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Accounting for Income Taxes Considerations of Final Regulations

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In light of the significant volume of recently issued Treasury regulations, this article summarizes some accounting for income taxes considerations for the issuance of final regulations that should be kept in mind when evaluating new regulations.

New regulations[1] generally represent changes in currently enacted law; however, some regulations may be released that interpret or clarify current law instead of enacting new law. To the extent the regulations are considered changes in tax law, the changes are accounted for in the period of enactment and should not be anticipated. To the extent regulations interpret or clarify current law, the impact the regulations have on evaluating uncertainty in the tax law are similarly accounted for in the period the regulations are finalized.[2] The enactment date for a change in tax law or rate is the date when all steps in the legislative process have been completed, not the date the law is applicable. While the wording of a regulation may be released or made available in a near final form, we believe a

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1 Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

2 If interpretive guidance becomes available after the balance sheet date but before the issuance of the financial statements, the additional interpretive guidance may need to be considered in evaluating the need for a valuation allowance. Additionally, we believe entities may make an accounting policy election as to whether changes in estimates for income tax uncertainties related to discontinued operations as a result of new interpretive guidance should be backwards traced to discontinued operations.

regulation is not considered enacted for financial reporting purposes under US GAAP until at least the final wording is issued.

In certain circumstances, near final wording becomes available before a set of regulations would be published in the Federal Register. If a favorable filing position exists in those regulations, an entity may need to conclude whether it would take such a position even if the regulations are never published and fully enacted. A presumption exists that beneficial tax positions will be taken even if they are not claimed on the originally filed income tax return. Similar to treatment for the issuance of proposed regulations and as part of assessing the expected filing position under the guidance on uncertainty in income taxes, if it is widely understood the taxing authority would not challenge the position if the regulations are never fully enacted, then the tax position would generally meet the recognition criteria through the administrative practices guidance on accounting for uncertainty in income taxes.

Conversely, if near final wording results in an unfavorable change to a filing position, an entity should assess the filing position it would take if the regulation were never fully enacted. As such, it is anticipated that unfavorable changes would not be reflected until the period the regulation is fully enacted.

Some final regulations may include provisions that have future applicability dates but for which an entity can elect to apply the regulations to the current or certain prior periods. While original or amended tax returns to reflect this early adoption may not need to be prepared immediately, we believe an entity would need to reasonably estimate and include the expected impact of any early adoption in the period the regulations are enacted. A company may revise its estimate in future periods as a result of new or better information, clarifications of the application of the regulations and/or more experience. The financial statements should include appropriate disclosures of estimates in applying new regulations that are reasonably possible to materially change in the near term. The complexity of both the judgments around which regulations to early adopt and the related calculations is not a sufficient reason to exclude the estimated impact from the period of enactment financial statements. Any estimates should be prepared within the level of precision required for other ASC 740 estimates related to the entity. If a taxpayer does not recognize an estimate of the impacts in this period, then any revisions in future periods may be considered a correction of an error for financial reporting purposes. Any correction of an error would need to be assessed and has the potential to result in the restatement of prior reported financial statements, if material.

Additionally, to the extent an entity may expect to change a prior tax position and file an amended return, the period in which to recognize the effect of the change will depend on why the entity plans to file an amended return.

- If the amended return is a new filing position that becomes available or required as the result of the enactment of a new law or the issuance of regulations, it is recognized upon enactment of the law or issuance of the regulations.

- If an amended return is being filed to effectuate a permitted alternative election (for instance, certain changes in accounting methods), it generally is recognized in the period in which management commits to the change, assuming the position meets the more-likely-than-not recognition threshold; however, there is a presumption that beneficial tax positions will be claimed.

An entity that commits to filing an amendment as of the reporting date (and intends to account for the changes arising from the amendment) typically prepares and submits the amendment before the period-end financial statements are issued (before the Form 10-Q or 10-K is filed for public companies) or are available to be issued (for private companies). However, all facts and circumstances should be considered in determining when to account for an amended return.

Conclusion

Entities should carefully consider and assess the impact of new regulations as they are issued and enacted, ensuring the impact of the regulations are reflected within the financial statements in the appropriate period.

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