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Corporate Income Tax Accounting: Year-End Wrapup

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2017 was another busy year for the Financial Accounting Standards Board (FASB) as it continues down the path of its simplification initiative, issuing a number of new Accounting Standards Updates (ASUs).

Several of the new ASUs will directly or indirectly affect financial reporting for income taxes in the near term. Additionally, as another calendar year closes, many companies will need to ensure that rule changes with effective dates during 2017 have been properly considered in preparing their income tax computations and disclosures. Other ASUs with later effective dates may be early-adopted in 2017. Finally, it is more likely than ever that significant tax reform is on the horizon. The enactment of a major U.S. federal tax law change and the impact it could have on corporate income tax accounting should be considered now so companies can be strategic and efficient when changes are enacted. This article discusses select ASUs and issues of importance to tax accountants.

ASUs Issued in 2017

Bond Premium Amortization Timing

ASU 2017-08, "Receivables – Nonrefundable Fees and Other Costs (Subtopic 31-20): Premium Amortization on Purchased Callable Debt Securities," was issued in March 2017.

This ASU changes the amortization period for the acquisition premium on debt securities with explicit noncontingent call features that are callable at fixed prices on preset dates. Premium amortization is shortened to the earliest call date. Previously, amortization was determined over the contractual life of the security. Acquisition discounts still are accreted to maturity.

For U.S. tax purposes, bondholders must compute and compare yields under both scenarios (held to maturity or to earliest call) on a bond-by-bond basis. For taxable bonds, tax amortization is required to follow the scenario that produces a higher yield to the holder (tax-exempt bonds must follow the lower-yield scenario). Generally, unless a bond features a significant call premium, the held-to-maturity scenario will produce a higher yield. Thus, for most taxable bonds, amortization timing for U.S. generally accepted accounting principles (GAAP) and tax purposes will diverge when the new ASU is adopted, creating a new temporary difference and tracking requirement.

Adoption is on a modified retrospective basis with cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Any adoption adjustment also will affect the unrealized gain or loss account for affected available-for-sale securities. Care should be taken to properly tax-effect the adoption adjustments, including any adjustment to deferred taxes on unrealized gain or loss.

This ASU is effective for public business entities (PBEs) for fiscal years beginning after Dec. 15, 2018, and interim periods therein. For all other entities, the ASU is effective for fiscal years beginning after Dec. 15, 2019. Early adoption, which may be desirable for holders of significant positions, is permitted, including adoption in an interim period; in such case, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

ASUs With Effective Dates Starting in Calendar Year 2017 (for PBEs)

The following ASUs are effective for PBEs for annual periods beginning after Dec. 15, 2016, and interim periods within those annual periods. Unless otherwise indicated, the effective date for entities other than public business entities is one year later and interim periods in the year following adoption. There were earlier application provisions for each ASU discussed.

Employee Share-Based Payment Accounting

ASU 2016-09, “Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting,” was issued in March 2016 and includes the following changes to GAAP:

- **Income taxes upon settlement of awards.** As background, excess tax benefits generally occur when the ultimate tax deduction for a share-based payment award exceeds the life-to-date amount of compensation recorded through the income statement for that award. Conversely, a tax deficiency arises when the award settles, or expires unexercised, and the tax deduction is less than the amount of previously tax-effected life-to-date compensation expense for the award. Also, a tax deduction is allowed on any dividends or dividend equivalents paid while the award is outstanding. To

the extent those dividends are recorded through retained earnings, the tax effect is an excess tax benefit. Under the ASU:

- All excess tax benefits and tax deficiencies will be recognized consistently in the income statement as income tax expense or benefit. Under existing GAAP, excess tax benefits are recognized in additional paid-in capital (APIC), and tax deficiencies are recognized as an offset to the pool of accumulated excess tax benefits or, if no such pool exists, in the income statement. Companies need not reclassify amounts from APIC to retained earnings upon adoption of the ASU.
 - Excess tax benefits will be recorded in the period in which they arise, unlike existing GAAP, which requires that an excess tax benefit be realized (via tax refund or reduction of taxes currently payable) before it can be recorded. Any unrealized excess benefits existing at the date of adoption will be recognized through equity as a cumulative-effect adjustment.
 - The tax effects related to settlement of awards should be treated as discrete items in the period they occur. It would not be appropriate to include them in the forecast computation of the estimated annual effective tax rate used to record income taxes at interim periods.
- **Forfeitures.** Existing GAAP requires the accrual of compensation expense to take into account an estimate of expected forfeitures. Under the ASU, for awards with service (as opposed to performance) conditions, an accounting policy election can be made to account for forfeitures when they occur. If the policy is elected, any nonforfeitable dividends previously paid on forfeited awards would be reclassified from retained earnings to compensation expense upon the award forfeiture. Tax accountants will have to take care to deduct these dividends only once, when paid, and not a second time when they are reclassified to expense.
 - **Minimum statutory withholding requirements.** The existing requirement that for equity classification an entity cannot partially settle the award in cash in excess of the employer's minimum statutory withholding requirements is revised. The threshold for equity classification is raised by permitting withholding up to the maximum individual statutory rate in the applicable jurisdiction.
 - **Cash flow statement presentation:**
 - Excess tax benefits will be presented in operating activities, a change from existing GAAP that requires classification in financing activities.
 - Employee taxes paid will be presented in financing activities when an employer withholds shares to meet statutory withholding requirements. This may be a change for some entities given that existing GAAP contained no guidance.

The items discussed are not a complete list of all changes in the ASU. For more detailed information, including transition rules, see the Crowe July 2016 article [“FASB Simplifies Accounting for Share-Based Payments: How Recent Guidance Affects Accounting for Income Taxes.”](#)

In March 2017, the FASB issued a proposed ASU that would expand the scope of Topic 718 to align guidance on share-based payments to nonemployees in exchange for goods and services with certain of the existing guidance on share-based payments to employees, including tax treatment.

Balance Sheet Classification of Deferred Taxes

ASU 2015-17, [“Income Taxes \(Topic 740\): Balance Sheet Classification of Deferred Taxes,”](#) was issued in November 2015.

The ASU eliminates the current requirement that entities presenting a classified balance sheet separate deferred tax assets (DTAs) and deferred tax liabilities (DTLs) into current and noncurrent amounts for each tax jurisdiction to which the DTAs and DTLs relate. Instead, organizations will be required to classify DTAs and DTLs as noncurrent for each tax jurisdiction. The changes apply to all entities that use a classified balance sheet.

Entities can apply the changes prospectively to all DTLs and DTAs or retrospectively to all periods presented. If an entity opts for prospective application, it should disclose

(in the first interim and first annual period of change) the nature of and reason for the change in accounting principle and a statement that prior periods weren’t retrospectively adjusted. Entities that apply the ASU retrospectively should disclose, in the first interim and first annual period of change, the nature of and reason for the change in the accounting principle and quantitative information about the effects of the accounting change on prior periods.

Measurement of Inventory

ASU 2015-11, [“Inventory \(Topic 330\): Simplifying the Measurement of Inventory,”](#) was issued in July 2015.

Companies measuring inventory using the first-in, first-out (FIFO) or average cost methods must measure inventory at the lower of cost or net realizable value, a change from lower of cost or market. Net realizable value is the estimated selling price in the ordinary course of business less reasonably predictable costs of completions, disposal, and transportation. Corporate tax accountants should consider whether any measurement changes made upon adoption of this ASU create, eliminate, or otherwise change the amount of any book-versus-tax differences in the basis of inventory. This ASU’s effective date for all entities is fiscal years beginning after Dec. 15, 2016; however, public business entities would apply the ASU to interim periods within that fiscal year and all other entities would apply it to interim periods in the following year.

ASUs With Future Effective Dates (Early Application Permitted for Many)

Revenue Recognition

ASU 2014-09, “Revenue From Contracts With Customers (Topic 606),” was issued in May 2014.

The first quarter of 2017 is the earliest time that any entity could adopt the sweeping changes of this new revenue recognition standard. It is intended to substantially enhance the quality and consistency of how revenue is reported while also improving comparability. It will replace previous guidance on revenue recognition in ASC 605 and eliminate industry-specific guidance. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Since its issuance, ASU 2014-09 has spawned multiple clarifying or correcting ASUs, including ASUs 2016-08, 2016-10, 2016-12, 2016-20, and 2017-13, with others still in proposal stage. A company’s income tax accountant will need to pay close attention to whether adoption of this ASU will create, eliminate, or change any temporary differences in the recognition of revenue for GAAP-versus-tax purposes.

In March 2017, the IRS issued Notice 2017-17, requesting comments on a proposed revenue procedure that would allow taxpayers to follow automatic consent procedures to change a method of accounting for taxable income recognition when the change is made in the same year as, and because of, ASU 2014-09 adoption (assuming the change is to a permissible tax method). Comments were due by July 24, 2017.

Due to the delay issued by ASU 2015-14, “Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date,” PBEs, certain not-for-profit entities, and certain employee benefit plans (public entities) must apply ASU 2014-09 to annual reporting periods beginning after Dec. 15, 2017, and related interim periods. All other entities must apply the guidance to annual reporting periods beginning after Dec. 15, 2018, and interim periods in the following year. All entities may apply the guidance early, but only as early as annual periods beginning after Dec. 15, 2016. If applied early, public entities also would apply it to interim periods within the year of application, while all other entities could choose to apply it to those same interim periods or interim periods in the following year.



Financial Instruments

ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,” was issued Jan. 5, 2016. Select changes are discussed in this section.

This ASU changes the accounting for most equity securities and provides new and changed financial statement disclosures. With limited exceptions, equity securities that were accounted for as available for sale, with unrealized gain or loss presented as a contra account to amortized cost and recorded to other comprehensive income, still will be carried at fair value but now will be presented on the balance sheet as one amount, with subsequent changes recorded through the income statement. Tax accountants will need to adjust how they identify and account for the temporary difference associated with changes in value after initial acquisition.

Additionally, the ASU addresses the assessment of valuation allowances on certain DTAs. Under previously accepted practice, DTAs related to unrealized losses on debt securities that are classified as available for sale did not require a source of income test for realization when there is intent and the ability to hold the securities until maturity or value recovery. This ASU now requires realizability of the DTAs to be evaluated in conjunction with other DTAs and with consideration to sources of income.

The ASU is effective for PBEs for fiscal years beginning after Dec. 15, 2017, and for interim periods within. For all other entities, it is effective for fiscal years beginning after Dec. 15, 2018, and for interim periods in the following year. Early adoption is not permitted for the specific topics discussed earlier.

Breakage on Certain Prepaid Stored-Value Products

ASU 2016-04, “Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products,” was issued in March 2016.

This ASU narrowly addresses breakage (that is, the monetary amount of the card that ultimately is not redeemed by the cardholder) for prepaid stored-value products that are redeemable for monetary values of goods or services but also may be redeemed for cash. It addresses the diversity in practice for recognizing breakage (income) by concluding that all such in-scope products are financial liabilities. Many products are scoped out, but examples of products in scope include prepaid gift cards issued by specific payment networks and redeemable at network-accepting merchant locations, prepaid telecommunications cards, and traveler’s checks. Similar to the revenue recognition ASU, any changes in financial statement recognition timing should be compared to the timing of the item’s recognition for tax purposes.

The ASU is effective for PBEs for fiscal years beginning after Dec. 15, 2017, and for interim periods within. For all other entities, it is effective for fiscal years beginning after Dec. 15, 2018, and for interim periods in the following year. Early application was permitted upon its March 2016 issuance, including adoption in an interim period.

Tax Consequences of Intra-Entity Taxable Asset Transfers

ASU 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory,” was issued in October 2016.

Once an entity adopts this ASU, it will recognize the income tax consequences of an intra-entity transfer of assets other than inventory when the transfer occurs. This situation most commonly occurs when one member of a consolidated financial reporting group transfers assets to another member, when the members file separate tax returns in various jurisdictions, and when some or all of those jurisdictions treat the transfer as a taxable transaction. Under current GAAP, the selling (or transferring) member defers recognizing, for consolidated financial reporting purposes, any resulting income tax expense, including taxes currently payable or paid, while the buying (or receiving) member does not recognize deferred income taxes for any basis difference for the transferred assets. The tracking burden this creates will be simplified or eliminated under the new ASU.

The ASU is effective for PBEs for annual reporting periods beginning after Dec. 15, 2017, including related interim periods. For all other entities, it is effective one year later and for interim periods within the following year. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which interim or annual financial statements have not been issued or made available for issuance. In other words, early adoption should be in the first interim period. Adoption should be on a modified retrospective basis through a cumulative-effect adjustment directly to beginning retained earnings.

Lease Accounting

ASU 2016-02, “Leases (Topic 842) Section A: Amendments to the FASB Accounting Standards Codification,” was issued in February 2016.

The most significant change in this new standard is that all leases, not just finance leases, will be recorded on the balance sheet unless they meet the short-term lease criteria (essentially, lease terms of 12 months or less with no bargain purchase element). A right-of-use asset, which will be amortized to the income statement, will be recorded to represent the right to use the leased asset, and a liability will be recorded to represent the lease obligation. Amounts still will be recorded to the income statement based on whether the lease is classified as finance or operating (with those criteria essentially unchanged from current GAAP). If a lease is classified as a finance lease, both interest expense and amortization expense will be recorded; if it's classified as an operating lease, a single lease expense will be recorded. The pattern of expense will be front-loaded for finance leases and straight-line for operating leases. Tax accountants will need to record separate DTAs and DTLs for the new balance sheet accounts, determine the new expense accounts or account locations, and otherwise determine what changes this ASU will bring to the tracking of book-versus-tax differences in accounting for leases.

For PBEs, the standard is effective for interim and annual periods beginning after Dec. 15, 2018. For all others, it is effective for fiscal years beginning after Dec. 15, 2019, and for interim periods the following year. Early adoption was permitted upon the February 2016 issuance of the ASU.

Credit Losses

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” was issued in June 2016. This ASU affects entities holding financial assets that are not accounted for at fair value through net income, including loans, debt securities, trade receivables, net investments in leases, and other financial assets not specifically excluded. Tax-relevant changes are discussed in this section.

The ASU changes the manner in which the allowance for credit-related losses is determined – from an incurred loss to an expected loss approach. As such, it could increase the size of a company’s allowance for credit losses. It does not change the manner or criteria for an actual charge-off of a bad debt, and thus should have minimal impact on the related income tax accounting.

The ASU also changes the accounting associated with the acquisition of financial assets in a business combination. For assets whose collectability has already deteriorated, the nonaccretable yield associated with purchase credit impairment is replaced with a credit loss allowance on purchase credit deterioration. The target’s existing allowance still is written off via day one acquisition method accounting, and a fair value adjustment for reasons other than credit quality still will be recorded. On nondeteriorated (healthy) financial assets, a new allowance for any expected

losses is established through the acquirer’s income statement. Tax accountants will need to identify and track any book-to-tax differences in order to adapt to the new terminology and requirements.

Last, with regard to credit impairment of investment securities, under the ASU the direct write-down to the basis of an impaired security for other-than-temporary impairment, with no subsequent reversal should the security improve, is being replaced. Once adopted, any recordable impairment will be isolated within an allowance for credit losses, presented as a contra investment account, which could be reversed in the future should the security’s expected performance improve. This could create new or revised tracking for tax accounting, depending on positions being taken in tax returns regarding these impairments.

This ASU is effective for all of the following:

- PBEs that are U.S. Securities and Exchange Commission (SEC) filers for annual and interim periods beginning after Dec. 15, 2019
- PBEs that are not SEC filers for fiscal years and interim periods beginning after Dec. 15, 2020
- All other entities for annual periods beginning after Dec. 15, 2021, and interim periods the following year

Early adoption is allowed for annual and interim periods beginning after Dec. 15, 2018.



Proposed Changes to Income Tax Disclosures

Proposed ASU, “Income Taxes (Topic 740):
Disclosure Framework – Changes to the
Disclosure Requirements for Income Taxes,”
was proposed in July 2016.

Though not yet finalized, this proposed ASU bears mention due to its direct impact on the financial reporting of income taxes. The proposed changes would provide for more transparency and detail on certain tax accounting topics and eliminate immaterial disclosures. While all of the proposed changes would impact public business entities, there are some changes that would impact all other entities as well.

The FASB met on Sept. 20, 2017, to continue discussion on this topic. The board has directed the staff to continue research on this project and to consider expanding the scope to include other simplifications to accounting for income taxes.

Potential Major Federal Tax Law Changes

Congress and the Trump Administration currently are working to enact major U.S. tax reform legislation. Many of the changes being considered would have a significant impact on corporations' income tax liability should they ultimately be enacted. Following are some broad tax accounting concepts to consider with respect to any tax law change.

- The effects of a tax law change are not recognized prior to the reporting period in which the change is enacted.
- The effects on taxes currently payable or refundable for the current annual reporting year:
 - Are only recorded after the effective dates prescribed in the statutes
 - Are reflected in the computation of the annual estimated tax rate at which to record taxes at interim periods beginning no earlier than the first interim period that includes the enactment date of the new legislation
- In the event a tax law change is effective retroactive to a time within a prior annual reporting period, the effect on taxes payable or refundable for that prior year is recognized as of the enactment date as tax expense (benefit) for the current year (as a discrete item, not part of the annual estimated tax rate computation).
- The effect on a DTL or DTA, and any related valuation allowance, is recorded as of the enactment date as tax expense (benefit) for the current year (as a discrete item,

not part of the annual estimated tax rate computation). These tax effects should be recorded to continuing operations.

- If a tax law change is effective on a date prior to the enactment date, its effect is measured on deferred tax items that existed at the effective date (or that existed at the first day of the annual period, if the effective date is earlier than that).
- If a tax law change is effective after the enactment date, a company must estimate which deferred tax items are expected to reverse after the effective date and apply the changes only to the measurement of those items, recording any change in deferred tax amount in the period of enactment.

Likely the widest-reaching corporate tax law change would be a potential reduction in the corporate tax rate. Such a change would require the remeasurement of DTAs and DTLs that would be expected to reverse after the effective date of the change. Also under consideration is a significant change in the taxation of profits earned outside of the U.S., calling for previously unrepatriated accumulated earnings to be deemed repatriated and taxed either upon the date of the law change or over a period of years. This change would require companies that previously have been using the "APB 23 exception," treating all undistributed earnings as indefinitely reinvested in their foreign operations, to treat such earnings as taxable, either by establishing a current payable or deferred tax liability.



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Summary

Income tax accounting isn't for the faint of heart. It is a challenging, dynamic practice area that requires constant diligence on ever-changing policy and procedure. Many of the changes discussed here will have a direct, and perhaps significant, impact, including a tax impact, on an entity's financial statements. Tax accountants will want to coordinate with their GAAP accounting counterparts to ensure they understand how these changes will be implemented and what the necessary tax effects are, so the path is well established in the provision process.

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