards**
- **Assessing internal controls over financial reporting (ICFR) and best practices**
- **Emerging issues and risks**
- **SEC focus areas**
- **Audit developments and their effect on financial reporting**
- **Demystifying emerging technologies**

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Leases

Lessors – Narrow-scope improvements

ASU 2018-20 (issued December 10)

- permits lessors, as an accounting policy election, to present sales and other similar taxes that arise from a specific leasing transaction on a net basis;
- requires lessors to present lessor costs paid by the lessee directly to a third party on a net basis, regardless of whether the lessor knows, can determine or can reliably estimate those costs;
- requires lessors to present lessor costs paid by the lessee to the lessor on a gross basis; and
- clarifies that lessors should recognize variable payments allocable to non-lease components as revenue under other relevant US GAAP (e.g. ASC 606).

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Leases – Other standard-setting and regulatory activity

FASB

Proposed ASU, Codification improvements for lessors
(comment period ends January 15)

- Fair value of underlying asset for lessors that are **not** manufacturers or dealers
- Cash flow presentation for lessors in-scope of ASC 942

SEC

SEC staff guidance on lease exchange rates

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Common implementation challenges

Accounting questions about implementing the leases standard continue to arise, primarily in these areas.

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Transition date election

Companies may use the effective date of the leases standard (e.g. January 1, 2019 for a calendar year-end public company) as the date of initial application. Companies that elect this option DO NOT:

- restate comparative periods, or
- provide ASC 842 disclosures in comparative periods.

Companies that elect the option WILL:

- carry forward ASC 840 comparative period disclosures during the year of adoption, and
- recognize their cumulative effect transition adjustment (e.g. for the effect of unamortized initial direct costs that are required to be written-off at transition) as of the effective date (January 1, 2019 for a calendar year-end public company).

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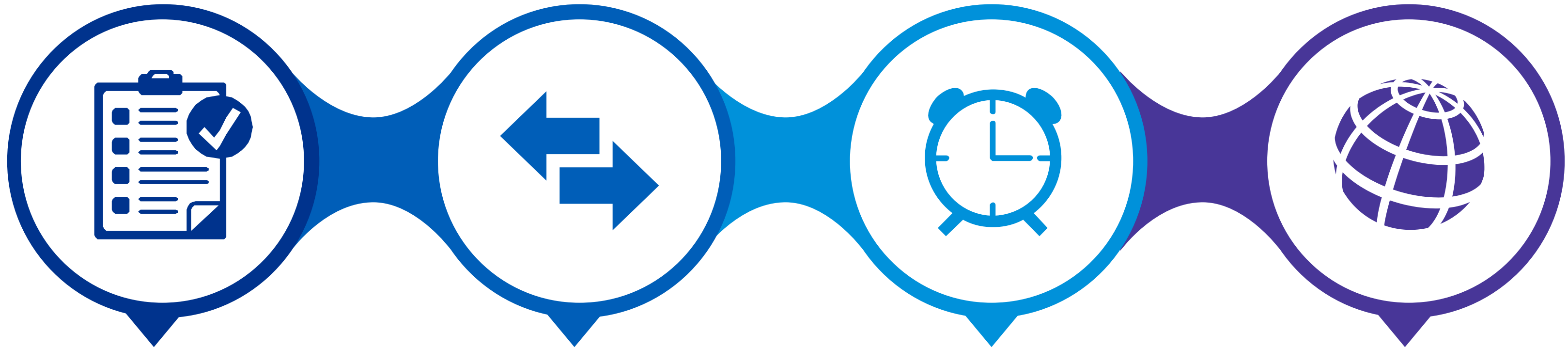
Other policy elections



Other transition elections

- Package of practical expedients (all or none)
- Use of hindsight
- Land easements

Option not to separate lease and non-lease components

Short-term lease exemption

Portfolio approach

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2018 financial reporting reminders

Lease identification	— Ensure complete and accurate lease inventory as part of ASC 840 lease disclosures – the same leases will (generally) be recognized on balance sheet in transition to ASC 842.
Lease measurement	— Lessees will, in general, use the 'minimum rental payments' required to be disclosed in their future operating lease commitments table to measure new lease liabilities and right-of-use assets for existing operating leases under ASC 842.
Processes and controls	— The processes and controls required for the current US GAAP disclosures are substantially similar to many of those needed under ASC 842.
SAB 74 disclosures	— Complete and accurate ASC 840 lease disclosure information may help companies to estimate quantitative information about the effect of adopting ASC 842 for their SAB 74 disclosures. — A focus on the ASC 840 disclosures may bring to light other key impacts that should be disclosed.

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Observations – adopting the revenue recognition standard

Observations – adopting the revenue recognition standard

The SEC staff is focused on disclosure requirements and areas of potential misapplication of the new standard.

The SEC staff cautioned registrants not to...

- take false comfort because they did not yet receive comments from the staff.
- assume that the staff reviews all registrant filings.
- assume that comments received to date represent all potential comments that the registrant could receive.
- benchmark themselves to other registrants when determining sufficiency of their disclosures.

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Observations on revenue implementation

Disclosure requirements.

The SEC staff has expressed disappointment in the quality of ASC 606 disclosures.

Operational challenges.

Many companies are applying manual or Excel-based methodologies until their automated systems are ready.

Other operational challenges: making new estimates, allocating contract costs between performance obligations, and managing investor relationships and their understanding of the business during this period of change.

Transaction considerations.

Companies that are considering major transactions, such as a merger or acquisition, or a public offering, need to understand the implications for the transaction of adopting the revenue recognition standard.

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Other 2018 year-end reminders

ASUs effective in 2018*

ASU 2016-01, Financial instruments – recognition and measurement

— Allows companies to measure equity securities without readily determinable fair values either (1) at fair value with changes in fair value recognized in net income or (2) using a new measurement alternative – cost adjusted to fair value when there are observable transactions, less impairment.

ASU 2016-04, Recognizing breakage for certain prepaid stored-value products

— Requires entities to recognize breakage (i.e. the unredeemed portion of the total dollar value on prepaid stored-value products) on certain financial liabilities.

ASU 2016-15, Classification of cash receipts and cash payments

— Provides guidance on eight issues related to cash flow classification.

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ASUs effective in 2018* (continued)

ASU 2016-16, Accounting for income taxes on intercompany transfers

— Requires the seller and buyer to recognize at the transaction date the current and deferred income tax consequences of intercompany asset transfers (except for inventory transfers).

ASU 2016-18, Restricted cash

— Requires companies to include in total cash (and cash equivalents) on the statement of cash flows cash (and cash equivalents) that have restrictions on withdrawal or use.

ASU 2017-01, Clarifying the definition of a business

— Provides a new framework for determining whether transactions should be accounted for as acquisitions (or disposals) of a group of assets or a business.

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ASUs effective in 2018* (continued)

ASU 2017-05, Accounting for derecognition of nonfinancial assets

— Clarifies when to apply the guidance in ASC 610-20 about accounting for derecognition of a nonfinancial asset, and includes guidance on partial sales of nonfinancial assets.

ASU 2017-07, Presentation of net periodic pension cost and net periodic postretirement benefit cost

— Requires a company to present the service cost component in the income statement line item in which it reports compensation cost. All other components of net benefit cost should be reported in the income statement separate from the service cost component and outside operating income, if that subtotal is presented. Additionally, the service cost component is the only component that a company can capitalize.

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ASUs effective in 2018* (continued)

ASU 2017-09, Scope of modification accounting

— Clarifies that companies should apply modification accounting when they change the terms or conditions of a share-based payment award unless the fair value, vesting conditions and classification of a modified award are the same before and after the modification.

ASU 2017-10, Identifying the customer in a service concession arrangement

— Clarifies that the customer in a service concession arrangement is always the grantor (i.e. the government or a public sector entity).

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Goodwill impairment ASU may be early adopted

Reminder: ASU 2017-04 about simplifying the goodwill impairment test is available for early adoption.

Effective

2020

for SEC filers

2021

for non-SEC filers

This ASU:

- Eliminates the requirement to calculate the implied fair value of goodwill (i.e. Step 2 of today's goodwill impairment test)
  - Impairment is measured using the difference between the carrying amount and fair value of the reporting unit
- Replaces the qualitative assessment
  - Entities must disclose the amount of goodwill allocated to each reporting unit with zero or negative carrying amounts and the related reportable segment

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Other FASB activity

Financial instruments – standard-setting update

Hedging

Reminder: The new hedge accounting standard (ASU 2017-12) is effective for public companies in 2019.

- Eliminates the requirements to separately measure and report hedge ineffectiveness.
- Requires companies to present all hedge accounting elements that affect earnings in the same income statement line as the earnings effect of the hedged item.

Issued: Proposed ASU, Codification improvements – Financial instruments overall

Ongoing: Two projects on FASB agenda

- 'Last-of-layer' method
- Hedge accounting – Phase 2

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Financial instruments – standard-setting update

Credit impairment

Nov 2018

Issued: ASU 2018-19, Codification improvements – CECL

- Amends the effective date of the credit impairment standard to require companies that are not public business entities to adopt the amendments for annual and interim periods for fiscal years beginning after December 15, 2021; and
- Clarifies that operating lease receivables accounted for under ASC 842 would be excluded from the scope of the credit impairment standard.

Effective
2020
for SEC filers
2021
for non-SEC filers

Nov 2018

Issued: Proposed ASU, Codification improvements – Financial instruments overall

Forthcoming: Proposed ASU, Targeted transition relief

- Would provide a one-time option at adoption of the credit impairment standard that would allow companies to irrevocably elect the fair value option for financial assets measured at amortized cost within the scope of ASC 326-20.

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New benchmark interest rate (ASU 2018-16, effective 2019*)

Adds the Overnight Index Swap (OIS) rate based on the Secured Overnight Financing Rate (SOFR) as a benchmark interest rate for hedge accounting purposes

- This expands the list of eligible benchmark interest rates to include OIS based on SOFR to facilitate marketplace transition from LIBOR.
- Applies only to new or redesignated hedging relationships entered into on or after the date of adoption.

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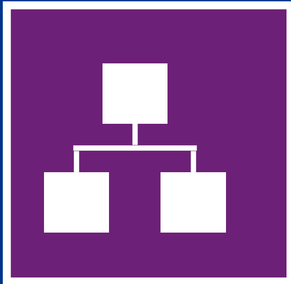
Consolidation – Related party guidance for VIEs
(ASU 2018-17, effective 2020*)



Provides a new private company variable interest entity exemption and changes how decision makers apply the variable interest criteria.

- **Private company accounting alternative:** Exempts private companies from applying the variable interest entity (VIE) consolidation guidance to interests in other private companies that are under common control if both the parent and the legal entity being evaluated for consolidation are not public business entities.
- **Decision-making fees:** Requires companies to consider indirect interests held through related parties in common control arrangements on a proportionate basis when determining whether fees paid to decision makers and service providers are variable interests.

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Collaborative arrangements (ASU 2018-18, effective 2020*)

Clarifies when transactions between participants in a collaborative arrangement may be within the scope of ASC 606

- No change to the current accounting for (a) transactions directly related to sales to third parties or (b) nonrevenue transactions between collaborative participants
- Entities will use the distinct good or service unit-of-account guidance in ASC 606 to determine whether a separate unit of account in a collaborative arrangement should be accounted for under ASC 606
- Transactions outside the scope of ASC 606 are precluded from being presented together with revenue recognized from contracts with customers

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EITF update

Recognition in a business combination of an assumed liability in a revenue contract

- **Status:** A proposed ASU is forthcoming (Q1 2019)
- **Applicability:** All companies that acquire revenue contracts in a business combination after adopting ASC 606.
- The proposals would align the recognition criteria for revenue contract liabilities in a business combination with the definition of a performance obligation in ASC 606.
- The obligation would be measured at fair value.

Cost capitalization for episodic television series

- **Status:** Comment period ended December 7.
- **Applicability:** Broadcasters and other companies that produce and distribute films and episodic television series.
- The proposals would converge the cost capitalization guidance for films and episodic television content.
- This will remove restrictions on capitalization of production costs for episodic television content.

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Thank you

Presenter's Contact Details

Clifford M. Crockett

Partner, Business Tax Services

KPMG LLP

Dallas, Texas

Ccrockett@kpmg.com

Matt Savatsky

Managing Director, State and Local Tax

KPMG LLP

Dallas, Texas

Msavatsky@kpmg.com

Michael Nesta

Partner, Deal Advisory

KPMG LLP

Dallas, Texas

mnesta@kpmg.com

Becca Thompson

Senior Manager, State and Local Tax

KPMG LLP

Dallas, Texas

beccathompson@kpmg.com

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