Cross-Border Aspects of ASC 740

Vickie Carr
Rich Hyman
Steve Losavio
Deloitte Tax LLP

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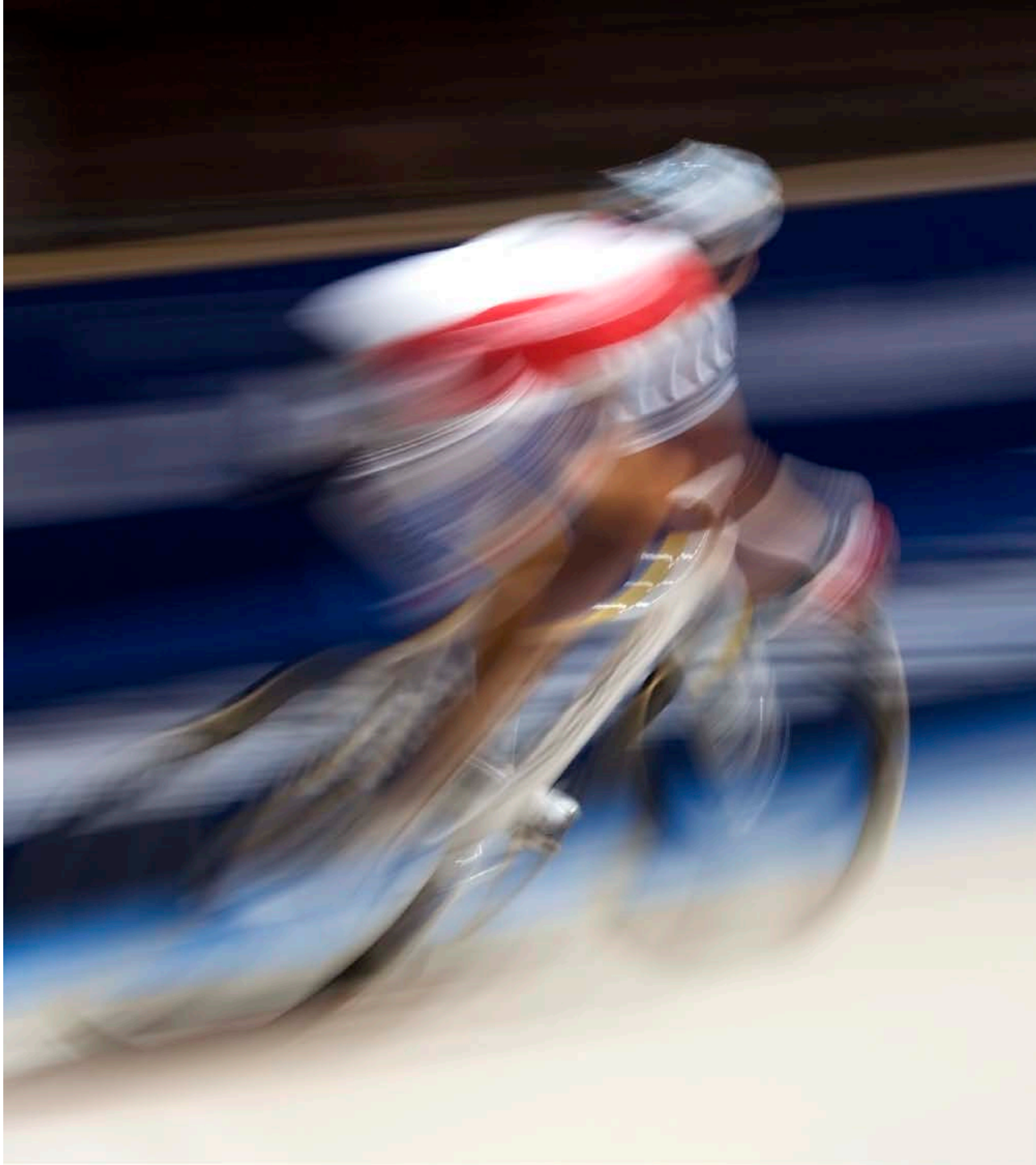


Agenda

- Standard setting update
- Outside basis differences (ASC 740-30)
- Intercompany or long-term loans
- Base Erosion and Profit Shifting (BEPS) overview and ASC 740 considerations
- Process and technology considerations
- Questions and answers

Standard setting update

FASB Income Tax project
FASB Exposure Draft – January 22, 2015

The Board proposed two ASUs as part of a simplification initiative:

Issues

- Intra-entity transfer of assets – eliminate prohibition on recognition of income taxes paid for intra-entity transactions and the related deferred tax asset on differences between the tax basis of the assets in a buyer’s tax jurisdiction and their cost as reported in the consolidated financial statements
- Balance Sheet Classification – classify all deferred taxes as noncurrent
  - Jurisdictional netting still required
- The comment period for the exposure draft ends on May 29, 2015

FASB Income Tax project

FASB Exposure Draft – January 22, 2015 (cont'd)

Transition guidance

- Intra-entity transfer of assets: Modified retrospective with a cumulative catch-up adjustment to opening retained earnings in the period of adoption
- Classification of deferred taxes: Prospective

Effective date

- The Board expects the effective date for both issues will be the same
- For public business entities, annual periods, including interim periods with those annual periods, beginning after December 15, 2016
- One year later for all other entities
- Private companies would be allowed to adopt early, but not before the effective date for public companies and must adopt both issues if elect to early adopt

Sale of inventory

Example – current rules

Parent

Sub A — **Tax rate = 30%**

Selling Price	$ 150
Cost	100
Margin	$ 50
Tax rate	30%
Tax paid	$ 15

Sub B — **Tax rate = 40%**

Tax basis	$ 150
Book basis	$ 100
Difference – no DTA	$ 50

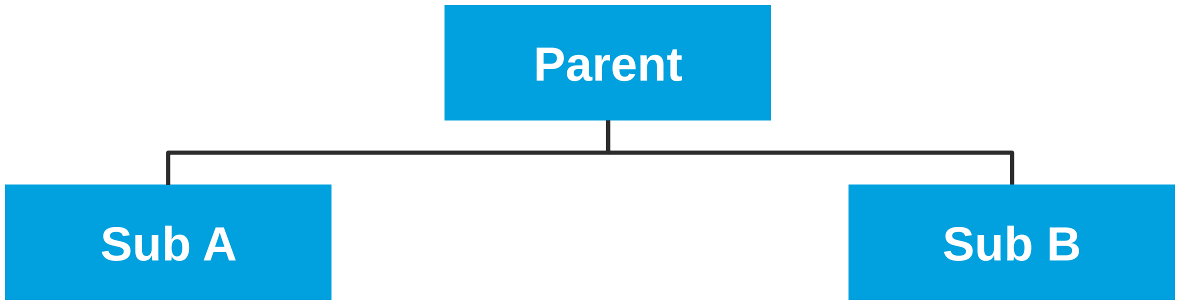
Consolidated F/S	
Prepaid taxes	$ 15
DTA	$ 0
Taxes payable	$ 15
Tax expense	$ 0

Tax expense deferred
(e.g., recorded as a prepaid)
pursuant to ASC 810-10-45-8

No DTA recorded pursuant
to ASC 740-10-25-3(e)

Sale of inventory

Example – as proposed



Tax rate = 30%

Tax rate = 40%

Selling Price	$ 150
Cost	100
Margin	$ 50
Tax rate	30%
Tax paid	$ 15

Tax basis	$ 150
Book basis	$ 100
Difference	$ 50
DTA	$20

Consolidated F/S	
DTA	$ 20
Taxes payable	$ 15
Tax benefit	$ 5

Intra-entity transfer of assets
Complexities in application

- Quantifying taxes subject to deferral
- Indirect effects (e.g., Subpart F)
- Effects of coming in and out of exceptions
- Unrecognized tax benefit
- Intercompany sale of stock
- Contributions
- Sale versus license
  - Has there been an asset transfer?

Classification of deferred taxes
Current accounting guidance

- Presenting current and noncurrent deferred taxes
- ASC 740-10-45-6 provides “for a particular tax-paying component of an entity and within a particular tax jurisdiction, all current deferred tax liabilities and assets shall be offset and presented as a single amount and all noncurrent deferred tax liabilities and assets shall be offset and presented as a single amount. However, an entity shall not offset deferred tax liabilities and assets attributable to different tax-paying components of the entity or to different tax jurisdictions.”

Classification of deferred taxes

Current and proposed accounting example

Facts

- Company ABC has a net DTA of $950 as of 20X1, as reflected below
- The Company expects the following reversals of the its DTA/(DTLs) in 20X2
  - Inventory – LIFO reserve ($10)
  - Fixed assets $10
  - Net operating loss $200

Question

- What is the current and non-current classification of the DTA/(DTL) at 20X1?

	Current guidance			Proposed guidance	
Balance sheet as of 20X1	**DTA/(DTL)**	**Current**	**Non-current**	**Current**	**Non-current**
Inventory – LIFO reserve	(100)	(100)			**(100)**
Fixed assets	50		50		**50**
Net operating loss	1,000	200	800		**1,000**
Total DTA/(DTL)	**$950**	**$100**	**$850**	**$0**	**$950**

FASB’s Review of Income Tax Disclosures

Disclosures Re: Undistributed Foreign Earnings

At its February 12, 2015 meeting the FASB deliberated additional proposed disclosure requirements related to undistributed foreign earnings and tentatively decided that entities should:

- Disclose information separately about the domestic and foreign components of income before income taxes.
  - Entities should separately disclose income before income taxes of individual countries that are significant in relation to total income before income taxes
- Disclose the domestic tax expense recognized in the period related to foreign earnings.
- Disclose unremitted foreign earnings that, during the current period, are no longer asserted to be indefinitely reinvested and an explanation of the circumstances that caused the entity to no longer assert that the earnings are indefinitely reinvested.
  - These disclosures should be provided in the aggregate and for each country for which the amount no longer asserted to be indefinitely reinvested is significant in relation to the aggregate amount.
- Separately disclose the accumulated amount of indefinitely reinvested foreign earnings for any country that is at least 10 percent of the aggregate amount.

Outside basis differences

Outside basis difference
ASC 740-30-25-18

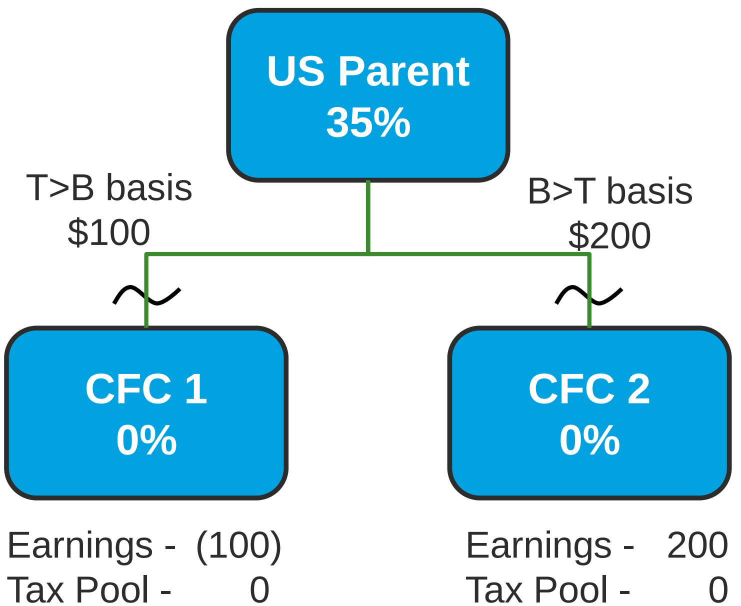
As indicated in paragraph 740-10-25-3, a deferred tax liability shall not be recognized for either of the following types of temporary differences unless it becomes apparent that those temporary differences will reverse in the foreseeable future

a. An excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary or a foreign corporate joint venture that is essentially permanent in duration.

b. Undistributed earnings of a domestic subsidiary or a domestic corporate joint venture that is essentially permanent in duration that arose in fiscal years beginning on or before December 15, 1992. A last-in, first-out (LIFO) pattern determines whether reversals pertain to differences that arose in fiscal years beginning on or before December 15, 1992.

Measurement of outside basis DTL

Example – flat structure



Facts: US Parent has concluded that it will distribute earnings from its foreign subsidiaries but has concluded that it is not foreseeable that it would dispose of its foreign subsidiaries

Question: What amount of DTL should be recognized?

Answer: $70

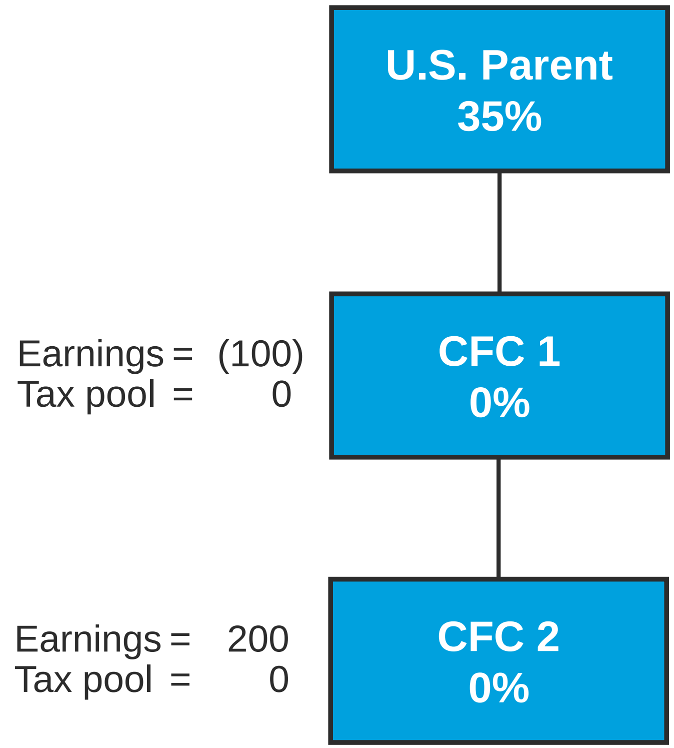
Measurement of outside basis DTL
Example – tiered structure

Facts

- US Parent has concluded that the basis difference in CFC1 is not indefinitely reinvested

Description	Book	Tax
Capital contribution	$100	$100
CFC 1 earnings	(100)	0
CFC 2 earnings	200	0
Total basis	**200**	**100**

B>T basis
$100



Question

- What amount of the DTL should be recognized?

Solution

- $35

Measurement of outside basis DTL

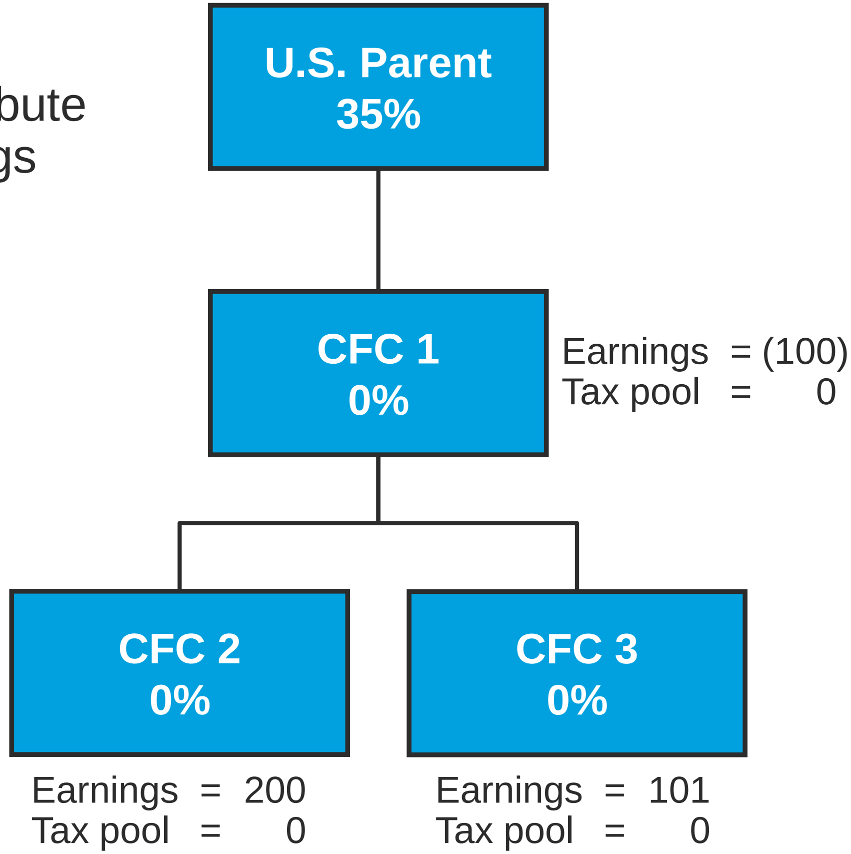
Example – tiered structure (cont'd)

Facts

- US Parent has concluded that it will distribute CFC 3's earnings but not CFC 2's earnings

Description	Book	Tax
Capital contribution	$100	$100
CFC 1 earnings	(100)	0
CFC 2 earnings	200	0
CFC 3 earnings	101	0
Total basis	**301**	**100**

B>T basis
$201



Question

- What amount of the basis difference is NOT indefinitely reinvested?

Solution

- $1

Subpart F potential in lower tier entity

Example

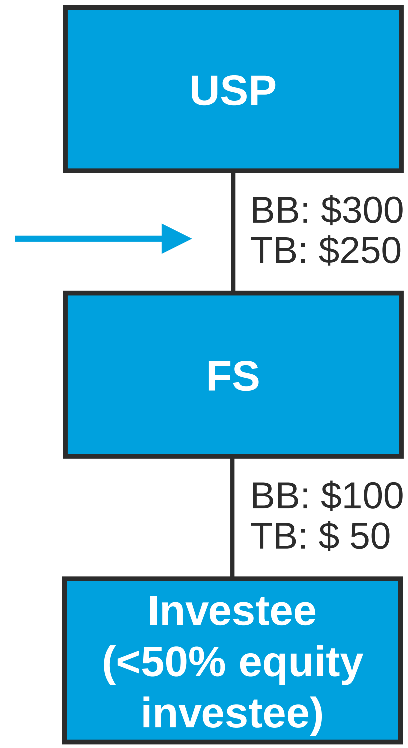
Facts

- If Investee pays a dividend, Subpart F income is created for USP
- FS does not control Investee, i.e. equity method
- Basis difference in investee is part of the overall outside basis difference in FS

Question

- Can the indefinite reversal assertion be applied to USP's investment in FS?

Consolidated assets include increased carrying amount of equity investee (related income is recognized by USP using equity method)



Subpart F income includes certain types of foreign source income (e.g., certain passive income) that under U.S. tax law is currently includible in U.S. taxable income. Even without an actual distribution, Subpart F income cannot be deferred (i.e., U.S. tax is assessed when earned)

Note: For simplicity, example ignores FX and tax effects at FS level

Intercompany loans

Long-term loans
Deferred taxes

Is the loan part of the net investment?	ASC 830-20-35-4 – ASC 830-20-35-3(b) Transaction gains and losses attributable to intercompany foreign currency transactions that are of a long-term investment nature. Transactions and balances for which settlement is not planned or anticipated in the foreseeable future are considered to be part of the net investment.
Is there an exception to recording deferred taxes on investments?	ASC 740-10-25-3(a) An excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary or a foreign corporate joint venture that is essentially permanent in duration when it is not apparent that the difference will reverse in the foreseeable future.
Are deferred taxes required on translation adjustments?	ASC 830-30-45-21 Translation adjustments shall be accounted for in the same way as temporary differences under the provisions of Subtopic 740-10. If under Subtopic 740-30 deferred taxes are not provided for unremitted earnings of a subsidiary; deferred taxes shall not be provided on translation adjustments.

Long-term loans

Deferred taxes (cont'd)

Debt versus equity characteristics

Equity characteristics (book)

For "long-term" treatment, a company is representing, and has consistent facts and circumstances to give such representation, that the related indebtedness will not be settled in the foreseeable future

Consider uncertain tax position relative to deductibility of interest

Debt characteristics (tax)

Generally, to qualify as debt for tax, the parties must have an expectation that the debt will be settled unconditionally

Plan to enter new loans upon settlement of old loans

Retain tax treatment, and qualify for long-term loan treatment as long as no time lag (loan amount always outstanding)

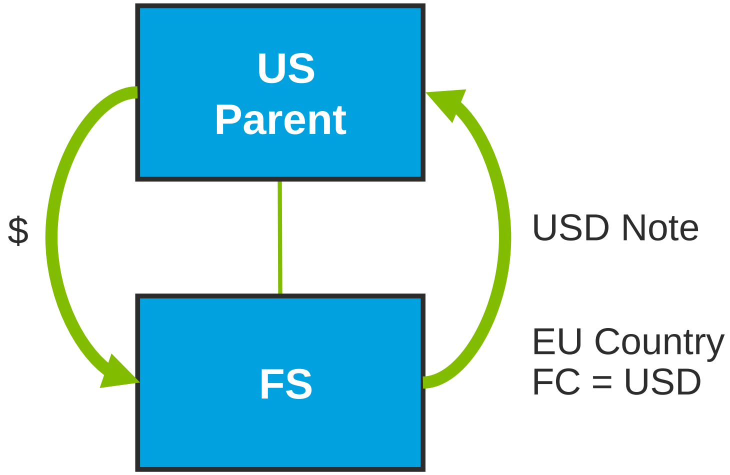
If tax consequences will be triggered

Impact on indefinite reinvestment claim needs to be considered

Note: Consultation with your attest firm is recommended

Special cases – loans

Example – local currency is not functional currency



Facts

- It would appear impossible for FS to have a gain or loss with respect to this note since the functional currency is USD and the loan is in USD
- However, the European Union (EU) jurisdiction will compare amount borrowed (in €) to amount required to repay loan (in €, which will be different as loan is in USD) to determine gain or loss
- Some countries "mark" gain or loss, so tax consequence is immediate (does not go to CTA, since it is a USD functional currency)

Questions

- What if a tax event (gain or loss) is expected at settlement?
- Is there a temporary difference in intervening periods?

Special cases – loans

Example – local currency is not functional currency (cont'd)

Solution

- Yes, there is a temporary difference
- ASC 740-10-25-3(f) prohibits recognizing deferred taxes related to remeasurement of the "in-country" book basis to the spot rate only for assets that would be translated at historical exchange rates
- Since monetary assets are not remeasured at historical exchange rates, ASC 740-10-25-3(f) does not apply, and the "in-country" book basis in the debt is remeasured at the spot rate and compared to the tax basis to determine the temporary difference

BEPS – overview and other considerations

Base Erosion and Profit Shifting (BEPS)

Overview

- The OECD published its Action Plan on BEPS in June of 2013
- Several items on the Action Plan have been published as discussion drafts for public comment
- Recently, the OECD published non-consensus discussion drafts identifying treaty abuse and hybrid arrangement as concerns
- Countries are moving forward on the BEPS agenda independent of agreement and finalization of BEPS action items (there are at least four countries to date with enacted BEPS-related legislation)
- Major areas of focus
  - Financing
  - Royalty deductions with little or no corresponding income
  - Intellectual property (IP)
  - Permanent establishment (PE)
  - Digital economy
  - Hybrid entities
  - Transfer pricing (TP) documentation and transparency

Audit committee communication (example)

Instability involving Global Legislative Environment

Mindset growing that not all jurisdictions are getting their "fair share" of tax revenue

- Organization of Economic Cooperation and Development ("OECD") initiated project to reduce base erosion and profit shifting ("BEPS") (potential adverse impact to multinational companies)
- Media and politicians questioning corporate structures that result in multinational companies reporting profits in low-tax countries
- Public scrutiny of companies with low tax rates

The OECD BEPS' project potential impact

- Challenges related to efficient use of foreign cash
- Repatriation costs could increase
- Disclosure of country data to tax authorities (sales, employees, property, tax, etc.)
- Lack of uniformity in jurisdictions and certain jurisdictions are considering BEPS-like legislation, e.g., limitation on related party deductions

BEPS – ASC 740 considerations

How and where might there be impact?

- Change in tax law – discrete vs. AETR
- Unrecognized tax benefits
- Indefinite reinvestment assertions
- Valuation allowance analysis

Risk Factors: Example #1
Forest Laboratories LLC (2013 10-K)

Future changes to U.S. and foreign tax laws could adversely affect Actavis.

The U.S. Congress, the Organization for Economic Co-operation and Development and other Government agencies in jurisdictions where Actavis and its affiliates do business have had an extended focus on issues related to the taxation of multinational corporations. One example is in the area of "base erosion and profit shifting," where payments are made between affiliates from a jurisdiction with high tax rates to a jurisdiction with lower tax rates. As a result, the tax laws in the United States and other countries in which Actavis and its affiliates do business could change on a prospective or retroactive basis, and any such changes could adversely affect Actavis and its affiliates (including the Company and its affiliates after the Actavis Merger).

Risk Factors: Example #2
Arch Group Capital Ltd (2013 10-K)

We may become subject to taxation on profits generated in Bermuda as a result of the OECD's plan on "Base erosion and profit shifting"

In 2013, the OECD published an "Action Plan on Base Erosion and Profit Shifting." The plan proposes the development of rules to prevent Base Erosion and Profit Shifting which may drive fundamental changes in the perception of tax structuring and transfer pricing by tax authorities. The action plan includes adopting transfer pricing rules or special measures to ensure that returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The action plan will likely put a much greater emphasis on the location of individuals and their contributions towards profit generation. This may result in a significant change to the existing transfer pricing rules and would potentially have a significant impact on the allocation of taxable profits throughout our subsidiaries. As a consequence, profits currently generated in Bermuda may become subject to taxation outside Bermuda.

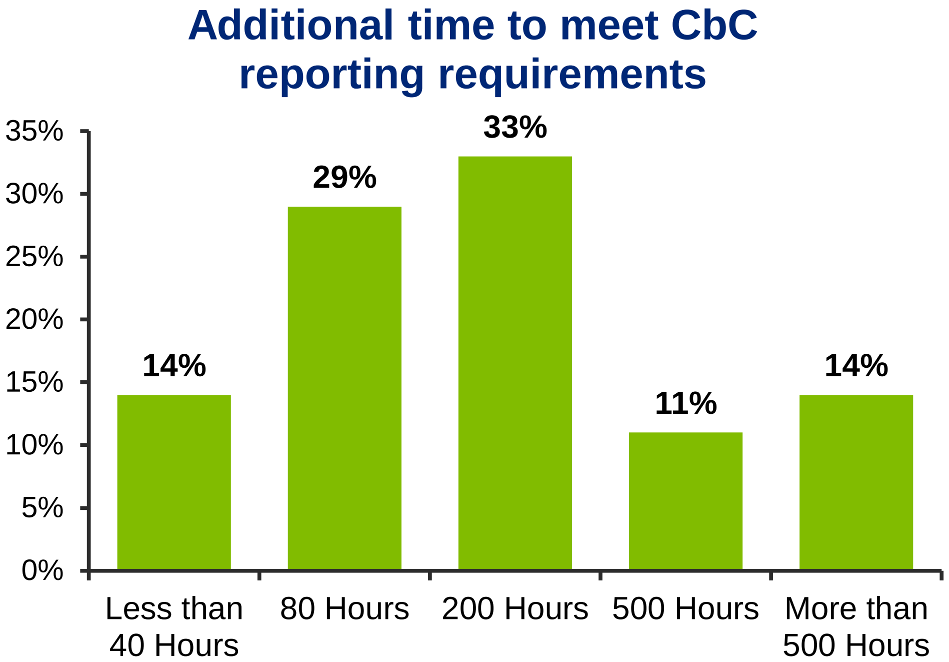
Process and technology considerations

Readiness assessment

In a poll conducted by Deloitte involving 2400 client representatives

We asked what each company saw as their main concern with CbC reporting

As a result, they envisaged additional time to locate, collect, validate and assemble the necessary information



CbC data field sourcing

Substantially the process would likely involve

1. Defining accounting data sources
2. Defining scope of constituent entities by country
3. Defining account line scope
4. Defining management reporting units
5. Defining fiscal year and tax year alignment
6. Defining any atypical accounting treatment of items
7. Determining raw data feed format
8. Creating templates for raw data dump
9. Establishing link to raw data sources
10. Populating templates with raw data
11. Mapping and formatting data
12. Creating bridging data flow
13. Creating adjustment sub-layers
14. Creating flow to final template
15. Creating checks in data flow, bridging, adjusting
16. Creating parameter change checks
17. Executing checks
18. Determining exception
19. Remedying exceptions
20. Sign off on data, format, bridging, adjusting, and controlling

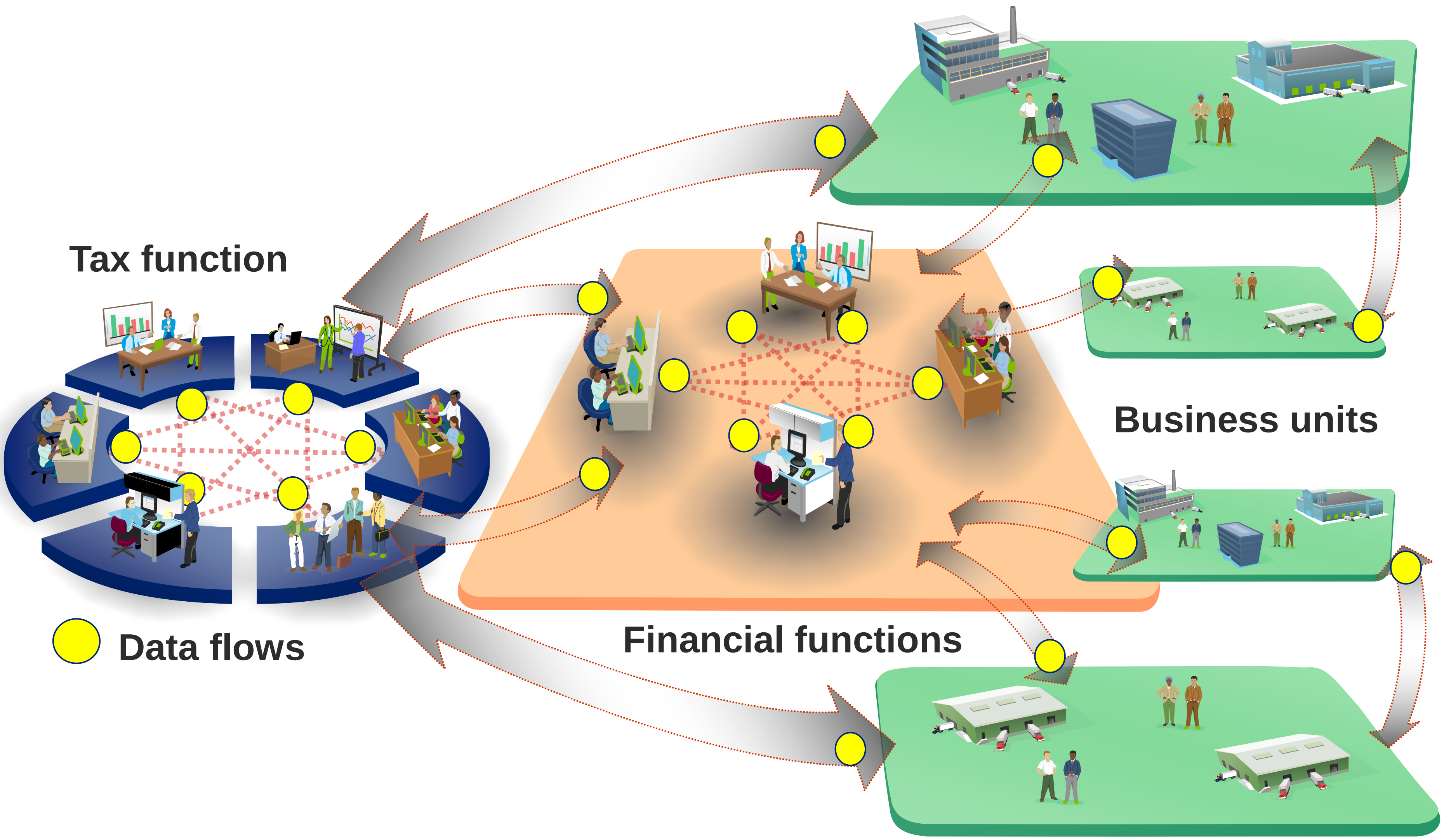
Top down approach points

- Dealing with intra-country eliminations
- Dealing with reconciliation to local accounts
- Dealing with no or subaccounts for foreign branches
- Dealing with intermediate HoldCos with foreign Subs
- Limiting number of data sources and raw data points
- Consistency of accounting methods, dates, and currencies
- Platform for centralized control

Bottom up approach points

- Dealing with maximum number of data sources and formats
- Account line definition variations
- Added timing adjustment considerations
- Added complexity in apportioning foreign taxes paid
- Option for unconsolidated but constituent entities
- Increased bridging requirements
- Decentralized control
- Opaque cross country interpretation
- Ease of reconciliation to local tax filings

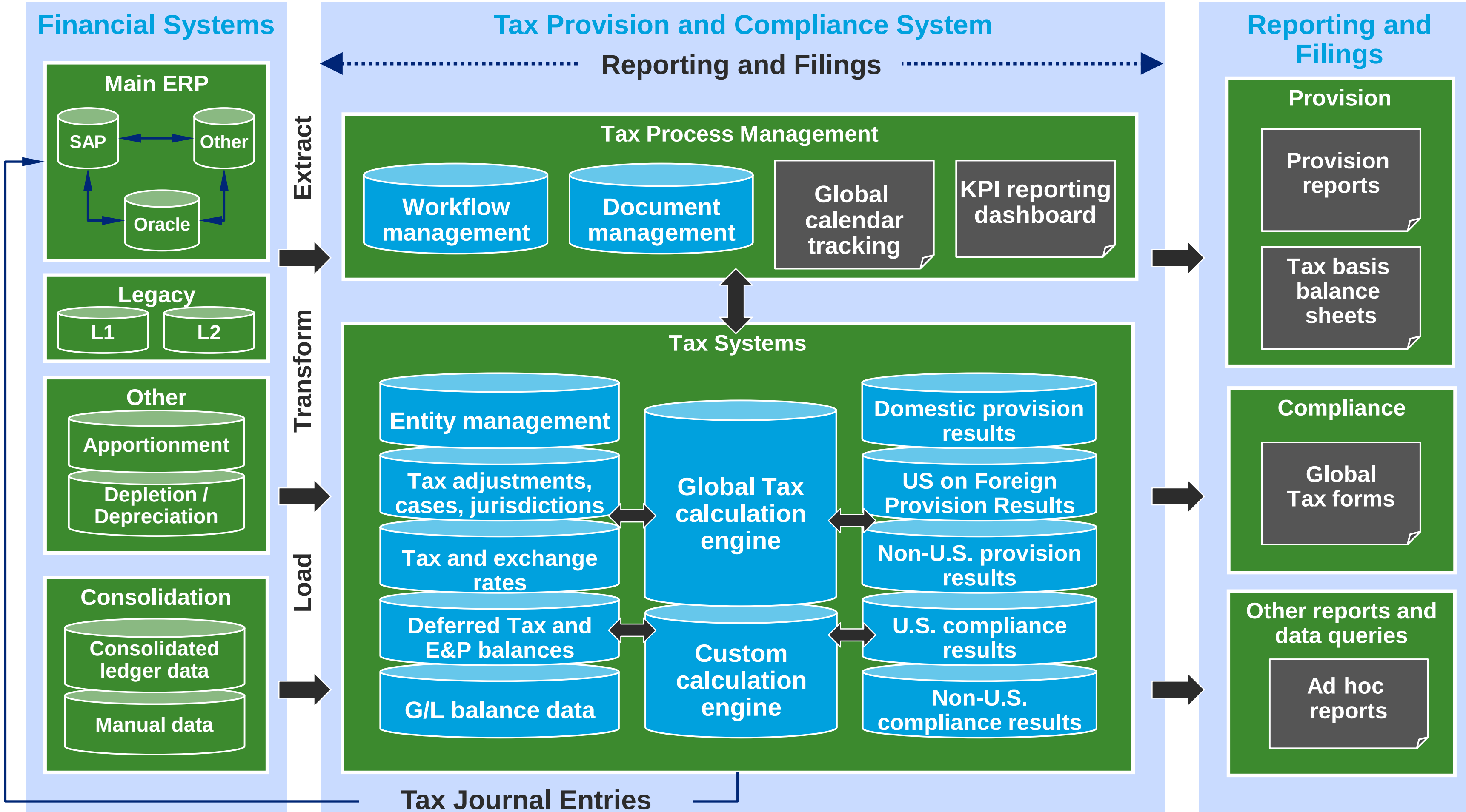
Typical close process



Close process redesign
General observations

- For many companies the majority of the close process involves computing the tax journal entry, with analysis and investigation taking a lesser role
- Automation of data flow and calculations can take large amounts of time out of the process
- Data quality and granularity is important to achieve greater process efficiency
- Many companies have implemented technology in the last few years with the goal of ‘automating’ the close process
- Many companies are under-utilizing software they have licensed or could benefit from additional training; or even a refresh of their current setup
- Workflow, document management, and data collection are important business processes that can now be considered during the design of a process design/implementation project

Creating a world class tax reporting system



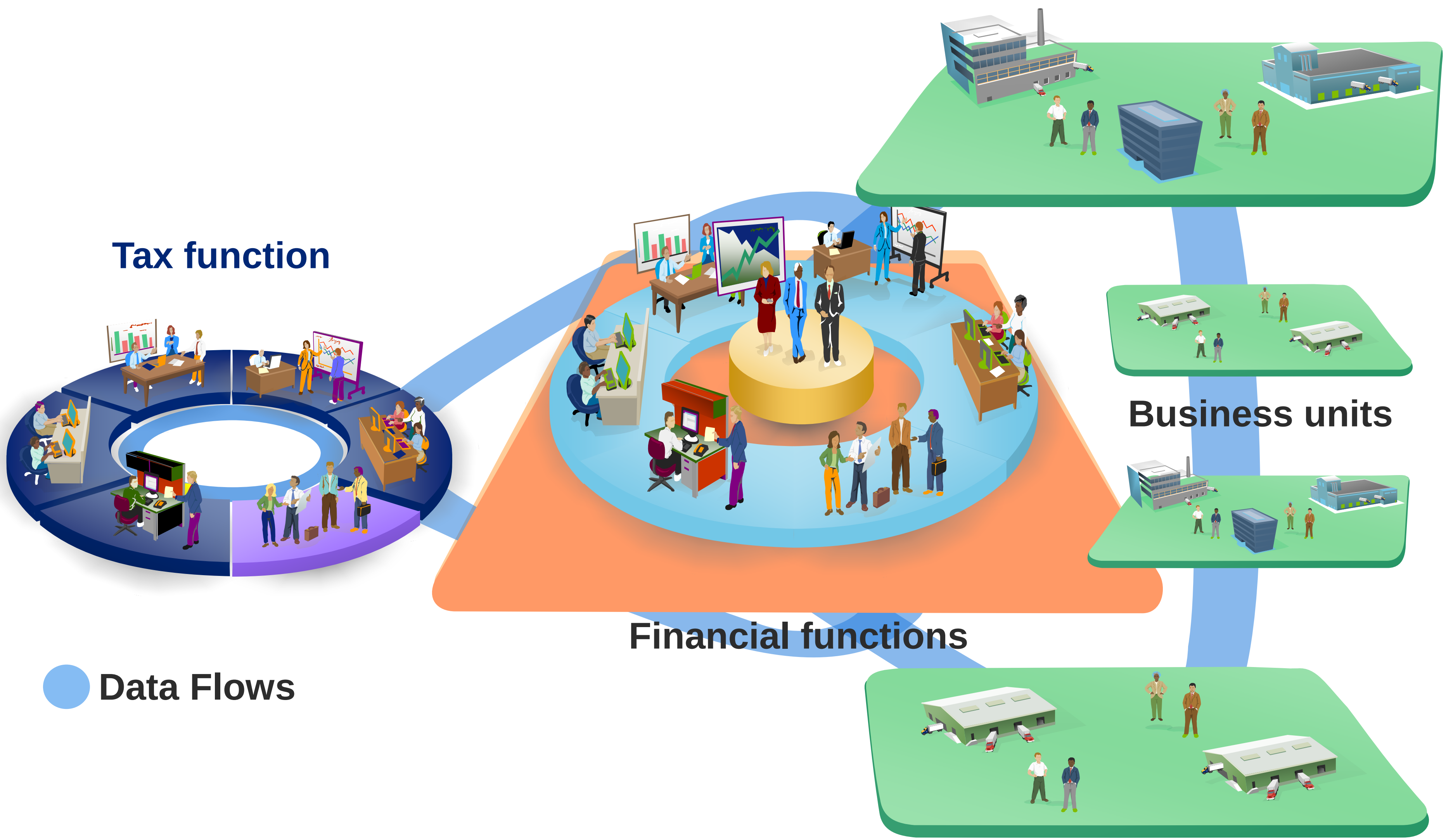
- Source data
- Source data needs
- Tax sensitization

- Location of all data
- Version control
- Results data stored in central location
- Data stored at the right level of detail

- Tax software system
- Tax rules in country engines
- Leverage third party maintenance

- Global tax forms
- Global provision reports
- Ad hoc user queries

Close process goal



Other technology issues for ASC 740

Currency conversion

- Differences between P&L rate for book income and tax expense
- Functional currency different than transactional currency

Branches, partnerships and other complex taxing structures

- Approach for configuration usually depends on tax accounting policy applied

GAAP to stat to tax approach

- Timing of the closing of the books creates issues
- Return to provision analysis can be complex if full walk not created during provision process

Please remember to complete your evaluation

Speaker bios

Vickie Carr has been a tax partner in Deloitte Tax LLP for more than 27 years providing services to public and private companies including multinational corporations and family-owned businesses primarily in the manufacturing and distribution industries. She began in the firm's Tulsa office before relocating to Memphis where she served clients for 12 years. She then served two years as a National leader in Financial Accounting & Reporting – Income Taxes group where she still serves as a co-leader of External Training. In 2010, Vickie relocated to Dallas where she serves as the lead tax partner on several large Global Strategic clients of the firm.

Throughout her career, Vickie has been a major contributor to the thought leader-ship developed on ASC 740 and other major tax issues and co-developed Deloitte Tax's methodology for FIN 48 compliance. She frequently speaks on tax topics at internal and external conferences, and she has served as a presenter for a number of Deloitte Dbriefs webcasts.

Vickie received a Bachelor of Science degree in Accounting from Oklahoma State University and a Masters in Federal Taxation from the University of Tulsa.

Phone: + 1 214 840 1457
Email: vcarr@deloitte.com

Rich Hyman is the Philadelphia Office Tax Managing Partner and the leader of our Philadelphia International Tax practice. Richard has more than 21 years of experience with the Firm in serving multinational companies in the manufacturing, pharmaceuticals, specialty chemicals, telecommunications, and consumer products sectors. During this time, Richard has advised clients on international mergers, acquisitions and divestitures, tax efficient supply chain and financing structures and other global tax and treasury enhancement strategies in Asia, Europe and the Americas while closely collaborating with clients' cross-functional leadership.

He has extensive knowledge and experience in the interpretation and application of ASC 740, accounting for income taxes, in an international context and in the areas of foreign tax credit planning, international tax attribute studies, and international tax compliance and controversy. He has served as the national leader of Deloitte Tax's International ASC 740 initiative and has worked with some of the Deloitte's largest clients in the resolution of complex tax accounting issues and in the area of ASC 740 process enhancement. Richard is a thought-leader in the International Tax Quantitative Consulting Services ("ITQCS") practice, which provides Deloitte clients with an approach to comprehensive international tax data management and quantitative analysis.

Richard received a Bachelor of Science in Accounting from the University of Delaware and a Master of Science in Taxation from Villanova University where he current serves as an adjunct faculty member teaching outbound international taxation.

Phone: +1 215 299 4612
Email: rhyman@deloitte.com

Speaker bios

Stephen Losavio is a Partner in the Deloitte Tax LLP Tax Management Consulting (TMC) practice with more than 17 years of tax and accounting experience, in both public accounting, as well as industry. His primary focus is on consulting with clients in the many areas of financial accounting for taxes, including tax contingencies and tax technologies.

Steve has worked with clients on a range of projects, including tax accounting and reporting assistance, tax transformation, and tax technology implementations. Steve has worked with these clients in the area of tax accounting through consulting on the appropriate tax accounting treatment for complex transactions, i.e. mergers, acquisitions, divestitures, etc., and financial accounting issues particularly relevant to the industry, i.e. mark to market accounting for securities, currency hedging, tax sharing agreements for separately stated financial statements, etc., under ASC 740, as well as advising on S.E.C. quarterly and annual filing requirements. These implementations include not only software design, but process design, integration of source data with the software, and training and support activities post implementation.

Prior to joining Deloitte, Steve was the head of tax for a publicly traded bio-technology company. His responsibilities included all areas of income tax reporting and compliance, as well as planning for tax entity structure and international cross-border transactions.

Phone: +1 212 436 2212
Email: slosavio@deloitte.com

Appendix
Risk Factors

Risk Factors: Example #3

Maiden Holdings LTD (2013 10-K)

The financial results of our operations may be affected by measures taken in response to the OECD BEPS project.

On July 19, 2013, the Organization for Economic Co-operation and Development published its Action Plan on Base Erosion and Profit Shifting (the "BEPS Action Plan"), in an attempt to coordinate multilateral action on international tax rules. The recommended actions include an examination of the definition of a "permanent establishment" and the rules for attributing profit to a permanent establishment. Other recommended actions relate to the goal of ensuring that transfer pricing outcomes are in line with value creation, noting that the current rules may facilitate the transfer of risks or capital away from countries where the economic activity takes place. Any changes in Australian, German, Russian, Swedish, U.K. or U.S. tax law in response to the BEPS Action Plan could adversely affect the Company's liability to tax.

Risk Factors: Example #4
American Express Credit Corp (2013 10-K)

Tax legislation initiatives or challenges to American Express' tax positions could adversely affect Credco's results of operations and financial condition.

American Express operates in jurisdictions throughout the world. As such, American Express remits a variety of taxes and fees to various governmental authorities, including U.S. federal, state and local governments and various foreign jurisdictions. The taxes and fees remitted by American Express are subject to review and audit by the applicable governmental authorities, which could result in liability for additional assessments. The laws and regulations related to tax matters are extremely complex and subject to varying interpretations. Although American Express believes its positions are reasonable, various authorities may challenge its positions or apply existing laws and regulations more broadly, which may potentially result in a significant increase in Credco's liabilities for taxes.

Legislative initiatives may be proposed from time to time, such as proposals for fundamental tax reform in the United States or multi-jurisdictional actions to address "base erosion and profit shifting" by multinational companies, which may impact Credco's effective tax rate and could adversely affect its tax positions and/or tax liabilities.

Risk Factors: Example #5
Assured Guaranty Ltd. (2013 10-K)

The financial results of our operations may be affected by measures taken in response to the OECD BEPS project.

On July 19, 2013, the Organization for Economic Co-operation and Development published its Action Plan on Base Erosion and Profit Shifting (the "BEPS Action Plan"), in an attempt to coordinate multilateral action on international tax rules. The recommended actions include an examination of the definition of a "permanent establishment" and the rules for attributing profit to a permanent establishment. Other recommended actions relate to the goal of ensuring that transfer pricing outcomes are in line with value creation, noting that the current rules may facilitate the transfer of risks or capital away from countries where the economic activity takes place. Any changes in U.S. or U.K. tax law in response to the BEPS Action Plan could adversely affect Assured Guaranty's liability to tax.

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