30th ANNUAL
PAUL J. HARTMAN
STATE AND LOCAL TAX FORUM

Getting SALTY with ASC 740 / 450

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Panel

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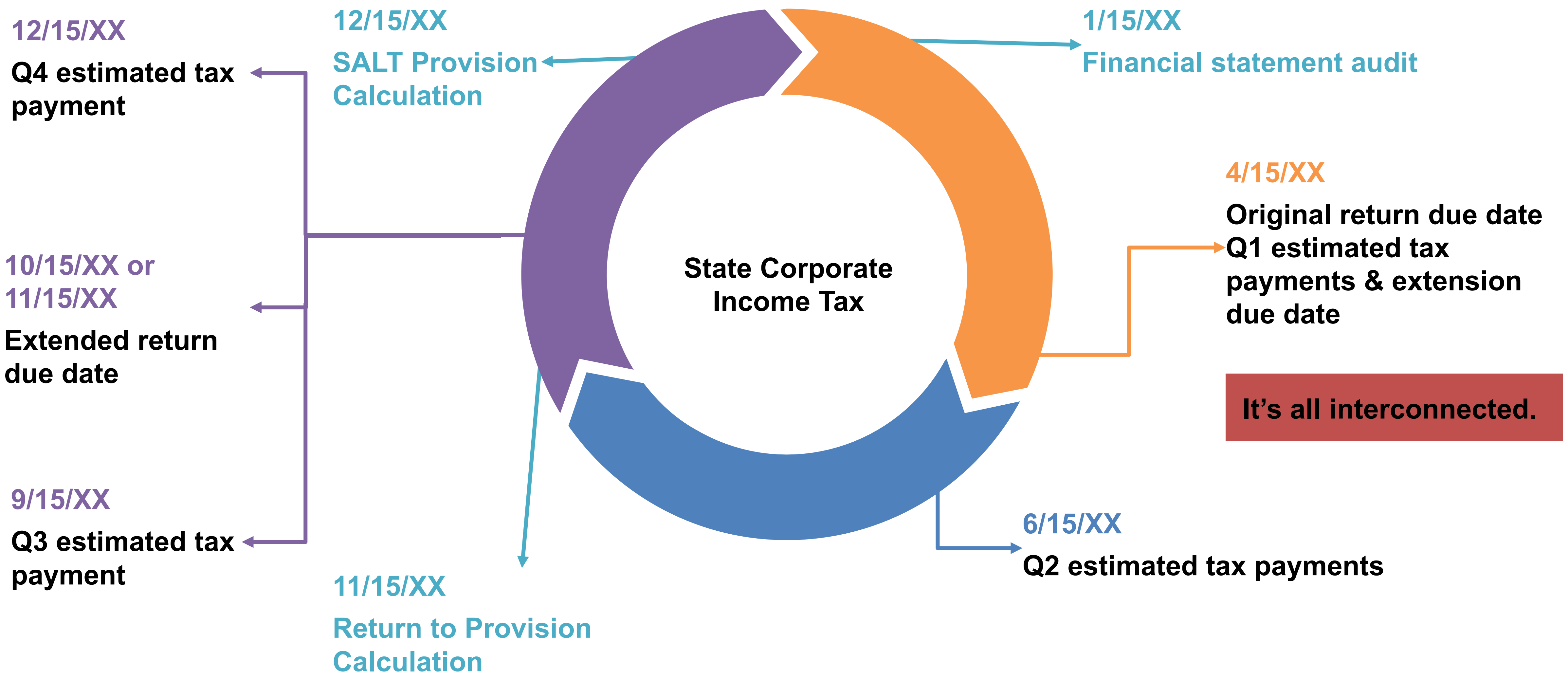
- Overview
- ASC 740-10
- Practical Considerations
- ASC 450
- Recent Updates
- Appendix`

Overview


12/15/XX
Q4 estimated tax payment
12/15/XX
SALT Provision Calculation
1/15/XX
Financial statement audit
State Corporate Income Tax
4/15/XX
Original return due date Q1 estimated tax payments & extension due date
It's all interconnected.
10/15/XX or 11/15/XX
Extended return due date
9/15/XX
Q3 estimated tax payment
11/15/XX
Return to Provision Calculation
6/15/XX
Q2 estimated tax payments

- Applies a **balance sheet approach**
  - Reflects taxes payable or refundable in the current period
  - Recognizes deferred tax assets and deferred tax liabilities for future tax consequences based on events that have already occurred
- There are 3 **components** to tax expense:
  - **Current tax** expense – the actual tax expected to be owed
  - **Deferred tax** expense – the change in future tax assets or liabilities
  - **Reserves** required to be reflected for uncertain tax positions
- Tax expense is computed using the statutory tax rate in effect each jurisdiction

Basics – Income tax provision

Total tax expense is the sum of two components…

Total tax provision = **Current tax provision + Deferred tax provision**

Current tax provision

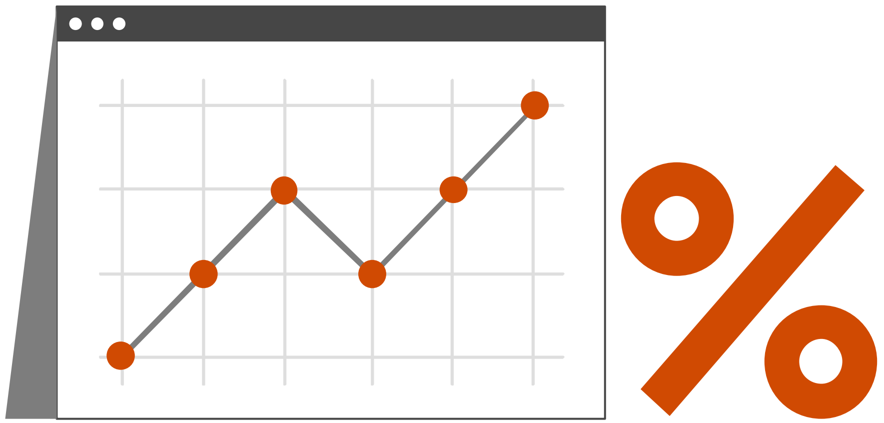
An estimate of taxes payable or refundable on tax returns for the current year.

- Alternatively stated - the best estimate of what will be reported as tax due on the tax return.

Deferred tax provision

The change in the estimated future tax effects relating to temporary differences and carryforwards.

- Alternatively stated – **the change** in net deferred taxes from the beginning balance to the ending balance. ASC 740 is based on this "balance sheet approach" for deferred taxes.



Effective rate – Statutory changes

- Legislative changes are accounted for in the period of "enactment"
  - Generally, when signed by the Governor
  - Note – if filing under IFRS then it's the period of "substantive enactment"

- Effective date of rate changes
  - Immediate, retroactive, phased-in, event triggered, & others…..
    - Recent Example – MA SSF legislation – Signed Oct 4th – effective 1/1/2025

- Phased in (Enacted)
  - Recent examples - Maryland SSF, Pennsylvania Tax Rate Reduction

- Event triggered – Recent Examples
  - Iowa Tax Rate Reduction – Contingent on fiscal goals/budget surplus
  - Kansas Tax Rate Reduction - Enacted on February 10, 2022 - the Attracting Powerful Economic Expansion (APEX) bill provided that the year following that a qualified firm enters an economic development agreement under the legislation and commences construction on a qualified business facility, the corporate tax rate for all taxpayers will be reduced by 0.5%.
    - On August 31, 2023, the Secretary announced the tax rate reduction in the Kansas Register.

Effective rate – Business changes

- Mergers / Acquisitions or Sales / Dispositions

- Last filed tax return data general source for state rate apportionment (as an estimate of current year)
  - Apportionment from prior filings may be "Old and Cold" (i.e. factors could have significantly changed from prior year to current year)
  - Generally best available information; however, should consider:
    - New/lost customers
    - Open/closed plants, offices
    - Acquisitions, dispositions
    - Apportionment methodology changes – COP v. market

- Real time data verification
  - Payroll
  - Property
  - Sales

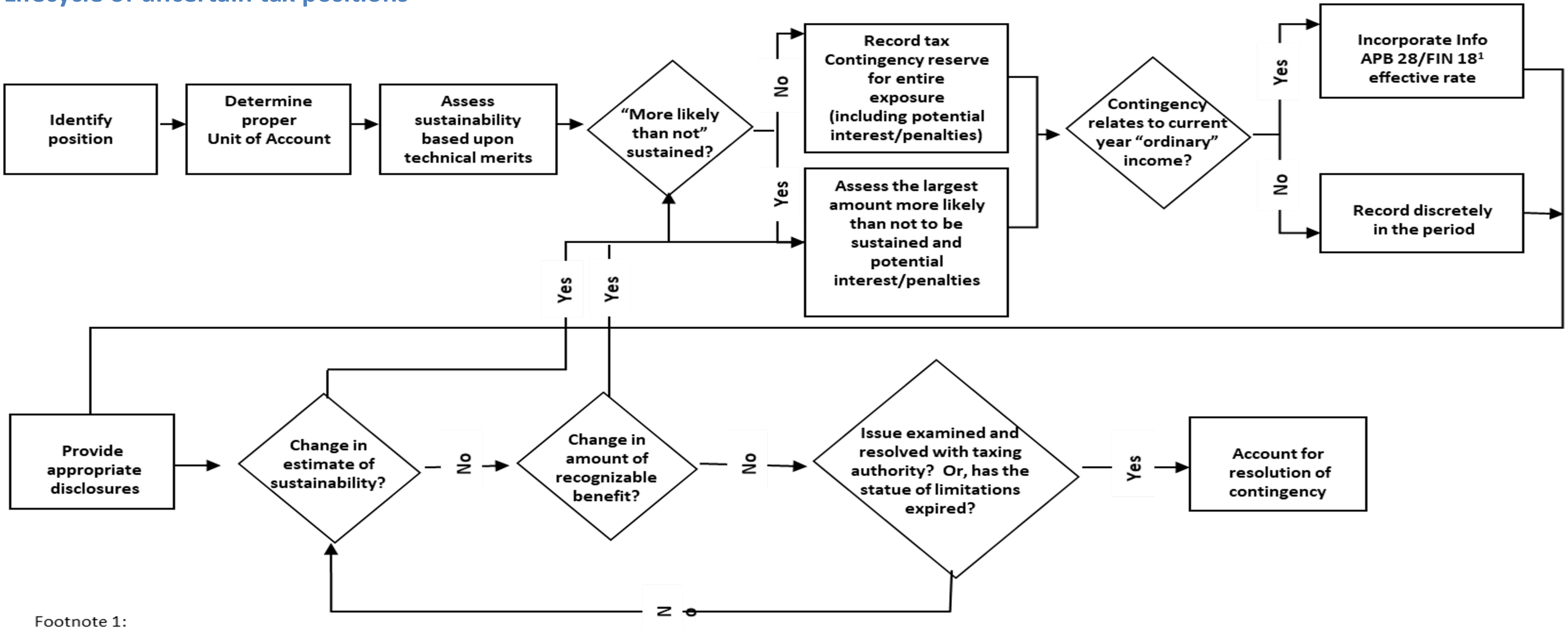
Valuation allowance – Overview

- An account used to adjust a net deferred tax asset to its realizable amount.
  - Valuation allowance **is a "contra-asset"**
- "More likely than not" criteria.
  - A valuation allowance **must be established for a deferred tax asset when it is more likely than not** -- a probability level of more than 50% -- **that it will not be realized.**
- Positive and negative evidence must be evaluated.

ASC 740-10

Uncertain tax positions- ASC 740-10

Lifecycle of uncertain tax positions



Footnote 1:
Accounting Principles Board Opinion No. 28, *Interim Financial Reporting*
FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*
** From 2006 adoption presentation*

ASC 740-10 – Identifying Tax Positions (General)

Identify tax positions – General examples of state positions

- **Nexus**
  - P.L. 86-272
  - Economic Nexus
  - Agency Nexus
- **Unitary/Combined Filing Groups**
  - Domestic v. Worldwide
  - Instant Unity
  - 1.1502 and application
- **Apportionment Filing Positions**
  - Gross vs. Net Receipts
  - Intercompany Sales/Eliminations
  - Cost of Performance/Mkt Based Sourcing
  - Joyce vs Finnegan
  - Throwback/throw-out
  - Alternative Method Without Permission
- **Treatment of Partnerships**
  - Entity v. Aggregate
  - Unitary Business
- **Tax Base**
  - IRC Deviations/Exceptions
  - State Addbacks and Exceptions
  - State Depreciation Adjustments
  - State Dividend Received Deductions
  - Business/Non-Business Income
  - Transfer Pricing
- **Tax Attributes**
  - Net Operating Losses
  - Credits
- **Affiliated Entities**
  - Intangible Holding Companies
  - Factoring Companies
  - Finance Companies
  - Captive Insurance Companies
  - Sales Companies
  - Procurement Companies
  - REIT/RIC
  - Check-the-box entities

ASC 740-10 – Identifying Tax Positions (Other)

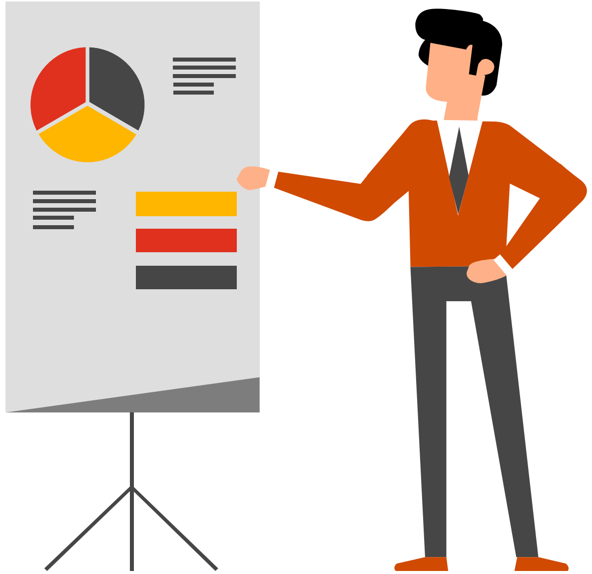
Identify tax positions – Other

- **IRC Conformity – for example**
  - Specific Conformity issues
    - 174
    - 451
  - Specific Tax Year – For Example
    - Kentucky
    - California
- **965**
  - 965(a) vs 965(c)
  - Applicability of State DRD
  - 1502 Conformity – Impact on Calc
  - Stock Basis
- **GILTI**
  - 250 deduction
    - Calculation
    - Applicability for States
  - Applicability of State DRD/Exclusion
  - 1502 Conformity – Impact on Calc
  - Stock Basis
- **FDII**
  - Conformity to 1502
  - 250 deduction
    - Calculation
    - Applicability for States
- **163(j)**
  - Carryover of prior limits
  - 1502 Conformity for Calculation
  - CARES Act
- **168(k)**
- **NOLs (172)**
  - 80% Limitation
  - Indefinite Carryover
  - CARES Act

ASC 740-10 – Subsequent Recognition & measurement

Subsequent recognition and measurement

- The recognition and measurement of UTPs should be reassessed at each reporting date.
- In making this assessment:
  - The FASB concluded that definitive triggering events were not needed to cause a change in assessment; however, a change in assessment must be based upon new information (rather than simply a re-evaluation of pre-existing information)
  - Such re-assessment could change not only the measurement of the benefit recorded but also the determination as to whether the recognition threshold has been or continues to be met.



Practical Considerations

Practical Considerations - Materiality

Materiality - Defined

- Materiality is the **magnitude of a misstatement or an omission** from the financial statements (or related disclosures) **that someone believes would make it <u>probable</u>** that **the judgment of a reasonable person** relying on the information **would have been changed** or influenced by the omission or misstatement.
  - It should be noted that the consideration of materiality for a financial statement audit **requires professional judgment** and **considers the needs of users of financial statements.**
  - Materiality is **not solely a quantitative analysis;** it should also considers **how a user would react** to a misstatement or omission due to error or fraud.

- In general, the provisions of ASC 740 are not required to be applied to immaterial items.
  - For example – ASC 740-10 (i.e. FIN 48), includes the following language: “the provisions of this Interpretation need not apply to immaterial items”
  - However– it's important to note that materially can potentially change each quarter for changes in amounts of income/expense and/or issues; therefore it is important to consider immaterial items from prior periods to verify that they are still immaterial.

Practical Considerations - Materiality

- Understanding the concept of materiality
  - In general, concerned with the significance of an item to the users of the financial statements
  - Different types of materiality—overall, performance, specific materiality thresholds
  - Significant professional judgement involved

- How should tax professionals and tax management think about materiality?

Practical Considerations – Internal Controls

- Significant deficiency vs. material weakness

- Income tax controls are often heavily focused on management review
  - Consider specific technical knowledge required
  - Areas of significant judgement
  - Need for clearly defined procedures
  - Documentation of activities performed

- Remedying internal control issues

- A 2021 study found that tax issues accounted for 10-15% of material weaknesses reported in IPO filings

Practical Considerations – Other Considerations

- Correction of an error vs. change in estimate
  - Increasing audit attention in this area
  - Importance of documentation and careful estimates
  - Analysis of whether information was “reasonably knowable”
- Out of period adjustments (and how to avoid them)
- Choice to estimate rather than obtaining information that is “readily accessible” may result in classification as an error

ASC 450

ASC 450: accounting for loss contingencies

- Uncertainties associated with non-income taxes should be accounted for under ASC 450

- First determine the likelihood of a material loss
  - Remote – chance for future event is slight
  - Reasonably possible – chance more than remote but less than likely
  - Probable – chance is likely to occur

- An estimated loss from a loss contingency is required to be accrued by a charge to income if both of the following conditions are met
  - Information available prior to issuance of the financial statements indicates that it is **"probable"** that an asset had been impaired or a liability incurred at the date of the financial statements.
  - The amount of loss can be **"reasonably estimated"**

ASC 450: accounting for loss contingencies

- A loss contingency and a liability are recorded if the loss is both probable and estimable.

- If the loss is either probable or estimable but not both and it is at the very least reasonably possible that a liability may have been incurred, a disclosure note is required.

- The disclosure must include:
  - The nature of the contingency
  - An estimate of the possible loss or range of loss or a statement that an estimate cannot be made

Recent Developments

ASU 2019-12

On December 18, 2019, the FASB issued Accounting Standards Update 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (the ASU). ASU 2019-12 included a change to franchise taxes and other taxes partially based on income.

The ASU amends the scope of ASC 740 related to a franchise tax (or similar tax) that is partially based on income.

- Requires an entity to recognize the amount of the tax based on income to be accounted for in accordance with ASC 740, with any incremental amount accounted for as a non-income-based tax (i.e., above the line) recognized entirely in the period incurred. This applies if, for example, a company is required to pay the greater of an income-based tax and a capital-based tax.
- Also specifies that deferred tax assets and liabilities should be measured using the applicable statutory income tax rate and that entities do not need to consider whether temporary differences will reverse in years when the tax is based on an amount other than income when assessing the need for a valuation allowance.
  - For example, a deductible temporary difference may reduce an entity's income tax liability, but because the entity remains subject to the non-income-based portion of the tax, the reversing deductible temporary difference may not actually result in less taxes paid during the period. In this circumstance, the assessment of realizability for any deductible temporary differences should disregard the fact that there may still be a non-income tax liability in a future period.

FASB – Update to Income Tax Disclosures

Exposure Draft Issued
March 15, 2023

Comment Period Ended
May 30, 2023

Final ASU
Estimated Q4 2023

Effective Date
PBEs:
For fiscal years beginning after December 15, 2024 (annual) and interim periods within fiscal years beginning after December 15, 2025
Other than PBEs:
For fiscal years beginning after December 15, 2025 (annual) and interim periods within fiscal years beginning after December 15, 2026

FASB Exposure Draft – Income Taxes (Topic 740) - Improvements to Income Tax Disclosures
FASB Tentative Board Decisions – August 30, 2023

The FASB will require **prospective** transition with a retrospective option

The FASB affirmed **early adoption** will be permitted

Questions?

Appendix

General current tax provision formula

ASC 740 defines the current tax provision as the amount of income payable (or refundable) for a year as determined by applying the provisions of the enacted tax laws to the taxable income/(loss).

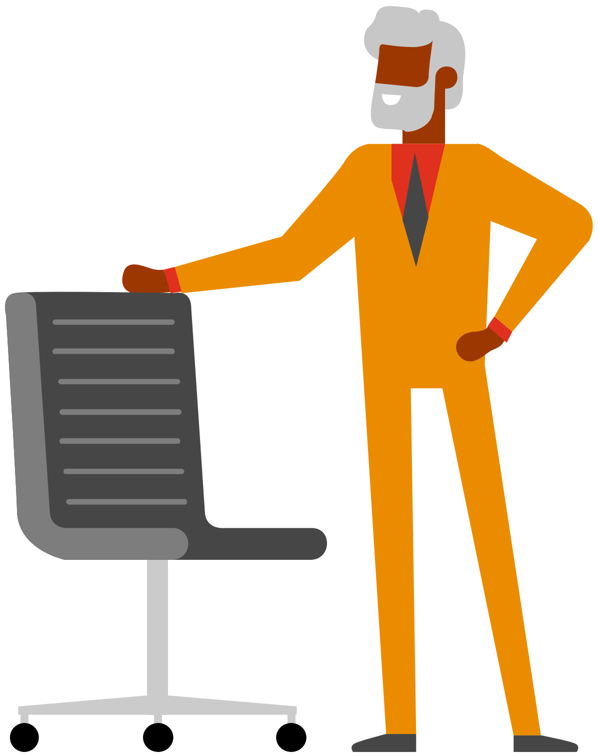
A typical method of calculation is as follows:

	Pre-tax book income (GAAP)
+/-	Permanent Differences
+/-	Temporary Differences
	Taxable Income
-	Net operating loss
	Regular Taxable Income
x	Tax Rate
	Current Tax Before Credits
-	Credits
	Current Tax
+/-	Return-to-provision adjustments
+/-	Changes to liabilities for uncertain tax positions
	Current Tax Expense (Provision)

General current state tax provision formula

A typical method of calculation for state purposes is as follows:

	Pre-tax book income (GAAP)
+/-	Permanent Differences (% applicable for state)
+/-	Temporary Differences (% applicable for state)
	Modified Federal Taxable Income
+/-	State only Permanent Differences
+/-	State only Temporary Differences
	State Taxable Income (less pre-apportioned NOLs)
x	Apportionment %
	Apportioned State Income
-	Net operating loss (Post apportioned)
	State Taxable Income
x	Tax Rate
	Current State Income Tax Before Credits
-	Credits
	Current State Income Tax
+/-	Return-to-provision adjustments
+/-	Changes to liabilities for uncertain tax positions
	Current State Income Tax Expense (Provision)



Permanent differences

Not defined in ASC 740

A difference in revenue or expense between what is reported on the income statement and what is reported on the tax return. May include items recognized in tax returns that will never be recognized in financial statements

A permanent difference is permanent, it will never reverse.

Examples include:

Federal Examples

- Meals & Entertainment – 50%
- Tax-exempt income is reported for book purposes, but is never taxable (i.e. Muni-interest)
- Penalties / bribes
- Officer's life insurance
- Excess Compensation

State Examples

- Tax-exempt income is reported for book purposes, but is never taxable (i.e. US-Gov and/or Muni-interest)
- State Only GILTI / DRD Deductions
- State addback adjustments
- Non-IRC conformity

Temporary differences

A difference between the tax basis of an asset or liability and its reported amount in the financial statements that will result in taxable or deductible amount in future years when the reported amount of the asset or liability is recovered or settled, respectively.

A temporary difference is temporary, it will reverse.

Examples include:

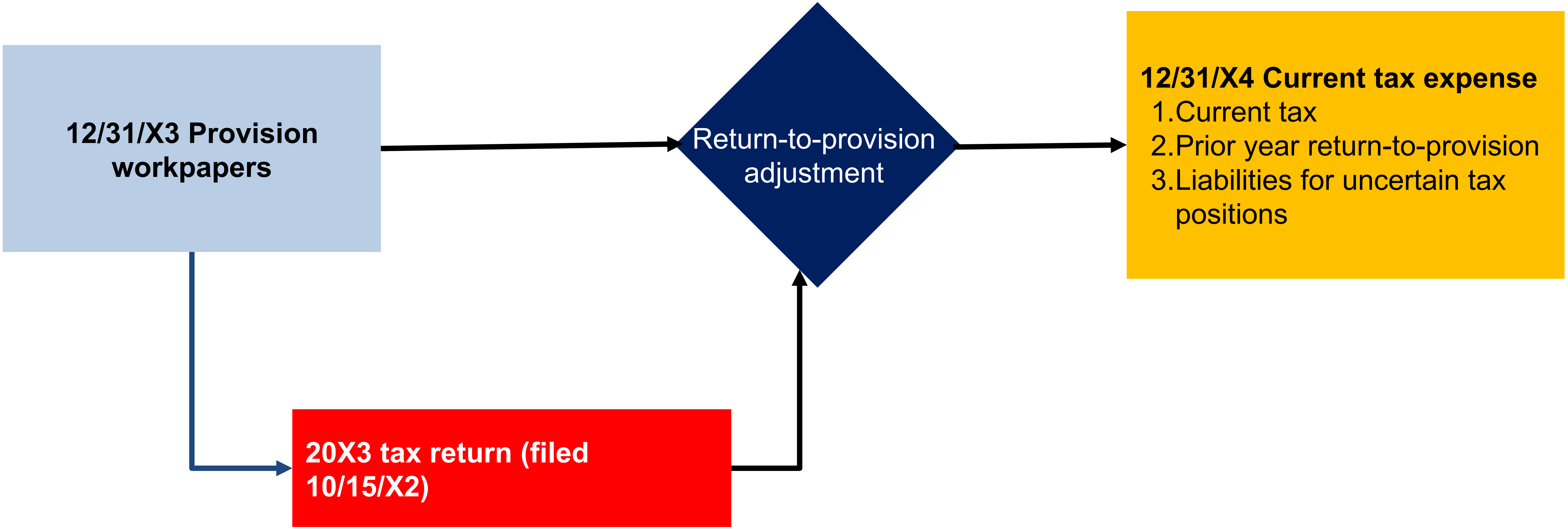
Federal Temp Differences

- Federal depreciation
  - Regular & bonus
- Allowance for bad debts
- Advanced Payments/Deferred Revenue

State Temp Differences

- State depreciation
  - Regular & bonus

Return to provision



Computation of deferred tax expense (benefit)

Net deferred tax asset/liability <u>end of year</u> (EOY) balance*

Less

Net deferred tax asset/liability <u>beginning of year</u> (EOY) balance

=

Deferred tax provision*

* **May include effects of**

- Prior-year provision-to-return reconciliation items
- Adjustments to valuation allowance
- Adjustments to uncertain tax positions
- Adjustments for business combination accounting

How DTAs & DTLs arise

How DTAs arise

- Expenses currently recognized for book purposes but not for tax purposes (e.g. NOLs)
- Revenues currently recognized for tax purposes but not for book purposes
- Stated another way – it's a deductible temporary difference which will **lower taxable income** in the year of reversal

Future → Book Income > Taxable Income

How DTLs arise

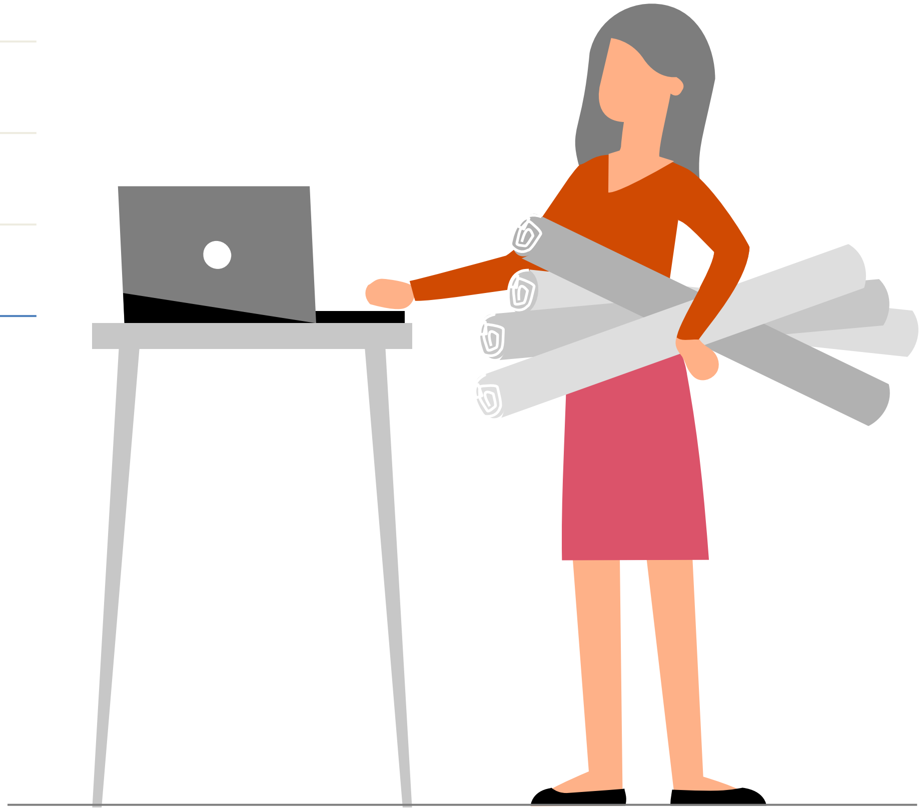
- Expenses currently recognized for tax purposes but not for book purposes (e.g. Depreciation)
- Revenues currently recognized for book purposes but not for tax purposes
- Stated another way – it's a temporary difference which will **increase taxable income** in the year of reversal

Future → Taxable Income > Book Income

Deferred tax provision

Net increase or decrease in deferred tax asset/liability from beginning of year to end of year.

BOY balance	EOY balance	Result
$200 DTA	$100 DTA	$100 deferred expense
$200 DTA	$500 DTA	$(300) deferred benefit
$200 DTA	($100) DTL	$300 deferred expense
($100) DTL	($400) DTL	$300 deferred expense



5-Step approach method of determining the deferred tax provision

1. Determine/Calculate the estimated applicable tax rate for which the deferred items will "turn".
   a. For State Provisions this would typically be State Apportionment Multiplied by State Statutory Rate

2. Determine the gross deferred tax liability for the taxable temporary differences using the applicable tax rate.

3. Determine the gross deferred tax asset for the deductible temporary difference and loss carryforwards using the
   applicable tax rate.

4. Determine the gross deferred tax asset or credit carryovers.

5. Provide a valuation allowance for gross deferred tax assets to the extent that it is more likely than not that the tax benefits will not be realized.

Effective rate – Blended rates

Aggregating tax computations for separate jurisdictions (i.e. Blended rate)

Overview

- Generally a state rate should be computed for each material taxpaying component within the consolidated financial reporting group
- As a shortcut, a "blended state rate" is often used to compute the state deferred taxes on a consolidated basis
  - Management should be able to support its decision to use a blended rate and must not presume that a blended rate approach is acceptable
- A blended rate approach should be continually assessed to ensure reasonableness
- Additional consideration – federal effects of state taxes should be presented separately in the balance sheet, and potentially in other disclosures.

From PwC Guide for Accounting for Income Tax 4.3.3.10

- Although deferred taxes ordinarily must be determined separately for each tax-paying component in each tax jurisdiction, ASC 740-10-55-25 acknowledges that in certain situations the tax computations for two or more jurisdictions can be combined
- In practice, many companies employ a "blended rate" approach at the legal-entity level to simplify the income tax calculation for entities operating in multiple jurisdictions (e.g., operating in multiple US states). Management should be able to support its decision to use a blended rate and must not presume that a blended-rate approach is acceptable. Use of this approach should be continually assessed in light of the considerations enumerated in ASC 740-10-55-25 and other practical considerations. This may make the use of a blended rate unacceptable—especially as more and more states continue to decouple their tax calculations from the US federal tax calculation.
- Examples of when problems can result from the use of a blended rate include the following:
  - When an entity enters or exits a particular jurisdiction
  - When an entity needs to schedule deductible temporary differences and taxable temporary differences in order to determine the realizability of deferred tax assets for a component jurisdiction
  - When there is a change in the assessment of a valuation allowance in one of the component jurisdictions
  - When there is a tax law change that substantially changes the tax structure of one of the component states
  - When there is a tax uncertainty that relates to only one or a subset of jurisdictions
  - When differences would result in the application of ASC 740-20's intraperiod allocation rules to one blended jurisdiction, as compared to applying those rules to multiple individual jurisdictions

See example….

Effective rate – Blended rate example

Facts		Entity X	Entity Y	Total
Gross Temporary Differences		900	100	1000
Current Year Taxable Income		100	200	300
State Tax Rate		3%	5%	
	Tax	**3**	**10**	**13**
Blended Rate Approach				
Blended State Rate ($13 divided by $300)				4.33%
Consolidated Temporary Differences:				1000
Deferred Tax Asset				**43**
Separate Company Approach				
Separate Company State Rates		3%	5%	
Separate Company Temporary Differences		900	100	
Deferred Tax Asset		**27**	**5**	**32**
Blended v. Separate Difference				**11**

Valuation allowance – Considerations

- Valuation allowance considerations:
  - Taxable income considerations
  - Use of tax planning strategies to minimize valuation allowances. For Example:
    - Accelerate taxable amounts to use expiring carryforwards
    - Change the character of taxable or deductible amounts from ordinary income or loss to capital gain or loss
    - Change the nature of the income, for example, from tax-exempt income to taxable income
  - Inter-company charges that result in income
  - Mergers and/or utilization of LLC's

Valuation allowance – Negative evidence

It is more difficult to conclude that a valuation allowance is not needed if negative evidence exists. Examples include:

- Cumulative losses in recent years
- History of operating loss or tax credit carryforwards expiring.
- Carryforwards expiring unused
- Expected losses in near-term
- Contingencies with material adverse, long-term effect
- Brief carryback/forward periods

Valuation allowance – Positive evidence

Positive evidence can outweigh negative evidence.

- Note – cumulative losses (which is considered significant negative evidence), can still make it difficult for the positive evidence to outweigh the negative

Examples of positive evidence includes:

- Strong earnings, exclusive of specific event
- Contracts/firm backlog
- Appreciated assets

Positive evidence refers to the existence of one or more of the four sources of taxable income as previously discussed

Other items to consider – Texas margins tax

- Hybrid Tax - Texas Margin Tax
  - Since the margin tax has a base that possesses characteristics of a tax based on income, it is accounted for under ASC 740.
  - Most companies will pay tax on either “revenue less cost of goods sold” or “revenue less compensation,” since those measures are likely to produce a smaller taxable margin than the “70 percent of total revenue”
  - Deferred considerations

Other items to consider – NOLs

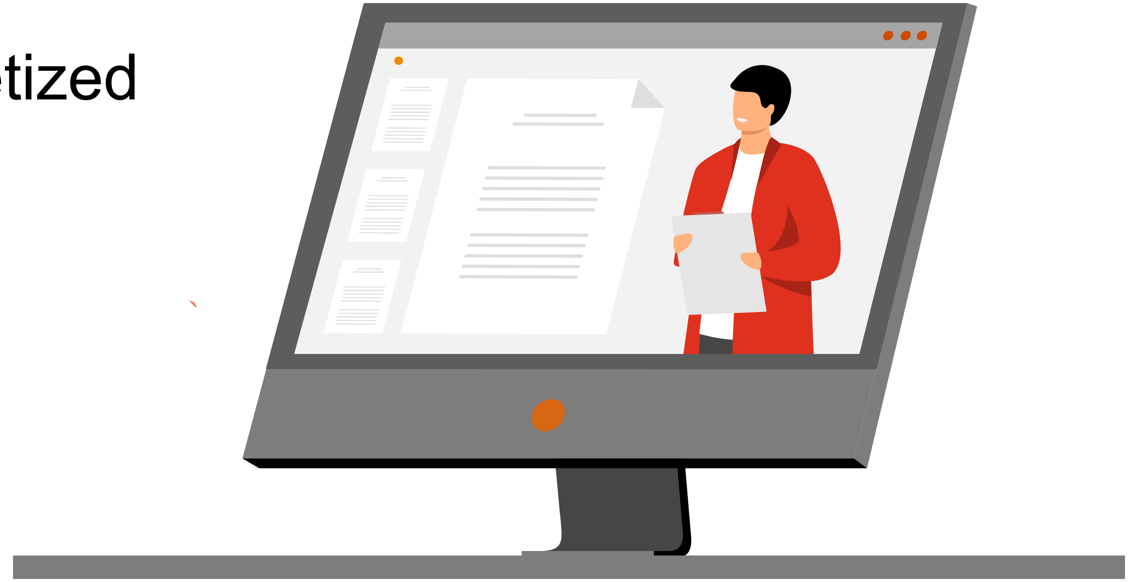
- Net Operating Losses
  - Most states exempt foreign inclusions from taxation (deduction)
    - Certain states will not allow NOLs to be created/increased by subtracting foreign inclusions
    - Risk of creating non-existent NOLs in current provision
    - Subsequent write-off
  - *Indiana Department of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014)
  - Arkansas - 965 Impact on NOLs - Administrative Decision 21-461, (7/31/21)
  - Delaware
    - *Director of Revenue v. Verisign Inc.*, – A.3d –, 2021 WL 5563437 (Del. 2021)
    - H.B. 171
  - New Hampshire - Double Apportioned NOLs
  - Virginia & Maryland - Pre-Apportioned NOLs adjusted for Mods

Other items to consider – Capital losses

- Capital Losses
  - Federal treatment - 3 year carryback & 5 year forward
    - DTA established for carryover
  - State treatment
    - Conform to federal
      - Basis differences
    - Separate state valuation allowance considerations
    - Carryforward only, no carryback
      - State DTA in excess of federal DTA
    - Different carryforward period (e.g. Minnesota 15 year carryforward)
      - Valuation allowance considerations?
    - Immediate deduction
    - No state DTA should be recognized for the capital loss
    - Future write-off of DTA with no current benefit?

Other items to consider – Tax credits

- When is a credit within the scope of ASC 740.
- Considerations may include, but are not limited to, the following:
  - Purpose of the credit
  - Refundable or monetizable versus non-refundable
  - Impact on tax basis
  - How the credit is calculated
  - How and when the credit is refunded/monetized
  - Historical accounting treatment
- Considerations related to purchased credits



ASC 740-10 – Definitions

Uncertain tax positions - Summary

- **Tax Position:** Refers to positions in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods.

- **Unit of Account:** The level of detail to assess each tax position. In other words, it is the level that the tax position is subject to challenge (level at which the position will either be sustained or challenged)

- **Recognition:** A tax benefit from a UTP may only be recognized if it is "more likely than not" that the position is sustainable based solely on its technical merits (i.e., excluding detection risk) and any relevant administrative practices.

- **Measurement:** The tax benefit of a qualifying position is the greatest amount of benefit that is cumulatively >50% likely of being realized.

- **Subsequent recognition and measurement:** The assessment of the recognition threshold and the measurement of the associated tax benefit are subject to change based on new information. Unrecognized tax benefits should be recognized (derecognized) in the period the position reaches (falls below) the recognition threshold, which may occur prior to final resolution of the matter.

- **Interest/Penalties:** Taxpayers are required to accrue interest and penalties deemed to have been incurred on the basis of the relevant tax law. Income statement classification of interest and penalties is an accounting policy election.

ASC 740-10 – Tax Positions

Tax positions

- A Tax Position can encompass, but is not limited to:
  - An allocation or shift of income between jurisdictions;
  - The characterization of income or a decision to include or exclude an item of income in a tax return;
  - A decision to classify a transaction, entity, or other position in a tax return as exempt from tax; or
  - A decision not to file a return.
- A Tax Position can result in:
  - A permanent reduction of income taxes payable
  - A deferral of income taxes otherwise currently payable to future year; or
  - A change in expected realizability of deferred tax assets.

ASC 740-10 – Unit of Account

Unit of account

- What is the appropriate level of detail to assess uncertain tax positions?
- ASC 740-10 uses the term "unit of account" to discuss this issue. The FASB intentionally did not provide definitive application guidance.
- However, the Board noted that:
  - Unit of account is based upon the facts and circumstances for each entity based on the manner in which it supports its tax returns
  - An entity should consider the approach that the taxing authority will take upon an examination.
- In general, the proper "unit of account" will likely be the level that the tax position is subject to challenge (level at which the position will either be sustained or challenged)

ASC 740-10 – Unit of Account

Unit of account – State considerations

- The Unit of Account is likely determined on a jurisdiction by jurisdiction level
- What is the appropriate level of detail for each unit of account?
  - By:
  - Issue;
  - Transaction;
  - Income/Expense Line Item; or
  - Audit Cycle
- How are issues or transactions that cover more than one jurisdiction handled?

ASC 740-10 – Recognition

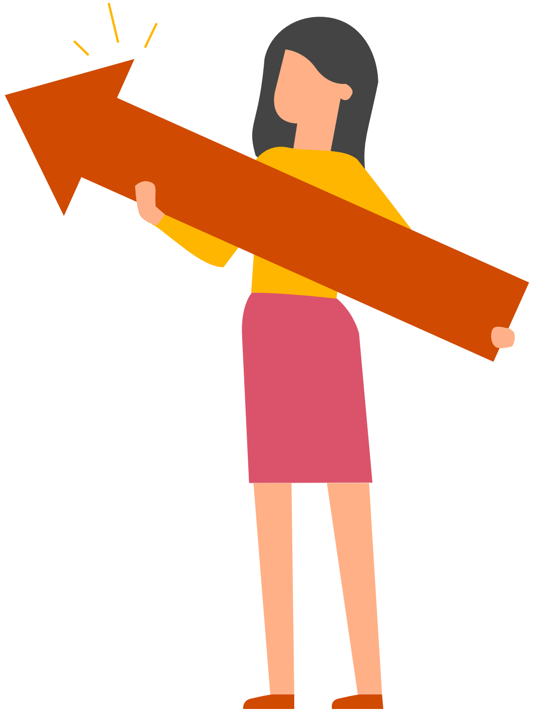
Recognition

- ASC 740-10 utilizes a **two-step process** (recognition then measurement) beginning with whether the tax position should be recognized (i.e., whether any benefit should be recorded)
  - Recognition is based on the following criteria:
    - More likely than not (>50%) that the position will be sustained upon examination by taxing authority (including any appeal or litigation process) based on the technical merits of the position
      - Assumes that tax authorities will examine position and will have full knowledge of relevant information (no consideration of detection risk)
      - Should consider the past administrative practices and precedents of taxing authorities in its dealings with the enterprise or similar enterprises, if these practices and precedents are widely understood.

ASC 740-10 – Measurement

Measurement

- Assuming the recognition threshold (Step 1) has been met (i.e., the likelihood that the Tax Position will be sustained is more likely than not), Step 2 involves measuring the benefit to be sustained:
  - Tax positions should be measured at the largest amount that has a cumulative probability > 50% of being the ultimate outcome.
  - Should consider the amounts and probabilities of various outcomes (resolution alternatives – e.g., negotiated settlement, litigation, no challenge) using available facts and circumstances at the reporting date.



ASC 740-10 – Cumulative Probability Approach

Cumulative probability approach

From PwC Guide for Accounting for Income Tax 15.4.1

- ASC 740 does not define "cumulative probability."
  - However, the term is included in the measurement examples provided in ASC 740-10-55-102 through ASC 740-10-55-107. When more than two outcomes may alternatively resolve an uncertain tax position (i.e., resolution may occur other than on an "all-or nothing" basis), the measurement step requires that each potential outcome be assigned a probability to determine the greatest amount of tax benefit whose probability of being realized is greater than 50%.
- The outcome that provides the greatest tax benefit should be assessed first.
  - If that outcome's individual probability is greater than 50%, the individual probabilities of the remaining outcomes need not be considered.
  - The measurement step is concluded because the greatest amount of benefit was obtained from the most favorable outcome.
  - Alternatively, if the individual probability of the greatest tax benefit is less than 50%, the next most beneficial outcome should be assessed. If that outcome's individual probability, coupled with the individual probability of the greatest tax benefit, is greater than 50%, the second most beneficial outcome should be selected for measurement. If the cumulative probability of the second most beneficial outcome is not greater than 50%, the entity should continue the process until the probability of the selected outcome (added to the more beneficial outcomes previously assessed) is greater than 50% on a cumulative basis.

ASC 740-10 – Cumulative Probability Approach

Cumulative probability approach

From PwC Guide for Accounting for Income Tax 15.4.1 (cont)

- Determining the individual probability of each possible outcome **will require management to exercise judgment**.
- Probabilities can be based on factors such as:
  1. the perceived weight of the tax law in the taxpayer's favor,
  2. the extent of precedent of the tax law being applied to the particular position or transaction,
  3. expectations regarding how aggressively the taxing authority might pursue a particular position or, alternatively, its willingness to reach a negotiated compromise, and
  4. the entity's willingness to defend the position in tax court (as opposed to conceding to a negotiated compromise to avoid extended litigation).

Comparable and resolved exposures that the entity or similar entities have experienced will often inform the development of measurement estimates and the assignment of individual probability. A history of negotiating and settling the same or similar tax positions would provide strong evidence in support of individual probabilities.

- Furthermore, while all potential outcomes (e.g., litigation, negotiated compromise) should be considered to determine possible measurement outcomes and their individual probabilities, detection risk cannot be considered. That is, measurement must be performed under the assumption that the taxing authority has full knowledge of the uncertain tax position
- Note that a virtually identical tax position could be measured differently by different preparers based solely on management's appetite for risk and willingness to compromise. For example, an entity might determine that if it is challenged, it would continue to litigate the tax position to the court of last resort and the probability of sustaining the full amount of the benefit is greater than 50%. In this fact pattern, the entity would record the full amount of the benefit. However, another entity might believe that upon challenge, it would be willing to settle for 80% of the tax benefit. Assuming the expectation of settlement at this level is greater than 50%, that entity would record 80% of the benefit.

ASC 740-10 – Cumulative Probability Approach

- Company X will take a R&D credit on its current Connecticut tax return. The R&D credit is a tax benefit of $100.
- Based on an analysis by Company X, this Tax Position meets the recognition threshold (i.e., MLTN).
- Distribution of the potential outcomes for this Tax Position for Connecticut are:

Potential benefit	Individual probability	Cumulative probability
$100	25%	25%
$60	30%	55%
$20	45%	100%

Recognition of the largest amount that has a cumulative probability of >50% of being ultimately realized is $60

Subsequent recognition and measurement – State tax considerations

- Monitor and Document the Impact to Tax Positions for:
  - Changes in federal tax law and/or regulations
  - Changes in state tax law and/or regulations
  - Changes in state audit policies/administrative policies
  - Tax Court cases
  - Changes in business:
    - Acquisitions/Dispositions
    - Expansions/Contractions
    - Corporate Restructuring

FASB – Update to Income Tax Disclosures

Disclosure	Exposure draft proposed disclosures	Expected final ASU
Effective tax rate (ETR) reconciliation	• Require PBEs to disclose eight specific categories in the rate reconciliation: 1. State and local income tax, net of federal (national) income tax effect 2. Foreign tax effects* 3. Enactment of new tax laws 4. Effect of cross-border tax laws* 5. Tax credits* 6. Valuation allowances 7. Nontaxable or nondeductible items* 8. Changes in unrecognized tax benefits • Apply 5% threshold* for additional disclosures (by nature and/or jurisdiction) within certain categories • Items presented by percentages and dollar amounts *(Note: current GAAP allows for policy choice)* **5% threshold computed by multiplying pretax income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate*	The exposure draft proposals were affirmed by the Board Additionally, the Board discussed and/or agreed with the following: • Retain discussion of materiality within the basis for conclusions (which refers to ASC 105) • Clarified that all reconciling items must be presented on a gross basis unless specific guidance permits net presentation • Affirmed that PBEs provide a qualitative disclosure of the description of individual reconciling items if not otherwise evident in the rate reconciliation

FASB – Update to Income Tax Disclosures

Disclosure	Exposure draft proposed disclosures	Expected final ASU
Income taxes paid	• Require all entities to disclose year-to-date income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign on both an interim and annual basis • Require all entities to disclose income taxes paid (net of refunds received) disaggregated by jurisdiction using a threshold of 5% of total income taxes paid (net of refunds received), on an annual basis.	• The Board decided that this disclosure is only required on an annual basis • The Board affirmed disaggregated disclosure on an annual basis for any jurisdiction meeting the 5% threshold

FASB – Update to Income Tax Disclosures

Disclosure	Exposure draft proposed disclosures	Expected final ASU
Unrecognized tax benefits	• Eliminate the requirement for all entities to (1) disclose the nature and estimate of the range of the reasonably possible change in the unrecognized tax benefits balance in the next 12 months or (2) make a statement that an estimate of the range cannot be made.	The exposure draft proposals were affirmed
Cumulative type of temporary difference	• Remove the requirement to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures	The exposure draft proposals were affirmed
Other disaggregation	• Income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign • Income tax expense (or benefit) from continuing operations disaggregated by federal (national), state, and foreign.	The exposure draft proposals were affirmed