Company life events, tax accounting challenges, and other financial reporting updates
The Dbriefs Tax Accounting & Provisions series
Patrice Mano, Partner, Deloitte Tax LLP
Mary Boelke, Partner, Deloitte Tax LLP
Gary Unkel, Partner, Deloitte Tax LLP
June 8, 2017
Agenda

• Business combinations
• Carve out financial statements
• Standard setting update
• Revenue recognition
• Legislative update
• Question and answer
Polling question #1

Has your company experienced a life event in the last 2 years?

• Yes, business combination
• Yes, spin-off
• Yes, large disposition
• Yes, large internal restructuring
• Yes, more than one of the above
• No, not applicable
Company life events
Business combinations
ASC 805, Business combinations

Underlying theory

The theory behind ASC 805 is that an acquirer should recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions (e.g., income taxes)

The fair value is determined without regard to the consideration used for acquisition (e.g., cash, stock), timing of consideration (e.g., upfront vs. contingent) or how the buyer facilitated the acquisition (e.g., in house due diligence vs. investment bankers)
Business combinations
Taxable transactions (i.e., tax step-up)

Acquirer

• “Steps up” the target’s historical tax bases in the assets acquired and liabilities assumed to fair market value

• Includes asset acquisitions, stock acquisitions treated as asset acquisitions by election (e.g., IRC § 338 elections), and integrated transactions treated as asset acquisitions

<table>
<thead>
<tr>
<th>IRC § 1060 Allocation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class I</td>
<td>Cash and near-cash</td>
</tr>
<tr>
<td>Class II</td>
<td>Actively traded property (e.g., publicly traded stock)</td>
</tr>
<tr>
<td>Class III</td>
<td>Mark-to-market assets</td>
</tr>
<tr>
<td>Class IV</td>
<td>Inventory</td>
</tr>
<tr>
<td>Class V</td>
<td>Assets not defined as any other class, including PP&amp;E</td>
</tr>
<tr>
<td>Class VI</td>
<td>IRC § 197 intangibles, except goodwill and going concern</td>
</tr>
<tr>
<td>Class VII</td>
<td>Goodwill and going concern value</td>
</tr>
</tbody>
</table>
Business combinations
Nontaxable transactions (i.e., tax carryover basis)

Acquirer

• Assumes the historical or “carryover” tax bases of the assets acquired and liabilities assumed
• Fair value accounting for book purposes will result in book/tax basis differences (in addition to the historical differences)
• Includes stock acquisitions (absent an IRC § 338 election) and tax-free asset and stock reorganizations (e.g., IRC §§ 368(a)(1)(A) and 368(a)(1)(B))
Goodwill

Overview

- Goodwill is the excess of the consideration transferred plus the fair value of any non-controlling interest in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired

ASC 740

- The tax basis of goodwill is not recognized for purposes of calculating temporary differences unless the amortization of the goodwill is deductible on a tax return
Goodwill Components

• When the amortization of goodwill is deductible for tax purposes, goodwill must be separated into two components as of the acquisition date for deferred tax considerations.

- Component 1 goodwill = Lesser of book or tax goodwill
- Component 2 goodwill = Remainder

• Difference between book and tax goodwill
  - Component 1 goodwill = Lesser of book or tax goodwill
  - Component 2 goodwill = Remainder
Goodwill
Component 2 goodwill

Tax accounting for component 2 goodwill

• A deferred tax asset is recognized for the excess of tax-deductible goodwill over book goodwill

• ASC 740-10-25-3(d) prohibits recording a deferred tax liability for component 2 goodwill

Issues and potential risk

• Historical books may have deferred tax liability or deferred tax asset related to a basis difference in goodwill from a prior taxable transaction

• Any deferred taxes related to historical accounting for goodwill must be removed and reset

  − Component 1 goodwill has no temporary difference on acquisition date (since component 1 goodwill is defined as the basis that is the same)
Nontaxable stock purchase

Assumptions

• USP issues its own shares to Target shareholders in exchange for their Target shares

• For financial reporting purposes, USP recognizes and measures each asset acquired and each liability assumed at its acquisition-date fair value

• For tax purposes, USP assumes the historical or “carryover” tax bases of the acquired assets and liabilities assumed

• The historical temporary differences are redetermined based on the difference between the new book value of the assets and the liabilities and their historical (or “carryover”) tax bases
Nontaxable stock purchase
Illustration (cont’d)

<table>
<thead>
<tr>
<th>Asset</th>
<th>Book Basis</th>
<th>Tax Basis</th>
<th>Difference</th>
<th>Tax Rate</th>
<th>DTA/(DTL)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PP&amp;E</td>
<td>$200</td>
<td>$150</td>
<td>$50</td>
<td>40%</td>
<td>($20)</td>
</tr>
<tr>
<td>Intangibles</td>
<td>1,000</td>
<td>0</td>
<td>1,000</td>
<td>40%</td>
<td>(400)</td>
</tr>
<tr>
<td>Goodwill</td>
<td>300*</td>
<td>0</td>
<td>300</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,500</strong></td>
<td><strong>$150</strong></td>
<td><strong>$1,350</strong></td>
<td></td>
<td><strong>($420)</strong></td>
</tr>
</tbody>
</table>

**Journal Entry**

<table>
<thead>
<tr>
<th>DR</th>
<th>PP&amp;E</th>
<th>$200</th>
</tr>
</thead>
<tbody>
<tr>
<td>DR</td>
<td>Intangibles</td>
<td>$1,000</td>
</tr>
<tr>
<td>DR</td>
<td>Goodwill [$300 + $420]</td>
<td>$720</td>
</tr>
<tr>
<td>CR</td>
<td>Deferred tax liability</td>
<td>$420</td>
</tr>
<tr>
<td>CR</td>
<td>Equity</td>
<td>$1,500</td>
</tr>
</tbody>
</table>

*To record the nontaxable stock purchase*

Note: * Before considering deferred taxes
# Goodwill

Illustration: Goodwill “reset” — book basis exceeds tax basis

## Preliminary Calculation

<table>
<thead>
<tr>
<th>Component</th>
<th>Book</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component 1 goodwill (pre-acquisition balance)</td>
<td>$400</td>
<td>$200*</td>
</tr>
<tr>
<td>Component 2 goodwill (pre-acquisition balance)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Component 2 goodwill (generated by acquisition-before resetting deferred taxes)</td>
<td>600</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total goodwill</strong></td>
<td><strong>$1,000</strong></td>
<td><strong>$200</strong></td>
</tr>
</tbody>
</table>

**Journal Entry**

- **DR** Deferred tax liability [$200 x 40%] $80
- **CR** Goodwill $80

*To record goodwill “reset”*

## Adjusted Calculation

<table>
<thead>
<tr>
<th>Component</th>
<th>Book</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component 1 goodwill</td>
<td>$200</td>
<td>$200</td>
</tr>
<tr>
<td>Component 2 goodwill</td>
<td>720</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total goodwill</strong></td>
<td><strong>$920</strong></td>
<td><strong>$200</strong></td>
</tr>
</tbody>
</table>

**Note:** * $80 DTL included in the historical books
Push-down accounting

Actual vs. notional

Guidance

• ASC 740-10-30-5 requires that “[d]eferred taxes shall be determined separately for each tax-paying component . . . in each tax jurisdiction”

• ASC 830-30-45-3 states that “[a]ll elements of financial statements shall be translated”

Actual push-down

• The amounts assigned for financial reporting purposes to the individual assets acquired and liabilities assumed generally must be reflected in the underlying books and records of each acquired entity in the correct currency

Notional push-down

• A methodology that reflects the amounts assigned for financial reporting purposes separately without adjustment of the underlying books and records

• Steps need to be taken to confirm that the “notional” approach produces the same results as an “actual” push-down
Push-down accounting
Example

Assumptions

• Parent (US$ RC) acquires Foreign Target (€ FC) when €1=$1.5
• Premium over net book value paid is allocated as follows
  − Indefinite-lived Intangibles = €1,000,000 and Goodwill = €1,000,000 (before deferred tax accounting)
• No step up in basis is achieved for local country tax purposes and the acquisition accounting is not “pushed down” onto the statutory books of Target
  − Local country tax rate is 30%
  − Exchange rate at year end moves to €1:$1.2

How should the change in the exchange rate be reflected in Parent’s consolidated financial statements?
# Push-down accounting

## Example — Answer

<table>
<thead>
<tr>
<th>Description</th>
<th>Local Currency</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Book Basis</td>
</tr>
<tr>
<td>Intangible</td>
<td>€1,000,000</td>
</tr>
<tr>
<td>Tax rate</td>
<td></td>
</tr>
<tr>
<td>Deferred tax liability (monetary)</td>
<td></td>
</tr>
</tbody>
</table>

## Journal Entries

| Exchange rate at time of acquisition              | €1 : $1.5      |
| DR Goodwill                                      | $450,000       |
| CR Deferred tax liability (€300,000 x 1.5)        | $450,000       |
| Exchange rate at end of year                     | €1 : $1.2      |
| DR Cumulative translation adjustment             | $690,000       |
| CR Indefinite-lived intangible                   | $300,000       |
| CR Goodwill (€1,300,000 x (1.2 – 1.5))           | $390,000       |
| DR Deferred tax liability (€300,000 x (1.2 – 1.5))| $ 90,000       |
| CR Cumulative translation adjustment             | $ 90,000       |

*To record the impact of the exchange rate at recognition and end of year*
Polling question #2

When your accounting department records foreign purchase accounting adjustments, do they:

• Push purchase accounting adjustments into a separate general ledger, but in the proper currency
• Push purchase accounting adjustments into the local ledger
• Record non-US purchase accounting adjustments in the US
• Record non-US purchase accounting adjustments in an entity that reflects multiple jurisdictions with different currencies
• Other
• Don’t know/not applicable
Contingent liabilities

Overview

Financial reporting

• The acquirer recognizes and measures each liability assumed

ASC 740

• A DTA is recorded for liabilities that are deductible when paid or otherwise reduce income for purposes of computing taxable income (e.g., Schedule M adjustment)

• No DTA is recorded for liabilities that are not deductible when paid (e.g., contingent liabilities assumed in an asset acquisition)

− Payment of these liabilities will result in an increase in tax basis of the acquired assets (including goodwill)
Contingent liabilities (assumed in taxable business combination)
Illustration

Assumptions

• Acquirer pays $100,000 to acquire the Target assets and records a contingent liability for workers compensation claims, with the corresponding entry to goodwill[1]

• The payment of an amount equal to the liability recorded at acquisition would result in tax-deductible goodwill (e.g., IRC § 197 amortizable asset), equaling the book goodwill recorded at acquisition (thus, no temp diff at acquisition date)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Book</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Land</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>PP&amp;E</td>
<td>87,000</td>
<td>87,000</td>
</tr>
<tr>
<td>Goodwill</td>
<td>10,000</td>
<td>2,000[1]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Book</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Worker’s comp liability</td>
<td>$8,000</td>
<td>0 [2]</td>
</tr>
<tr>
<td>Equity</td>
<td>100,000</td>
<td>100,000</td>
</tr>
</tbody>
</table>

Notes: [1] Payment of the worker’s comp liability results in an increase in the tax basis of goodwill from $2k to $10k when paid [2] While the liability is zero for tax at acquisition, it is not deductible when settled
Carve out financial statements
Carve-Out financial statements – Overview

• “Carve-out financial statements” is a generic term to describe separate financial statements derived from financial statements of a larger consolidated financial statement group

• Often prepared for a sale, spin-off, or divestiture of the “carve-out” entity

• “Carve-out” entity may consist of:
  − All or part of individual entity
  − Multiple entities
  − Individual segment
  − Multiple business lines
  − Any combination of the above

• Identifying “carve-out” operations
  − Can be complex and challenging – partly due to an absence of detailed accounting guidance
  − Look to terms and conditions of purchase-and-sale agreement

• Understand legal structure of operations being carved out
Standard setting update
Proposed income tax disclosures

Overview

Disclose (all)

- Domestic and foreign components of pretax income or loss
- Disaggregation of income tax expense (or benefit) by foreign and domestic
- Disaggregation of income taxes paid by country
- Indefinitely reinvested foreign earnings
- Aggregate of cash, cash equivalents, and marketable securities held by foreign subsidiaries
- Enacted tax law change
- Attribute carryforwards (more detailed for public business entities)

Disclose (public business entities)

- ETR – Separately present rate item >5% of tax at statutory rate
- Unrecognized tax benefits
- Reason for changes in realizability estimates of deferred tax assets
- Government assistance

April 4, 2014
Field study results and next steps

June 8, 2016
Draft proposed ASU

July 26, 2016
Issued proposed ASU

Sept. 30, 2016
Comment period ended

Jan. 25, 2017
Discussed comments received

March 17, 2017
Roundtable on all disclosure projects

???
Final ASU
Other standard setting reminders

**Stock compensation (ASU 2016-09)**
- Effective for public entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2016; one year later for nonpublic entities

**Intra-entity asset transfers (ASU 2016-16)**
- Effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017 (for non-public entities: one year later for annual periods, 2 years later for interim periods – i.e., FYs beginning after 12/15/19)

**Financial Instruments (ASU 2016-01)**
- Effective for public entities for annual reporting periods beginning after December 15, 2017; one year later for nonpublic entities

**Leasing (ASU 2016-02)**
- Effective for calendar periods beginning on 1/1/2019 and interim periods therein (public companies); one year later for non-public entities
Revenue recognition
Polling question #3

Will the Revenue Recognition ASU (2014-09) have a significant impact on your Company?

• Yes from a GAAP perspective, but minimal tax impact
• Yes from a GAAP perspective and I will have to change my tax accounting methods
• Not sure yet, we are still completing our analysis
• No
• Don’t know/Not applicable
Introduction
Key points—adoption of ASC 606 / IFRS 15

Effective Date
Annual reporting periods beginning after December 15, 2017 and December 15, 2018 for public entities and nonpublic entities, respectively

GAAP Analysis
Will require companies to perform an in depth analysis of each type of revenue stream for financial statement purposes. Tax departments should be involved throughout this analysis to assess the areas of tax compliance and planning, as well as the associated magnitudes.

System Impacts
May impact the way data is captured, as well as additional information that may be required.

Overall Tax Impacts
Will result in numerous tax impacts from both a technical and systems standpoint

IRS Expectations
The Internal Revenue Service understands that the adoption of the new revenue recognition standards will have federal income tax implications and expects companies to perform the requisite procedures in order to address these implications*

Cash Tax Impact
The new revenue recognition standards may result in accelerated revenue recognition for tax purposes and associated cash outlays to taxing authorities

Note: * On March 28, 2017, the IRS issued Notice 2017-17, proposing automatic consent procedures for companies to change their tax revenue recognition methods related to the adoption of the new revenue standards. The IRS is soliciting comments on the proposed procedural guidance.
New revenue guidance

Transition options

**Full retrospective approach**
- Restate prior periods in compliance with ASC 250
- Optional practical expedients

**Modified retrospective approach**
- Apply revenue standard to contracts not completed as of effective date and record cumulative catch-up

**Required disclosures:**
- Amount of each F/S line item affected in current period
- Explanation of significant changes

<table>
<thead>
<tr>
<th></th>
<th>January 1, 2018 Initial Application Year</th>
<th>2018 Current Year</th>
<th>2017 Prior Year 1</th>
<th>2016 Prior Year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>New contracts</td>
<td>New ASU</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Existing contracts</td>
<td>New ASU + cumulative catch-up</td>
<td>Legacy GAAP</td>
<td>Legacy GAAP</td>
<td></td>
</tr>
<tr>
<td>Completed contracts</td>
<td></td>
<td>Legacy GAAP</td>
<td>Legacy GAAP</td>
<td></td>
</tr>
</tbody>
</table>
Retrospective application
Accounting guidance — ASC 250-10-45-8

Retrospective application shall include only the direct effects of a change in accounting principle, including any related income tax effects. Indirect effects that would have been recognized if the newly adopted accounting principle had been followed in prior periods shall not be included in the retrospective application. If indirect effects are actually incurred and recognized, they shall be reported in the period in which the accounting change is made.

Glossary terms

**Direct effects:** Those recognized changes in assets or liabilities necessary to effect a change in accounting principle. An example of a direct effect is an adjustment to an inventory balance to effect a change in inventory valuation method. Related changes, such as an effect on deferred income tax assets or liabilities or an impairment adjustment resulting from applying the subsequent measurement guidance in [ASC] 330-10 to the adjusted inventory balance, also are examples of direct effects of a change in accounting principle.

**Indirect effects:** Any changes to current or future cash flows of an entity that result from making a change in accounting principle that is applied retrospectively. An example of an indirect effect is a change in a nondiscretionary profit sharing or royalty payment that is based on a reported amount such as revenue or net income.
Legislative update
Tax reform proposals
Polling question #4

Has your company considered implications of the various tax reform proposals?

• Yes, we’ve done significant modeling
• We’ve scratched the surface
• No, haven’t thought about it
• Don’t know/not applicable
Federal tax reform overview
Evaluation of proposed tax rates and ongoing proposals

Corporate Tax Rate Reform
Proposed Rate Considerations

- 35% Current Tax Rate
- 25% Camp II Proposal
- 20% House GOP Proposal
- 15% Trump Administration Proposal

Considerations that may lower tax base:
- Repeal Corporate AMT
  - Full Expensing of Capital Investments
  - Retain R&D Credit
  - Retain LIFO

Considerations that may increase tax base:
- Interest Expense Limitation
  - Repeal Most Business Expenses (Trump Administration)
  - Repeal IRC § 199
ASC 740 effect of tax law changes

**Timing**

- The effect of a change in tax laws or rates shall be recognized at the date of enactment.

**Intraperiod allocations**

- Income tax effects of changes in tax law or rates are allocated to continuing operations.

**Interim**

- Items/events partially excluded from the AETR may include changes in tax laws/rates:
  - Rate: Impact of tax law/rate changes on current taxes of the CY
  - Discrete: Impact of tax law changes on beginning of the year DTAs/DTLs recognized in period of tax law/rate change (reflected in the period the changes are enacted)
  - Rate: Impact of tax law changes on DTAs/DTLs arising in the CY subsequent to the enactment date.
Tax Reform Proposals
ASC 740 considerations

Evaluate the impact on:

- Deferred taxes – reduction in tax rate could have unfavorable impact for net DTA position, favorable impact for net DTL position
  - Inventory of temporary differences – e.g., DTA for interest could be eliminated
- DTAs for specific tax attributes – foreign tax credits (i.e., future availability), AMT credits
- Potential effective tax rate (ETR) impact
  - Unfavorable impact for Section 199, COGS related to imports, interest or other business expenses
  - Favorable impact for exempt foreign sales, dividends received and non-passive Subpart F income
- Valuation allowance implications
  - Change in net deferred tax position
  - Future projections of income

Re-evaluate outside basis exceptions:

- Repatriate prior to enactment to utilize FTC (no longer permanently reinvested)
- “Deemed repatriation”—enactment may cause forced change in assertion

Other considerations:

- State tax conformity
- Border adjustability tax
- Disclosures
Question and answer
Join us June 13 at 2 p.m. ET as our Multistate Tax series presents:

**US federal tax reform: State tax implications**
Eligible viewers may now download CPE certificates.

Click the CPE icon in the dock at the bottom of your screen.
Contact Info

Patrice Mano  
Partner  
Deloitte Tax LLP  
pogrdy@deloitte.com

Mary Boelke  
Partner  
Deloitte Tax LLP  
mboelke@deloitte.com

Gary Unkel  
Partner  
Deloitte Tax LLP  
gunkel@deloitte.com
Appendix
Business combinations
Contingent consideration
Overview

Financial reporting

• Record at fair value and classify as a liability or in equity

• Liability-classified earnout arrangements will be remeasured to fair value at each balance sheet date and changes will be recognized in post-acquisition income statement

ASC 740

• In a nontaxable business combination, payment of contingency will generally result in additional purchase price for the target stock (due to exceptions to recording deferred taxes on outside basis differences in the stock of a subsidiary, payment of an amount equal to the liability recorded in the financial statements would be expected to eliminate the related “initial” book/tax basis difference in the target assets)

• In a taxable business combination, payment of contingency will generally result in tax deductible goodwill or additional amortizable or depreciable tax basis in acquired assets (payment of an amount equal to the liability recorded in the financial statements would be expected to eliminate the related “initial” book/tax basis differences in the target assets)
Contingent consideration
Illustration — Nontaxable business combination — Assumptions

- Acquirer purchases Target stock for $200 plus a contingent payment with a fair value of $50. The fair value of the identifiable assets is $200, the tax basis is $25, and the tax rate is 40%.

<table>
<thead>
<tr>
<th>Journal Entries</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DR</strong></td>
<td><strong>Investment</strong></td>
</tr>
<tr>
<td><strong>CR</strong></td>
<td><strong>Cash</strong></td>
</tr>
<tr>
<td><strong>CR</strong></td>
<td><strong>Contingent consideration liability</strong></td>
</tr>
</tbody>
</table>

*To record Day 1 accounting — Parent*

| DR | Assets | $200 |
| DR | Goodwill | $120 |

| CR | Equity | $250 |
| CR | Deferred tax liability [(200 - 25) x 40%] | $70 |

*Note: * The subsidiary’s equity is reset in acquisition accounting to be equal to the Parent’s investment in the subsidiary
Contingent consideration
Illustration — Nontaxable business combination

In non-taxable business combinations, settlement of contingent consideration classified as a liability for an amount greater than initial amount is recorded as an expense for book purposes and as increased stock purchase price for tax purposes.

An unfavorable permanent item is generally created because ASC 740-30-25-9 prohibits recognition of a DTA when the tax basis exceeds the book basis in the stock when the temporary difference will not reverse in the foreseeable future.

Note: These are parent-only entries – the subsidiary is unaffected.

### Journal Entries

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>To record Scenario 1 — Settle at amount accrued</td>
<td>Contingent consideration liability</td>
<td>$50</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>$50</td>
</tr>
<tr>
<td>To record Scenario 2 — Settle at $50 &gt; initial amount</td>
<td>Expense</td>
<td>$50</td>
</tr>
<tr>
<td></td>
<td>Contingent consideration liability</td>
<td>$50</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
<td>$100</td>
</tr>
</tbody>
</table>
Contingent consideration
Illustration — Nontaxable business combination (cont’d)

Journal Entry

<table>
<thead>
<tr>
<th>DR</th>
<th>Contingent consideration liability</th>
<th>$50</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR</td>
<td>Income</td>
<td>$40</td>
</tr>
<tr>
<td>CR</td>
<td>Cash</td>
<td>$10</td>
</tr>
</tbody>
</table>

To record Scenario 3 — Settle at $40 < initial amount accrued (parent)

Settlement for an amount less than the initial amount is recorded as income for book purposes and as a decreased stock purchase price for tax purposes.

A favorable permanent item will typically arise if (1) the Target is a domestic corporation, (2) the stock basis difference can be eliminated in a tax-free manner (e.g., liquidation), and (3) the Acquirer intends to use that means to realize the stock basis difference (ASC 740-30-25-7 exception to DTL applicable to a domestic subsidiary).

Other exceptions might apply to a foreign target entity.

Note: These are parent-only entries – the subsidiary is unaffected.
Revenue recognition
## Common Tax Considerations and Anticipated Action Items

<table>
<thead>
<tr>
<th>Area</th>
<th>Common Tax Considerations</th>
<th>Anticipated Action Items</th>
</tr>
</thead>
</table>
| **GAAP Revenue Recognition**  | • Current types of revenue streams and related GAAP treatment  
• Assess how the GAAP change in method of accounting under the new standards for each of the various revenue streams will impact the current tax method                                                                 | • Opportunity to leverage financial statement revenue stream analysis to proactively generate additional cash and fund project implementation costs                                                                 |
| **Tax Provision**             | • Any changes to tax accounting methods or book tax difference computations must be incorporated into the tax provision process  
• Consideration should be given to the correct period to reflect the change                                                                                                                                          | • Computation and tracking of new or altered book-tax differences                                                                                                                                                      |
| **Tax Accounting Methods**    | • Changes to revenue recognition will impact some combination of:  
• the amount of book-tax differences,  
• a change in the calculation of existing book-tax differences,  
• creation of a new book-tax difference, or  
• require a tax accounting method change  
• Timing and impact of method changes must be considered (automatic vs. non-automatic, and IRC § 481 adjustment calculation)  
• Enactment of tax reform could convert the timing benefits to permanent benefits thereby increasing the power of tax planning                                                                 | • Requests for changes in tax method of accounting  
• Identifying the most advantageous tax method for certain items impacted by the new standards during adoption can reduce the overall unfavorable tax impact (e.g., changing to recognize unbilled revenue upon the earlier of payment becoming due or performance occurring and to deduct contract costs as incurred) |

Copyright © 2017 Deloitte Development LLC. All rights reserved.
## Common Tax Considerations and Anticipated Action Items (cont.)

<table>
<thead>
<tr>
<th>Area</th>
<th>Common Tax Considerations</th>
<th>Anticipated Action Items</th>
</tr>
</thead>
</table>
| **Tax Data and Process/Systems** | - Systems will need to be evaluated to confirm that the software solutions used by accounting will provide the necessary data for tax analysis  
- Identify additional data needed to support tax accounting                                                                                          | - Reconciliation of the book restatement with tax’s lack thereof and associated tracking considerations |
| **Indirect and Multistate Tax**     | - Sales tax, VAT, telecom taxes, fuel taxes, etc.  
- Impact to indirect tax varies greatly by industry and type of taxes imposed.  
- Impacts generally expected in areas where the basis of tax is book revenue or where the tax base is not well defined  
- Changes to the basis of tax could impact the amount of tax reported as well as collections. In some instances, there may be a disconnect between the basis on which a company collects and the base on which it remits to the taxing authorities (e.g., telecom taxes imposed on book revenue but collected on billings to the customer which may not change due to the adoption process)  
- Many tax types are based upon billed revenues, which underlies the importance of reducing changes to the billing systems | - Indirect tax reporting  
- Multistate allocation and apportionment                                                                                                               |
| **Global Tax Implications**     | - Any changes to the statutory financial statements can potentially impact tax measures based upon the financial statements, such as: thin capitalization limits, distributable reserves and transfer pricing  
- Since both IFRS and US GAAP are changing, cash taxes may be impacted in local countries due to changes in statutory financial statements. For jurisdictions similar to the US, tax methods may need to be reviewed. For jurisdictions where the statutory filings form the basis of tax with few modifications, cash taxes paid to the jurisdiction may be impacted | - Thin capitalization limits, distributable reserves, foreign tax credits and transfer pricing |
This presentation contains general information only and Deloitte is not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this presentation.