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Tax accounting considerations for recent legislative and global developments

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With you today

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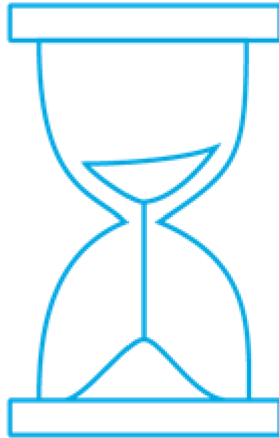
Agenda



- Domestic tax law changes
- Updates from the Financial Accounting Standards Board
- Pillar Two, federal tax credits, and foreign tax law changes

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Learning objectives

By the end of this presentation, participants will be able to:

1. List in general the recent tax law and regulation updates
2. Interpret the FASB disclosure requirements
3. Explain the changes in accounting for credit structures
4. Demonstrate the basic concepts in accounting for Corporate Alternative Minimum Tax
5. Review the basic concepts in accounting for Pillar Two

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Domestic tax law changes

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Corporate alternative minimum tax (CAMT) overview

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- The Inflation Reduction Act of 2022 introduced the CAMT, which is a 15% minimum tax imposed on corporations (not S corporations), based on adjusted financial statement income (AFSI) and subject to income thresholds. Applicability:
- Domestic-parented corporations with average AFSI of greater than $1 billion for one or more taxable years that are prior to the current tax year and end after Dec. 31, 2021
- Foreign-parented corporations with U.S. average financial statement income of greater than $100 million, where the AFSI of the group is greater than $1 billion
- Aggregation rules apply:
  - Parent-subsidiary group
  - Brother-sister group
  - Combined groups

CAMT safe harbors

- IRS Notice 2023-7 provides a simplified method to determine whether a corporation is an applicable corporation subject to CAMT.
- Companies are permitted to use the simplified method, which disregards most of the adjustments prescribed under Internal Revenue Code (IRC) section 56A.
- The testing period to determine if a corporation is subject to CAMT is the prior three tax periods.
  - Ex.: For the 2023 tax year, the taxpayer would use 2020, 2021 and 2022 as the testing period for adjusted financial statement income calculations.
  - If the corporation's annual AFSI is less than the safe harbor amount of $500 million, the corporation is not an applicable corporation.
  - If the corporation is a foreign-parented multinational corporation, the threshold for the safe harbor test is $50 million.
- If a corporation fails the safe harbor test, then it will need to perform the more in-depth applicable corporation calculation.

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Common adjustments to applicable financial statement income

- Depreciation
- Disregarded entity income
- Effectively connected income
- Distributive share of partnership income (probably one of the most-discussed items)
- Domestic federal income taxes
- Foreign taxes—to the extent a foreign tax credit is taken

ASC 740 implications of CAMT

Payment of CAMT will generate a CAMT credit with an indefinite life.

Because of the credit, the payment of CAMT is largely a timing item with no expected impact on a company's effective tax rate.

Under Accounting Standards Codification (ASC) 740, a company that expects to be subject to CAMT should measure its deferred taxes using the regular tax rate (i.e., not adjust deferred taxes for the CAMT rate).

Companies must also consider the realizability of any CAMT credit carryforward deferred tax asset, assessing the need for a valuation allowance.

If the CAMT is expected to be material to the company's financial statements, the company should consider a financial statement disclosure of the expected impacts.

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CAMT

The IRS has released several notices to provide guidance on CAMT but has yet to publish regulations.

The notices provide some guidance on the calculation of various adjustments and seek input from taxpayers on other adjustments. The notices also provide the safe harbor for determining applicable corporate status discussed earlier and provide guidance on the treatment of various merger and acquisition transactions.

Given the complexity of calculating adjusted financial statement income (AFSI), there are still many open questions regarding that calculation.

Notice 2023-64 indicated that taxpayers may rely on the notices and that any regulations would apply to tax years beginning on or after Jan. 1, 2024, at the earliest.

The IRS has published a draft of Form 4626; however, no instructions to the form have been published so far.

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Financial statement net operating loss and CAMT foreign tax credit

- A financial statement net operating loss (NOL) is allowed against up to 80% of AFSI.
- A financial statement NOL is the amount of the net loss on a corporation's applicable financial statements (as adjusted for CAMT) for taxable years ending after Dec. 31, 2019.
- A CAMT foreign tax credit is also allowed.
- The amount is equal to the sum of a corporation's creditable taxes included on its financial statements and a pro rata share of a controlled foreign corporation's (CFC's) foreign taxes.
- A CFC foreign tax credit is limited to 15% of the CFC's AFSI.

Energy credits: refundable credits

- The Inflation Reduction Act of 2022 introduced several new tax credits aimed at encouraging domestic investment in renewable technologies and clean energy.
- Some of these credits are eligible for direct pay while others are transferable.
- Due to the unique nature of the transferability and direct pay provisions, companies taking these credits need to carefully consider the accounting treatment.
- If an entity can elect to treat a credit as a direct payment of tax and receive a refund in the absence of any taxable income, the credit would be accounted for outside of ASC 740.

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Energy credits: transferable credits

- There are several views on how to treat transferable credits, including some suggesting the accounting for the credit is outside ASC 740.
- The Financial Accounting Standards Board (FASB) suggested earlier this year that accounting for the credits under ASC 740 is the most appropriate view.
- When the entity transfers the credit, the gain or loss on the transfer is recognized in income tax expense (benefit) in the income statement.
- Since ASC 740 is applied to the credit, an entity will need to assess the realizability of any credit deferred tax asset. The ability to transfer the credit can be included in the valuation allowance assessment.

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Other federal items

Notice 2023-2, issued earlier this year, provided preliminary guidance on the new excise tax on publicly traded corporations that repurchase their stock. The tax is applicable to buybacks occurring on or after Jan. 1, 2023.

- The tax on share repurchases is not an income tax accounted for under ASC 740, but rather, likely accounted for in equity as part of the cost of repurchasing shares.

Expenditures after Dec. 31, 2022, for food and beverages provided by a restaurant will no longer be 100% deductible and will revert to the general limitations on meals.

Congressional wish list (items that are not enacted but have significant support):

- Restore the more favorable definition of adjusted taxable income used to compute the interest expense limitation under section 163(j).
- Repeal section 174 required capitalization requirements for specified research and experimental expenditures.
- Restore 100% bonus depreciation, as the applicable percentage for bonus depreciation deductions under section 168(k) for property placed in service after Dec. 31, 2022, is reduced to 80%.

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Continuing ASC 740 challenges

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Valuation allowance and deferred scheduling

- We continue to see the need for entities to schedule temporary differences to support utilization of deferred tax assets (DTAs). This is particularly an issue with loss companies. The new section 174 capitalization rules have created significant DTAs, and the interplay of the capitalization with NOLs subject to an 80% taxable income limitation, and with 163(j) carryovers that are limited to 30% of income, creates complexities and the need for additional valuation allowances.

Goodwill impairment and the impact of deferred taxes on goodwill write-downs

- The requirement under Accounting Standards Update (ASU) 2017-4 can result in a deferred tax asset related to the impairment of tax-deductible goodwill creating an incremental impairment charge, resulting in the use of simultaneous equations to get the correct DTA and impairment charge.

Select state and local tax law changes

- Texas increased the franchise tax exemption amount from $1.23 million to $2.47 million, effective for reports due on or after Jan. 1, 2024.
- Virginia increased the disallowed interest deduction from 30% to 50% for tax years beginning on and after Jan. 1, 2024.
- New Hampshire decoupled from section 163(j), allowing a deduction equal to the amount disallowed at the federal level for tax years beginning on or after Jan. 1, 2024.
- Georgia enacted Senate Bill 56, updating the state's IRC conformity to section 174 to allow state-level current expensing of capitalized costs.
- New Jersey signed into law on July 3, 2023, a bill amending the treatment of global intangible low-taxed income (GILTI) to be treated as a dividend, and accordingly, now qualifies for the effective 95% dividends received deduction when received from an 80% or more owned CFC.
- On Aug. 9, 2023, the New York Department of Taxation and Finance proposed new and amended corporate tax rules that are intended to implement the comprehensive corporate tax reform of 2014 and 2015; the department also adopted the Multistate State Commission revised guidance on P.L. 86-272.

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Updates from the financial accounting standards board

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ASC 740 improvements to income tax disclosures

In March 2023, the FASB issued a proposed ASU that would add new and modify existing income tax disclosures.

The proposal is the result of a long-standing FASB project around income tax disclosures; however, the proposal is significantly reduced in scope.

The revised scope is limited to additional disclosures around cash flows/taxes paid to jurisdictions and the effective tax rate reconciliation.

ASC 740 improvements to income tax disclosures

- In August 2023, the FASB met to deliberate and vote on changes to the proposed ASU, directing the FASB staff to draft a final ASU that largely mirrors the proposed version.
- The effective date for public business entities will be fiscal years beginning after Dec. 15, 2024, and interim periods within fiscal years beginning on or after Dec. 15, 2025.
- The effective date for entities other than public business entities is fiscal years beginning after Dec. 15, 2025, and interim periods within fiscal years beginning on or after Dec. 15, 2026. Early adoption is permitted.
- Entities would apply the amendments prospectively, with retrospective adoption permitted.

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Targeted improvements to disclosures – taxes paid

- All entities will be required to disclose income taxes paid, disaggregated by federal, state, and foreign taxes, net of refunds received.
- Income taxes paid will be disaggregated by individual jurisdiction on the basis of a quantitative threshold of 5% of total income taxes paid.
- The 5% threshold will be calculated from the absolute value of each jurisdiction over the absolute value of the total income taxes paid.
- The FASB decided to require this disclosure on an annual basis only, eliminating the need to disclose disaggregation by federal, state and foreign taxes on an interim basis.

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Targeted improvements to disclosures – effective tax rate

- Public business entities will be required to disclose rate reconciliation information using specific categories, in both dollars and percentages:
  - State and local income tax, net of federal income tax effect
  - Foreign tax effects (e.g., foreign rate differential and other local country items)
  - Enactment of new tax laws
  - Effect of cross-border tax laws (e.g., GILTI, FDII, foreign tax credits)
  - Tax credits
  - Valuation allowances
  - Nontaxable or nondeductible items
  - Changes in reserves for tax positions

	Year Ended December 31, 20X2	
	Amount	Percent
U.S. Federal Statutory Tax Rate	$ AA	aa %
State and Local Income Taxes, Net of Federal Income Tax Effects[1]	AA	aa
Foreign Tax Effects		
United Kingdom		
Tax rate differential	(AA)	(aa)
Share-based payment awards	AA	aa
Changes in unrecognized tax benefits	(AA)	(aa)
Other	(AA)	(aa)
Ireland		
Tax rate differential	(AA)	(aa)
Valuation allowances adjustments	(AA)	(aa)
Enactment of new tax laws	—	—
Other	AA	aa
Switzerland	(AA)	(aa)
Mexico	AA	aa
Other foreign jurisdictions	(AA)	(aa)
Enactment of New Tax Laws		

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Targeted improvements to disclosures – effective tax rate

- Public business entities will be required to provide additional information regarding the rate reconciling items:
- Separately disclose reconciling items by nature, on the basis of a quantitative threshold of 5%, within the effect of cross-border tax laws, tax credits, and nontaxable or nondeductible items categories.
  - The final ASU is expected to clarify that cross-border tax effects may be presented on a net basis (e.g., GILTI, net of foreign tax credits).
- Separately disclose reconciling items by nature and by jurisdiction, on the basis of a quantitative threshold of 5%, within the foreign tax effect category.
- Separately disclose reconciling items by nature, on the basis of a quantitative threshold of 5%, for other items that do not fall within any specific category.
- Changes in unrecognized tax benefits can be aggregated from all jurisdictions and reported as one line in the rate reconciliation.

Effect of Cross-Border Tax Laws			
Global intangible low-taxed income	AA	aa	
Foreign-derived intangible income	(AA)	(aa)	
Base erosion and anti-abuse tax	AA	aa	
Other	AA	aa	
Tax Credits			
Research and development tax credits	—	—	
Energy-related tax credits	(AA)	(aa)	
Foreign tax credits	(AA)	(aa)	
Other	—	—	
Valuation Allowances	AA	aa	
Nontaxable or Nondeductible Items			
Share-based payment awards	AA	aa	
Goodwill impairment	AA	aa	
Other	AA	aa	
Changes in Unrecognized Tax Benefits	(AA)	(aa)	
Other Adjustments	AA	aa	
Effective Tax Rate	$ AA	aa	%

Targeted improvements to disclosures – effective tax rate

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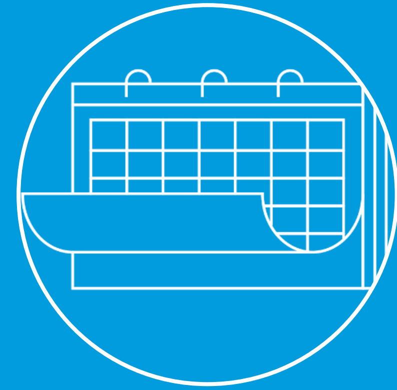
Public companies will also need to provide qualitative disclosure about state taxes that contribute to the majority of the effect of state and local income taxes on the rate reconciliation.

- The FASB clarified that "the majority of the effect" means greater than 50%.

Nonpublic entities will be required to provide qualitative disclosure about specific categories and individual jurisdictions that result in a significant difference between the statutory tax rate and the effective tax rate.



The FASB decided to eliminate a proposed interim disclosure requirement for a separate qualitative analysis of reconciling items that result in significant changes in the estimated annual effective tax rate from the effective tax rate of the prior annual reporting period.

ASU 2023-02: accounting for investments in tax credit structures

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- On March 29, 2023, the FASB issued ASU 2023-02, expanding the use of the proportional amortization method (PAM) of accounting to equity investments in other tax credit structures that meet certain criteria.
  - Historically, PAM has only been available for investments in low-income housing tax credit structures.
- ASU 2023-02 is effective for public business entities for years beginning after Dec. 15, 2023, including interim periods within those fiscal years. All other entities have an additional year to adopt the new guidance. If adopted in an interim period, the guidance must be applied retrospectively to the beginning of the fiscal year that includes the interim period.
- Under PAM, the investment in the tax credit structure is amortized in proportion to the income tax credits and other income tax benefits received each period in relation to the total benefits to be received over the life of the investment.
- The amortization is presented net of related tax credits and other tax benefits within the income statement as a component of income tax expense (benefit).

ASU 2023-02: example

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On Jan. 1, 2023, investor A made a $1 million investment in a renewable energy project in return for a 5% limited partnership interest and will receive a cash distribution of $2,000 per year based on a fixed percentage of the project's net cash flow.

The project is eligible for a tax credit and is anticipated to generate an annual tax credit allocation of $100,000 each year, for eight years.

Investor A plans to sell its investment on Dec. 31, 2032, for an estimated residual value of $50,000 pursuant to a put right in the partnership agreement.

Assume investor A's tax rate is 25%.

ASU 2023-02: example

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	1	2	3	4	5	6	7	8
Year	Net Investment	Amortization of Investment	Income Tax Credits	Net Tax Losses from K-1	Other Income Tax Benefits from Tax Losses	Income Tax Credits and Other Income Tax Benefits	Income Tax Credits and Other Income Tax Benefits Net of Amortization	Non-income Related Cash Returns
1	$ 885,448	$ 114,552	$ 100,000	$ 98,000	$ 24,500	$ 124,500	$ 9,948	$ 2,000
2	770,896	114,552	100,000	98,000	24,500	124,500	9,948	2,000
3	656,344	114,552	100,000	98,000	24,500	124,500	9,948	2,000
4	541,792	114,552	100,000	98,000	24,500	124,500	9,948	2,000
5	427,240	114,552	100,000	98,000	24,500	124,500	9,948	2,000
6	312,688	114,552	100,000	98,000	24,500	124,500	9,948	2,000
7	198,136	114,552	100,000	98,000	24,500	124,500	9,948	2,000
8	83,584	114,552	100,000	98,000	24,500	124,500	9,948	2,000
9	61,041	22,542		98,000	24,500	24,500	1,958	2,000
10	50,000	11,041		48,000	12,000	12,000	959	52,000
Total		**$ 950,000**	**$ 800,000**	**$ 930,000**	**$ 232,500**	**$ 1,032,500**	**$ 82,500**	**$ 70,000**

- Column 1 reflects the carrying amount of investment net of amortization.
- Column 2 is the initial investment less expected residual value of $50,000 x (income tax credits and other income tax benefits received during the year (column 6) / total anticipated income tax benefits).
- Column 3 is income tax credits over eight years.
- Column 4 is hypothetical losses from the partnership, mainly from tax depreciation.
- Column 5 is tax losses at a 25% tax rate.
- Column 6 is the sum of columns 3 and 5.
- Column 7 is the subtraction of column 2 from column 6.

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Pillar Two, federal tax credits, and foreign tax law changes

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Pillar Two – the basics

The Organisation for Economic Co-operation and Development (OECD) Pillar Two initiative aims to impose a global minimum corporate tax of 15% of adjusted net income on companies with total sales in excess of 750 million euros, regardless of the location of the business's headquarters or jurisdictions in which the business operates.

The model rules will top up the tax burden on a jurisdiction-by-jurisdiction basis to ensure that each jurisdiction is at a 15% tax rate.

Safe harbor tests were made available to allow jurisdictions more time to sign Pillar Two into law. A tested jurisdiction would need to pass at least one of the following tests:

- **De minimis test:** Revenue is less than 10 million euros and profit (loss) before income tax is less than 1 million euros, based on revenue and profit (loss) before income tax as reported in the country-by-country (CbC) report.
- **Simplified effective tax rate (ETR) test:** Uses income tax expense from financial statements adjusted for uncertain tax positions and noncovered taxes compared to profit (loss) before income tax as reported in the CbC report. ETR >= 15% (2023-2024), 16% (2025) and 17% (2026)
- **Routine profits test:** Uses profits before income tax <= Substance-based carve-out amount under global anti-base erosion (GloBE) based on payroll and tangible assets.

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Pillar Two – enactment

More than 130 countries have agreed to implement Pillar Two.

As of Sept. 30, 2023, approximately 22 countries have come forward with proposed legislative changes to adopt the objectives of Pillar Two.

- South Korea, Japan and the UK are some of the earliest to take legislative action.

Note that only legislation enacted as of the balance sheet date is applicable for an income tax provision under GAAP.

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ASC 740 implications of Pillar Two

- FASB staff believe the Pillar Two global minimum tax should be viewed as similar to the alternative minimum tax as discussed in ASC 740, which states that deferred taxes would not be recognized or adjusted for the future effects of the minimum tax.
- The International Accounting Standards Board has provided guidance regarding the global minimum tax, proposing a temporary exception to the accounting required for deferred taxes arising from the implementation of the Pillar Two rules and outlining specific disclosure requirements.

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International law changes

- Effective Jan. 1, 2023, the Netherlands has increased the lower tax bracket from 15% to 19%. The upper threshold for the 19% bracket has been reduced from 395,000 euros to 200,000 euros.
- Brazil has published several tax bills in 2023 that align Brazilian transfer pricing with OECD guidelines. One goal of the new transfer pricing legislation was to comply with rules for the recognition of foreign tax credits in the United States since the disparity in the transfer pricing legislation of the two countries represented an obstacle to qualifying for a foreign tax credit.
- Ireland's Knowledge Development Box (KDB) regime, which provides relief from corporate tax on income arising from qualifying assets such as computer programs, inventions protected by a qualifying patent, or certified inventions for small and medium-sized companies, will be affected by the Pillar Two Subject to Tax Rule (STTR). As part of the 2022 Finance Act, the effective tax rate of the KDB increased from 6.25% to 10%. The commencement order was signed on Sept. 5, 2023, and the increase will take effect Oct. 1, 2023.
- The United Kingdom passed its third reading of Finance (No. 2) Bill 2022-23 on June 20, 2023. Relevant changes include:
  - The introduction of the OECD's Pillar Two global minimum tax rate rules in the UK (including an associated domestic top-up tax), effective for periods beginning on or after Dec. 31, 2023
  - Changes to the UK's enhanced tax reliefs for expenditure by companies on research and development, most of which take effect for accounting periods beginning on or after April 1, 2023
  - The introduction of temporary "full expensing" with respect to certain capital expenditure on plant and machinery by companies, incurred between April 1, 2023, and March 31, 2026.

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Foreign tax credits – 2022 final regulations

The 2022 final regulations addressed the following:

- The definition of foreign income tax and in-lieu-of tax for purposes of IRC sections 901 and 903
- The timing rules for claiming a foreign tax credit
- The allocation and apportionment of foreign income taxes
- The disallowance of a foreign tax credit or deduction under section 245A(d)
- Clarity on certain foreign-derived intangible income (FDII) rules

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Foreign tax credits – Notice 2023-55: Relief from 2022 final regulations

- Notice 2023-55 provides temporary relief from the 2022 final regulations.
- Companies may apply former Treas. Reg. section 1.901-2(a) and (b) (revised as of April 1, 2021) for the definition of a foreign net income tax and the net gain requirement, except for language related to the non-confiscatory gross basis tax rule.
- Digital services taxes still do not satisfy the definition of a foreign net income tax.
- Taxpayers may apply existing Treas. Reg. section 1.901-3 without applying the jurisdiction to tax excluded income or source-based attribution requirement.
- Relief must be applied to all foreign taxes paid in any relief year.
- The notice applies to tax years beginning on or after Dec. 28, 2021, and ending on or before Dec. 31, 2023 (e.g., 2022 and 2023 calendar years).
- The IRS has indicated that it may extend relief to 2024.

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THANK YOU FOR YOUR TIME AND ATTENTION

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