Accounting for Income Taxes Bulletin

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Featured items

Year-end reminders

As 2020 comes to a close, there are a number of accounting for income taxes matters to consider as companies finalize accounting for the year, prepare year-end disclosures, and look forward to the first quarter of 2021. A few select considerations are highlighted below.

ASU 2019-12

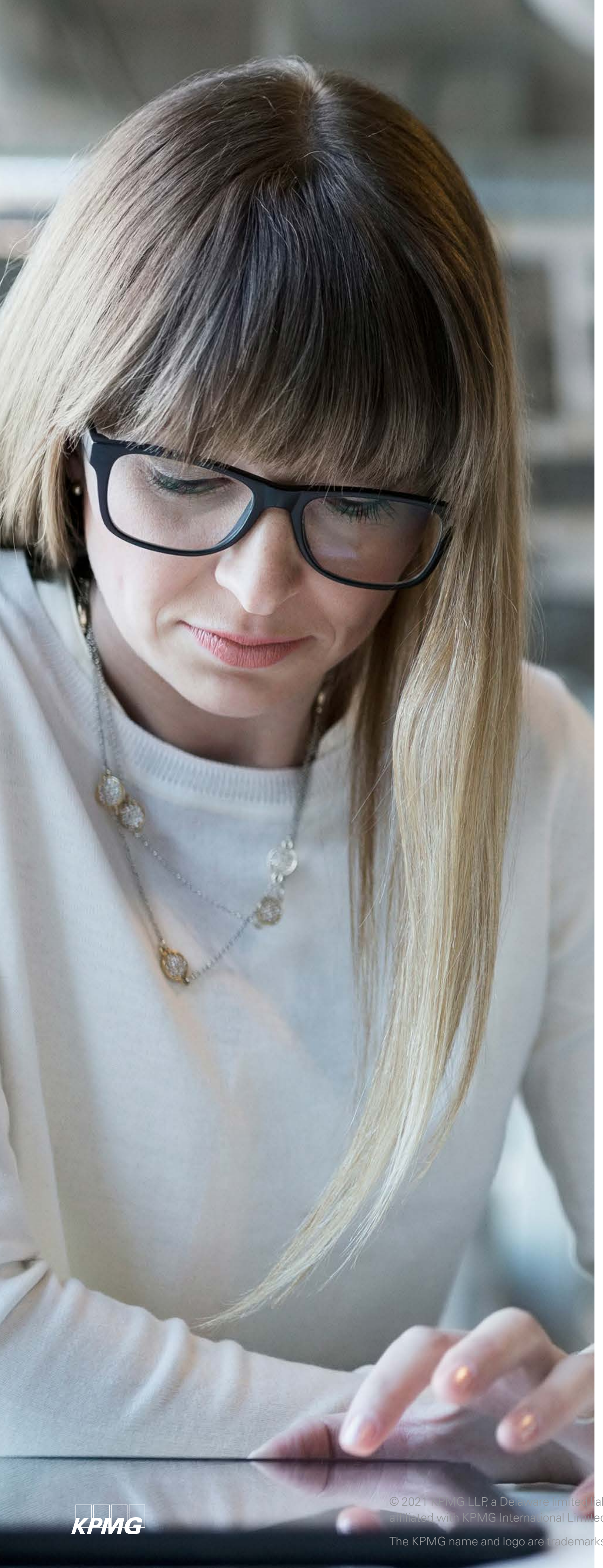
Accounting Standards Update (ASU) No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*, (ASU 2019-12), was issued in December of 2019 with the objective to simplify the accounting for income taxes by removing certain exceptions to general principles in ASC 740 and by clarifying and amending existing guidance within US generally accepted accounting principles (US GAAP). ASU 2019-12 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020, and for all other entities for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022. Early adoption is permitted. Prior to adoption of the standard, SEC registrants should disclose a brief description of the standard, the date adoption is required, the date the registrant plans to adopt, the method of adoption, the impact of adoption and other significant matters. Refer to the December 2019 Defining Issues for further information on the changes included in the ASU.

Accounting for income taxes considerations of current economic conditions

COVID-19 is having a significant impact on global markets driven by a number of factors, many of which are negatively impacting the financial performance of many entities. These effects, and a company's actions in responding, may affect certain aspects of a company's accounting for income taxes. Potential areas impacted include the analysis of the realizability of deferred tax assets, intraperiod tax allocations, assessment of the indefinite reversal criterion, and accounting for the tax effects of goodwill impairments, among others. Refer to the April 2020 Hot Topic for additional details on potential accounting for income taxes impacts of the COVID-19 outbreak, as well as the December 2020 Hot Topic on COVID-19 relief legislation, including the CARES Act and the Consolidated Appropriations Act, 2021.

Accounting for income taxes considerations of final Treasury Regulations

In recent months, a significant volume of Treasury Regulations has been released in final (or near final) wording or published to the Federal Register, which generally represent changes in currently enacted law. Some considerations to appropriately reflect the impact of the regulations may include, but are not limited to, whether the regulations are enacted, whether the changes would result in favorable or unfavorable impacts, whether there are future applicability dates with elections to apply the regulations to current or prior periods, and if amended income tax returns are expected to be filed. Refer to the September 2020 What's News in Tax article for additional detail.



Brexit

On December 31, 2020, the transition period concluded during which the United Kingdom (UK) and European Union (EU) worked to determine the terms of its future relationship after the UK's withdrawal from the EU (Brexit). With the expiration of the transition period and the execution of the EU-UK Trade and Cooperation Agreement, certain tax exemptions and reliefs on intra-European transactions no longer apply to transactions between UK companies and EU companies. As a result, many entities may encounter a change to the withholding tax rates that apply to dividends payments made to UK companies from EU resident companies. Accordingly, companies' assertions and estimates of deferred taxes for investments in EU subsidiaries held by UK entities should consider any potential dividend withholding. Additionally, royalties and interest payments between UK and certain EU entities may be subject to withholding beginning in 2021. Further, as additional potential impacts, the UK will no longer be subject to the EU Merger Directive or other directives. Refer to the KPMG UK Insights article for additional discussion over the UK corporate tax implications following Brexit.

See KPMG UK's Navigating Brexit webpage for additional resources and paragraphs 5.054 through 5.057b of KPMG's Handbook, *Accounting for income taxes*, for additional discussion on the accounting for income taxes considerations of Brexit, including when to account for potential changes from the separation.

Accounting for income taxes considerations of attribute reduction as a result of emergence from bankruptcy

In light of recent negative economic conditions a number of companies are expected to emerge from bankruptcy in the near term. Consequently, there are accounting for income taxes considerations of attribute reduction that may result from the emergence from bankruptcy as cancellation of debt (COD) income is excluded from taxable income. Sections 108 and 1017 require an entity to reduce the amount of carryforwards and the tax basis of assets, subject to certain limitations and according to prescribed ordering rules, based on the amount of COD income excluded from taxable income. To the extent there is COD income in excess of the amount used to reduce tax attributes, the excess is commonly referred to as "black hole" COD income. The final amounts of attribute reduction and black hole COD income are dependent on events that occur after the emergence date and prior to the end of the tax year.

For financial reporting purposes, entities apply fresh-start reporting as of the emergence date, which is similar to purchase accounting. We believe a deferred tax liability should be recognized as of the date of fresh-start reporting for future attribute reduction, if any. As part of measuring the deferred tax liablilty as of the emergence date, we believe an acceptable approach would be to determine the attributes that would be reducted if the reduction were to occur based on the facts and circumstances at the emergence date.

When emerging from bankruptcy, entities should carefully consider the accounting for income taxes consequences of attribute reduction under sections 108 and 1017 of the Code. Refer to the December 2020 What's News in Tax article for additional detail and discussion of considerations related to accounting for attribute reduction.

SEC comments on accounting for income taxes

A What's News in Tax article from the Accounting for Income Taxes group in Washington National Tax (WNT) provides examples of comments regarding accounting for income taxes matters recently issued by the US Securities and Exchange Commission (SEC) to registrants. Recent comments from regulators and standard setters may help issuers identify areas for improvements in existing income taxes disclosures in order to provide more robust and relevant information to investors.

The selection of SEC comment letters specific to accounting for income taxes are provided to illustrate areas in which the SEC staff questioned whether the disclosures provided adequate insight for investors to understand a company's income taxes environment or when the SEC staff wanted a better understanding of the basis for management's judgments. The examples involve comments related to the effective tax rate reconciliations, valuation allowances, investments in subsidiaries, unrecognized tax benefits, intra-entity transfers of assets other than inventory, intraperiod tax allocations, accounting for income taxes in interim periods, and corrections of errors and assessment of materiality.

Updates to KPMG's accounting for income taxes handbook

KPMG recently updated its Handbook, *Accounting for income taxes*, to add interpretive guidance on several accounting for income taxes matters.

The October 2020 edition incorporates:

— Updated guidance on the CARES Act;

— Updates to conform with KPMG Handbook, *Impairment of nonfinancial assets*;

— Guidance on share-based payment arrangement in consolidated pass-through entity structures; and

— Clarification of guidance on intraperiod tax allocation.

The publication includes a brief summary of the revisions since the April 2020 edition.

Updates on accounting matters

ASU 2020-10, *Codification improvements*

The FASB issued ASU 2020-10, Codification Improvements, to clarify various topics in the Accounting Standards Codification. The ASU was issued as part of the FASB's codification improvements project to address minor improvements to the codification that were deemed necessary by the Board. The amendments in this ASU affect a wide variety of Codification Topics, including, but not limited to:

— Duplicating existing disclosure guidance into the disclosure section of Codification around income tax expense (benefit) allocated to other comprehensive income;

— Removing outdated terminology around income taxes; and

— Correcting references and adding headings to the income tax related matters in ASC 830.

The amendments in this ASU do not change U.S. generally accepted accounting principles (U.S. GAAP) and, therefore, are not expected to result in a significant change in practice.

IFRS® standards updates

KPMG LLP has released the following update that may impact tax professionals working on accounting for income taxes matters under IFRS Standards.

— KPMG's International Standards Group has issued the 2020 guides to annual financial statements that comprise Illustrative disclosures, a companion disclosure checklist, and a COVID-19 disclosure supplement, to help companies prepare financial statements under IFRS Standards.

— KPMG recently updated the IFRS compared to US GAAP handbook. This side-by-side comparison of IFRS Standards and US GAAP highlights the key differences between the two frameworks based on 2020 calendar year-ends.

KPMG DPP Quarterly Outlook—December 2020 provides accounting and financial reporting developments.

Recent pronouncements

Professionals should be mindful of certain recently updated US GAAP standards, listed by order of required application.

Updated Standard	Brief Description of Standard	Public Business Entities Effective Date	Other Entities Effective Date
ASU 2018-09, Codification Improvements	Clarifies, corrects errors in, and makes improvements to several income taxes related matters	Generally, fiscal years beginning after December 15, 2018	Generally, fiscal years beginning after December 15, 2019
ASU 2017-04, Simplifying the Test for Goodwill Impairment	Provides guidance, amongst others, on the income tax effects from tax deductible goodwill when measuring goodwill impairment loss	Annual and interim impairment tests for periods beginning after December 15, 2019 for SEC filers other than smaller reporting companies	Annual and interim impairment tests for periods beginning after December 15, 2022
ASU 2019-12, Simplifying the Accounting for Income Taxes	Removes specific exceptions to the general principles of ASC 740 and improves financial statement preparers' application of income tax-related guidance and simplifies GAAP for certain income tax items	Fiscal years beginning after December 15, 2020, and interim periods within those fiscal years	Fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022

On the horizon

Financial accounting standards board (FASB) projects

The FASB's Disclosure Review: Income Taxes project continues to be in the revised exposure draft redeliberations stage after the Board directed the staff in February 2020 to perform research and additional outreach on potential alternatives to disclose certain disaggregated income taxes information and to perform additional research on other proposed amendments. In a September 2020 meeting, the staff updated the FASB's Private Company Council (PCC) on comments received on the project and obtained the PCC's feedback on proposed disclosures and potential alternative disclosures. In a November 2020 meeting, the Investor Advisory Committee noted that there is a need for more granular information, such as profits and income taxes, on a geographical or jurisdictional level.

The Board's disclosures by business entities about government assistance project is in the exposure draft redeliberations stage.

At its meeting on agenda prioritization on December 16, 2020, the Board tentatively removed the project on backwards tracing to consider whether changes should be made to the prohibition on backwards tracing and may consider alternatives to backwards tracing.

International accounting standards board discusses *deferred tax related to assets and liabilities arising from a single transaction* (Amendments to IAS 12)

During its October meeting, the International Accounting Standards Board (the Board) discussed feedback received on the Board's July 2019 Exposure Draft, *Deferred Tax related to Assets and Liabilities arising from a Single Transaction*, which proposed amendments to IAS 12. The Board tentatively decided to:

— Confirm its proposal to narrow the scope of the initial recognition exemption such that it would not apply to transactions that give rise to equal amounts of deductible and taxable temporary differences

— Remove the capping proposal included in the initial exposure draft

— Provide no application guidance or examples illustrating how an entity determines whether tax deductions relate to the lease asset or lease liability

— Provide an illustrative example explaining the deferred tax accounting for advance lease payments and initial direct costs

The Board also determined how to apply the amendments for leases and decommissioning obligations through a cumulative effect recognized at the beginning of the earliest comparative period and to apply the amendments prospectively for all other transactions. Later, at the November meeting, the Board tentatively decided that entities should apply the amendments for annual periods beginning on or after January 1, 2023, with earlier application permitted. The Board also decided that the amendments do not require re-exposure and expects to issue the amendments in the second quarter of 2021.

Other items of interest

Center for Audit Quality issues report on critical audit matters

The Center for Audit Quality (CAQ) has issued Critical Audit Matters: A Year in Review, which includes data and analysis about the critical audit matters (CAMs) that were communicated for the S&P 100 companies. This publication presents observations from the CAQ's analysis of the CAMs communicated in the auditor's reports for companies broadly, as well as a deeper dive into the S&P 100, which comprises 100 public companies across multiple industry groups. CAMs are required to be communicated in auditors' reports for all entities for periods ending on or after December 15, 2020.

Taxes were the most prevalent CAM topic within the auditor's reports for companies in the S&P 100, with 32 of those companies reporting CAMs on taxes. Tax account balances and disclosures are frequently material to the financial statements and reflect management estimates involving higher estimation uncertainty. In turn, it is not surprising that this audit area would involve especially challenging, subjective, or complex auditor judgment. CAMs related to taxes identified various judgmental taxation areas such as the impact of new federal tax laws (for instance, the Tax Cuts and Jobs Act of 2017), deferred tax assets, unrecognized tax benefits, and accounting for income taxes in general.

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Resources

- KPMG's Accounting for Income Taxes Bulletin
- Handbook: Accounting for income taxes
- Financial Reporting View
- TaxNewsFlash
- Insights into IFRS
- IFRS compared to U.S. GAAP

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