

TEI-SJSU High Tech Institute

Hot Topics in Accounting for Income Taxes

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Presenters

Cheryl Colvin, Managing Director – EY
John Ruan, Senior Manager – Deloitte
David Murdock, Partner – Grant Thornton

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Presenters



Cheryl Colvin
Managing Director
EY
T +1 415 298 6279
E Cheryl.Colvin@ey.com
[LinkedIn Profile](#)



John Ruan
Senior Manager
Deloitte Tax LLP
T +1 415 823 3987
E joruan@deloitte.com
[LinkedIn Profile](#)



David Murdock
Partner, Tax Services
Grant Thornton Advisors LLC
T +1 408 346 4322
E david.murdock@us.gt.com
[LinkedIn Profile](#)

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Agenda

- One Big Beautiful Bill Act (OBBBA)
- ASU 2023-09 Improvements to Income Tax Disclosures
- Current Internal Control Environment

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One Big Beautiful Bill Act (OBBBA)

U.S. Federal Considerations

Accounting considerations related to the new U.S. tax legislation

Current taxes payable

- Provisions that could affect an entity's **current taxes payable** may include:
- Immediate expensing of domestic research and experimental expenditures ("R&E" or "Section 174") for amounts paid or incurred in taxable years beginning after December 31, 2024
- Election to deduct the remaining unamortized balance of capitalized domestic R&E expenditures for amounts paid or incurred after December 31, 2021, and before January 1, 2025
- Reinstatement of full expensing ("bonus depreciation") for qualified business property acquired and placed in service after January 19, 2025
- Modification of the limitation on the business interest deduction under Section 163(j) for periods beginning after December 31, 2024
- Termination of the qualified commercial clean vehicles credit for vehicles acquired after September 30, 2025 (Section 45W)
- Termination of the energy credit for certain energy property for which construction begins on or after June 16, 2025 (Section 48)

Disclaimer: This list is not intended to be all inclusive.

Accounting considerations related to the new U.S. tax legislation

Deferred tax assets and liabilities

The Act has the potential to affect **deferred tax assets and liabilities** arising before and after enactment. For example:

- Book-tax differences – amounts of taxable or deductible temporary differences (for example, immediate expensing of domestic R&E)
- Measurement – measurement of a deferred tax asset or liability (for example, removal of the reduction to GILTI related to a taxpayer's qualified business asset investment ("QBAI") for GILTI deferred providers)

The Act may require a reassessment of a **valuation allowance** for deferred tax assets. For example:

- Changes to the GILTI regime (now referred to as NCTI) may have an impact on the realizability of DTAs
- Modification of the computation of the deduction limits for net business interest expense may affect the VA assessment of the section 163(j) DTA and other DTAs
- In certain circumstances, changes in the Act may increase the amount of current taxes payable and corporate alternative minimum tax (CAMT) tax credit carryforward. The changes could affect the VA assessment for CAMT credit carryforwards and other DTAs

Disclaimer: This list is not intended to be all inclusive.

Realizability of deferred tax assets

- A valuation allowance is required when all or some portion of DTA will not be realized
- Realizability is based on whether it is more-likely-than-not asset will be realized (MLTN probability level > 50%)
- Realization depends on having sufficient income of the right character, jurisdiction and timing
- All available evidence, both positive and negative, shall be considered to determine whether, based on the weight of that evidence, a valuation allowance for deferred tax assets is needed (ASC 740-10-30-17)

Cumulative Losses

- Most objectively verifiable form of negative evidence
- ASC 740 does not provide a definition, and guidance is not a bright line test
- Analysis must be done separately for each tax-paying component in each tax jurisdiction

Four sources of taxable income:

1 Future reversals of existing taxable temporary differences

#2 Future taxable income exclusive of reversing temporary differences and carryforwards

#3 Taxable income in prior carryback year(s) if carryback is permitted under the tax law

#4 Tax-planning strategies

CAMT Overview

- The **CAMT** was added to the Internal Revenue Code following the enactment of the Inflation Reduction Act of 2022.
- CAMT imposes a **15% minimum tax** on the **adjusted financial statement income (AFSI)** of an **applicable corporation**.
- AFSI is the net income or loss set forth on the taxpayer's applicable financial statement (AFS), subject to certain adjustments (e.g., tax depreciation).
- An applicable corporation's **CAMT** is:

$$\text{CAMT} = \text{Tentative Minimum Tax (TMT)} - \text{Regular tax (plus any Base Erosion and Anti-Abuse Tax (BEAT))}$$

- An applicable corporation's **TMT** is:

$$\text{TMT} = \left[\text{AFSI} - \text{MIN} \left\{ \text{FS NOL}, 80\% \times \text{AFSI} \right\} \right] \times 15\% - \text{CAMT foreign tax credit (AMT FTC)}$$

- FS NOL is the net loss of a corporation on its AFS for a taxable year ending after December 31, 2019.
- AMT FTC is the (i) lesser of (a) pro rata share of taxes paid or accrued by CFC, and (b) pro rata share of CFC income taken into account as AFSI x 15%, plus (ii) foreign taxes paid or accrued directly by the applicable corporation.
- A corporation is eligible to claim a **credit against regular tax** (plus any BEAT) for CAMT paid in prior years (CAMT credit).
- General business credits including R&D may generally offset up to approximately **75% of the sum of a corporation's regular tax and CAMT**.

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CAMT Credit

- A corporation is eligible to claim a **credit against regular tax** (plus any BEAT) for CAMT paid in prior taxable years.
- CAMT **credit limitation**
 - o The amount of CAMT credit allowable for a taxable year cannot exceed the excess (if any) of—
 - the regular tax liability (plus any BEAT liability) of the corporation for such taxable year reduced by various credits, including the general business credit (e.g., R&D), over
 - the TMT of the corporation for the taxable year
 - o Generally intended to be a timing item
 - However, since the limitation provides that regular tax liability is reduced by credits, can result in the inability to use CAMT credits (potentially indefinitely)
- Unused CAMT credits can be carried forward indefinitely
 - o Some taxpayers may be perpetual CAMT taxpayers

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Key Drivers of CAMT

- Certain items may have a significant impact on, or are otherwise relevant to, a corporation's CAMT profile.
- **H.R. 1, informally called the One Big Beautiful Bill Act ("OBBBA")**, affected certain of these items and brought in new items.
- **R&D Capitalization and Tax Depreciation**
 - o Section 174 capitalization - large temporary difference between AFSI and taxable income - resulted in no CAMT liability/made it less likely.
 - o Substituting section 168 tax depreciation for AFSI purposes – resulted in no CAMT liability/made it less likely.
- **GILTI Income**
 - o Corporations with low foreign tax rates generally are taxed on GILTI income at a reduced regular tax rate (10.5%) - now NCTI (12.6%).
 - o Having a CAMT liability would effectively bring the GILTI (or now NCTI) rate up to 15%.
- **Permanent differences, NOLs, and FTCs**
 - o FDII and other permanent book/tax differences and pre-2020 tax NOLs may reduce regular taxable income and increase CAMT.
 - o CAMT FTC rules can be more favorable than regular tax FTC rules, which can impact whether there will be a CAMT liability.

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Assessing the realizability of deferred tax assets (DTAs) due to anticipated Corporate Alternative Minimum Tax (CAMT) liabilities

Potential interaction with valuation allowance assessment to consider in the period of enactment:

- An entity may need to determine if it needs a valuation allowance on its **CAMT credit carryforward DTAs**
- The corporate AMT may affect the expected tax benefit of **DTAs in the regular tax system if an entity expects to perpetually pay corporate AMT (e.g., the DTA is a reduction in tax under the regular system, but utilization might result in a higher amount of corporate AMT)**. There are two approaches to assessing the realizability of DTAs in the regular system for perpetual corporate AMT taxpayers:
 - Approach 1 – assess realizability of its DTAs on the basis of **all available information**, including CAMT
 - Approach 2 – assess realizability **solely on the basis of the regular tax system** without taking into account amounts due under the corporate AMT system
- Any valuation allowance change would be recorded in the period of enactment (i.e., period that includes July 4, 2025).

Example: Assessing the realizability of DTAs when considering a future CAMT liability

Assumptions:

- Entity A has a \$1,000 pre-2018 NOL carryforward as of year-end and no corporate AMT credit or NOL carryforward
- Entity A expects sufficient future income to fully utilize the NOL before it expires
- Entity A expects to perpetually pay AMT in the future and will need to record a VA against any future corporate AMT credit DTAs
- No permanent or temporary differences

	Regular Tax	AMT
Future AFSI & taxable income before NOL c/f [A]	\$ 1,000	\$ 1,000
NOL deduction	(1,000)	0
Taxable income/AFSI [B]	\$ 0	\$ 1,000
Tax rate [C]	21%	15%
Taxes payable with NOL carryforward [B] × [C]	\$ 0	[E] \$ 150
Taxes payable without NOL carryforward [A] × [C]	[D] \$ 210	\$ 150

Approach 1

Reduction of future cash outflows of \$60 $[(D) - (E)]$, valuation allowance equals \$150

Approach 2

Sufficient regular taxable income in future years to utilize NOLs, no valuation allowance

State Considerations

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

State reports on the projected impact of OBBBA on revenues:

- Colorado
- Connecticut
- Maryland
- Nebraska
- New York
- Oregon

State responses to OBBBA

The estimated effective tax rate should reflect both enacted federal and state income tax laws. Therefore, companies should understand the conformity rules in the states in which they operate and monitor any changes in state tax law so they can appropriately account for the effects of changes in tax law separate and apart from their EAETR.

Alabama:

- Notice R&E Expenditures (September 11, 2025) - Federal deduction for unamortized amounts allowed under OBBBA will have to be added back to Alabama income, to the extent previously deducted on the 2024 Alabama return.

Colorado:

- HB 25B-1001 (enacted August 28, 2025) makes permanent the state's qualified business income addback in alignment with the OBBBA changes.

State responses to OBBBA

Colorado (con't):

- HB 25B-1002 (enacted August 28, 2025) effective for tax years beginning on or after January 1, 2026, does the following:
 - Creates an addback to federal taxable income in an amount equal to the federal deduction for foreign-derived deduction eligible income (FDDEI) under IRC Section 250.
 - Removes restrictions on which IRC Section 78 dividends from foreign subsidiaries can be subtracted from federal taxable income, thus allowing all IRC Section 78 dividends to be deducted regardless of foreign jurisdiction.

Maryland:

- Md. Comp., "60-Day Report" (September 5, 2025) states that the "State will decouple from tax year 2025 and any applicable prior tax years for amendments to (1) R&E expenses; (2) the new qualified production property depreciation under [IRC] Section 168(n); and (3) the business interest deduction limitation.
- Absent legislative action, the State will conform to the federal amendments in tax year 2026 and after

State responses to OBBBA

Rhode Island:

- HB 5076 Sub A (enacted June 29, 2025), for tax years beginning on or before January 1, 2025, requires a corporate taxpayer to add to its taxable income the amount of any income, deduction or allowance that would be subject to federal income tax but for the enactment OBBBA.
- ADV 2025-18 (September 12, 2025) Rhode Island decouples from OBBBA changes to domestic R&E expenditures, specifically, the federal treatment of accelerated expensing of domestic R&E expenditures and from federal allowance for small business to retroactively accelerate expensing of R&E expenditures for tax years 2022 – 2024.

Virginia:

- HB 1600 (signed May 2, 2025) temporarily paused its rolling conformity to the IRC.
- "Virginia will not automatically conform to any amendment to the IRC enacted on or after January 1, 2025, but before January 1, 2027, with a projected revenue impact that would increase or decrease General Fund revenues by any amount in the fiscal year in which the amendment was enacted or any of the succeeding four fiscal years. **However, Virginia will continue to conform** to any federal tax changes that the General Assembly subsequently adopts and to **any federal tax extenders.**" – Virginia Department of Taxation, 2025 Legislative Summary (June 10, 2025) [emphasis added].

Financial Statement Disclosure Considerations

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ASC 740 financial statement disclosure considerations of changes in tax laws

	Period ended <u>before</u> enactment, filing issued after enactment	Period ended <u>after</u> enactment
Interim periods	Nonrecognized subsequent event: Disclose both the nature of the event and an estimate of its financial effect, or a statement that that such an estimate cannot be made. MD&A: Disclose anticipated <u>future impact</u> of material events and uncertainties on results of operations, financial position, liquidity and capital resources	MD&A: Disclose anticipated <u>current and future impacts</u> of material events and uncertainties on results of operations, financial position, liquidity and capital resources Income Tax Footnote: Consider guidance in ASC 740-270-50-1. If any annual disclosures have significantly changed since the most recently filed 10-K, consider updating them in the interim disclosure
Annual periods	Nonrecognized subsequent event: Same as interim periods above. MD&A: Same as interim periods above.	MD&A: Same as interim periods above. Income Tax Footnote: Disclose impacts relevant to the reporting period, consider qualitative disclosures, and disclosure of policy choices (if applicable)

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Financial Statement Disclosure

Best Practices for Disclosure

- **Be specific:** Clearly identify which provisions of OB3 impact your company's financial statements.
- **Quantify Effects:** Provide quantitative estimates of the impact on DTAs, DTLs, and discrete items if material.
- **Explain Judgments:** Discuss significant judgments, such as valuation allowance assessments and state conformity issues as well as uncertainties or pending guidance

Disclosure Area	Requirement (Q3 2025)
Tax Law Change	Describe OBBBA provisions and effective dates
Deferred Tax Impact	Quantify DTA/DTL remeasurement due to OBBBA
Provision Modeling	Explain discrete item treatment in Q3 provision
Subsequent Events	ASC 855 disclosure if Q2 financials issued post-enactment
Footnote Update	Summarize impacts, uncertainties, and next steps

ASU 2023-09 Improvements to Income Tax Disclosures

ASU 2023-09

Improvements to Income Tax Disclosure

December 14, 2023

Final ASU issued (ASU 2023-09)

Scope

Public Business Entities (PBEs) and non-PBEs

Effective Date: *PBEs* - Annual periods beginning after 12/15/2024;
non-PBEs - one year later

Early Adoption: Permitted

Transition: Prospective, with the option to retrospectively apply
Prospective: apply new ASU disclosures for the period ending December 31, 2025 and continue to reflect the old ASU disclosures for the prior comparative periods
Retrospective: apply new ASU disclosures for all periods presented

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ASU 2023-09

Improvements to Income Tax Disclosure

All entities – disclose (annual basis only) income taxes paid (net of refunds received) disaggregated by:

- Federal, state, and foreign taxes.
- Individual jurisdiction on basis of quantitative threshold of 5% of total income taxes paid (net of refunds received).
- Comparative disclosures are not required.

All entities – disclose rate reconciliation information using both percentages and dollar amounts:

- Requires that PBEs disclose rate reconciliation information by category, including consideration of eight specific categories with further disaggregation
- Provide a qualitative disclosure about the states that contribute to the majority of the effect
- Provide a qualitative disclosure of individual reconciling items
- Require nonpublic entities provide a qualitative disclosure about specific categories and individual jurisdictions

Other disclosures

- Income statement amounts
- Unrecognized tax benefits
- Temporary differences

Materiality

ASC 105-10-05-6 The provisions of the Codification need not be applied to immaterial items.

Public Business Entity:

A public business entity is a business entity meeting any one of the criteria below. Neither a not-for-profit nor an employee benefit plan is a business entity.

- It is required by the US SEC to file or furnish FS or does file or furnish FS with the SEC
- It is required by the Securities Exchange Act of 1934 to file or furnish FS with a regulatory agency other than the SEC
- It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale or for issuing securities not subject to contractual restrictions on transfer
- It has issued, or is a conduit bond obligor for securities that are traded, listed or quoted on an exchange or over-the-counter market
- It has issued one or more securities not subject to contractual restrictions on transfer and it is required by law, contract or regulation to prepare US GAAP FS and make them publicly available on a periodic basis

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Effective Tax Rate Reconciliation

PUBLIC BUSINESS ENTITIES ("PBE")					NON - PBE
Min. eight required categories*	\$ and %	Country of Domicile	Breakout Requirements**	Gross/Net	Qualitative requirement, numerical reconciliation is NOT required
0. Tax at statutory rate	Yes	Yes	N/A	N/A	
1. State and local income taxes, net of federal effect	Yes	Yes	Qualitative (>50%)	Gross	
2. Foreign tax effects	Yes	No	=>5%	Gross	
3. Changes in tax laws or rates enacted in the current period	Yes	Yes	No	Gross	
4. Cross-border tax laws	Yes	Yes	=>5%	Gross	
5. Tax credits	Yes	Yes	=>5%	Gross or Net	
6. Changes in valuation allowances	Yes	Yes	No	Gross	
7. Nontaxable or nondeductible items	Yes	Yes	=>5%	Gross	
8. Changes in unrecognized tax benefits	Yes	No	No	Gross or Net***	
* Other areas to consider: Stock Based Compensation, Return to Provision True-up, Pillar 2, Restructuring, Withholding Taxes, etc. ** 5% of statutory tax rate *** Subsequent changes in prior year UTB disclosed on gross basis. Current year UTB can choose gross or net.					

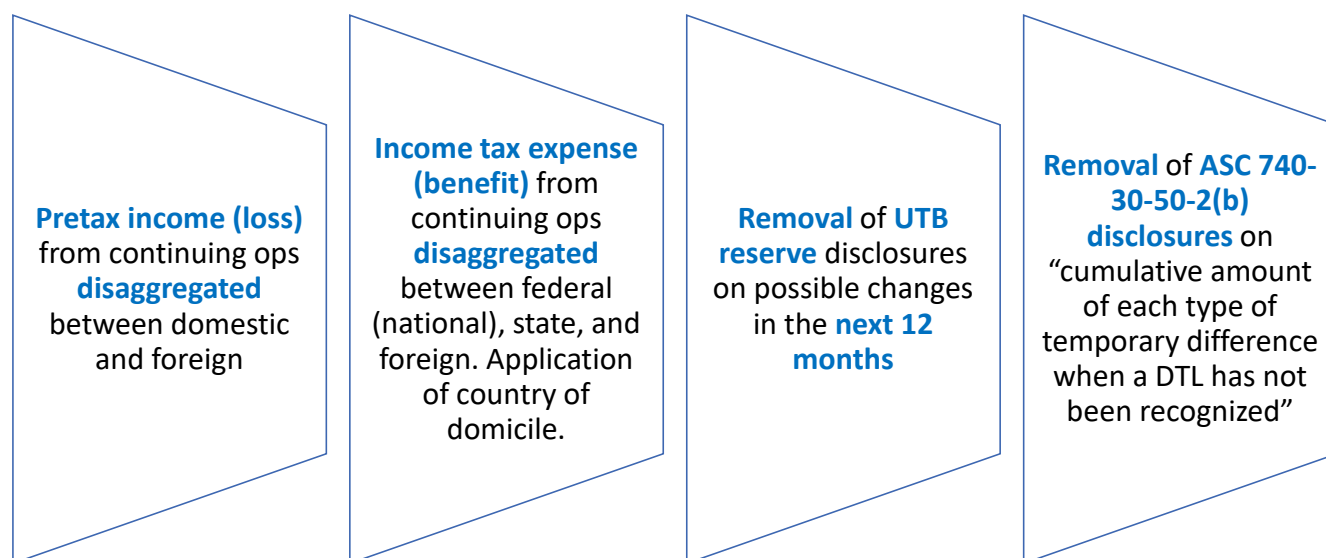
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Example - Rate Reconciliation (PBE)

	Year Ended December 31, 20X2			Year Ended December 31, 20X1			Year Ended December 31, 20X0		
	Amount	Percent		Amount	Percent		Amount	Percent	
U.S. Federal Statutory Tax Rate	\$	AA	aa %	\$	BB	bb %	\$	CC	cc %
State and Local Income Taxes, Net of Federal Income Tax Effect ^(a)		AA	aa		BB	bb		CC	cc
Foreign Tax Effects									
United Kingdom									
Statutory tax rate difference between United Kingdom and United States	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Share-based payment awards	AA	aa		BB	bb		CC	cc	
Research and development tax credits	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Other	(AA)	(aa)		BB	bb		(CC)	(cc)	
Ireland									
Statutory tax rate difference between Ireland and United States	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Changes in valuation allowances	(AA)	(aa)		(BB)	(bb)		CC	cc	
Enacted changes in tax laws or rates	-	-		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	
Effect of Changes in Tax Laws or Rates Enacted in the Current Period	-	-		-	-		(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)		-	-		-	-	
Other	-	-		(BB)	(bb)		-	-	
Changes in 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 %

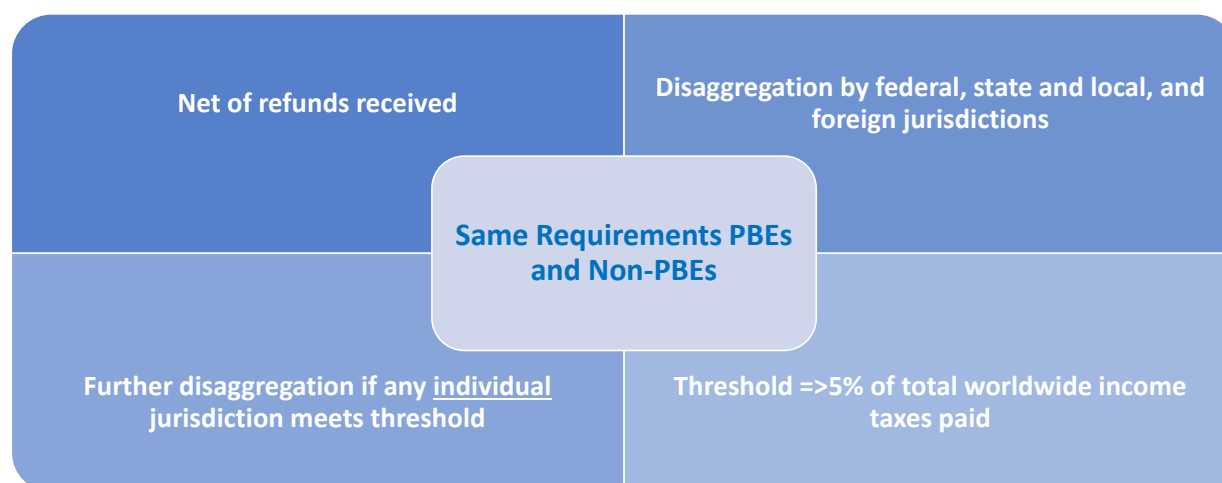
^(a) State taxes in California and New York made up the majority (greater than 50 percent) of the tax effect in this category.

Others



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Income Taxes Paid



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Example – Income Taxes Paid

	Year Ended December 31, 20X2	Year Ended December 31, 20X1	Year Ended December 31, 20X0
U.S. federal	AA	BB	CC
U.S. state and local			
California	AA	BB	CC
New Jersey	-	BB	CC
New York	AA	BB	CC
Other	AA	BB	CC
Foreign			
United Kingdom	AA	BB	-
Ireland	AA	-	-
Japan	AA	BB	CC
Mexico	AA	BB	CC
Other	AA	BB	CC
Total	AA	BB	CC

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Tax software practical advice

What our clients have learned...

- Success of aggregation/disaggregation will depend on how granular your configuration is
- Understand your tool's limitations and adapt – don't fight the system and don't waste time
- Use supplemental tools if needed for formatting (i.e., Alteryx, Power Query, etc.)
- Incorporate analytics (i.e., Power BI, Tableau, etc.)

Internal Controls

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PCAOB and Hence Auditor Focus

- Companies should consider having more robust business process documentation for systems, processes, etc.
- Companies need to document the controls in place to identify the impact of law changes such as OBBBA and Pillar 2?
- When new systems (e.g. Sales Tax Engine, OneSource Tax Provision, etc.) are implemented, companies need to identify and document the following
 - where the new information that feeds into and out of the software comes from and flows to
 - how the new system was chosen
 - retirement of old controls and adoption of new controls that come as a result of implementation
- Companies that have one Super Control (e.g. a single Tax Provision control that covers DTA/DTL, VA, ETR, etc.) should disaggregate into multiple controls.

PCAOB and Hence Auditor Focus

- ASU 2023-09
 - In addition to updating the Tax Footnote, companies may need to update controls around the new reporting.
 - Example control:
 - Based on the understanding of the new income tax disclosure guidance in ASU 2023-09, the corporate controller performs additional procedures to verify that the income tax disclosures are complete and accurate. The corporate controller also validates that significant reconciling items related to the rate reconciliation are evaluated and judgments used in the determination of such items were appropriate.
 - Potential questions to ask:
 - How were reconciling items determined?
 - What methods and reports were used to develop the rate reconciliation information?
 - What is the source of the underlying data used to determine the additional disclosures?
 - How was such data determined to be relevant, complete, and accurate (including at the appropriate level of disaggregation)?
 - What methods and reports were used to develop the rate reconciliation information?

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Other Control Items

- Audit of the Tax Provision
 - If private companies are deemed to have sufficient controls in place around the income tax function then the audit of the provision may be done by testing the controls.

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