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Tax Accounting Quarterly Update – December 2019

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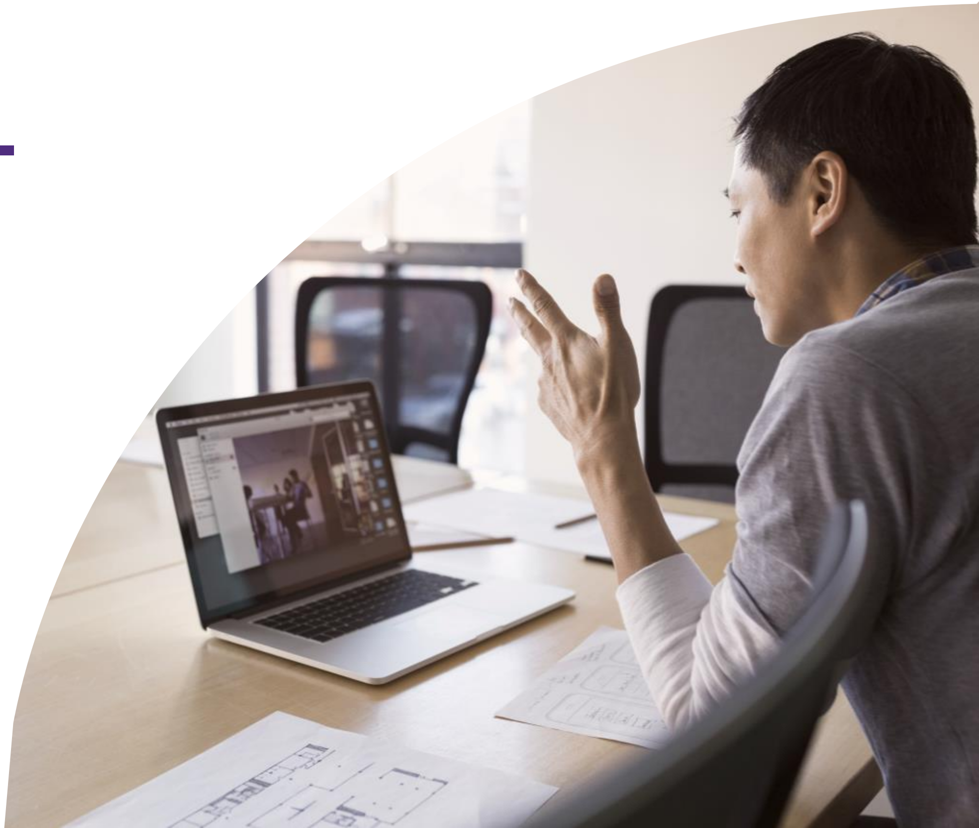

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Learning objectives

1. Identify updates in federal tax matters
2. Recognize significant state tax developments
3. Describe significant international tax developments
4. Apply relevant FASB, SEC and other accounting updates
4. Cite compensation and benefits developments

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Agenda

1. Federal Tax
2. State and Local Tax
3. International Tax
4. Accounting
4. Human Capital Services

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Federal Tax Updates

1. IRS Issues Final Regulations Removing Sec. 385 Documentation Requirements
2. IRS Publishes Its New List of Automatic Method Changes under Rev. Proc. 2019-43
3. Lawmakers Eye New December 20, 2019 Deadline for Tax Bills

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IRS Issues Final Regulations Removing Sec. 385 Documentation Requirements

October 2016

Final and temporary regulations issued under section 385 including documentation requirements that ordinarily must be met for certain related-party debt issued on or after Jan. 1, 2018 to be treated as indebtedness for U.S. federal income tax purposes

April 2017

Executive order issued to review all significant tax regulations issued after Dec. 31, 2015 that:

- Impose undue financial burden
- Add undue complexity
- Exceed the statutory authority of the IRS

Section 385 regulations were identified in an interim report issued in June 2017

October 2017

Treasury Department and the IRS announced that changes to the documentation requirements are being considered, following the issuance in July 2017 of Notice 2017-36 announcing a one-year delay in the effective date to interests issued or deemed issued on or after Jan. 1, 2019

September 2018

The IRS filed a notice of proposed rulemaking to remove the documentation requirements

The Treasury Dept. and the IRS noted that they will continue to study the issues and may propose a simplified and streamlined version with a prospective effective date

October 2019

The Treasury Dept. and the IRS issued final regulations, effective as of Nov. 4, 2019, which eliminate the costly documentation requirements

An advance notice of proposed rulemaking was also issued announcing that Treasury intends to issue proposed regulations streamlining the other regulations under Sec. 385

IRS Issues Final Regulations Removing Sec. 385 Documentation Requirements

Tax accounting implications

- Continue to monitor whether the Treasury Department and the IRS propose a modified version of the documentation requirements with a prospective effective date
- Despite the removal of the documentation requirements, taxpayers should nevertheless carefully analyze related-party debt instruments as to whether unrecognized tax benefits should be recorded as a result of an uncertain tax position
    - Taxpayers may have to consider whether debt characterization will be sustained upon examination even in the absence of the documentation requirements
    - If such a position may not be sustained, the taxpayer will be required to record a respective liability based on the recognition and measurement standards required under U.S. GAAP, e.g., if the debt is more likely than not to be treated as equity, then the related interest expense deductions would be non-deductible and would create unrecognized tax benefits

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IRS Releases New List of Automatic Method Changes Under Rev. Proc. 2019-43

On Nov. 8, 2019, the IRS released the new comprehensive list of automatic method changes under Rev. Proc. 2019-43 which:

- Provides favorable modifications to two existing automatic method changes that impact common leasing arrangements
- Makes the audit protection procedures more generous for certain changes under Section 263A
- Adds new automatic method changes for certain revenue recognition changes
- Incorporates all of the new automatic changes in method issued since Rev. Proc. 2018-31 was released
- Makes various housekeeping changes

IRS Releases New List of Automatic Method Changes Under Rev. Proc. 2019-43

Background

- Rev. Proc. 2019-43 supersedes Rev. Proc. 2018-31 as the new comprehensive list of accounting method changes that are eligible for automatic consent
- This list is separate from Rev. Proc. 2015-13, which contains the actual procedures for requesting consent for both automatic and non-automatic accounting method changes
    - The list is kept separately so the IRS can update it easily, which they have been doing annually since 2015

Effective date

- The new list of automatic method changes is effective for a Form 3115 filed on or after November 8, 2019, for a year of change ending on or after March 31, 2019
- Transition rules similar to those provided in Rev. Proc. 2018-31 are available, allowing taxpayers that filed a non-automatic method change before November 8, 2019 to convert it to an automatic change if the taxpayer is otherwise eligible

IRS Releases New List of Automatic Method Changes Under Rev. Proc. 2019-43

Leasing impact

- One of the more significant modifications provided by Rev. Proc. 2019-43 is a Section 481(a) adjustment and audit protection to two existing automatic changes related to common leasing issues
    - Change in (1) characterization of sale, lease or financing transactions and (2) accounting for tenant construction allowances
- Under the prior procedures, these method changes were made on a cut-off basis without audit protection, which meant the proposed method only applied to new agreements entered into on or after the year of change
- The new procedures provide that a change in method of accounting for a transaction entered into before the beginning of the year of change is eligible to be made under the automatic change procedures of Rev. Proc. 2015-13 with a Section 481(a) adjustment

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IRS Releases New List of Automatic Method Changes Under Rev. Proc. 2019-43

Leasing impact (cont'd)

- The new procedures also simply require a statement with the name of the counterparty instead of the representation, signed under penalties of perjury, from the counterparty
- The new procedures provide that the audit protection rules in Section 8 of Rev. Proc. 2015-13 apply, but ruling protection is not provided on the characterization of any transaction as a lease, sale, or financing transaction or on the ownership of property constructed with a tenant construction allowance
    - While the IRS cannot change the characterization in prior years if it was impermissible, the IRS can challenge whether the proposed method is the right permissible method under the taxpayer's facts

IRS Releases New List of Automatic Method Changes Under Rev. Proc. 2019-43

Other changes

- The audit protection procedures are more generous to taxpayers that file changes to conform to the final regulations under Section 263A, related to the capitalization of costs to property produced or acquired for resale, by temporarily suspending the default rule that taxpayers under exam do not receive audit protection
- Rev. Proc. 2019-43 also modified Section 16.12 of Rev. Proc. 2018-31 relating to changes in the timing of income recognition under Sections 451(b) and (c) for taxpayers without an applicable financial statement
- The procedures also modified Section 26.04, relating to changes in basis of computing reserves under Section 807(f) for insurance companies
- The remaining changes made by Rev. Proc. 2019-43 are mostly housekeeping, e.g., the new procedures incorporate the new automatic changes in method issued since Rev. Proc. 2018-31 was released

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IRS Releases New List of Automatic Method Changes Under Rev. Proc. 2019-43

Tax accounting implications

- The effects of an automatic change *from a proper method* to another may generally be reflected in the financial statements when management has concluded that the entity qualifies for such change, and management has the intent and ability to request the change (if the entity is not currently under IRS audit in which the consent of the IRS director to file Form 3115 is required)
    - A deferred tax liability may be created for any positive Section 481(a) adjustments (resulting in additional taxable income)
    - Adjustments to existing deferred tax assets and liabilities may be necessary to the extent that the method change results in a different tax basis in the underlying asset or liability
- The effects of an automatic change *from an improper method* to a proper method should generally be recorded in the financial statements when the Form 3115 has been filed with the IRS, as audit protection, if applicable, would then be triggered
    - May require the reversal of previously unrecognized tax benefits (and related interest and penalties) attributable to the use of an improper method, with the recording of a deferred tax liability attributable to any positive Section 481(a) adjustment

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Lawmakers Eye New December 20, 2019 Deadline for Tax Bills (current as of December 12, 2019)

- Congress has approved a continuing resolution to extend government funding at existing levels through December 20, 2019, setting up this deadline as the likely last chance to move tax legislative priorities
- An omnibus spending bill by the December 20th deadline remains the best hope for carrying a tax package
- Lawmakers on both sides support renewing many of the temporary expired tax provisions and fixing a drafting error in the TCJA that resulted in qualified improvement property being excluded from bonus depreciation
- Democrats are more resistant to other technical corrections for TCJA, and are pushing priorities such as enhancing renewable energy incentives, expanding the Earned Income Tax Credit, child tax credit, and the child and dependent care tax credit, and even relief from the $10,000 SALT cap
- Negotiations remain fluid, with discussions of incremental steps, such as a one-year extenders bill
- Monitor legislative progress on tax bills including extensions to the expiring tax provisions, a fix to the drafting error in the TCJA that resulted in qualified improvement property being excluded from bonus depreciation and a package of retirement incentives

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5. Human Capital Services

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State and Local Tax Update

1. Developments related to federal tax reform
2. Other income tax developments
3. Non-income tax developments

The following slides summarize notable developments since our last webcast but may not capture all developments that may be applicable to your company

Tax accounting effects - reminder

The effect of a tax law change is reported as a discrete item in continuing operations in the period of enactment

- The effect includes any necessary adjustments to existing deferred tax assets and liabilities
- Since deferred taxes are measured at the enacted tax rate at which the underlying temporary differences are expected to reverse, scheduling the reversal of existing temporary differences may be necessary in some cases

The forthcoming highlights, of both legislative and non-legislative activity, are not intended to be an all-inclusive compilation of state and local tax developments that may affect your company

Enacted changes can significantly impact state deferred tax amounts

State developments related to federal tax reform

Overview

- To the extent the Internal Revenue Code (IRC) changes as a result of federal tax reform, state conformity to those changes will vary from state to state based on the manner in which each state's laws interact with the IRC
  - Some state laws may automatically adopt the IRC currently in place (rolling conformity)
  - Some state laws may adopt the IRC as of a certain date (static conformity)
  - Some state laws may adopt only select portions of the IRC with the state tax code conforming to, or decoupling from, IRC provisions

Acronyms used

- GILTI = global intangible low-taxed income
- FDII = foreign derived intangible income
- TCJA = Tax Cuts and Jobs Act (enacted Dec. 2017)

Key IRC Sections (§) cited

- Section 163(j) interest expense limitations
- Section 245A dividends received deduction
- Section 250 foreign derived intangible income and GILTI deductions
- Section 951A global intangible low-taxed income
- Section 965 repatriation of foreign earnings (one-time transition tax)

Due to time limitations, we will not discuss each of the state conformity developments

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State developments related to federal tax reform

Iowa

- Iowa issued *Reform Guidance - GILTI & FDII* on November 21st, which discusses the state's treatment of GILTI and FDII for tax years beginning on or after January 1, 2019
- Iowa net income will include GILTI and the GILTI and FDII deductions reported on the federal return
- Taxpayers that file consolidated federal returns may have to make certain adjustments to the amounts of GILTI and FDII included for Iowa purposes
- Net GILTI must be included in the apportionment factor to the extent the income arises out of the taxpayer’s ownership interests in CFCs that are an integral part of some business activity occurring regularly in or outside Iowa
- All other net GILTI that is investment business income may be included in the apportionment factor at the taxpayer's election, with certain limitations
- If a taxpayer elects or is required to include GILTI in the Iowa apportionment factor, the net GILTI included in Iowa net income must be included in the denominator of the apportionment factor

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State developments related to federal tax reform

Louisiana

- Louisiana issued *Revenue Information Bulletin No. 19-016* on October 8th, which discusses the state's treatment of GILTI
- Dividend income is once again 100% deductible from Louisiana taxable income (for taxable years beginning in 2015-2017, Louisiana had a temporary 72% limitation on dividend subtractions)
- For purposes of Louisiana corporate income tax, GILTI is classified as a dividend, so no portion of GILTI is taxable for Louisiana corporate income tax purposes
- Any deduction taken on the corporation's federal return related to GILTI is not allowed for Louisiana corporate income tax purposes and must be added back

State developments related to federal tax reform

Montana

- Montana issued *Montana Corporate Income Tax Treatment of International Tax Provisions under Tax Cuts and Jobs Act of 2017* on October 4th, which discusses the state's treatment of IRC § 965 repatriation, GILTI and FDII
- IRC § 965 income is treated as Subpart F income for Montana purposes
- GILTI is considered a foreign dividend for Montana purposes
- FDII is not considered a foreign dividend for Montana purposes
- All taxpayers must attach federal transition tax statement, federal Form 8992 (U.S. Shareholder Calculation of GILTI) and federal Form 8993 (§ 250 Deduction for FDII and GILTI) to their Montana return
- Specific guidance provided for (i) water's edge filers; (ii) worldwide filers; and (iii) separate company, domestic or limited combination filers for the 2017 and 2018 tax years as it relates to IRC § 965 and the 2018 tax year as it relates to GILTI and FDII

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State developments related to federal tax reform

Nebraska

- Nebraska issued *General Information Letter 24-19-3 Income Tax: Global Intangible Low-Taxed Income and Foreign-Derived Intangible Income* on December 10th, which provides guidance on GILTI and FDII
- GILTI that is included in the taxpayer's federal return as federal taxable income, as adjusted, for corporations must also be included in the Nebraska return
- For domestic corporations, GILTI and FDII deductions are included in federal taxable income and included on the Nebraska return as well
- GILTI is not subject to the Nebraska deduction for dividends or deemed dividends because it is not a foreign dividend or included in Subpart F
- For apportionment purposes, an entity's share of GILTI should be included in the sales factor denominator
- If an entity's commercial domicile is in Nebraska, the state will presume that the entity's share of GILTI should also be included in the sales factor numerator

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State developments related to federal tax reform

New Jersey

- New Jersey Division of Taxation issued *Technical Bulletin TB-92(R)* on October 31st, which discusses the apportionment of IRC §§ 951A (GILTI) and 250 (FDII and GILTI/FDII deduction) and incorporates the clarification that the Division issued on Aug. 22nd
- While FDII has been newly classified under the IRC for the purposes of qualifying for the export subsidy deduction, the income has always been in the tax base for both federal and New Jersey tax purposes as part of entire net income (ENI)
- Barring an unusual set of facts and circumstances, net GILTI will be included in the denominator only, for most taxpayers
- Outside of hypothetical scenarios, the Division is not aware of any real-life situations that would require the net GILTI related amounts to be included in the numerator of the allocation factor
- If a situation arises in which the net GILTI is included in the numerator based on the taxpayer's unique facts and circumstances, the taxpayer may request discretionary relief

State developments related to federal tax reform

New York City

- New York City issued *Finance Memorandum 18-11* on October 7th, which provides guidance on the attribution of interest deductions for taxpayers with IRC § 163(j) limitations under the business corporation tax, general corporation tax, banking corporation tax and unincorporated business tax
- Modifications made to the required methodology for the attribution of interest deductions for taxpayers with:

    (i) a carryforward of interest deductions limited by § 163(j) that is deductible for federal purposes in the current year; or

    (ii) federal interest deductions limited by § 163(j) in the current tax year

State developments related to federal tax reform

Virginia

- Virginia issued *Guidelines Regarding the Business Interest Limitation* on November 1st, which proposes clarification of the state's treatment of IRC § 163(j) business interest deduction limitation
- Numerous aspects of the business interest expense deduction under § 163(j) are addressed, including:
    - Calculation of the current year interest limitation under each of Virginia's combined, consolidated, and separate company filing elections
    - Impact of state's fixed date conformity modification adjustments on the calculation of the interest limitation
    - Disallowed interest carryforward provisions
    - Additional deduction for 20% of disallowed interest expense
    - Impact of Virginia nexus upon the limitation and carryforwards

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Other income tax developments

Kentucky

- On October 4th, Kentucky issued a new regulation for combined unitary reporting for tax years beginning on or after January 1, 2019
- The new regulation addresses the following topics:
    - 50% ownership test
    - Unitary business principle
    - Determination of a unitary business
    - Indicators of a unitary business
    - Taxable year of the combined group
    - Members with different accounting periods
    - Responsibilities of a designated filer

Other income tax developments

Kentucky, cont.

- Additionally on October 4th, Kentucky amended the regulation providing for the NOL computation and deduction for corporations
- Regulation now provides examples for sharing of Kentucky NOLs within a combined group and sharing of Kentucky NOLs within a combined group that includes a non-taxpayer member
- The regulation for filing consolidated corporation income tax returns was also amended, the amendments address the following:
    - Election to file a consolidated return
    - Corporations included in a consolidated return
    - Deferred intercompany transactions
    - Consolidated return filing
    - Limited liability entity tax on a consolidated return
- This regulation includes special apportionment provisions for an affiliated group that includes one or more members that are providers (defined as providers of communications service, cable service or Internet access) and other members that are not providers

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Other income tax developments

Massachusetts

- On October 18th Massachusetts amended its corporate nexus regulation to provide an economic nexus standard
- A corporation has corporate excise tax nexus if it has considerable in-state sales derived through either economic or virtual contacts (citing *Wayfair*)
- State will presume that a corporation's virtual and economic contacts subject the corporation to corporate excise tax where the volume of its Massachusetts sales for the taxable year exceeds $500,000
- A corporation may be exempt from the income measure of the corporate excise, though not the non-income measure or minimum excise, by reason of P.L. 86-272

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Other income tax developments

New Jersey

- On October 17th New Jersey issued *Technical Bulletin TB-93*, which provides guidance on the unitary business principle and combined returns
- Unitary business principle is explained and the definition of unitary business for New Jersey Corporation Business Tax (CBT) purposes
- If the taxpayers meet either the "independence of functions test" or the "unity of operations and use test," the taxpayers are part of the unitary business
    - A determination of whether an entity forms part of a unitary business with another is determined based on the facts and circumstances of each case.
- On October 25th New Jersey issued *Technical Bulletin TB-94*, which provides guidance on the new NOL carryovers for taxpayers filing a separate return for New Jersey purposes
- The state noted that additional guidance on the new NOL carryovers for members of combined groups filing New Jersey combined returns will be provided

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Other income tax developments

North Carolina

- On November 8th North Carolina enacted legislation adopting market-based sourcing for income tax apportionment for taxable years beginning on or after January 1, 2020
- Under the state's market-based sourcing rules, receipts are sourced to North Carolina if the taxpayer's market for the receipts is in the state:
  - Receipts from services are sourced to the state if and to the extent the service is delivered to a location in the state
  - Receipts from intangible property that is rented, leased, or licensed are sourced to the state if and to the extent the property is used in the state
  - Intangible property utilized in the marketing of a good or service to a customer is used in the state if that good or service is purchased by a consumer who is in the state
  - Intangible property that is sold is sourced to the state if and to the extent the property is used in the state
  - Specific provisions are provided for contract rights, licenses and other similar intangibles
- All other receipts from the sale of intangible property are excluded from the sales factor

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Other income tax developments

North Carolina, cont.

- A taxpayer with a state net loss carryforward into the 2020 taxable year may elect on the 2020 tax return to continue to apportion *receipts from services* based on the percentage of its income-producing activities performed in the state
  - Once the election is made, the election is irrevocable and binding until the existing state net loss carryforward has been fully utilized or expires
  - The election will not impact the computation of the apportionment factor utilized in apportioning the net worth base for franchise tax
- New state net loss carryforwards generated in the 2020 taxable year and later years must be computed using market-based sourcing
- Legislation includes special apportionment provisions for electric power companies, wholesale content distributors and banks
  - "Wholesale content distributor" is defined as a broadcast television network, a cable program network, or any television distribution company owned by, affiliated with, or under common ownership with any such network

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Other income tax developments

Oregon

- On November 7th the Department of Revenue updated its list of FAQs to provide corporate activity tax (CAT) guidance, including what is commercial activity and who is not subject to the CAT
- FAQs clarified that CAT is imposed only after a taxpayer exceeds $1 million of taxable commercial activity; once this threshold is passed, the tax is $250 plus 0.57% on gross receipts greater than $1 million after subtractions.
- On December 9th the Department posted draft regulations for the CAT, which address the following topics:
    - Substantial nexus guidelines
    - Factors used in determining whether a unitary group exists
    - Agent exclusion
    - Property brought into Oregon
    - Estimated payments requirements
    - Delinquent or underestimated estimated tax payments
    - Estimated tax issues related to unitary groups and apportioned returns
    - Extensions

Other income tax developments

Pennsylvania

- On September 30th the Pennsylvania Department of Revenue (DOR) issued Corporation Tax Bulletin 2019-4, *Nexus for corporate net income tax purposes*
- The DOR announced, for tax periods starting on or after January 1, 2020, that it is implementing an economic nexus standard for corporate net income tax (CNIT) based on the U.S. Supreme Court's decision in *Wayfair*
- The DOR will deem there to be a rebuttable presumption that corporations without physical presence in the state, but having $500,000 or more of direct or indirect gross receipts from any combination of the following, sourced to Pennsylvania per year under the statutory sales factor rules, have a CNIT filing requirement:
    - Gross receipts from the sale, rental, lease, or licensing of tangible personal property
    - Gross receipts from the sale of services
    - Gross receipts from the sale or licensing of intangibles, including franchise agreements
- The DOR noted that taxpayers with or without physical presence in Pennsylvania can still potentially claim exemption from the CNIT under P.L. 86-272

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Other income tax developments

Wisconsin

- On September 30th the Wisconsin Department of Revenue (DOR) published a final rule, effective November 1, 2019, which prescribes that if a corporation has 15 or more days of activity within Wisconsin, the corporation will have nexus for income and franchise tax purposes
    - Although not noted by the DOR, taxpayers may still potentially claim exemption under P.L. 86-272
- The 15-day nexus threshold can be met by either one person with 15 days of activity or 15 persons with one day each of activity, or any combination of persons and days that results in at least 15 person-days of activity
    - Days of activity include any day, or portion thereof, upon which business activity took place
    - Days of activity do not include travel days, holidays or weekends, unless business activities were conducted on those days
- The rule will result in less sales being thrown back to Wisconsin to the extent its application would create nexus in another state inasmuch the nexus standards set forth in Wisconsin rules determine whether a taxpayer has nexus in another state for purposes of Wisconsin's throwback provisions

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Other income tax developments

Jurisdiction	Enactment date	Change
Colorado	October 2019	Colorado Department of Revenue announced that the 2019 TABOR surplus refund will temporarily lower the corporate income tax rate for the 2019 tax year from 4.63% to 4.5%
New York	October 18, 2019	New York Department of Taxation and Finance issued guidance for tax years beginning on or after January 1, 2018 which changes the definition of qualified New York manufacturer to use the New York State adjusted basis rather than the federal adjusted basis when determining whether a manufacturer meets the $1 million or $100 million property thresholds for determining eligibility for the manufacturer's tax rate reductions and the real property tax credit
New York Metropolitan	November 25, 2019	New York Department of Taxation and Finance adopted an emergency rule (which is proposed as a permanent rule) that increases the rate of New York's Metropolitan Commuter Transportation Business Tax Surcharge from 28.9% to 29.4% for tax years beginning on or after January 1, 2020 and before January 1, 2021
Utah	Pending	The Governor has stated he will sign legislation (S.B. 2001) which was passed by the Utah legislature on December 12, 2019; the legislation would decrease the corporate income tax rate from 4.95% to 4.66%, with potential effect for tax years beginning on or after January 1, 2020

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Non-income tax developments

Financial statement considerations

- May create accruals or contingent liabilities for non-compliance
- May result in an "above the line" expense (pre-tax income)
- May require the adoption of new procedures and controls to ensure the timely collection, reporting and remittance of the tax

Non-income tax developments

Remote seller developments

State legislation in response to U.S. Supreme Court decision in *South Dakota v. Wayfair, Inc.* (June 2018)

- States have continued to enact statutes and/or issue regulations addressing the obligation of remote sellers, who otherwise do not have a physical presence in a state, to collect and remit sales and use tax
    - The obligation may extend beyond state-level taxes to include applicable county and local taxes, e.g., the Alaska Remote Seller Sales Tax Commission will begin collecting taxes from out-of-state sellers as soon as early 2020 on behalf of those localities that have entered into the agreement (Alaska does not have state-level sales tax but many Alaska localities have a local sales tax)
- Legislation also continues related to marketplace facilitators

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International tax updates

1. IRS Compliance Campaign on Section 965 – Transition Tax
2. 9th Circuit Denial of Altera Petition for Rehearing
3. Section 958(b)(4) Proposed Regulations & Rev. Proc. 2019-40
4. Foreign Tax Credit (FTC) & Base Erosion Anti-Abuse Tax (BEAT) Regulations
5. Foreign country developments

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IRS Compliance Campaign – Sec. 965

Overview

- Section 965 was enacted as part of the Tax Cuts & Jobs Act ("TCJA")
  - Imposes a transition tax on previously untaxed post-1986 foreign earnings and profits ("E&P") of certain foreign corporations owned by U.S. shareholders
  - This E&P is deemed to be repatriated and recognized as income for the relevant U.S. shareholders as of December 31, 2017
  - The E&P held in the form of cash and cash equivalents is taxed at a 15.5% rate and the remaining E&P is taxed at an 8% rate
- The transition tax under Section 965 applies to the last taxable year of the relevant foreign corporation that begins before January 1, 2018 and the amount included in income under Section 965 is includible in the U.S. shareholder's year in which or with which such foreign corporation's year ends, e.g., tax year ended December 31, 2017 for a calendar-year taxpayer
  - The vast majority of Section 965 liabilities are reported on taxpayer returns for 2017 and 2018 tax years

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IRS Compliance Campaign – Sec. 965

Overview

- Final regulations were issued in January 2019 - after the extended 2017 tax return filing deadline for calendar year (and certain fiscal year) taxpayers
  - 2017 tax returns, including the reported Section 965 liability, may have been filed inconsistent with the final regulations
- Notably, the statute of limitations on any Section 965 tax liability is extended, under statute, to 6 years

IRS Compliance Campaign – Sec. 965

- Goal is to promote compliance with Section 965 through conducting examinations as well as providing technical assistance to teams on Section 965, with a focus on identifying and addressing taxpayer populations with potential material compliance risk
- Campaign will target both 2017 and 2018 tax year returns
    - It is anticipated that returns selected will also be examined for other material issues, especially issues related to TCJA planning
- Although no particular details have been provided by the IRS, the campaign may focus on the following:
    - Calculations of foreign corporation E&P
    - Foreign tax credits claimed
    - Section 965 anti-abuse rules
    - Other operational rules associated with Section 965

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IRS Compliance Campaign – Sec. 965
Tax accounting implications

- Taxpayers subject to Section 965 should perform a detailed review of whether the transition tax was computed on the basis of the final regulations
- If not, unrecognized tax benefits should be recorded for financial statement purposes, keeping in mind
  - The recognition and measurement of unrecognized tax benefits assumes that the taxing authority will examine the position with full knowledge of the facts
  - The six-year statute of limitations applicable to Section 965 assessments

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Ninth Circuit Denies Altera Petition

- In a prior webcast, we discussed the June 7, 2019 decision by the U.S. Court of Appeals for the Ninth Circuit in *Altera Corporation & Subsidiaries v. Commissioner of Internal Revenue*
  - The 2003 regulations were at issue, which required participants in a cost-sharing arrangement ("CSA") to share stock-based compensation ("SBC") costs to achieve an arm's-length result
  - The 3-judge panel of the Ninth Circuit upheld the validity of the 2003 regulations
- A petition for rehearing en banc was subsequently filed with the Ninth Circuit
- On November 12, 2019, the Ninth Circuit issued an order denying the petition
  - The order ends Altera's options in the Ninth Circuit
  - Altera may still file a petition requesting the U.S. Supreme Court to review the decision; therefore, the matter may still not be settled with certainty

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Ninth Circuit Denies Altera Petition
Tax accounting implications

- For purposes of potentially recognizing and measuring unrecognized tax benefits for financial statement purposes:
  - Taxpayers must assume that their transfer pricing positions will be examined and evaluated by the relevant taxing authority with full knowledge of all relevant information
  - For taxpayers residing in the Ninth Circuit, evaluate the "finality" of the Ninth Circuit's 3-judge panel decision given the recognition step is based on management taking the issue to the court of last resort; however, the measurement step may factor in the likelihood of the court of last resort hearing the issue
  - For taxpayers residing outside of the Ninth Circuit, evaluate the precedential value of the 2015 Tax Court decision in *Altera*, which held that the regulations at issue were invalid

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International tax updates

1. IRS Compliance Campaign on Section 965 – Transition Tax
2. 9th Circuit Denial of Altera Petition for Rehearing
3. Section 958(b)(4) Proposed Regulations & Rev. Proc. 2019-40
4. Foreign Tax Credit (FTC) & Base Erosion Anti-Abuse Tax (BEAT) Regulations
5. Foreign country developments

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CFC Downward Attribution Relief

Background

- Section 958 provides rules for determining stock ownership for purposes of Sections 951-964, including the determination of controlled foreign corporation ("CFC") and U.S. shareholder status
  - In general, a U.S. person is considered a U.S. shareholder when they own at least 10% of a CFC
- The TCJA expanded the definition of U.S. shareholder to include a U.S. person that owns at least 10% of the value of the CFC
  - Rather than narrowly targeting the transactions of concern, Congress repealed the limitation on downward attribution from foreign persons previously found in Section 958(b)(4)
- This repeal unintentionally broadened the universe of foreign corporations that should be treated as CFCs, with stock owned (directly, indirectly, or constructively) by a foreign person becoming subject to downward attribution to a U.S. person

CFC Downward Attribution Relief

Proposed regulations and Rev. Proc. 2019-40

- On October 1, 2019, the IRS issued proposed regulations and Rev. Proc. 2019-40 to address the unintended consequences
  - The regulations provide targeted relief where foreign entities become CFCs solely as a result of "downward attribution" in situations where Treasury has regulatory authority
  - The Rev. Proc. includes certain safe harbors for taxpayers with limited ability to obtain information regarding certain corporate foreign investments as to CFC status and reporting

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CFC Downward Attribution Relief
Proposed regulations

- The proposed rules provide relief to foreign-owned multinationals in some areas, but U.S. multinationals may be negatively impacted in other areas
    - The proposed regulations were issued under Sections 267, 332, 367, 672, 863, 706, 904, 1297, and 6049
- The regulations are generally proposed to apply to tax years ending on or after October 1, 2019
    - The proposed regulations also apply to certain relevant transactions that occur on or after October 1, 2019
    - Each individual proposed regulation can be applied to taxable years that begin before January 1, 2018 provided that the taxpayer and related persons consistently apply that particular proposed regulation

Proposed regulations under Section 267(a)(3)(B)

- Section 267(a)(3)(B) provides that an item paid to a CFC is deductible by the payor only to the extent that it is includible in the gross income of a Section 958(a) U.S. shareholder
- The proposed regulations provide that an amount (other than interest) that is income of a related foreign person with respect to which the related foreign person is exempt from U.S. taxation on the amount owed pursuant to a U.S. treaty obligation is exempt from the application of Section 267(a)(3)(B)(i) if the related foreign person is a CFC that does not have any Section 958(a) U.S. shareholders

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Proposed regulations
Tax accounting implications

- In acknowledging the concerns and challenges created by the repeal of Section 958(b)(4), the proposed regulations seek to limit the impact of the repeal in areas of the tax code where Treasury concluded it had regulatory authority to do so
- Taxpayers impacted by the repeal of Section 958(b)(4) should assess how the proposed rules would affect them
  - Taxpayers who took certain positions prior to the release of the proposed regulations should review such positions for financial statement purposes, including for purposes of the recognition and measurement of uncertain tax positions
- The ability to adopt the rules for prior years may provide opportunities for refund claims and may carry financial statement implications

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Rev. Proc. 2019-40

- As a result of the repeal of Section 958(b)(4), foreign corporations that were not previously treated as CFCs may become CFCs
- Once becoming a CFC, taxpayers may be faced with income inclusions and reporting requirements related to Sections 951 and 951A (Subpart F and GILTI) with limited information available to compute and report these amounts
- Rev. Proc. 2019-40 provides guidance to taxpayers in applying the impact of the repeal of Section 958(b)(4)
  - Provides three safe harbor rules
  - Addresses the applicability of certain penalties
  - Revises the requirements for certain U.S. shareholders to file or report certain information on Form 5471

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Rev. Proc. 2019-40
Tax accounting implications

- Companies should take special note of the safe harbor rules under Rev. Prov. 2019-40 and determine whether such rules apply to their specific facts and circumstances
- To the extent relief could be sought under the revenue procedure, companies should determine if such relief may have an impact on any prior year tax provision
- In addition, for companies that have recorded uncertain tax positions with respect to computations based on estimates, due to insufficient information, there may be an opportunity to release such reserves (unrecognized tax benefits) if relief is available

International tax updates

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FTC and BEAT Regulations
Background

- On December 2, 2019, Treasury released final regulations related to the determination of foreign tax credits ("FTCs") and the Base Erosion and Anti-Abuse Tax ("BEAT")
  - The final FTC regulations are generally consistent with the proposed regulations released on November 28, 2018 but deviate in certain instances and make important clarifications
  - The final BEAT regulations are largely consistent with the proposed regulations released on December 13, 2018 but adopt several significant changes
- On the same date, Treasury also released (1) proposed FTC regulations addressing the allocation and apportionment of expenses and (2) proposed BEAT regulations addressing various issues

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FTC Final Regulations

Certain provisions and changes

- New safe harbor methods for applying transition rules for carryover FTCs and loss accounts as required under TCJA resulting from the addition of the foreign branch category of income
- Consolidation of the 16 PTEP groups down to 10
- Clarifications on allocation and apportionment of interest expense of a CFC under the modified gross income method
- Applicability dates: For items relating to amendments under TCJA, generally tax years beginning after December 31, 2017; for items unrelated to TCJA, generally tax years ending on or after December 4, 2019

Tax accounting implications

- For companies who claim FTCs, it is important to consider the final regulations and the relevant effective dates

FTC Proposed Regulations

Certain provisions and changes

- Excludes the allocation and apportionment of R&E expenses to dividends, subpart F, and GILTI
- Allocation of stewardship expenses to dividends, subpart F, and GILTI followed by allocation of such expense based on the asset method used for the apportionment of interest expense
- New guidance on the allocation and apportionment of foreign taxes to separate categories of income, and other items such as damages
- Changes related to Section 905(c) dealing with foreign tax redeterminations that affect deemed paid taxes
- Applicability dates: Mostly applicable for tax years ending on or after the rules are published with the Federal Register but some apply to tax beginning after December 31, 2019

Tax accounting implications

- Companies should review their FTC expense allocation methodologies for dividends, subpart F, and GILTI to determine whether such methodologies are consistent with the proposed regulations

BEAT Regulations

Background

- The TCJA enacted BEAT, which affects corporate taxpayers which are part of a group with gross receipts of at least $500 million over a 3-year period and have a ratio of base erosion deductions compared to total deductions of 3% or higher (2% or higher for certain banks and securities dealers) for the taxable year
    - Modified taxable income is computed without regard to certain deductible payments made to foreign-related parties
    - The tax is phased in at a rate of 5% for tax years beginning in 2018, 10% for tax years beginning in 2019 through 2025, and 12.5% for tax years beginning after Dec. 31, 2025 (the rates are increased by 1% for certain banks/securities dealers)
    - When applicable, the tax is added to the taxpayer's regular tax liability
- The FASB staff previously concluded that any incremental tax effects of BEAT are recognized as incurred, with deferred tax assets and liabilities not computed in accordance with the BEAT even if a company expects to be subject to BEAT

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BEAT Final Regulations

Certain provisions and changes

- Certain non-recognition transactions excluded from definition of base erosion payment
- Disregard of transactions between members of an aggregate group, so long as both parties were members of the aggregate at the time of the transaction
- Loss on sale or transfer of property is not a base erosion payment
- Modifications/clarifications related to interest expense allocation to ECI of a foreign corporation
- No requirement to blend the BEAT tax rate for fiscal year taxpayers
- Apply to tax years ending on or after December 17, 2018 (taxpayers may also apply the final regulations to prior tax years, but must do so in their entirety)

Tax accounting implications

- Companies should consider the applicability dates of the final regulations as for calendar year taxpayers, the regulations could impact both 2018 and 2019 tax years

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BEAT Proposed Regulations

Certain provisions and changes

- Election to waive allowable deductions
    - Foregone deductions will not be treated as a base erosion tax benefit **only if** the taxpayer waives the deduction for **all** U.S. federal income tax purposes
- Clarifications on the determination of aggregate group
- Several new rules addressing the application of BEAT to partnerships and their partners
- Apply to tax years beginning on or after the date that the final regulations are published; however, taxpayers may rely on them in their entirety for taxable years beginning after Dec. 31, 2017, and before the final regulations are finalized

Tax accounting implications

- Companies should review the proposed regulations for applicability and closely monitor the finalization of the proposed regulations

International tax updates

1 IRS Compliance Campaign on Section 965 – Transition Tax

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4 Foreign Tax Credit (FTC) & Base Erosion Anti-Abuse Tax (BEAT) Regulations

5 Foreign country developments

Recent foreign tax law developments

In Appendix A, we have summarized various foreign tax law developments occurring since our September webcast, which may not capture all developments that may be applicable to your company

- Reminder: the effect of an income tax law change is reported as a discrete item in continuing operations in the period of enactment
- Click the Resources button to download Appendix A
- Certain non-income tax developments are also included given they can impact "above the line" earnings

We will selectively discuss OECD, United Kingdom, and India developments given their potential material impact on U.S. multinational companies

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Recent foreign tax law developments
OECD

- In our June 2019 webcast, we discussed the OECD's release in May 2019 of the Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy
    - The tax challenges of the digitalization of the economy were a main area of focus of the OECD's Base Erosion and Profit Shifting (BEPS) Project, which led to the 2015 BEPS Action 1 Report
    - The Action 1 report found that the whole economy was digitalizing; therefore, it would be difficult, if not impossible, to ring-fence the digital economy
    - To address the tax challenges arising from an increasingly digital economy, the OECD proposed a two-pillar approach

Recent foreign tax law developments
OECD

- Pillar One focuses on the allocation of taxing rights including a review of profit allocation and nexus rules
- On October 9, 2019, the OECD released for public consultation the Secretariat Proposal for a "Unified Approach" under Pillar One
    - The Proposal would use a three-part allocation formula to apportion and allocate above-normal profits to market jurisdictions, irrespective of physical presence
    - The allocation of above-normal profits would only apply to consumer-facing businesses that either sell to or interact directly with users or consumers and which likely meet minimum annual revenue thresholds such as potentially €750 million of annual sales in line with country-by-country (CbC) reporting requirements

Recent foreign tax law developments
OECD

- Pillar Two focuses on developing rules that would provide tax jurisdictions with the right to "tax back" group profits where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation
- On November 8, 2019, the OECD published for public consultation the Global Anti-Base Erosion (GloBE) Proposal under Pillar Two
  - The primary focus is on the income inclusion rule, which would tax the income of a foreign branch or a controlled entity if such income was subject to tax at an effective rate that is lower than a minimum rate
  - While being described similar to the U.S. global intangible low-taxed income (GILTI) provision, the minimum rate of tax has not been established, but will be discussed once other key design elements are fully developed

Recent foreign tax law developments
OECD

- The proposals require consensus by a group of 130-plus OECD member and non-member countries
  - Achieving consensus on how international tax systems need to be changed may be quite difficult even if countries otherwise agree on the need for change
- The objective is to have a consensus-based solution by the end of 2020
  - As the OECD does not have lawmaking authority, any solution will ultimately depend on changes in local country tax laws, double tax treaties, the Model Tax Treaty, and the OECD Transfer Pricing Guidelines

Recent foreign tax law developments

OECD

- If implemented, multinational entities possibly could experience a sea change in the global tax landscape, potentially with substantial financial statement ramifications
  - The GloBE proposal is not limited to highly digitalized businesses; rather, it is intended to ensure that all internationally operating businesses pay a minimum level of tax
  - Despite the focus on simplification, potential formulaic approaches, and dispute resolution mechanisms, the changes could increase tax compliance costs and the risk of disputes across taxing jurisdictions
- If these changes are not made, Pascal Saint-Amans, Director of the OECD's Centre for Tax Policy and Administration, has stated there could be chaos for a few years before going back to the project again
  - The chaos would be caused by countries unilaterally enacting or considering digital services tax (DST) legislation, such as that enacted by France in July 2019

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Recent foreign tax law developments
United Kingdom

- In previous webcasts, we have discussed the U.K.'s pending exit from the European Union (EU) (Brexit)
  - Brexit was originally scheduled for no later than March 29, 2019 following the outcome of a referendum held in the U.K. in 2016
  - An extension was granted on April 10, 2019, following an earlier abbreviated extension, for no later than October 31, 2019
- Since our last webcast:
  - On October 22, 2019, U.K.'s House of Commons voted to endorse the broad principles of the revised Brexit withdrawal agreement that Prime Minister Boris Johnson was able to reach with the EU's remaining 27 member states (EU27) the week before
  - On October 28, 2019, the EU27 agreed to provide the U.K. with a three-month extension for Brexit until January 31, 2020

Recent foreign tax law developments
United Kingdom

- Since our last webcast (cont'd):
  - On December 12, 2019, the U.K. held a pivotal general election to cast ballots for members of Parliament, which still must formally approve the revised withdrawal agreement
  - The Conservative Party, led by Prime Minister Boris Johnson who vowed to "get Brexit done," won a working majority in Parliament
  - Given the election results, Parliament is expected to formally approve the revised withdrawal agreement, with Brexit occurring by January 31, 2020; as a side note, the Conservative Party had announced on November 18, 2019 that it plans to postpone the previously enacted decrease in the U.K. corporate income tax rate from 19% to 17%, which is scheduled to take effect in April 2020 (new legislation will be required to postpone this rate decrease)

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Recent foreign tax law developments
United Kingdom

- Brexit will likely have a major impact on U.S. international trade, as the U.K. is home to over 50% of U.S. company headquarters in Europe
- Depending on what transpires, companies may need to evaluate the accounting and financial reporting implications
    - SEC registrants may need to update their disclosures in Management's Discussion and Analysis and other parts of their SEC filings
    - SEC staff has stated that it expects companies to expand disclosures about the potential effects of Brexit on matters such as taxes, assets, financing and business operations

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Recent foreign tax law developments
India

- On September 20, 2019, the Taxation Laws (Amendment) Ordinance, 2019 (Tax Ordinance) was promulgated by the President of India during the recess of the Parliament and published in the Official Gazette
  - Under Article 123 of India's Constitution, the Tax Ordinance must be approved by the Indian Parliament within six weeks of its reassembly
  - Since it was highly unlikely that the Tax Ordinance would face any challenge in being approved, it may be considered substantively enacted as of September 20, 2019 for IFRS purposes; however, since the full legislative process was not yet complete, it should not be considered enacted for purposes of U.S. generally accepted accounting principles (U.S. GAAP) as of such date
- On December 11, 2019, Parliament passed the Tax Ordinance with certain changes
  - With the legislative process complete, the Tax Ordinance is enacted as of December 11, 2019 for U.S. GAAP purposes

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Recent foreign tax law developments
India

- The Tax Ordinance provides two options for a lower corporate income tax rate applicable for the financial year starting April 1, 2019
  - A rate of 22%, instead of the current 25%/30% rate, is available for existing domestic companies
  - A rate of 15% is available for domestic manufacturing companies incorporated on or after October 1, 2019 and commencing production on or before March 31, 2023
- If either option is chosen
  - Specified exemptions or incentives are no longer available, thereby requiring an economic analysis of the relative tax benefits of the lower rate vs. the available exemptions/incentives to determine if the lower rate option should be chosen
  - The minimum alternative tax (MAT) is not applicable

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Agenda

1. Federal Tax
2. State and Local Tax
3. International Tax
4. Accounting
4. Human Capital Services

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Proposed ASU: Income tax simplification

Simplify certain areas of accounting for income taxes:

- Franchise taxes which are based in part on income
- Transactions resulting in a step up in the tax basis of goodwill
- Separate financial statements for legal entities not subject to tax
- Enacted changes in tax laws in interim periods
- Other minor codification improvements

Remove certain exceptions currently required in ASC 740

- Incremental approach for intraperiod tax allocation
- Ownership changes in investments
- Interim period allocation when YTD losses exceed annual losses

Effective date deferral: Leasing, CECL

Leasing Guidance	Effective date
Public business entities, certain NFPs and certain employee benefit plans	Dec. 15, 2018
All other entities	Dec. 15, 2020

Measuring Credit Losses (CECL)	Effective date
SEC filers (excluding smaller reporting companies)	Dec. 15, 2019
All other entities	Dec. 15, 2022

Note: All effective dates refer to fiscal years beginning after such date

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Effective date deferral: Hedging, goodwill impairment, insurance

Hedging	Effective date
Public business entities	Dec. 15, 2018
All other entities	Dec. 15, 2020
Simplified goodwill impairment test	**Effective date**
SEC filers (excluding smaller reporting companies)	Dec. 15, 2019
All other entities	Dec. 15, 2022
Long Duration Insurance Contracts	**Effective date**
SEC filers (excluding smaller reporting companies)	Dec. 15, 2021
All other entities	Dec. 15, 2023

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Agenda

1 Federal Tax

2 State and Local Tax

3 International Tax

4 Accounting

4 Human Capital Services

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Final regulations on life insurance contracts and related proceeds

- On October 31, 2019, Treasury and the IRS published final regulations under Sections 101(a) and 6050Y
- Section 101(a) addresses proceeds of life insurance contracts payable by reason of death
- Section 6050Y, which was added by the TCJA, imposes (1) information reporting obligations on the buyer in the case of the purchase of an existing life insurance contract in a reportable policy sale and (2) reporting requirements on the payor (underlying insurance company) in the case of the payment of reportable death benefits
    - A "reportable death benefit" means an amount paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale
    - A "reportable policy sale" means the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer's interest in such life insurance contract; the term “indirectly” applies to the acquisition of an interest in a partnership, trust, or other entity that holds an interest in the life insurance contract

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Background

- Death benefit proceeds paid under corporate-owned life insurance (COLI) and bank-owned life insurance (BOLI) are generally excluded from taxable income under Section 101(a)(1)
- However, if an insurance contract is sold or otherwise transferred for valuable consideration, the “transfer for value rule” in Section 101(a)(2) generally limits the excludable portion to the amount paid for the contract plus any future premiums paid
    - Thereby likely causing some of the death benefit proceeds to be taxable
- Two exceptions exist to the transfer for value rule – it does not apply:
    - If there is a carryover basis (e.g., a tax-free merger or acquisition of the original owner of the policy), or
    - If the transfer is to the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder or officer

Background

- Under the changes made by the TCJA, the exceptions under Section 101(a) to the transfer for value rule remain, but they no longer apply if the acquisition of the life insurance contract constitutes a "reportable policy sale"
    - Reminder, a reportable policy sale includes the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer's interest in such life insurance contract
- Before the regulations were issued, it was not clear the extent to which ordinary course business transactions (for example, corporate mergers and acquisitions) could fall within the definition of reportable policy sales with respect to policies owned by the target before the transaction

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Final regulations

- Address information reporting for reportable sales of life insurance contracts and payments of reportable death benefits
- Provide guidance regarding the amount of death benefits excluded from gross income following a reportable policy sale
- Clarify when ordinary course business transactions are excluded from the definition of reportable policy sales

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Final regulations

- Provide that a substantial business relationship exists if:
    - The insured was an employee of the acquired business immediately before the acquisition
    - The insured was a director, highly compensated employee or individual of the acquired trade or business, and the acquirer, immediately after the acquisition, has ongoing financial obligations to the insured with respect to the insured’s employment by the trade or business (for example, the life insurance contract is maintained by the acquirer to fund current or future retirement, pension or survivorship obligations based on the insured’s relationship with the entity or to fund a buy-out of the insured’s interest in the acquired trade or business)
    - Reminder: A "reportable policy sale" does not exist if the acquirer of an interest in a life insurance contract has a substantial family, business, or financial relationship with the insured
- Provide that persons that acquire shares in a C corporation that holds an interest in a life insurance contract generally will not be considered to have an indirect acquisition of an interest in such contracts; however, if more than 50% of the gross value of the assets of the C corporation consists of life insurance contracts, any person that acquires shares in the C corporation will be considered to have an indirect acquisition of an interest in any life insurance contracts held by the C corporation

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Final regulations

- In the preamble to the final regulations, the IRS acknowledges that the exclusions from the definition of reportable policy sales can result in different treatment with respect to stock and asset acquisitions
    - The exceptions apply in the case of acquisition transactions in which the corporate existence of the target survives the acquisition (for instance, a taxable stock sale with no Section 338 election, a reverse subsidiary merger structured to qualify as a tax-free reorganization under Section 368(a)(2)(E), or a tax-free reorganization under Section 368(a)(1)(B))
    - The exceptions may not apply in the case of acquisition transactions in which the target corporation is merged with and into the acquiring corporation and the target's separate corporate existence is terminated as of the merger date (for instance, a tax-free reorganization under Sections 368(a)(1)(A), (C), or (D) or Section 368(a)(2)(D))

Effective date

- For purposes of determining whether (1) a transfer of an interest in a life insurance contract is a reportable policy sale or (2) a payment of death benefits is a payment of reportable death benefits subject to the new reporting requirements, the final regulations apply to reportable policy sales made after December 31, 2018, and to reportable death benefits paid after December 31, 2018
- For purposes of determining the amount of the proceeds of life insurance contracts payable by reason of death excluded from gross income under Section 101, the final regulations apply to amounts paid by reason of the death of the insured under a life insurance contract transferred after October 31, 2019
    - However, the final regulations provide that a taxpayer may apply the final regulations with respect to all amounts paid by reason of the death of the insured under a life insurance contract transferred after December 31, 2017, and on or before October 31, 2019

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Tax accounting implications

- Questions have arisen whether buyers are required to record a deferred tax liability to reflect the potential future tax liability following certain merger and acquisition transactions
    - A deferred tax liability is generally recorded whenever the book basis differs from the tax basis in any particular asset or liability
- With COLI, a company would not record a deferred tax liability on the excess of the cash surrender value of a life insurance policy (the book basis) held by an employer over the premiums paid (the tax basis) if (1) management has the ability and intention to hold the policy until the death of the insured <u>and</u> (2) the recovery of the asset (i.e., policy proceeds) is without tax consequence upon the death of the insured
    - In such case, the difference is a permanent difference (not a taxable temporary difference), as the policy proceeds do not result in any taxable income
- If the merger or acquisition transaction results in a reportable policy sale potentially because the target's separate corporate existence is terminated as of the merger date (and no exception applied), the recovery of the asset (i.e., the policy proceeds) will have tax consequence as the excludible portion is limited to the amount paid for the contract plus any future premiums paid
    - The taxable portion would be a temporary difference for which a deferred tax liability would be required

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Any final questions?

Q&A

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