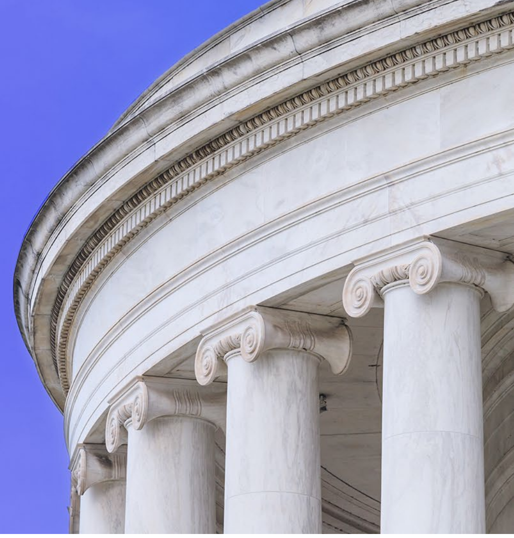
What's News in Tax

Analysis that matters from Washington National Tax

January 30, 2024



SEC Comments on Accounting for Income Taxes

by Krystel Gruber, Jenna Summer, and Ashby Corum, Washington National Tax

Examples of comments about accounting for income taxes recently issued by the U.S. Securities and Exchange Commission ("SEC") to registrants are provided in this article. 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 and users of the financial statements.

Examples of Recent SEC Comment Letters

The following selection of SEC comment letters specific to income taxes is provided to illustrate areas in which the SEC staff ("the Staff") questioned whether the disclosures provided adequate insight for investors to understand a company's income taxes environment or when the Staff wanted a better understanding of the basis for management's judgements. The comments below highlight common findings that are representative of the Staff's areas of recent focus associated with income taxes.

Example 1: Effective Tax Rate Reconciliation and Jurisdictional Disaggregation of Pretax Income

The Staff may request revisions to the notes and Management's Discussion and Analysis ("MD&A") to include omitted disclosures as well as additional detail on the components included within specific categories in the effective tax rate reconciliation:

> ***Initial Comment:***
>
> Please revise to provide a breakdown, between foreign and domestic, for the components of income (loss) before income taxes expense (benefit) for each period presented. Refer to Rule 4-08(h) of Regulation S-X. Also, tell us what the line items in your effective tax rate reconciliation for "other deferred adjustments" and "return to provision" represent and explain why your effective tax rate was not impacted by taxes paid in foreign jurisdictions. In addition, revise to include a discussion regarding the nature of these adjustments. Refer to ASC 740-10-50-12. Lastly, revise your disclosures on page X [MD&A] to include a quantified discussion of the factors that contributed significantly to your tax provision (benefit) and discuss any material items that are not expected to impact your effective tax rate in the future. Refer to Item 303 of Regulation S-K.

> ***Follow-up Comment:***
>
> We note your revisions in response to prior comment 34. It appears certain line items in the breakdown of the Income before provision (benefit) for income taxes table have been mislabeled. Please revise. Also, with regard to the rate reconciliation table, revise to explain what the tax credit and return to provision line items relate to.

Example 2: Effective Tax Rate Reconciliation

The Staff may request additional detail on the components included within specific categories in the effective tax rate reconciliation:

> We note your response to prior comment 21 and the related adjustment to your effective tax rate reconciliation. Please tell us how you determined the stock-based compensation adjustment of -X%, including why you have not recognized a deferred tax asset related to stock-based compensation in prior periods. Please also tell us how you determined the change in the valuation allowance adjustment of X%. Refer to ASC 740-10-50-14.

Example 3: Effective Tax Rate Reconciliation

The Staff may request additional detail on the components included within the other category in the effective tax rate reconciliation:

> Please revise to describe what is included in the "other" reconciling item in your 2021 statutory income tax rate reconciliation. To the extent this represents more than one significant item, please revise to present each significant item on a separate line. Refer to Rule 4-08(h)(2) of Regulation S-X.

Example 4: Valuation Allowances

The Staff may request additional detail on the change in the valuation allowance, the stated impact of the valuation allowance in the effective tax rate reconciliation and the relationship between the amounts presented:

> We note your disclosure on page X [Notes] that the decreased effective tax rate for 2020 is due to changes in deferred taxes resulting from statutory rate changes and a release of an income tax valuation allowance. However, we note no significant change in your valuation allowance per pages X [Notes] and Y [Schedule II], yet the more significant change in your taxes for 2021 per the reconciliation of the statutory rate to the effective rate on page X [Notes] is from the change in valuation allowance versus the change in statutory rates. Please provide further details on the nature of the change in the valuation allowance including how a $X million change per page Y [Schedule II] resulted in a significant reduction in your tax expense for 2021.

Example 5: Pretax Jurisdictional Information

The Staff may request additional jurisdictional discussion in MD&A of the results of pretax operations as a result of jurisdictional information provided in the income tax disclosures:

> You disclose pre-tax earnings from foreign operations of $X, $X and $X in the 2020, 2021 and 2022 fiscal years in Note X. You also disclose significant pre-tax losses from domestic operations of $X, $X and $X in the 2020, 2021 and 2022 fiscal years in Note X. You discuss your results on a consolidated basis and state that you have recorded no U.S. Federal current income tax and provided a full valuation allowance for U.S. deferred tax assets. However, it is unclear from your discussion what underlying factors are driving these disparate domestic and foreign operating results. Please discuss and analyze the factors driving your pre-tax earnings from foreign operations and your pre-tax losses from domestic operations. Also disclose qualitative and quantitative reasons for any material changes in results or known trends in your domestic and international operations. Refer to the guidance in Item 303 of Regulation S-K and SEC Release No. 33-8350.

Example 6: Unrecognized Tax Benefits

The Staff may request additional detail on an entity's judgment on a tax position with uncertainty:

> Tell us why there was a significant increase in unrecognized tax benefits related to the current year. Disclose substantive information regarding the unrecognized tax position in critical accounting policies and estimates. Your disclosure should discuss specific judgments made and assumptions and factors considered.

Example 7: Indefinite Reinvestment

The Staff may request additional detail on indefinite reinvestment assertions:

> You disclose that substantially all your $X million of cash on hand at June 30, 2022 resides in your international subsidiaries. Subject to maintaining sufficient cash requirements to support the strategic objectives of these international subsidiaries and complying with applicable exchange or cash controls, you expect to continue to repatriate available cash from these international subsidiaries. In addition, you had net cash outflows from operations in 2021 and the six months ended June 30, 2022 in comparison to net cash inflows from operations in 2020 and 2019. Please disclose the impact on your liquidity of having substantially all of your cash in international subsidiaries, how much cash you expect to repatriate. the tax impact of any repatriation and any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in liquidity increasing or decreasing in any material way.

Example 8: Indefinite Reinvestment

The Staff may request additional detail on changes in indefinite reinvestment assertions:

> Please expand your disclosures to explain why you reversed a portion of your deferred tax liabilities for undistributed earnings during fiscal year 2022, providing the specific facts and circumstances that led you to conclude that those earnings are now indefinitely reinvested; and to include the aggregate amount of undistributed earnings from your foreign subsidiaries that you have concluded are indefinitely reinvested in accordance with ASC 740-30-50-2.b.

Example 9: Investments in Partnerships

The Staff may request additional detail on deferred taxes related to an investment in partnership:

> We note that you recorded a $X million deferred tax liability during the fiscal year ended January 2, 2022 related to your investment in [Company]. We further note that such deferred tax liability appears to be a permanent difference in that it will not reverse. In this regard, please tell us the impact on your financial statements of recording this deferred tax liability including why you determined this liability to be necessary in the current fiscal year versus the prior fiscal year when [Company] was acquired. Refer to ASC 740-30-25-18 and advise.

Example 10: Intraperiod Tax Allocations

The Staff may request including required disclosures on the income tax expense allocated to each component of other comprehensive income:

> Please present the amount of income tax expense or benefit allocated to each component of other comprehensive income, including reclassification adjustments. Refer to ASC 220-10-45-12.

Example 11: Non-GAAP Financial Measures

The Staff may request additional detail on the tax rate applied to non-GAAP financial measures:

> Please revise your reconciliation to present income taxes as a separate adjustment with a clear explanation of how the income taxes adjustment was computed. Also, explain any differences between the revised remeasurement adjustments for incentive units reconciling item and the similarly-titled

> amount disclosed for the same period in Note 14 to the financial statements included in your Form 10-Q filed December 8, 2022. Refer to Question 102.11 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations and Item 10(e)(i)(B) of Regulation S-K.

Example 12: Non-GAAP Financial Measures

The Staff may request additional detail on the determination of non-GAAP adjustments and whether removing a valuation allowance represents an individually tailored accounting policies:

> Your response to prior comment 8 states that the adjustment for the discrete income tax item in the December 31, 2020 reconciliation of Adjusted Net Income (Loss) relates to the valuation allowance recorded that year. Please explain why this adjustment is appropriate as it appears to result in an individually tailored recognition method. For additional guidance, see Question 100.04 of the Compliance and Disclosure Interpretations on Non- GAAP Financial Measures.

Example 13: Non-GAAP Financial Measures

The Staff may request additional detail on the determination of non-GAAP adjustments and whether removing a valuation allowance represents an individually tailored accounting policies:

> ***Initial Comment:***
>
> Please disclose in greater detail the nature of and reason for the deferred tax valuation allowance adjustment. Also, disclose how you computed the amount of the adjustment in each period presented.
>
> ***1st Follow-up Comment:***
>
> We read your response to comment 8. Your non-GAAP adjustment for deferred tax valuation allowance removes the effects of the valuation allowance from your GAAP tax provision and appears to change your income taxes recognition method, resulting in an individually tailored accounting. Please remove this adjustment from your reconciliation of Net Income (Loss) Attributable to [Company] Shareholders. Refer to Question 100.04 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations.
>
> ***2nd Follow-up Comment:***
>
> We read your response to comment 2 and continue to believe that your non-GAAP adjustment to remove the effects of the deferred tax asset valuation allowance results in individually-tailored accounting. Please remove this adjustment from Adjusted Net Income (Loss) Attributable to [Company] Shareholders. Refer to Question 100.04 of the Non-GAAP Financial Measures Compliance and Disclosure Interpretations.

Conclusion

In summary, as demonstrated in recent Staff comment letters, accounting for income taxes continues to be an area of focus for the SEC. Consequently, financial statement preparers may decide to consider the recent comments from regulators and standard setters to identify areas for improvements in existing income taxes disclosures.

kpmg.com/socialmedia

The information in this article is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 because the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP.