

Accounting for Income Taxes: A Year in Review

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The Financial Accounting Standards Board (FASB) has continued to pursue changes to accounting standards affecting public and nonpublic entities. Many of these changes have directly or indirectly affected the financial accounting for income taxes.

Standard Setting Updates

The FASB has been very active of late as part of its Simplification Initiative to reduce complexity in accounting standards. The initiative is intended to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which the cost and complexity can be reduced while maintaining or improving the usefulness of the information provided for financial statement users. The activity affecting the accounting for income taxes now, or within the next few years, is summarized below.

Final Standards Issued

■ **ASU No. 2015-17, “Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes.”** The FASB issued ASU 2015-17 on Nov. 20, 2015.

The Accounting Standards Update (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.

The ASU is effective for public entities for annual periods and related interim periods beginning after Dec. 15, 2016, and for all other entities for annual periods beginning after Dec. 15, 2017, and interim periods in the following year. Early adoption is permitted for all entities. The revised guidance can be adopted for any financial statement not yet issued.

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.

- **ASU No. 2015-16, “Business Combinations (Topic 805): Simplifying the Accounting for Measurement Period Adjustments.”** The FASB issued ASU 2015-16 on Sept. 25, 2015.

The ASU eliminates the requirement to retrospectively account for adjustments made during the measurement period to provisional amounts recognized in a business combination. Instead, these adjustments are to be recognized in the period they are determined. Furthermore, the effect on earnings related to changes in depreciation, amortization, and any other resulting income effects are recorded in the reporting period the adjustments are determined (not retrospectively). This would include recording the income tax effects on the adjustments, as applicable.

Entities also are required to separately disclose by line item on the face of the income statement, or in the notes, the portion of the amount recorded in current period earnings that would have been recorded in previous periods if the adjustments had been recognized as of the acquisition date.

The ASU is effective for public entities for fiscal years beginning after Dec. 15, 2015, and interim periods within those years. For all other entities, the ASU is effective for fiscal years beginning after Dec. 15, 2016, and interim periods within fiscal years beginning after Dec. 15, 2017. The ASU must be applied prospectively to adjustments that occur after its effective date. Early adoption is permitted for financial statements that have not yet been issued.

Disclosures regarding the nature of and reason for the change in accounting principle are required in the first annual period of adoption and in the interim periods within the first annual period of adoption.



Final Update Pending

- **Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Accounting.** An exposure draft (ED) was issued on June 8, 2015, and the board completed redeliberations on Nov. 23, 2015. The FASB directed its staff to draft a final ASU for vote by written ballot. This ASU would make multiple changes to the accounting for this compensation. Only those changes affecting income tax accounting are discussed below. FASB decisions are considered tentative until a final ASU is issued.

Currently, if the tax deduction for the vesting or settlement of share-based compensation exceeds the compensation cost for financial reporting purposes, the additional tax benefit on the excess amount is recognized in additional paid-in capital and referred to as an excess tax benefit (sometimes also called a windfall). The accumulated excess tax benefits can offset current- and subsequent-period tax deficiencies (shortfalls) when the tax deduction is less than the related financial reporting compensation cost. If the accumulated excess tax benefit amount is exhausted, tax deficiencies must be recognized in the income statement. Finally, an excess tax benefit cannot be recorded to additional paid-in capital until it is realized, resulting in a tax refund or otherwise reducing cash taxes payable.

Selected changes affirmed by the FASB include the following:

- Entities would be required to recognize all excess tax benefits and tax deficiencies in the income statement. The tax effects of windfalls and shortfalls would be recorded discretely in the period in which they occur. Note: This is a change from the proposed ASU, which would have required that the tax effects of windfalls and shortfalls be considered in determining the estimated annual effective tax rate. This change would be adopted prospectively.
- Entities would recognize excess tax benefits in the current period, no longer having to delay recognition until realized in cash. This change would be transitioned to retrospectively, with a cumulative-effect adjustment recognized in equity. From a disclosure perspective, entities will be required to classify excess tax benefits in the statement of cash flows as an operating activity, while classifying the cash paid when directly withholding shares to meet minimum statutory withholding requirements as a financing activity. The change in classification of cash paid would be adopted retrospectively, but entities have the option of adopting the classification of excess tax benefits either prospectively or retroactively.

The guidance would be effective for public entities for annual periods beginning after Dec. 15, 2016, including interim periods within those annual periods. For all other entities, the guidance would be effective for annual periods beginning after Dec. 15, 2017, and interim periods within annual periods beginning after Dec. 15, 2018. Early adoption would be permitted for all entities.

In the period of adoption, disclosures related to a change in accounting principle would be required with one exception: Entities would not be required to quantify the income statement effect of the change (direct or indirect) in the period of adoption.

It should be noted that FASB decisions are considered tentative until the final ASU is issued. Once the ASU is finalized, entities can adopt the guidance for any financial statement not yet issued.

Exposure Drafts Issued

- **Income Taxes (Topic 740): Intra-entity Asset Transfers.** An exposure draft was issued on Jan. 22, 2015, and the FASB completed re-deliberations during the fourth quarter of 2015.

The proposed ASU would eliminate the exception in GAAP that prohibits entities from recognizing current and deferred income tax consequences for an intra-entity asset transfer until the asset or assets have been sold to an outside party. Entities would be required to recognize the consequences when the transfer occurs.

During re-deliberations, the board decided not to affirm the prior decision described in the exposure draft and directed the staff to perform additional narrowly scoped research on the costs and benefits of applying the exception only to inventory.

- **Disclosures by Business Entities About Government Assistance.** An exposure draft was issued on Nov. 12, 2015, and comments were due by Feb. 10, 2016.

GAAP currently lacks explicit guidance on how to account for government assistance received by business entities. The proposed ASU would require disclosure about 1) the types of arrangements (tax credits, tax exemptions, tax abatements, loan guarantees, grants, and low-interest or interest-free loans), 2) the policies for accounting for the government assistance, 3) the effect of the assistance on the business's financial statements, and 4) the significant terms and conditions of the legally enforceable agreement. Specifically, businesses would be required to make the following disclosures in their annual financial statements:

- Information about the nature of the assistance, including a general description of the significant categories and the related accounting policies adopted or the method applied to account for government assistance.
- Which line items on the balance sheet and income statement are affected by government assistance and the amounts applicable to each line item.
- Significant terms and conditions of the agreement, including commitments and contingencies.
- Unless impracticable, the amount of government assistance received but not recognized directly in the financial statements. The amount of government assistance received but not recognized includes value that was received by an entity for which no amount has been recorded directly in any financial statement line item (for example, a benefit of a loan guarantee, a benefit of a below-market rate loan, or a benefit from tax or other expenses that have been abated).

The guidance would apply to all business entities except not-for-profit entities within the scope of ASC Topic 958. The guidance would apply to all legally enforceable agreements under which the government determines whether and to what extent an entity will receive assistance. It would not apply to transactions in which the government is the customer or to nondiscretionary benefits that are broadly available to entities meeting specified eligibility requirements.

“Government” is broadly defined to include domestic, foreign, local, regional, and national governments as well as governmental entities and intergovernmental organizations. Because “government” is so broadly defined, the arrangements that may be subject to the proposed guidance cover a wide range of activities and may have far-reaching implications to reporting entities.

As currently drafted, there is no scope exception for income tax incentives that would meet the criteria.

An effective date hasn't been determined, but the amendments would apply to all agreements existing at the effective date and those entered into after it. Retrospective application would be allowed.

FASB decisions are considered tentative until a final ASU is issued.

In the Pipeline

Income Tax Disclosures

- **Foreign earnings.** The FASB made tentative board decisions on Feb. 11, 2015, to require all entities to disclose the following information related to foreign earnings:
 - Income before taxes disaggregated between domestic and foreign
 - Further disaggregation of foreign jurisdictions with earnings “significant” to total earnings
 - Amount of domestic tax expense on foreign earnings recognized in the period
 - Undistributed foreign earnings for which there is no longer an assertion of indefinite reinvestment, including separate disclosure of “significant” foreign jurisdictions, along with an explanation of the circumstances that cause the entity to make that assertion
 - Disaggregated cumulative amount of foreign earnings for which there is an assertion of indefinite reinvestment for any country that represents at least 10 percent of the disclosed amount

- **Uncertain tax positions.** The FASB made tentative board decisions on Aug. 26, 2015, to require expanded income tax disclosures related to unrecognized tax benefits as follows:
 - Enhanced tabular reconciliation to include:
 - Bifurcation of settlements using existing tax assets from those settled with cash
 - Detail of ending unrecognized tax benefits liability by line item in the balance sheet in which the liability is recognized
 - Elimination of the current requirement to disclose positions for which it is reasonably possible that the unrecognized tax benefit will significantly change within 12 months of the reporting date
 - Other disclosures were discussed but not approved

- **Effective tax rate reconciliation.** The FASB made tentative decisions on Oct. 21, 2015, to require expanded income tax disclosures related to the effective tax rate reconciliation as follows:
 - Tabular reconciliation disclosure for all entities (currently only public entities are required to include a tabular reconciliation)
 - Separate disclosure for reconciling items that exceed 5 percent of the amount computed by multiplying the income before tax by the applicable statutory federal tax rate
 - Qualitative description of items driving a significant change in the effective tax rate year-over-year

- **Carryforward disclosure requirements.** The FASB made tentative board decisions on Oct. 21, 2015, to require the following income tax disclosures related to tax attribute carryforwards for all entities:
 - Amounts and expiration dates of gross carryforwards recorded on the tax return
 - Amounts and expiration dates of tax-effected carryforwards that will give rise to a DTA
 - Total amount of the unrecognized tax benefit that offsets tax-effected carryforwards



- **Other Disclosures.** The FASB made tentative decisions on Oct. 21, 2015, to require disclosures related to the following:
 - The enactment of tax law changes if it is probable that the changes will have a future impact
 - If deferred taxes are not presented separately on the balance sheet, the line item(s) in which the amounts are presented
 - The amount of domestic and foreign income taxes paid
 - The amount of the valuation allowance recorded and released during the reporting period, including an explanation of the nature of the change

Staff Research Topics

- **Presentation of Tax Expense or Benefit.** The FASB is conducting a staff research project to evaluate the presentation of total tax expense or benefit as a single item on the income statement.
- **Intraperiod Allocations.** The FASB discussed eliminating the exception that exists within ASC 740-20-45-7 to modify the incremental approach to intraperiod tax allocation when there are current-year losses from continuing operations. However, the board would prefer to eliminate intraperiod allocations altogether. The FASB staff currently is performing additional research and outreach on the topic.

FASB decisions are considered tentative until a final ASU is issued.

Other Standard Updates to Consider

- **ASU No. 2013-11, “Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists.”** The FASB issued ASU 2013-11 on July 18, 2013.

The ASU requires an entity to present an unrecognized tax benefit (or portion thereof) in the financial statements as a reduction to a DTA for a net operating loss (NOL) carryforward, a similar tax loss, or a tax credit carryforward. But, to the extent an NOL carryforward, similar tax loss, or tax credit carryforward isn't available at the reporting date under the applicable tax law to settle any additional income taxes that would result from the disallowance of a tax position – or the applicable tax law doesn't require the entity to use, and the entity doesn't intend to use, the DTA for such purpose – the unrecognized tax benefit should be presented as a liability and not combined with DTAs.

The ASU is effective for public entities for annual and related interim periods beginning after Dec. 15, 2013, and for all other entities for annual and related interim periods beginning after Dec. 15, 2014. The guidance can be adopted for any financial statement not yet issued.

The amendments are applicable to all unrecognized tax benefits that exist as of the effective date. Entities have the choice of applying the guidance prospectively or retrospectively to each prior reporting period presented.

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- **ASU No. 2014-02, “Intangibles – Goodwill and Other (Topic 350): Accounting for Goodwill (a Consensus of the Private Company Council).”** The FASB issued ASU 2014-02 on Jan. 16, 2014.

The ASU is applicable to all entities other than public business entities and not-for-profit entities. The standard provides private entities with an alternative accounting model that permits amortization of goodwill on a straight-line basis over 10 years (or less if supportable). The alternative accounting model classifies all goodwill existing at the beginning of the election period as a finite-lived asset. This could have implications related to valuation allowances, as it may result in taxable temporary differences that support the realization of deferred tax assets. It should be noted that the alternative accounting model does not change the prohibition on recording a DTL for the excess of book over tax goodwill.

The ASU is effective for annual periods beginning after Dec. 15, 2014, and interim periods in the following year. The guidance can be adopted for any financial statement not yet issued.

- **ASU No. 2014-18, “Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination (a Consensus of the Private Company Council).”** The FASB issued ASU 2014-18 on Dec. 23, 2014.

The ASU provides an accounting alternative for private entities that acquire identifiable intangible assets in a business combination. Under the alternative, customer-related intangible assets that aren’t capable of being sold or licensed independently and noncompete agreements acquired in a business combination could be subsumed into goodwill rather than being recognized and amortized as a separately identifiable intangible asset. Some intangibles, such as commodity supply contracts, customer information, core deposits, and mortgage servicing rights, still must be recognized separately.

The ASU is effective for annual and related interim periods beginning after Dec. 15, 2015, or Dec. 15, 2016, depending on the date of the first in-scope transaction and is elected in conjunction with the goodwill accounting alternative (ASU 2014-02). Early adoption is permitted. The guidance can be adopted for any financial statement not yet issued.

Conclusion

Rules affecting the accounting for and reporting of income taxes continue to evolve. It appears the FASB indeed is simplifying certain aspects of accounting and reporting, including those related to income taxes. As the accounting standards continue to change, entities and their tax departments are challenged with not only staying on top of evolving federal, state, and international tax legislation, but also ensuring proper tax accounting and disclosures in an ever-shifting environment.