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Global tax accounting services newsletter

Focusing on tax accounting issues affecting businesses today

July – September 2016

pwc

Introduction

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Senior tax buyers name PwC as their first choice provider for tax accounting services globally*

**These results are based on an independent survey of 2,536 primary buyers of tax accounting services globally, conducted by research agency Jigsaw Research (Q1–Q4 2015).*

The *Global tax accounting services newsletter* is a quarterly publication from PwC's Global Tax Accounting Services (TAS) group. In the newsletter we highlight issues that may be of interest to tax executives, finance directors, and financial controllers.

In this issue, we provide an update on the recent activity of the Financial Accounting Standards Board (FASB) and the International Financial Reporting Standards (IFRS) Interpretations Committee, as well as recent State aid developments.

We also draw your attention to some significant tax law changes that occurred around the globe during the quarter ended September 2016.

Finally, we discuss some key tax accounting considerations under IFRS and US GAAP in relation to outside basis differences – an area that is both complex and subjective.

This newsletter, tax accounting guides, and other tax accounting publications are also available online. You can also register and access quarterly TAS webcasts for periodic updates on the latest developments.

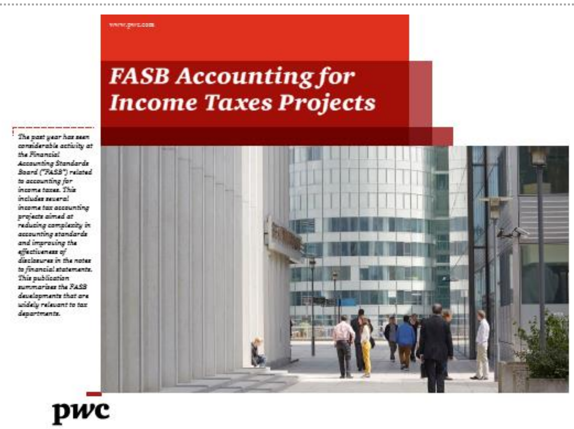
If you would like to discuss any of the items in this newsletter, tax accounting issues affecting businesses today, or general tax accounting matters, please contact your local PwC team or the relevant Tax Accounting Services network member listed at the end of this document.

You should not rely on the information contained within this newsletter without seeking professional advice. For a thorough summary of developments, please consult with your local PwC team.

In this issue

Accounting and reporting updates

This section offers insight into the most recent developments in accounting standards, financial reporting, and related matters, along with the tax accounting implications.



FASB Accounting for Income Taxes Projects placemat

The FASB activity update

Overview

On 26 July 2016 the FASB issued a proposed Accounting Standards Update (ASU), *Disclosure Framework - Changes to the Disclosure Requirements for Income Taxes*, which would significantly impact income tax disclosures for companies reporting under US GAAP.

The ASU was issued following the FASB's tentative decisions on tax disclosures in the second quarter of 2016 (see the Q2 2016 Global TAS newsletter) and is part of the Board's on-going project to improve disclosure effectiveness.

Proposed disclosure requirements

The proposed guidance would add new income tax disclosures, modify existing disclosures, and in some cases require further disaggregation of information.

The ASU would include requirements for all entities (public and private) to disclose the following:

- the terms of any rights or privileges granted by a governmental entity directly to the reporting entity that have reduced, or may reduce, the entity's income tax burden in a particular jurisdiction (this would not include grants for which the entity meets eligibility requirements that are broadly available to other taxpayers)
- the amount of income taxes paid to any country that is significant to the total income tax paid
- the circumstances causing changes in the assertion related to the indefinite reinvestment of undistributed foreign earnings and the corresponding amount of earnings impacted
- the aggregate balance of cash, cash equivalents, and marketable securities held by foreign subsidiaries
- income or loss from continuing operations, income tax expense or benefit from continuing operations, and income taxes paid, each disaggregated between domestic and foreign
- the gross pre-tax and tax-effected amounts (before valuation allowance) of federal, state, and foreign carryforwards
- a description of an enacted tax law change that is probable to have an impact in a future period

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Accounting and reporting updates

Public business entities would have additional disclosure requirements related to unrecognised tax benefits. For example, as proposed, the amount of settlements, which is already required in the reconciliation of the beginning and ending balance of unrecognised tax benefits, would need to be separated between those settled in cash and those settled using deferred tax assets. In addition, reporting entities would need to disclose the financial statement line item where unrecognised tax benefits are recorded, with a separate disclosure for items not presented in the statement of financial position.

Public business entities would also be required to disclose the amount of, and explanation for, a valuation allowance recognised or released during the reporting period.

In addition, the existing requirement for public entities to disclose an effective tax rate reconciliation would be made consistent with the SEC requirements in Regulation S-X. As a result, individual reconciling items that are more than 5% of the amount computed by multiplying pre-tax income by the statutory rate would be disclosed separately in the rate reconciliation. Furthermore, public business entities will be required to provide an explanation of significant changes in the reconciling items from year-to-year.

What's next?

The FASB requested comments on the proposed ASU by 30 September 2016. Stakeholders are encouraged to provide comments on the proposals. The application of the ASU would be on a prospective basis with an effective date to be determined after the FASB considers stakeholder feedback.

Takeaway

The proposed ASU will affect financial statement disclosures of virtually all entities that apply US GAAP. Although many of the proposed disclosure requirements codify existing SEC disclosure requirements, certain of the new disclosures will make information public that was not previously available. Companies should consider how the additional disclosures may be utilised and interpreted by various stakeholders. In addition, compiling the necessary information, particularly for multinational corporations, may be challenging and may require updates to systems, processes, and controls.

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Accounting and reporting updates

The IFRS Interpretations Committee update

Overview

During the third quarter of 2016, the IFRS Interpretations Committee considered the following tax-related issues:

- summary of the feedback on the draft Interpretation on uncertain tax positions that was issued in October 2015
- the expected manner of recovery of an indefinite-life intangible asset for the purposes of measuring deferred tax
- recognition of deferred taxes when acquiring a single-asset entity

During the previous quarter, the Interpretations Committee also considered the accounting for cash received from a government to finance research and development (R&D) projects.

We summarise below the Interpretations Committee's discussions on these issues. For more information see the IFRS Interpretations Committee Update web page.

Feedback on the draft Interpretation on uncertain tax positions

The Interpretations Committee discussed a summary of 61 comment letters received on the draft Interpretation on uncertain tax positions (*Uncertainty over Income Tax Treatments*) that was issued in October 2015. The majority of comment letters were broadly in agreement with the draft Interpretation. However, several areas were noted where clarifications may be required.

The Interpretations Committee discussed these areas during its September meeting, taking into account the feedback received. The Interpretations Committee tentatively decided to make no changes to the proposals in the exposure draft in connection with the scope of the interpretation, the assumption that the tax authority has full knowledge, the probable recognition threshold, the transition requirements and the disclosure proposals.

The Interpretations Committee also tentatively decided to restructure the guidance around the outcome of a review by the tax authority, to clarify that IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* is applied to a change in circumstances and that IAS 10, *Events After the Reporting Period* is applied to events after the balance sheet date.

The Interpretations Committee will finalise its deliberations at a future meeting.

Expected manner of recovery of an indefinite-life intangible asset for the purposes of measuring deferred tax

The Interpretations Committee received a request to clarify the determination of the expected manner of recovery of an indefinite-life intangible asset for the purposes of measuring deferred tax.

The Interpretations Committee noted that paragraph 51 of IAS 12, *Income Taxes* states that the measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that follow from the manner in which an entity expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

The Interpretations Committee also noted the requirements in paragraph 88 of IAS 38, *Intangible Assets* regarding indefinite-life intangible assets.

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Accounting and reporting updates

The Interpretations Committee observed that an indefinite-life intangible asset is not a non-depreciable asset as described by paragraph 51B of IAS 12. This is because a non-depreciable asset has an unlimited (or infinite) life, and IAS 38 explains that indefinite does not mean infinite. Consequently, the requirements in paragraph 51B of IAS 12 do not apply to indefinite-life intangible assets.

The Interpretations Committee noted the International Accounting Standards Board's (IASB) observation about indefinite life intangible assets when the Board amended IAS 38 in 2004. The Board observed that an indefinite-life intangible asset is not amortised because there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in the asset and, hence, amortisation over an arbitrarily determined maximum period would not be appropriate. Therefore, the reason for not amortising an indefinite life intangible asset is not because there is no consumption of the future economic benefits embodied in the asset.

The Interpretations Committee observed that an entity recovers the carrying amount of an asset in the form of economic benefits that flow to the entity in future periods, which could be through use or sale of the asset. Accordingly, the recovery of the carrying amount of an indefinite life intangible asset does not depend on whether the asset is amortised. Consequently, the fact that an entity does not amortise an indefinite life intangible asset does not necessarily mean that the entity will recover the carrying amount of that asset only through sale and not through use.

The Interpretations Committee noted that an entity applies the principle and requirements in paragraphs 51 and 51A of IAS 12 when measuring deferred tax on an indefinite life-intangible asset. In applying paragraphs 51 and 51A of IAS 12, an entity determines its expected manner of recovery of the carrying amount of the indefinite life intangible asset, and reflects the tax consequences that follow from that expected manner of recovery.

The Interpretations Committee tentatively concluded that the principles and requirements in paragraphs 51 and 51A of IAS 12 provide sufficient guidance with respect to measuring deferred tax on indefinite life intangible assets.

In the light of existing requirements in IFRS Standards, the Interpretations Committee tentatively determined that neither an Interpretation nor an amendment to a Standard was necessary.

Practical considerations

Once the agenda decision is finalised, some entities may need to review their accounting policies to ensure that they have properly considered the expected manner of recovery of any indefinite life intangible assets and reflected the appropriate tax consequences.

Indefinite life intangible assets in the form of brands are common in the consumer products and services, life science and healthcare, and entertainment and media industries. Determining that the carrying amount of the indefinite life intangible asset will be recovered through sale as opposed to use may mean that deferred tax is calculated using a tax rate applicable to capital transactions rather than to revenue transactions.

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Accounting and reporting updates

Recognition of deferred taxes when acquiring a single-asset entity

The Interpretations Committee received a request to clarify how an entity accounts in its consolidated financial statements for a transaction in which it acquires all of the shares of another entity that has an investment property as its only asset. In the fact pattern submitted, the acquired entity had previously recognised a deferred tax liability arising from measuring the investment property at fair value in its statement of financial position, and that deferred tax liability was reflected in the amount paid for the shares by the acquirer. The transaction described in the submission does not meet the definition of a business combination in IFRS 3, *Business Combinations*.

The Interpretations Committee noted that paragraph 15(b) of IAS 12, *Income Taxes* states that an entity does not recognise a deferred tax liability for taxable temporary differences that arise from the initial recognition of an asset or a liability in a transaction that is not a business combination and that, at the time of the transaction, affects neither accounting profit or loss nor taxable profit (tax loss). Accordingly, on acquisition, the entity recognises only the investment property and does not recognise the previously recorded deferred tax liability in the allocation of the purchase price. The entity allocates the purchase price of the shares to the investment property applying paragraph 2(b) of IFRS 3.

The Interpretations Committee concluded that the requirements in IFRS Standards provide an adequate basis which enables an entity to determine how to account for the transaction. The Interpretations Committee also concluded that any reconsideration of the initial recognition exception in paragraph 15(b) of IAS 12 is something that would require a Board-level project. Consequently, the Interpretations Committee tentatively decided not to add this issue to its agenda.

Practical considerations

These transactions are common in certain jurisdictions where there are tax advantages to selling shares as opposed to the sale of individual investment properties. Although there is some diversity in how these transactions are accounted for in practice, the tentative agenda decision indicates that the requirements of IAS 12 provide sufficient guidance. Organisations in similar circumstances should therefore review their approach to ensure it is in line with that required by the Standards.

Cash received from the government to finance R&D projects

The Interpretations Committee received a request to clarify the accounting for cash received from the government to finance R&D projects. More specifically, the request asked whether the entity must recognise the cash received as a liability or in profit or loss in the following fact pattern:

The fact pattern submitted to the Interpretations Committee was as follows:

- The government gives cash to an entity to finance a qualifying research project.
- The cash is repayable if the entity decides to exploit and commercialise the results of the research project.
- If the entity decides not to exploit and commercialise the results of the research phase, the cash is not repayable, but the research results are transferred to the government.

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Accounting and reporting updates

The Interpretations Committee concluded that contingently repayable cash received from a government to finance an R&D project is a financial liability under IFRS 9, *Financial instruments,* and under IAS 32, *Financial instruments: Presentation*. This is because the entity can avoid a transfer of cash only by settling a non-financial obligation (i.e., by transferring the rights to the research to the government).

The Interpretations Committee stated that the cash received from the government was not in the scope of IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*. This is because, the government will not waive repayment of the loan, but rather requires settlement in cash or by transfer of the rights to the research.

The Interpretations Committee noted that initially a financial liability is recorded at fair value. If there is any difference between the cash received and fair value of the liability, that difference may represent a government grant that would be accounted for under IAS 20.

In the light of existing requirements in IFRS Standards, the Interpretations Committee tentatively determined that neither an Interpretation nor an amendment to a Standard was necessary.

Practical considerations

The above decision of the Interpretations Committee may have an impact on the pharmaceutical industry. R&D funding in the pharmaceutical industry comes from many sources, including governments, charitable organisations, and venture capitalists (VC). The fact pattern considered by the Interpretations Committee was very specific but has broader implications for any arrangement that has similar characteristics.

Government programs of this type are most likely to be used by smaller biotech and pharma companies, often in the start-up period.

Charitable organisations often support the search for a cure of a specific disease or condition or more broadly support research and science projects. A grant from a charitable organisation may include the same broad features as a government program or VC funding. The trustees of a charity have a duty to ensure that the charity does not enrich a commercial organisation such as a pharma start-up without sharing any beneficial outcome.

A VC might finance an R&D project for a start-up pharma company. Repayment can be triggered by commercialisation of the drug and may be fixed or a percentage of sales. Similar to a governmental program, the pharma company could be required to transfer any intellectual property or research result to the VC if the pharma company chooses not to commercialise or the research fails. The requirement to transfer the intellectual property protects the interest of the VC in situations where the commercialisation of drug might not be the most attractive prospect for the pharma company.

Organisations that obtain assistance from the government, charitable organisations or other parties (like VC) under similar terms as described in the fact pattern above should consider the impact of the Interpretations Committee's decision on their current accounting. It is likely that they may need to recognise a financial liability when cash is received in accordance with the provisions of IFRS 9.

The Interpretations Committee's decision is effective immediately and serves as a clarification of the accounting treatment that should have been followed. Any revisions should be accounted for retrospectively and comparative amounts should be restated.

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Accounting and reporting updates

State aid developments

Overview

In August 2016, the European Commission (EC) announced its final decision in the formal State aid investigation into the profit attribution arrangements and corporate taxation of Apple in Ireland. The EC concluded that, in its opinion, Apple benefitted from unlawful State aid granted by Ireland, and it ordered full recovery of the aid in an amount of up to €13 billion plus compound interest.

In detail

The EC's investigation related to two rulings on the attribution of profits to the Irish branches of two Irish incorporated, non-resident companies ultimately owned by Apple Inc. These rulings were granted in 1991 and 2007.

The EC's position is that the agreements made between Apple and Ireland do not reflect economic reality of profit attribution. The EC concluded that the rulings deviated from the arm's length principle in a manner which was selective and thus constituted unlawful State aid.

The EC has ordered Ireland to recover the unlawful aid from Apple as outlined above. However, the EC has also stated that the amount of unpaid taxes to be recovered by Ireland could be reduced if other countries were to require Apple to pay more taxes on the profits recorded by each entity. The recovery is subject to a limitation period of ten years.

The Irish government has stated publicly that it will contest the negative decision. Additionally Apple has issued a press release stating that they will appeal the decision and expects to win such an appeal. Under EU State aid law, both Apple and the Irish government can challenge the validity of the decision and ask for its annulment before the EU's General Court. The General Court's judgment can in turn be appealed before the Court of Justice of the EU, which will ultimately have the final say on the merits of the EC's decision. This could take several years. However, an appeal does not suspend recovery procedures. As such, the amount of the aid could be paid into an escrow account pending the outcome of any appeal.

The EC's decision in the Apple case has been met with significant negative reaction in the United States. Just before the decision was released, the US Treasury published a white paper suggesting that any negative decision by the EC with retroactive recovery would be wholly inappropriate for a number of reasons. Following the press release of the EC's decision there have been negative reactions from the US Administration, both the White House and the US Treasury, as well as politicians on both sides of the House and Senate. However, there has been no indication of what steps the US may take in response.

Takeaway

Organisations should consider the above decision and monitor further State aid developments to assess if a tax ruling, tax settlement, or even tax regime may be considered unlawful State aid. The accounting consequences of such investigations, based on available information, are in many cases likely to be in the scope of ASC 740 and IAS 12.

State aid should be an important consideration when establishing any new tax position with the tax authorities, whether in relation to a tax ruling, tax settlement, or the application of a specific tax regime. Organisations should also assess the potential effect of these continuing developments on existing uncertain tax positions, as well as amounts owed for periods previously considered closed.

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Accounting and reporting updates

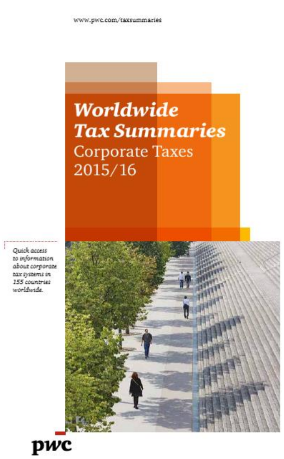
Organisations may need to seek expert support in assessing risks from appropriate legal counsel. Expert analysis should also address the company's position in the context of the relevant accounting standard.

Organisations will need to document management's assessment, as well as related internal controls. Enhanced disclosure should also be considered to more directly address the impact of the EC's actions on ongoing risk assessments.

Continued

Recent and upcoming major tax law changes

This section focuses on major changes in the tax law that may be of interest to multinational companies and can be helpful in accounting for income taxes. It is intended to increase readers' awareness of the main global tax law changes during the quarter, but does not offer a comprehensive list of tax law changes that should be considered for financial statements.



Worldwide tax summaries

Belgium

During the third quarter of 2016, the Belgian government discussed the following key proposals for a corporate tax reform. These proposals would be subject to further discussions and political negotiations, and further changes are expected:

- The corporate income tax rate would be reduced from 33.99% to 20% progressively by 2020.
- The 100% participation exemption would apply to dividends received and certain capital gains.
- The fairness tax, the notional interest deduction and investment deduction regimes would be abolished.
- The use of carryforward losses would be limited, for example to a percentage of taxable income.

Luxembourg

During the third quarter of 2016, the Luxembourg government introduced a bill that proposes certain corporate income tax changes, including the following:

- The corporate income tax rate for large companies would be reduced from 21% to 18% over two years, beginning in 2017.
- The minimum net wealth tax (NWT) applicable to certain holding and finance companies would be increased from EUR 3,210 to EUR 4,815 (including the solidarity surtax).
- Losses generated after 1 January 2017 could be carried forward for up to 17 years. Losses generated before 2017 would not be affected by the proposed loss carryforward period.

South Africa

During the third quarter of 2016, the South African National Treasury released drafts bills for the following 2016 Budget tax proposals:

- The hybrid debt instrument and hybrid interest rules would no longer apply to transactions with non-resident issuers (borrowers) that are outside South Africa's tax net. The hybrid rules effectively reclassify debt instruments issued by a company as equity if the terms of the instrument contain equity features, and reclassify interest as a deemed dividend.

Continued

Recent and upcoming major tax law changes

The proposed changes aim at discouraging non-resident issuers from structuring their loans to include the equity features that would trigger a tax-exempt deemed dividend for South African resident holders.

- Withholding tax on service fees would be repealed.
- Withholding tax on interest would be refundable if it was paid on interest that became due and payable but later was written off.

United Kingdom (UK)

During the third quarter of 2016, the UK enacted the following key measures as part of the Finance Act 2016:

- The corporate income tax rate has been reduced from 19% to 17% starting from 1 April 2020.
- Anti-hybrid rules have been introduced to implement recommendations under BEPS Action 2. These rules are effective from 1 January 2017.
- The amount of profit that banks can offset with pre-April 2015 carryforward losses is restricted to 25% starting from 1 April 2016.

In addition, further to the UK's Budget 2015 commitment to transform the tax system through digital technology and abolishing the need for an annual tax return by 2020, the UK tax authority (HMRC) published a package of six 'Making Tax Digital' consultation papers which covers issues such as digital record keeping, reduced reporting requirements, use of third party information, voluntary Pay as You Go (PAYG) tax payments and introducing simplifications, e.g., extending cash basis accounting to more businesses and simplifying late filing and late payment sanctions. The comment period is open until 7 November 2016.

The HMRC also invited public comment on new legislation that would require UK taxpayers with outstanding tax liabilities relating to any offshore interests to come forward and correct those liabilities by September 2018 and strongly penalize those who do not meet this obligation. The new legislation is open for comment until 19 October 2016.

In a referendum on 23 June 2016, voters in the United Kingdom chose to leave the European Union (EU) – often called 'Brexit.' The referendum vote has not caused a direct legislative tax change in the UK or in the EU. In order to leave the EU, the UK needs to invoke Article 50 of the Treaty on the Functioning of the European Union (TFEU), which will then trigger a two year exit procedure. The UK will also need to negotiate a withdrawal agreement and agree to terms on its relationship with the EU and the rest of the world, which could take some time. Other legislative changes may follow. Multinational companies that participate in the UK or EU markets should consider near-term financial reporting implications of Brexit similar to those described for US companies here.

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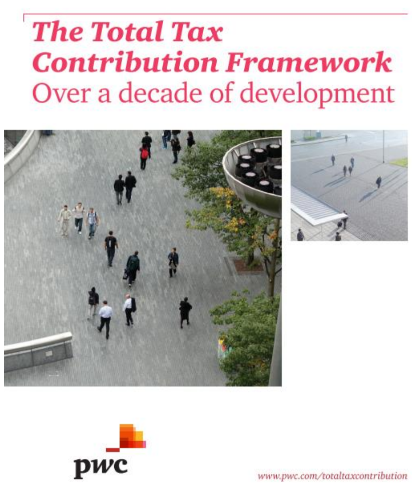
Tax accounting refresher

In this section we discuss key tax accounting considerations under IFRS and US GAAP in relation to outside basis differences – an area that is both complex and subjective.



The Total Tax Contribution Framework

Outside basis differences

Background

Under both IFRS and US GAAP, a temporary difference may arise between a parent's book value of the investment in an investee and its tax basis. These temporary differences are known as 'outside basis' differences and are different from the 'inside basis' differences, i.e., differences between the investee's book and tax basis in its individual assets and liabilities within the entity.

Outside basis differences may arise in a number of situations. Often times such differences arise as a result of profit or loss, as it impacts the parent's book investment in the investee while generally not adjusting tax basis. In the US, outside basis difference arising due to undistributed retained earnings, and in particular the indefinite reversal assertion (discussed below), are a common area of focus and comment by the Security and Exchange Commission's (SEC).

Outside basis differences can also arise when the carrying value of an investment is impaired or otherwise changes due to foreign exchange movements, or due to changes in the book or tax basis with business combinations or reorganisations. Outside basis differences can also arise due to changes in a parent's equity in the net assets of a subsidiary resulting from transactions with noncontrolling shareholders (i.e., the subsidiary's capital transactions and transactions between parent and noncontrolling shareholders), and other comprehensive income items such as unrealised gains or losses on available for-sale securities.

Typically, reversal of the outside basis differences will occur through dividends from the investee, sale of the investee's stock by the parent, liquidation of the investee, or, in case of a subsidiary – a merger of the subsidiary into the parent.

Below we discuss IFRS and US GAAP considerations for outside basis differences arising from investments in subsidiaries, associates and interests in joint ventures. For considerations relevant to outside basis differences arising from investments in branches, partnerships and other flow-through entities please refer to the Q2 2015 Global TAS newsletter and Q3 2015 Global TAS newsletter.

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Tax accounting refresher

IFRS

Deferred tax liability and deferred tax asset

Under IFRS, a deferred tax liability should be recognised for all taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures in the company's consolidated financial statements. A taxable temporary difference would typically arise as a result of unremitted profits (earnings) as it would generally increase the parent's book investment in the investee when compared with its tax basis.

The deferred tax liability on outside basis differences should be recognised except to the extent that both of the following conditions are satisfied:

- the parent, investor or venturer is able to control the timing of the reversal of the temporary difference
- it is probable that the temporary difference will not reverse in the foreseeable future

Conversely, a deductible taxable difference may arise due to the impairment of the carrying value of the investment to a value below its tax basis, for example, due to the investee's accumulated losses.

A deferred tax asset should be recognised in the company's consolidated financial statements for all deductible temporary differences arising from investments, provided the following requirements are satisfied:

- the reporting entity expects that the temporary difference will reverse in the foreseeable future
- taxable profit will be available against which the temporary difference can be utilised

The above provisions apply in the same way irrespective of the level of an investment, i.e., whether it is an investment in a subsidiary, an associate or a joint venture. However, given the above recognition requirements, it is less common that a deferred tax asset would be recognised in relation to outside basis differences arising from investments.

The calculation of any deferred tax asset or liability must follow the expected manner of recovery of the investment, usually through either disposal or liquidation of the investment, or distribution of the accumulated profits. In addition, the calculation should factor in the relevant tax laws and rates expected to apply on remittance or disposal. This could include considerations such as the availability of a participation exemption or the application of withholding taxes on dividends. If there is a complex holding structure in place, the route via which profits are expected to be distributed or the entity is expected to be disposed of should also be considered. Any significant assumptions made for the purposes of the calculation may warrant disclosure in the company's consolidated financial statements.

Investment in a subsidiary

In the case of an investment in a subsidiary (i.e., an entity where the parent holds more than 50% of voting power), the parent controls the subsidiary's financial and operating policies, including its dividend policy. As a result, the parent can typically control the timing of the reversal of the temporary differences arising from an investment. Therefore, where the parent entity has determined that the subsidiary's profits and reserves will not be distributed in the foreseeable future and that the subsidiary will not be disposed of, it does not recognise a deferred tax liability in relation to the investment.

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Tax accounting refresher

The parent's management needs to be able to provide sufficient evidence that the undistributed earnings will continue to be reinvested for the foreseeable future as part of the parent's continuing investment in the subsidiary. This evidence might include documentary resolutions by the parent's management, formal communication to minority shareholders and specific plans for reinvesting the funds. Reinvestment plans should take into account financial requirements of the parent and the subsidiary; their long-term and short-term operational and fiscal objectives; remittance restrictions imposed by governments, financing agreements or others; and tax consequences of any remittances.

Investment in an associate

In the case of an associate (i.e., an entity where an investor holds 20% to 50% of voting power), although the investor has significant influence over the operating and financial policies of the associate, it does not have control of the associate, including its dividend distribution. Therefore, unless there is an agreement that the associate's profits will not be distributed in the foreseeable future, a deferred tax liability should be recorded on any post-acquisition profits. Since such agreements are rare in practice, it is common for a deferred tax liability to be recorded with respect to investments in associates. In cases, where it might not be possible to determine the tax that will be payable when the investment cost is recovered – whether through distribution of the retained profits or through disposal, the standard allows the entity to calculate the amount based on the minimum amount that can be determined.

Interest in a joint venture

In the case of joint ventures, the investor accounts for its investment using the equity method. Temporary differences would arise between the carrying amount of the investor's interest (i.e., the investor's capital contributions plus its share of undistributed profit) and the tax base of the investment. The terms of the contractual arrangement between the venturers on the retention of any profit in the joint venture will determine whether any deferred tax should be provided on the temporary difference (similar to the treatment for associates discussed above). Where the venturer can control the timing of the distribution of its share of the profits, and it is probable that the profits will not be distributed in the foreseeable future, a deferred tax liability is not recognised. As in the case of an investment in a subsidiary, the assertion that profits will not be distributed should be supported by sufficient evidence.

Disclosure of unrecognised temporary differences

Under IFRS, in the case where no deferred tax is recorded in relation to outside basis differences, the total amount of temporary difference (i.e., the gross temporary difference rather than a deferred tax asset or a liability) should still be disclosed in the parent's or group's financial statements. Disclosure of the deferred tax assets and liabilities associated with such temporary differences is not required but encouraged.

This approach is different from the approach adopted under US GAAP and discussed later in this section. This is because IFRS considers the fact that it is often difficult, particularly for foreign investments, to quantify the future tax payable in view of a number of factors, including the tax laws and tax rates in force, the intended timing of future

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Tax accounting refresher

remittances, and the terms of any tax treaty that might exist between the two countries.

US GAAP

Under US GAAP, a distinction is made between outside basis differences in domestic investments, and outside basis differences in foreign subsidiaries (i.e., an entity where the parent holds more than 50% of voting power), corporate joint ventures and fifty-percent-or-less investees.

Similar to IFRS, measurement of a deferred tax asset or liability would depend on expectations as to how the investment will ultimately be realised (e.g., through sale or liquidation).

Investment in domestic subsidiaries and domestic corporate joint ventures

For investments in domestic subsidiaries and corporate joint ventures, deferred tax liability is required to be recognised with respect to the outside basis differences arising after 1992, unless such amounts can be recovered tax free, or without incurring significant cost, and the entity expects to use that method of recovery. This exemption can apply when the jurisdiction of the investor can receive tax free treatment on dividends and assessable gains from either the sale or liquidation of domestic investments.

Similar to IFRS, a deferred tax asset should be recorded on deductible temporary differences related to outside basis differences in domestic subsidiaries and corporate joint ventures where it is apparent that the temporary difference will reverse in the foreseeable future.

Investment in foreign subsidiaries and foreign corporate joint ventures

For investments in foreign subsidiaries and corporate joint ventures, it should be presumed that the undistributed earnings of a subsidiary will be transferred to the parent company. This reflects the general rule that the temporary difference with respect to the undistributed earnings of a subsidiary should be assumed to reverse in the foreseeable future.

US GAAP contains an exception (formerly known as APB 23 and now as an indefinite reversal exception) for outside basis taxable differences in foreign subsidiaries and joint ventures. The exception applies if the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax free liquidation. The indefinite reversal exception extends to the entire outside basis difference in a foreign subsidiary or foreign joint venture that is essentially permanent in duration, whether it arises for example, due to unremitted earnings, cumulative currency translations or changes in the investee's equity.

Similar to the requirement under IFRS, US GAAP requires that sufficient evidence is available to support the parent entity's assertion that the foreign unremitted earnings are indefinitely reinvested in order to qualify for the indefinite reversal exception. This evidence should consist of specific reinvestment plans which demonstrate that a remittance will be postponed indefinitely. Also similar to IFRS, consideration must be given to matters such as the long- and short-term financial and operating requirements, forecast and budgets of the parent and subsidiary, remittance restrictions and tax consequences, as well as a past history of dividend actions.

Any deferred tax asset arising on outside basis of investments in foreign subsidiaries and corporate joint ventures should be recorded similar to investments in domestic subsidiaries and corporate joint ventures discussed above.

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Tax accounting refresher

Specifically, a deferred tax asset is recorded only if it is apparent that the temporary difference will reverse in the foreseeable future. Although 'foreseeable future' is not explicitly defined, we believe that generally, within the context of a potential sale of an investment in a subsidiary or a corporate joint venture, the term means sometime within the next year. To record a deferred tax asset in this circumstance, management should be fully committed to the plan to reverse the temporary difference, and not just exploring it as a possibility.

Investment in fifty-percent-or-less investees

Under US GAAP, there is no exception applicable to fifty-percent-or-less investees that are not a corporate joint venture, whether they are domestic or foreign. A deferred tax liability must be recorded with respect to all outside basis taxable temporary differences, even where the investor intends to purchase sufficient shares to gain control.

Similarly, a deferred tax asset should be recorded on any deductible outside basis differences (subject to a separate valuation allowance assessment). This notably differs from the accounting model for domestic and foreign subsidiaries and corporate joint ventures where the deferred tax asset is recorded only where it is apparent that the temporary difference will reverse in the foreseeable future. Measurement of a deferred tax asset would consider expectations as to how the investment will ultimately be realised, e.g., through disposal or liquidation.

Disclosure of unrecognised temporary differences

Similar to IFRS, if a deferred tax liability has not been recognised because of the indefinite reinvestment assertion, the parent entity should disclose the cumulative amount of each temporary difference (e.g., unremitted earnings, cumulative currency translation). In addition, the parent will need to disclose the estimated amount of unrecognised deferred tax liability. Alternatively, the parent may make a statement that the determination of such an estimate is not practicable.

For companies that do not disclose an estimate of the unrecorded tax liability, the SEC staff has in certain instances requested an explanation as to why determination of an estimate is not practicable. Some companies that had historically concluded that an estimate was not practicable have more recently started disclosing an estimate. Companies should also consider the proposed changes to income tax disclosures related to outside basis differences discussed in the FASB activity update above.

Conclusion

There are a lot of similarities in application of IFRS and US GAAP to outside basis differences. Even if the required analysis may be different, the resulting deferred tax assets or liabilities would in many cases be the same. Similarly, under both frameworks one of the most challenging area of accounting for outside basis differences is the practical application of the exceptions available under US GAAP and IFRS for recognition of a deferred tax liability. These exceptions require significant judgements with subjectivity by companies' management, as well as substantial documentation support. In the US, this topic remains an area of ongoing focus by the SEC.

Continued

Tax accounting refresher

Over the years we covered a number of technical topics in the tax accounting refresher section of this newsletter. Here we present a summary of the most recent topics and links to the relevant newsletters. We would love your input on what topics you would like us to cover in future newsletters. If you have any feedback, please feel free to reach out to any of the primary authors listed below.

Past tax accounting refresher topics

Topic	Newsletter
Tax accounting for M&A transactions	Q3 2013
2013 Hot topics: Indefinite reinvestment assertions, valuation allowance assessments and uncertain tax positions	Q4 2013
IFRS and US GAAP: similarities and differences	Q1 2014
When to account for tax law changes	Q1 2014
Importance of technology for tax function effectiveness	Q2 2014
Tax accounting and reporting considerations in relation to transfer pricing	Q3 2014
Key tax accounting hot topics and year-end reminders	Q4 2014
Taxes based on income, taxes not based on income and 'hybrid' taxes	Q1 2015
Accounting for income taxes associated with foreign branch operations	Q2 2015
Accounting for income taxes associated with partnerships and other 'flow-through' entities	Q3 2015
Key tax accounting areas for preparation of 2015 year-end financial statements	Q4 2015
Tax provisions for carve-out financial statements	Q1 2016
Foreign currency tax accounting	Q2 2016

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