Accounting for Income Taxes

39th Annual TEI-SJSU High Tech Tax Institute
November 7, 2023

Emily Cashwell, Managing Director – *EY*
Kelly Georgiou, Partner - *Deloitte*
Jared Huish, Partner – *KPMG*
JJ Schneider, Partner – *Grant Thornton*

SJSU | LUCAS COLLEGE AND GRADUATE SCHOOL OF BUSINESS
MST Program

TAX EXECUTIVES INSTITUTE, INC.
Silicon Valley Chapter

Agenda

- Section 174 research and experimental expenditures
- Organization for Economic Co-operation and Development (OECD) Pillar Two
- Accounting for refundable & transferable credits
- Income tax disclosure developments

Section 174 R&E Expenditures

- TCJA resulted in significant changes to the treatment of R&E expenditures under Section 174.
  - For tax years beginning after 2021, taxpayers are required to capitalize and amortize all R&E expenditures regardless of how they were treated previously.
  - Section 174 expenditures required to be capitalized and amortized:
    - Over 5 years (with half year convention) for R&E performed in the US
    - Over 15 years (with half year convention) for R&E performed outside of the US

Section 174 R&E Expenditures

Financial statement impact

- Potential new book-tax differences and related deferred tax assets
- Potential impact effective tax rates if a valuation allowance is required for the deferred tax asset, or due to the indirect effects on other calculations, including:
  - Interest expense limitation under Section 163(j)
  - Base erosion and anti-abuse tax (BEAT)
  - Tax on global intangible low-taxed income (GILTI)
  - Foreign-derived intangible income (FDII)
- State conformity impact on deferred tax assets
- Transactions between related parties should be considered:
  - If CFC is reimbursed by US parent, for example, then agreements must be analyzed to determine which party retains IP rights.

Section 174 R&E Expenditures

Valuation allowance considerations

- Limited impact on VA where replacing DTAs (e.g. Utilizing NOL/R&D credits)
- Generally no impact on VA when new capitalized costs result in tax liabilities
- GILTI Perm differences can have a material impact on VA analysis

Provision to Return true ups

- Due to refined method for calculation may result in a change in estimate
- Notice 2023-63 impact on calculation may result in new guidance impacting estimate

Overview: The Pillar 2 Charging Rules

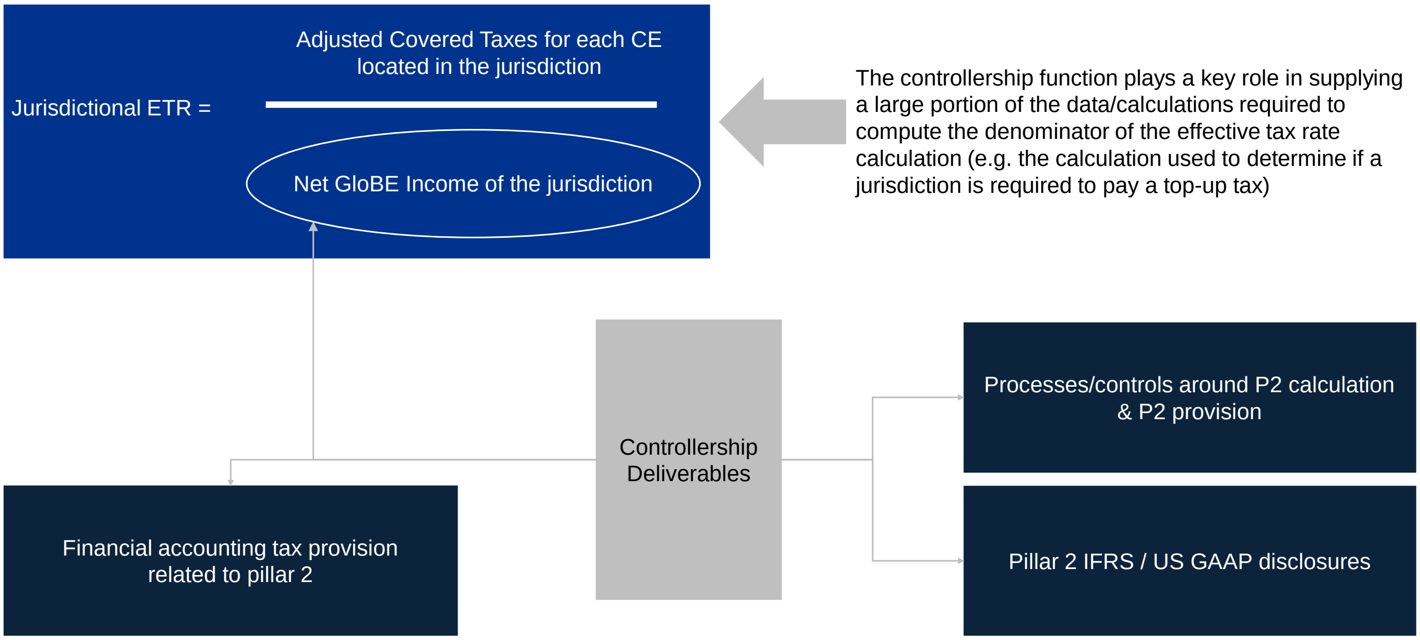
Policy objective:

To ensure that large multinational companies pay a 15% minimum level of tax on income earned in every jurisdiction they operate.

Three shots at achieving this policy objective (in order of priority application):

Local country measure	"Parent" country measure	Backstop measure
Qualified Domestic Minimum top-up tax ("QDMTT") Allows the local jurisdiction to collect any top-up tax to the 15% minimum tax rate that would otherwise be paid to another jurisdiction under Pillar 2.	**Income Inclusion Rule ("IIR")** Triggers top-up tax at the level of a Parent company where the income of a subsidiary or other constituent entity ("CE") (aggregated at the jurisdictional level) is taxed at a rate less than 15%.	**Undertaxed profits rule ("UTPR")** 1. UTPR is the ultimate backstop measure 2. The top-up tax is allocated among relevant jurisdictions that adopted UTPR 3. It operates by denying deductions (or an "equivalent adjustment"). 4. Applies to income in ultimate parent jurisdiction, including the U.S.

Pillar 2 Overview for the Controllership Function



Auditor expectations

Auditors are starting to release audit programs covering the information they expect to be available to review in relation to Pillar Two, this can include:

- Confirmation that an MNE Group is in-scope of Pillar Two.
- Understanding and documentation of processes adopted to identify the UPE and Constituent Entities.
- Understanding and documentation of processes to identify impact of Pillar Two, including Transitional CbCR Safe Harbor rules where applicable.
- Understanding and documentation of processes to identify data required to compute any Pillar Two tax liability.
- Documentation of transactions that have taken place between December 1, 2021 and the start of the transition period, including how these transactions are impacted by the GloBE Rules.
- Confirmation that management has considered the relevant accounting disclosure requirements.

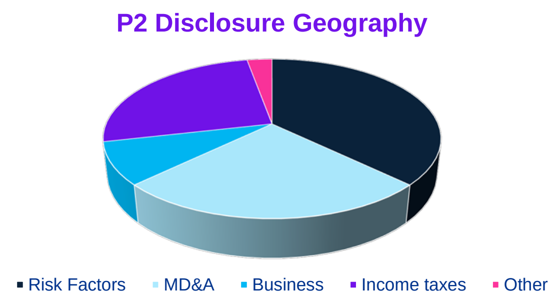
Disclosure considerations

Under US GAAP, there have been no P2 specific disclosure requirements issued to date. However, we expect that entities will be required to disclose the impact of P2 as part of existing SEC disclosure requirements. IFRS (IAS 12) has introduced specific, additional P2 disclosures.

With respect filings by SEC Registrants through the end of August 2023:

- For Annual reports to date, less than 50 companies included any Pillar 2 disclosures. All disclosures were qualitative.
- For Quarterly reports to date, less than 10 companies included any Pillar 2 disclosures. All disclosures were qualitative.

We observed the following trends in relation to p2 disclosure geography:



We did not observe a Company's auditor, size or industry having any significant correlation with the geography of the P2 disclosure

Reporting and Compliance Timeline

Jan 2024
First year that the IIR (or QDMTT) will apply to an in-scope Group, coming into effect for Fiscal Periods beginning on or after January 1, 2024*

Dec 2024
Fiscal Year end December 31, 2024. GloBE Information Return (GIR) due 18 months after this date

Jan 2025
Second year that the IIR (or QDMTT) will apply to the Group, with potential that the Group will also be subject to the UTPR (unless jurisdiction eligible for a safe harbor)

Dec 2025
Fiscal Year end December 31, 2025. GloBE Information Return (GIR) due 15 months after this date

Jun 2026
Filing deadline for the GIR for FY25 (first Fiscal Period) and potentially other domestic filing requirements

Mar 2027
Filing deadline for the GIR for FY26 (second Fiscal Period) and potentially other domestic filing requirements

* Disclosures in financial statements likely required in Jan 2024

Refundable Tax Credits

- Realization does not depend on the entity's generation of taxable income or the entity's ongoing tax status or tax position, treated as a government grant or assistance
- Outside the scope of income tax accounting under ASC 740
- No specific authoritative guidance under U.S. GAAP for government grants (except the disclosure guidance under ASU 2022-10, Disclosures by Business Entities about Government Assistance)
- Acceptable recognition and measurement framework
  - IAS 20*
  - Capital approach
    - Deferred income
    - Reduction to carrying amount of the asset
  - Income approach
    - Credit to income or reduction to the related expense
  - ASC 450-30 gain contingency
  - ASC 958-605 contribution

* FASB is exploring whether IAS 20 should be adopted in U.S. GAAP (invitation to comment issued in June 2022)

Refundable Tax Credits

- Change in tax law – non-refundable credits becoming refundable credits
  - Generally, continue to apply ASC 740 to the credits recognized at the time of the law change
  - Any new refundable credits earned after the tax law change would be accounted for in accordance with the refundable tax credit guidance

Transferable Credits

- Some tax jurisdictions allow sale of all or portion of credits (e.g., IRA introduced a number of tax credits that can be transferred/sold)
- Seller (regardless its intent how the credits will be monetized, offsetting its own tax liability or selling the credits):
  - Within scope of ASC 740 (if this accounting policy is chosen, additional accounting policies related to the presentation of the proceeds and expected gain or loss from the sale & consideration of the expected proceeds for valuation allowance purposes)
  - Outside the scope of ASC 740 (similar to refundable credits)
- Buyer – within scope of ASC 740

Income Tax Disclosure Developments

- FASB tentative decisions on targeted improvements to income tax disclosures
  - Income taxes paid disaggregation
  - Rate reconciliation
  - Elimination of certain disclosures
- Expected to be finalized by Q4 2023
- Tentative effective dates
  - PBEs - Fiscal years beginning after December 15, 2024
  - Non-PBEs – Fiscal years beginning after December 15, 2025

Illustration of rate reconciliation

	Year Ended December 31, 20X2		Year Ended December 31, 20X1		Year Ended December 31, 20X0	
	Amount	Percent	Amount	Percent	Amount	Percent
US Federal Statutory Tax Rate	$ AA	aa %	$ BB	bb %	$ CC	cc %
State and Local Income Taxes, Net of Federal Income Tax Effects*	AA	aa	BB	bb	CC	cc
Foreign Tax Effects						
United Kingdom						
Tax rate differential	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Share-based payment awards	AA	aa	BB	bb	CC	cc
Changes in unrecognized tax benefits	(AA)	(aa)	(BB)	(bb)	CC	cc
Other	(AA)	(aa)	BB	bb	(CC)	(cc)
Ireland						
Tax rate differential	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Valuation allowances adjustments	(AA)	(aa)	(BB)	(bb)	CC	cc
Enactment of new tax laws	-	-	BB	bb	-	-
Other	AA	aa	(BB)	(bb)	(CC)	(cc)
Switzerland	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Mexico	AA	aa	BB	bb	CC	cc
Other foreign jurisdictions	(AA)	(aa)	(BB)	(bb)	CC	cc
Enactment of New Tax Laws						
Change in tax rate	-	-	-	-	(CC)	(cc)
Effect of Cross-Border Tax Laws						
Global intangible low-taxed income	AA	aa	BB	bb	CC	cc
Foreign-derived intangible income	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Base erosion and anti-abuse tax	AA	aa	BB	bb	CC	cc
Other	AA	aa	-	-	-	-
Tax Credits						
Research and development tax credits	-	-	(BB)	(bb)	(CC)	(cc)
Energy-related tax credits	(AA)	(aa)	-	-	-	-
Foreign tax credits	(AA)	(aa)	(BB)	(bb)	(CC)	(cc)
Other	-	-	(BB)	(bb)	-	-
Valuation Allowances	AA	aa	(BB)	(bb)	(CC)	(cc)
Nontaxable or Nondeductible Items						
Share-based payment awards	AA	aa	BB	bb	CC	cc
Goodwill impairment	AA	aa	BB	bb	-	-
Other	AA	aa	(BB)	(bb)	CC	cc
Changes in Unrecognized Tax Benefits	(AA)	(aa)	BB	bb	(CC)	(cc)
Other Adjustments	AA	aa	(BB)	(bb)	(CC)	(cc)
Effective Tax Rate	$ AA	aa %	$ BB	bb %	$ CC	cc %

*State taxes in California and New York contributed to the majority of the tax effect in this category.

Notice

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.