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Objectives

- Recognize the basic principles of accounting for income taxes
- Identify pertinent tax accounting matters that apply to exempt organizations
- Calculate several examples of income tax provisions
- Determine the tax accounting impact of the Tax Cuts and Jobs Act (TCJA)
- Identify new accounting pronouncements that may affect exempt organizations
- Recognize leading practices for preparing and reviewing the income tax provision
Agenda

- Discuss tax legislative and policy update
- Accounting for income taxes of exempt organizations
- Basic principles of Accounting Standards Codification (ASC) 740
- Accounting for uncertainty in income taxes
- Net operating losses (NOLs) and valuation allowances
- TCJA considerations for tax provisions
- Accounting standards update
- Tax provision leading practices
- Questions
Tax legislative and policy update

Washington Council
Ernst & Young LLP
116th Congress

Senate
53 Republicans — 47 Democrats

- Majority Leader: Mitch McConnell (R-KY)
- Whip: John Thune (R-SD)
- Republican Conference Chairman: John Barrasso (R-WY)
- Democratic Leader: Chuck Schumer (D-NY)
- Whip: Dick Durbin (D-IL)
- Assistant Democratic Leader: Patty Murray (D-WA)

House
235 Democrats — 197 Republicans

- Speaker: Nancy Pelosi (D-CA)
- Majority Leader: Steny Hoyer (D-MD)
- Asst. Leader: James Clyburn (D-SC)
- Democratic Caucus Chairman: Hakeem Jeffries (D-NY)
- GOP Leader: Kevin McCarthy (R-CA)
- Minority Whip: Steve Scalise (R-LA)
- Republican Conference Chair: Liz Cheney (R-WY)

3 vacancies — PA, 2 in NC
Congress

2019 House: 235 Democrats
   197 Republicans
   1 Independent

2019 Senate ratio:
   53 Republicans (1 seat 2018 pickup) 47 Democrats

Senate
   - 22 Republican seats up for re-election
   - 12 Democratic seats up for re-election

2020 election
   - Democrats flipped 43 GOP seats in 2018 election
   - 31 Democrats are in Trump districts
   - 21 are freshmen
   - Republicans need to flip 19 seats in 2020 to win back control

House re-elect predictions*
   Solid seats
     D — 182  R — 160
   Likely/lean seats
     36  33
   Toss-up or worse
     6

*As rated by Cook Political Report

Democrats flipped 43 GOP seats in 2018 election
31 Democrats are in Trump districts
21 are freshmen
Republicans need to flip 19 seats in 2020 to win back control

2019 Senate ratio:
53 Republicans (1 seat 2018 pickup) 47 Democrats
## Key dates

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
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<tbody>
<tr>
<td>August 2</td>
<td>President signed bill setting FY #2020/2021 spending levels, suspending debt limit</td>
</tr>
<tr>
<td>September 9</td>
<td>Congress returns from summer recess</td>
</tr>
</tbody>
</table>
| September 30          | - Appropriations bills for FY20 or a continuing resolution necessary to avoid government shutdown  
                        | - Expiration of  
                        |   - Flood insurance  
                        |   - Export-Import Bank  
                        |   - Temporary Assistance for Needy Families (TANF)                                                                                                       |
| October               | OECD target timeframe for presenting to G20 broad architecture on a tax proposal responding to challenges of digitalization                                                                                       |
| October 31            | Brexit deadline                                                                                                                                                                                                   |
| December 31           | - Expiration of  
                        |   - Controlled foreign corporation (CFC) look-through rule  
                        |   - Work Opportunity Tax Credit, New Markets Tax Credit  
                        |   - TCJA alcohol provisions  
                        |   - Medical device tax, health insurer fee suspensions                                                                                                     |
| January 2020          | Target time frame for outline of the architecture of a tax proposal responding to challenges of digitalization to be agreed to by the Inclusive Framework on BEPS                                                                 |
| February 3            | Democratic primaries/caucuses begin (Iowa)                                                                                                                                                                           |
| July 13-16            | Democratic National Convention (Milwaukee)                                                                                                                                                                          |
| August 24-27          | Republican National Convention (Charlotte)                                                                                                                                                                           |
| November 3            | Election Day                                                                                                                                                                                                       |
Polling question

Which of the following is a true statement?

A. Appropriations bills for FY20 or a continuing resolution is necessary by 12/31/19 to avoid a government shutdown
B. Brexit deadline is 11/30/19
C. The Democratic National Convention and the Republican National Convention will both be held in Des Moines Iowa next year
D. Election Day is 11/28/19
E. None of the above
2019 legislative priorities

Democratic priorities
- Single-payer health system
- Affordable Care Act (ACA) stabilization
- Fighting climate change
- Multi employer retirement proposals
- Lowering drug prices
- Infrastructure

Republican priorities
- Government funding, debt limit
- TCJA technical corrections
- Making TCJA provisions permanent
- US-Mexico-Canada Agreement (USMCA), other trade items
- Entitlement reform
- Judicial nominations
- Border wall
- Oversight of Trump Administration

"Green New Deal"
Washington tax agenda

Done
- IRS reform – signed into law July 1
- 2-year budget caps, debt limit deal — signed August 2
- 4 tax protocols — Spain, Switzerland, Japan, Luxembourg

Passed by House
- SECURE retirement bill – Senate snag over 529 expansion
- “Cadillac tax” repeal – passed House 419-6

Awaiting action, tax
- Extenders – 2017-18-19 provisions; plus offsets?
- Technical corrections
- 3 tax treaties — Chile, Hungary, Poland

Awaiting action, non-tax
- Trade – USMCA awaiting vote in Congress
- Health – drug pricing, surprise medical bills
- Government funding – FY 2020 spending bills

Beyond Congress
- White House – considered payroll tax, capital gains changes
- CBO – post-budget deal projections have revived deficit concerns
- OECD – digital tax work plan for digital+ agreement in 2020

These items could move this year as part of a:
- Continuing resolution (CR) or “minibus” appropriations bill
- Stand-alone tax bill

September 19, 2019
Dynamics in Congress

House
- Fiscally moderate/conservative and progressive members roughly evenly divided in House
- Moderate vs. liberal tension also playing out in 2020 presidential race
- Topics that split Democrats

Senate
- Senate Republicans fear opening up legislative initiatives on the Senate floor
  - Want to avoid politically embarrassing votes
  - Tax bills are particularly difficult — fear of populist Democratic amendments
  - Therefore, bulk of Senate floor time and votes this year related to nominations

<table>
<thead>
<tr>
<th>Taxes</th>
<th>Health care</th>
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</thead>
<tbody>
<tr>
<td>Changes to TCJ A ← →</td>
<td>Stabilizing ACA ← → Medicare for All</td>
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<tr>
<td>Significant wealth tax</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Spending</th>
<th>Environment</th>
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<tbody>
<tr>
<td>Restraining deficit ← →</td>
<td>Incremental changes ← → Green New Deal</td>
</tr>
<tr>
<td>More domestic spending</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Oversight of Trump Administration</th>
<th>Border security</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeding cautiously ← → Impeachment</td>
<td>$4.6 billion funding bill ← → “Child abuse caucus”</td>
</tr>
</tbody>
</table>
### Tax legislative partisanship scale

<table>
<thead>
<tr>
<th>IRS reform ✓</th>
<th>SECURE Act</th>
<th>Extenders</th>
<th>Infrastructure</th>
<th>Technical corrections</th>
<th>TCJA, Wealth tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Taxpayers can appeal IRS actions</td>
<td>• Facilitate multiple employer plans</td>
<td>• 2017 expired, 2019 expiring provisions</td>
<td>• Support for significant investment: $1t-$2t</td>
<td>• Democrats reluctant to help fix a law they did not author</td>
<td>• Providing further middle-income tax relief is possible</td>
</tr>
<tr>
<td>• Limits non-IRS access to returns</td>
<td>• Fiduciary safe harbor for selecting annuity provider</td>
<td>• Revenue offsets?</td>
<td>• No consensus on how to pay for it</td>
<td>• Leasehold depreciation fix for retailers among high-profile corrections</td>
<td>• Democrats want to roll back TCJA A provisions to pay for other priorities</td>
</tr>
<tr>
<td>• Cybersecurity and identity protections</td>
<td>• Required min. distribution age increased from 70 ½ to 72</td>
<td></td>
<td></td>
<td></td>
<td>• Progressives want wealth tax</td>
</tr>
<tr>
<td>• IRS information technology modernization</td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

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*Bipartisan*  

*Partisan*
More gridlock, less consensus than usual

- Bipartisan 2018 tax bills that didn’t get enacted would seem like low-hanging fruit, but they’re not
  - Retirement savings legislation
    - Stuck in Senate over use of 529 plans for home-schooling expenses
  - Tax extender legislation
    - Stuck in House over question of revenue offsets
  - Technical corrections legislation
  - IRS reform legislation
    - Finally enacted after progressive Democrats opposed Free File provision
- Stuck
  - Infrastructure legislation
- Potential collateral damage — veteran House committee chairmen seen as not progressive enough
Avenues for changes and/or clarifications to the Tax Cuts and Jobs Act

| 1 | Treasury regulations |
|   | The Treasury Department is writing regulations to implement the TCJA. |
|   | Lawmakers are insistent that congressional intent be followed. |
|   | Memorandum of Agreement between Office of Management and Budget (OMB) and Treasury. |

| 2 | Technical corrections |
|   | Former Ways & Means Chairman Brady released draft corrections bill January 2. |
|   | A few high-profile corrections could move before others: |
|   | Write-off/bonus depreciation for qualified leasehold improvements |
|   | Modifications to NOL carryforwards, carrybacks apply to NOLs in tax years beginning after 12/31/17 |
|   | Attorney’s fees for harassment cases (deductible by victims) |

| 3 | Joint Committee on Taxation Bluebook |
|   | Explanation of the TCJA was published December 20 and identifies dozens of potentially necessary technical corrections. |

| 4 | Possible World Trade Organization (WTO) challenges |
|   | Foreign-derived intangible income (FDII) |
|   | Base erosion and anti-abuse tax (BEAT) |

| 5 | Policy changes |
|   | Legislation could address policy issues that are more substantive than technical corrections and have revenue consequences. |
Polling question

The Tax Cuts and Jobs Act requires no need for further clarification. True or False.

A. True
B. False
### Senate Finance Committee

<table>
<thead>
<tr>
<th>Republicans (15)</th>
<th>Democrats (13)</th>
</tr>
</thead>
<tbody>
<tr>
<td>► Chuck Grassley (R-IA)</td>
<td>► Ron Wyden (D-OR)</td>
</tr>
<tr>
<td>► Mike Crapo (R-ID)</td>
<td>► Debbie Stabenow (D-MI)</td>
</tr>
<tr>
<td>► Pat Roberts (R-KS)</td>
<td>► Maria Cantwell (D-WA)</td>
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<tr>
<td>► Mike Enzi (R-WY)</td>
<td>► Robert Menendez (D-NJ)</td>
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<tr>
<td>► John Cornyn (R-TX)</td>
<td>► Thomas Carper (D-DE)</td>
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<tr>
<td>► John Thune (R-SD)</td>
<td>► Ben Cardin (D-MD)</td>
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<tr>
<td>► Richard Burr (R-NC)</td>
<td>► Sherrod Brown (D-OH)</td>
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<tr>
<td>► Johnny Isakson (R-GA)</td>
<td>► Michael Bennet (D-CO)</td>
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<tr>
<td>► Rob Portman (R-OH)</td>
<td>► Bob Casey (D-PA)</td>
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<tr>
<td>► Pat Toomey (R-PA)</td>
<td>► Mark Warner (D-VA)</td>
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<tr>
<td>► Tim Scott (R-SC)</td>
<td>► Sheldon Whitehouse (D-RI)</td>
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<tr>
<td>► Bill Cassidy (R-LA)</td>
<td>► Maggie Hassan (D-NH)</td>
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<tr>
<td>► James Lankford (R-OK)</td>
<td>► Catherine Cortez Masto (D-NV)</td>
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<tr>
<td>► Steve Daines (R-MT)</td>
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<tr>
<td>► Todd Young (R-IN)</td>
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*Italics = new member*
<table>
<thead>
<tr>
<th>Democrats (25)</th>
<th>Republicans (17)</th>
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</thead>
<tbody>
<tr>
<td>► Richard Neal (D-MA), Chairman</td>
<td>► Kevin Brady (R-TX)</td>
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<tr>
<td>► John Lewis (D-GA)</td>
<td>► Devin Nunes (R-CA)</td>
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<td>► Lloyd Doggett (D-TX)</td>
<td>► Vern Buchanan (R-FL)</td>
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<tr>
<td>► Mike Thompson (D-CA)</td>
<td>► Adrian Smith (R-NE)</td>
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<td>► John Larson (D-CT)</td>
<td>► Kenny Marchant (R-TX)</td>
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<td>► Earl Blumenauer (D-OR)</td>
<td>► Tom Reed (R-NY)</td>
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<td>► Ron Kind (D-WI)</td>
<td>► Mike Kelly (R-PA)</td>
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<td>► Bill Pascrell (D-NJ)</td>
<td>► George Holding (R-NC)</td>
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<td>► Danny Davis (D-IL)</td>
<td>► J ason Smith (R-MO)</td>
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<td>► Linda Sanchez (D-CA)</td>
<td>► Tom Rice (R-SC)</td>
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<td>► Brian Higgins (D-NY)</td>
<td>► J ackie Walorski (R-IN)</td>
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<td>► Terri Sewell (D-AL)</td>
<td>► David Schweikert (R-AZ)</td>
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<td>► Suzan DelBene (D-WA)</td>
<td>► Darin LaHood (R-IL)</td>
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<td>► Judy Chu (D-CA)</td>
<td>► Brad Wenstrup (R-OH)</td>
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<td>► Gwen Moore (D-WI)</td>
<td>► Drew Ferguson (R-GA)</td>
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<td>► Dan Kildee (D-MI)</td>
<td>► J odey Arrington (R-TX)</td>
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<tr>
<td>► Brendan Boyle (D-PA)</td>
<td>► Ron Estes (R-KS)</td>
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<tr>
<td>► Don Beyer (D-VA)</td>
<td>►</td>
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<tr>
<td>► Dwight Evans (D-PA)</td>
<td>►</td>
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<tr>
<td>► Tom Suozzi (D-NY)</td>
<td>►</td>
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<tr>
<td>► Jimmy Panetta (D-CA)</td>
<td>►</td>
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<td>► Stephanie Murphy (D-FL)</td>
<td>►</td>
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<td>► Brad Schneider (D-IL)</td>
<td>►</td>
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<td>► Steven Horsford (D-NV)</td>
<td>►</td>
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<tr>
<td>► J immy Gomez (D-CA)</td>
<td>►</td>
</tr>
<tr>
<td></td>
<td>► Italics = new member</td>
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September 19, 2019
## Tax extenders

<table>
<thead>
<tr>
<th>Provision</th>
<th>Senate bill (S. 617)</th>
<th>House bill (H.R. 3301)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017 expired provisions —26 split between energy, non-energy</td>
<td>✓</td>
<td>✓ (omits horse, mine equipment, Indian coal provisions)</td>
</tr>
<tr>
<td>2018 expired provisions —7.5% of income medical expense deduction floor, oil spill liability trust fund rate, black lung liability trust fund excise tax</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>2019 expired provisions:</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>► CFC look-through rule</td>
<td></td>
<td></td>
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<tr>
<td>► New Markets Tax Credit</td>
<td></td>
<td></td>
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<tr>
<td>► Work Opportunity Tax Credit</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>► Provisions related to beer, wine and distilled spirits excise taxes</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>► health Coverage Tax Credit (HCTC)</td>
<td></td>
<td>✓</td>
</tr>
<tr>
<td>Revenue offset — accelerate sunset of the TCJA estate tax regime to the end of 2022 instead of the end of 2025</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Disaster tax relief for disasters since beginning of 2018</td>
<td>✓</td>
<td>✓</td>
</tr>
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</table>
## Expiration dates of various tax provisions

<table>
<thead>
<tr>
<th>Provision</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
<th>2024</th>
<th>2025</th>
<th>2026</th>
<th>2027</th>
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<tbody>
<tr>
<td>Individual rate cuts</td>
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<td>Individual AMT exemption amount</td>
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<td>20% pass-through deduction</td>
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<td>Estate tax doubled exemption</td>
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<td>$10,000 state and local deduction</td>
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<td>21% corporate rate</td>
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<td>Corporate AMT repeal</td>
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<td>100% expensing — effective 9/27/17</td>
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<td>Interest deduction 30% of EBITDA</td>
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<td>Amortization of R&amp;D expense</td>
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<td>Alcohol tax modernization</td>
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<td>Medical deduction 7.5% AGI floor</td>
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<tr>
<td>More than two dozen extenders</td>
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<td>Other extenders: CFC look-through, NMTC, WOTC</td>
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<td>Device tax</td>
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<td>Health insurance tax (HIT)</td>
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</tbody>
</table>

- In effect
- Not in effect

(Phased down in 20% increments after 2022)

(EBIT after 2021)

(10% beginning in 2019)
## Tax ideas of the 10 Democratic candidates to participate in September 12 debate

<table>
<thead>
<tr>
<th>Candidate</th>
<th>Wealth tax</th>
<th>Business proposals</th>
<th>Individual proposals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joe Biden</td>
<td>End stepped-up basis</td>
<td>“Real Corporate Profits Tax” of 7% on a corporation’s profit above $100 million</td>
<td>Equalize capital gains, ordinary income rates</td>
</tr>
<tr>
<td>Elizabeth Warren</td>
<td>2% tax on assets over $50m, 3% tax on net worth over $1b</td>
<td>Financial transactions tax 0.5% for stocks, 0.1% for bonds and 0.005% for derivatives</td>
<td></td>
</tr>
<tr>
<td>Bernie Sanders</td>
<td>2009 estate tax of 45% on estates over $3.5m, plus</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>► 50% over $10m</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>► 55% over $50m</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>► 77% over $1b</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kamala Harris</td>
<td>Tax increases on the wealthy</td>
<td>Tax increases on corporations</td>
<td>Refundable tax credit for middle class</td>
</tr>
<tr>
<td>Pete Buttigieg</td>
<td>► Unspecified financial transactions tax</td>
<td>International formulary apportionment</td>
<td>Tax wealth more than work</td>
</tr>
<tr>
<td></td>
<td>► International formulary apportionment</td>
<td></td>
<td>Unspecified higher top rate</td>
</tr>
<tr>
<td>Andrew Yang</td>
<td>“Tech value-added tax (VAT)”</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cory Booker</td>
<td>► 2009 estate tax ($3.5m exemption, 45% rate) + surtax of</td>
<td>Savings account for each child</td>
<td></td>
</tr>
<tr>
<td></td>
<td>► 10% on $10m-$50m</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>► 20% on more than $50m</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>► End stepped-up basis</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beto O’Rourke</td>
<td>End stepped-up basis</td>
<td>28% corporate rate</td>
<td>39% top marginal rate</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Equalize rates for capital gains, ordinary income</td>
</tr>
<tr>
<td>Julian Castro</td>
<td>► “Inherited wealth” tax</td>
<td>Equalize rates for capital gains, ordinary income</td>
<td>Child credit of $3,000 for those “of modest means”</td>
</tr>
<tr>
<td></td>
<td>► “Wealth inequality” mark-to-market system to tax capital gains annually</td>
<td>Expand EITC</td>
<td></td>
</tr>
<tr>
<td></td>
<td>for wealthiest 1/10 of 1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amy Klobuchar</td>
<td>Buffett rule</td>
<td>Institute a per-country minimum tax,</td>
<td>Repeal “regressive portions” of TCJA</td>
</tr>
<tr>
<td></td>
<td></td>
<td>10% reduction for routine return on tangible assets</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>25% corporate rate</td>
<td>Expand EITC and CTC</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Close “Big Oil loopholes”</td>
<td>Tax carried interest as ordinary income</td>
</tr>
</tbody>
</table>
Infrastructure

**Priority for both parties in 2019**
- Biggest question: how to pay for it?
  - Gas tax increase
  - TCJA rollbacks
  - Carbon tax

**Second biggest: role of financing?**
- Gas tax increase
- TCJA rollbacks
- Carbon tax

**President Trump’s 2018 outline**
- Asks Congress for $200b over 10 years to spur $1.5t state/local, private infrastructure investment
- Includes $6b for eligibility for private activity bonds (PABs)
- No revenue source identified

**Senate Democrats’ 2018 plan**
- $1t investment paid for by:
  - Increasing top individual tax rate and corporate rate
  - Restoring 2017 parameters for AMT and estate tax
  - Taxing carried interest as ordinary income
China
► US has imposed 25% tariffs on $250b worth of Chinese products
► August 1 — President Trump announced 10% tariffs on $300 billion more
► August 13 — Some products exempt from new tariffs, tariffs on holiday-season consumer goods delayed until December 15
► August 23 — Responding to China tariffs, President announces hikes to 30% on the $250b tariffs, 15% on the $300b

USMCA
► US Trade Representative (USTR) and the House Democratic USMCA Working Group are exchanging proposals
► Working group has proposed modifications to the deal with respect to the labor, environment, enforcement and biologics provisions
► The Administration is working towards scheduling a vote in Congress on USMCA this fall

Japan
► US has reached “agreement in principle” on deal with Japan, may be signed in September
► Japan to increase purchases of US ag products, open markets
► Won’t eliminate 2.5% auto tariffs but removes threat of 25% tariffs on Japanese autos and parts
► Also addresses digital trade
**Budget outlook**

**FY 2019 projected deficit = $897b**

**Going forward**

- $1t+ annual deficits beginning in FY 2022
- About $1.2t a year in 2025, 2026 and 2027
- $1.4t in 2028 and 2029
- Federal debt held by public 93% of gross domestic product (GDP) by end of 2029
- Federal debt held by public 152% of GDP by 2049
- **Main culprits:**
  - Aging population increases Social Security, Medicare spending
  - Outlays for net interest will increase substantially, particularly over the next five years

Source: CBO, The Budget and Economic Outlook: 2019 to 2029, 1/28/19
Spending, interest continue to grow as percent of GDP, while revenue remains flat

Source: CBO, The 2018 Long-Term Budget Outlook, June 26, 2018
Sources and uses of federal revenues, FY #2018

Revenues
- Individual income taxes 50.6%
- Social Security 35.2%
- Corporation income taxes 6.2%
- Excise taxes 2.9%
- Other 5.3%

Total: $3.3t

Expenditures
- Medicare and health 27.0%
- Social Security 24.0%
- National defense 16.2%
- Nondefense discretionary 6.4%
- Income security 12.1%
- Net interest 7.9%
- Other entitlements 6.4%

Total: $4.1t

Note: “Other” revenue includes Federal Reserve earnings, fees from the FCC’s Universal Service Fund, customs duties, estate and gift taxes and other miscellaneous receipts. “Other entitlements” includes commerce and housing credit, education, training, employment, social services, and veterans benefits and services. “Nondefense discretionary” includes international affairs, general science, space and technology, energy, natural resources and environment, agriculture, transportation, community and regional development, administration of justice, general government and undistributed offsetting receipts.

Accounting for income taxes of exempt organizations
ASC Topic 740, Income Taxes, addresses financial accounting and reporting for the effects of income taxes that result from an entity’s activities during the current and preceding years.

- Exempt organizations (EOs):
  - May have a tax provision for significant unrelated business income activities (federal and state income tax) or significant income subject to tax outside of the US
  - Need to evaluate and document continued qualification for tax exemption

- Taxable subsidiaries and unrelated business income activities
  - ASC 740 applies
  - Financial statement impact, depending on materiality
Unrelated business income

- Estimate unrelated business taxable income
  - Include active businesses and pass-through income
  - Consider reasonableness of expense methodology
  - Profit motive for activities in a loss position
  - Document everything
- Calculate tax and test against materiality thresholds
  - Generally, current-year tax and unpaid tax for the two preceding tax years are tested
  - Failure to file certain foreign information returns when required (e.g., Forms 5471, 926, 8865, 8621) holds open the year the return was triggered for federal income tax assessment
- ASC 740 rules apply in full
Taxable subsidiaries income tax calculations

- Taxable subsidiaries
  - Consolidated groups
  - Tax-sharing agreements
  - Sufficient documentation supporting tax calculations
  - Determination of tax years open for federal income tax assessment
Polling question

Mayfield Memorial Hospital has determined that a portion of the rental income earned by the organization in one of its hospital facilities is subject to acquisition indebtedness pursuant to the provisions of IRC Section 514. What is the appropriate tax accounting regime under which this income should be accounted for?

a. Accounting Principles Board Opinion 23
b. FASB Interpretation Number 48
c. Accounting Standards Codification Section 740
d. Accounting Standards Codification Section 450
Basic principles of ASC 740
Key terms

- Pre-tax income (aka profit before tax (PBT), earnings before tax (EBT), pre-tax book income (PTBI), net income before tax (NIBT))
- Permanent differences
- Temporary differences
- Total tax expense
  - Current tax expense + deferred tax expense
- Effective tax rate (ETR)
Pre-tax income

- Pre-tax income is “book income” before income tax expense
  - Can also be presented as PBT, EBT, PTBI, NIBT, etc.
- Computed under US GAAP financial accounting standards
- Audit team audits book income while the Tax team computes the tax to be accrued on that book income
  - We (Tax) rely on the book income as our starting point and we compute/audit the “M-1” adjustments to arrive at taxable income
Tax differences

• Permanent book-tax differences
  • May include items recognized in tax returns that will never be recognized in financial statements
  • Common examples
    • Meals and entertainment
    • Qualified transportation fringe (QTF) benefits
    • Fines and penalties

• Temporary book–tax differences
  • Difference between the book and tax basis of an asset or liability:
    • Results in taxable or deductible amounts in future years
    • When the reported amount of the asset or liability is recovered or settled
Effective tax rate

• What “moves” the ETR/appears in the rate reconciliation (rate rec)?
  • Anything that impacted tax expense this year and is not captured in the phrase “book income * federal tax rate”

• Common examples:
  • Permanent adjustments
  • State taxes
  • Movement in valuation allowance
  • ASC 740 (FIN 48) reserve movement
  • Foreign tax rate differential
  • Provision to return true-up
Basic steps of the income tax provision process: current tax

- Pre-tax book income
  +/- permanent differences
  +/- temporary differences
  = Taxable income before NOL
    - NOL carryforward
    Taxable income
    x Statutory tax rate
    = Tax expense on current-year income before credits
      - Tax credits
      = Current tax expense on current-year income
        +/- Provision-to-return adjustments
        +/- Changes to ASC 740 (FIN 48) liability
        = Total current tax expense
Computation of tax expense: without deferred taxes

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-tax book income</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>+/- Permanent differences</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>+/- Temporary differences</td>
<td>(100)</td>
<td>100</td>
</tr>
<tr>
<td>= Taxable income</td>
<td>100</td>
<td>300</td>
</tr>
<tr>
<td>x Tax rate 21%</td>
<td>21</td>
<td>63</td>
</tr>
<tr>
<td>= Current tax expense</td>
<td>21</td>
<td>63</td>
</tr>
<tr>
<td>+ Deferred tax expense</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>= Total tax expense</td>
<td>21</td>
<td>63</td>
</tr>
<tr>
<td>ETR 10.5%</td>
<td>10.5%</td>
<td>31.5%</td>
</tr>
</tbody>
</table>
## Computation of tax expense: with deferred taxes

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-tax book income</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>+/- Permanent differences</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>+/- Temporary differences</td>
<td>(100)</td>
<td>100</td>
</tr>
<tr>
<td>= Taxable income</td>
<td>100</td>
<td>300</td>
</tr>
<tr>
<td>x Tax rate</td>
<td>21%</td>
<td>21%</td>
</tr>
<tr>
<td>= Current tax expense</td>
<td>21</td>
<td>63</td>
</tr>
<tr>
<td>+ Deferred tax expense</td>
<td>21</td>
<td>(21)</td>
</tr>
<tr>
<td>= Total tax expense</td>
<td>42</td>
<td>42</td>
</tr>
<tr>
<td>ETR</td>
<td>21%</td>
<td>21%</td>
</tr>
</tbody>
</table>
## Rate rec example

<table>
<thead>
<tr>
<th>Description</th>
<th>$</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-tax book income</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>Tax on pre-tax book income</td>
<td>210</td>
<td>21.0</td>
</tr>
<tr>
<td>+/- Meals and entertainment</td>
<td>20</td>
<td>2.0</td>
</tr>
<tr>
<td>+/- Municipal bond</td>
<td>(80)</td>
<td>(8.0)</td>
</tr>
<tr>
<td>+/- IRS audit adjustment</td>
<td>30</td>
<td>3.0</td>
</tr>
<tr>
<td>+/- State taxes net of fed benefit</td>
<td>25</td>
<td>2.5</td>
</tr>
<tr>
<td>= Total tax provision</td>
<td>205</td>
<td>20.5</td>
</tr>
</tbody>
</table>

ETR: 20.5 %
Computation of total tax expense (benefit)

\[
\text{Total tax expense (benefit)} = \text{Current tax expense (benefit)} + \text{Deferred tax expense (benefit)}
\]
Computation of deferred tax expense (benefit)

Net deferred tax asset (DTA) /liability end-of-year (EOY) balance

Less

Net DTA /liabilities beginning-of-year (BOY) balance

= 

Deferred tax provision
Deferred tax assets and liabilities

- A deferred tax liability (DTL) recognizes the deferred tax consequences attributable to taxable temporary differences.
  - Taxable temporary differences result in taxable amounts in future years
- A deferred tax asset recognizes the deferred tax consequences attributable to deductible temporary differences and carryforwards.
  - Deductible temporary differences result in deductible amounts in future years
How DTAs arise

• Expenses currently recognized for book purposes but not for tax purposes
• Revenues currently recognized for tax purposes but not for book purposes
• Positive M1 adjustment in current year’s taxable income
Examples of DTAs

- **Expense items:**
  - Allowance for bad debts
  - Compensation accruals (vacation, bonus, commission)
  - Contingency reserve accruals (legal, environmental)

- **Revenue items:**
  - Advance receipts for goods (revenue deferred for book but not tax)

- **Tax carryforward items:**
  - Foreign tax credits in worldwide taxation regimes that allow credits for foreign taxes paid
  - NOLs
How DTLs liabilities arise

- Expenses currently recognized for tax purposes but not for US GAAP purposes
- Revenues currently recognized for US GAAP purposes but not for tax purposes
- Negative M1 adjustment in current year’s taxable income

Future (as items reverse) → Taxable income → Book income
Examples of DTLs

• Expense items:
  • Fixed assets (tax depreciation > book depreciation)
  • Intangible assets (tax goodwill amortization > book goodwill impairment)

• Revenue items:
  • Installment sale receivable (revenue deferred for tax but not book)
  • Completed contract tax accounting method
## Temporary differences summary

<table>
<thead>
<tr>
<th></th>
<th>Assets</th>
<th>Liabilities</th>
<th>Tax carryforwards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax benefit/(DTA)</td>
<td>Tax basis &gt; book basis</td>
<td>Tax basis &lt; book basis</td>
<td>Only</td>
</tr>
<tr>
<td>Deferred tax expense/(DTL)</td>
<td>Tax basis &lt; book basis</td>
<td>Tax basis &gt; book basis</td>
<td>N/A</td>
</tr>
</tbody>
</table>
Polling question

- The Beckham Biological Institute has entered into a number of contracts to provide commercial testing activities for third-party laboratories. In order to provide these unrelated services, on the first day of their tax year the organization purchased $1 million of new equipment that has a five-year useful life but that can be expensed immediately for tax purposes. Using a 25% blended tax rate, what should the organization record?
  - $250,000 DTA
  - $250,000 DTL
  - $200,000 DTL
  - $200,000 DTA
Accounting for uncertainty in income taxes
Liability method basic principles

- Focus is on the balance sheet
- Current
  - Current tax liabilities or assets recognized for the estimated taxes payable or refundable on tax returns for the current and prior years
- Deferred
  - DTAs/DTLs are recognized for the estimated future tax effects attributable to temporary differences and carryforwards
Accounting for uncertainty in income taxes

- Benefit recognition model
  - Tax position must meet minimum recognition threshold before being recognized in financial statements
- ASC 450, Contingencies is not applicable to income taxes
- Applies to all entities, including non-public entities
- Determination that exempt status is highly certain
- Review of less-than-highly-certain positions
Uncertain tax positions
Presentation

- Difference between tax benefit as (or to be) reflected in the income tax return and the amount recorded in the financial statements should be classified as either:
  - A current or non-current liability, or
  - A reduction of DTA for a temporary difference, a net operating loss carryforward, similar tax loss or a tax credit carryforward
- The amount expected to be paid in the next year should be classified as a current liability
- Indirect tax effects on other tax positions:
  - State taxes often have an indirect effect on federal taxes
  - Indirect tax effects on other tax positions are not included in the unrecognized tax benefit tabular rollforward disclosure
• Assume tax position is disallowed at the reporting date
  • If net settlement of a net operating loss, similar tax loss or tax credit carryforward and an unrecognized tax benefit is required or expected, present liability associated with uncertain tax benefit as a reduction to related DTA for net operating loss, similar tax loss or tax credit carryforward
  • If net settlement is not required or expected, present uncertain tax benefit as a liability, not combined with DTA
• Not expected to change DTA realizability assessment
• Does not change disclosure requirements of uncertain tax positions
Uncertain tax positions
Documentation

- Nature and extent of documentation required may vary based upon the character of the uncertain income tax position
- Distinguish between highly certain tax positions and tax positions for which greater uncertainty is present
  - Highly certain tax positions are based on clear and unambiguous tax law
    - Clearly meets more-likely-than-not recognition standard, and there is a greater than 50% likelihood that 100% of benefit will be sustained
Net operating losses and valuation allowances
Evaluating the need for a valuation allowance

- DTAs represent future tax deductions (or tax carryforwards/tax credits)
- Reduced by a valuation allowance if it is more likely than not (>50%) that some portion, or all, of the DTAs will not be realized
  - Evaluation is made on a gross basis —common pitfall
  - Based on weight of all available evidence
  - Depends on sufficient taxable income
- Consider four sources of income
- Not existence of DTA; only realizability —common pitfall
- Consider presentation of valuation allowance (current/non-current)
Evaluation of positive and negative evidence

- Weight given to evidence should be commensurate with the ability to objectively verify it.
- Examples of positive and negative evidence include:

<table>
<thead>
<tr>
<th>Negative evidence</th>
<th>Positive evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cumulative pretax losses in recent history (generally three years) or projections of cumulative pretax losses — common pitfall</td>
<td>Existing contracts or firm sales backlog</td>
</tr>
<tr>
<td>History of carryforwards expiring unused</td>
<td>Strong earnings history, exclusive of loss that created the future deductible amount, coupled with evidence that the loss is an aberration</td>
</tr>
<tr>
<td>Brief carryback, carryforward periods</td>
<td>Implemented cost reduction plans that can be objectively verified (however, consider any effects on revenues)</td>
</tr>
</tbody>
</table>
Cumulative losses in recent years

- **Calculation**
  - Cumulative pretax income or loss for three years (current year and two preceding years)
  - Annual calculation — common pitfall
  - Exclude only the cumulative effect of accounting changes

- **Not an on/off switch**
  - Does not, in itself, result in a conclusion of the realizability of deferred tax assets — common pitfall
  - Quantitative considerations
  - Qualitative considerations

- **Significant piece of negative evidence that is often difficult to overcome**
Releasing a valuation allowance

- What framework do I apply when determining whether to release a valuation allowance?
  - Same framework
  - Change in circumstance causes change in judgment about realization in future years
- Key considerations
  - Extent of positive and negative evidence that exists
  - Ability to rely on future projections of income
- Return to profitability
  - Not an on/off switch
  - No quarterly rolling reversal
Polling question

The Landry Center for Performance Enhancement has incurred cumulative net operating losses of approximately $40 million during years 1-3 as they prepare for the launch of Medicare Part D. Recently, the Center of Medicare Managed Services awarded them two contracts to provide Medicare Part D services in Nebraska and Wisconsin in year 4. The company has projected that these new contracts will result in over $500 million of additional revenue and approximately $100+ million of net income in year 4. Assuming a 25% blended tax rate, what should the company record?

- A $10 million DTA with a full valuation allowance
- A $10 million DTA without any valuation allowance
- A $15 million DTL
- A $25 million deferred tax expense
TCJ A considerations for tax provisions
TCJ A: update on guidance from Internal Revenue Service

- Notice 2018-67 —Unrelated business taxable income (UBTI) separately computed for each trade or business —includes guidance for purposes of computing UBTI separately for each trade or business and general principles surrounding income from partnerships —aka “UBTI silo rule”
- Notice 2018-99 —UBTI increased by certain fringe expenses for which deduction is disallowed —includes guidance to determine QTF parking expenses to be treated as UBTI by exempt organizations
- Notice 2019-09 —Excise tax on excess executive compensation —includes guidance to determine excise tax upon remuneration in excess of $1 million and any excess parachute payment of covered employees
- Excise tax based on investment income of private colleges and universities —While guidance is pending, the excise tax is effective for the upcoming audits where applicable
UBTI separately computed for each trade or business

- For tax years beginning after December 31, 2017, tax-exempt organizations operating more than one unrelated trade or business (TOB) must compute UBTI separately for each TOB
  - Tax provision workpapers should be prepared tracking income and losses of each UBTI activity separately for tax years after December 31, 2017 making a reasonable, good-faith interpretation as to how those activities should be separated.
  - For example, reference laboratory and UBTI from alternative investments should not be aggregated to determine income tax liability.
Alternative investments

- Until regulations are proposed, tax-exempt entities should determine whether partnership interests meet the requirements of either the “de minimis test” or the “control test”
  - “De minimis test” — tax-exempt organization (TEO) holds no more than an average 2% profits or capital interest in the partnership.
  - “Control test” — TEO holds no more than 20% of a profits or capital interest in the partnership and does not have control or influence over the partnership.
- TEOs typically have a greater than 20% interest in ancillary joint ventures and other operating partnerships; therefore, it is unlikely those partnerships would meet the de minimis test or the control test to be aggregated.
- For partnership interests acquired prior to August 21, 2018 (date of Notice), a transition rule permits an exempt organization to treat each of its partnership interests as a single trade or business, even if more than one unrelated trade or business is conducted by a partnership.
UBTI increased by certain fringe expenses for which deduction is disallowed

- Four-step method to allocate QTF benefits
- TEOs that have separated their administrative operations off campus where there is little to no public access are unlikely to meet the public-use exceptions to limit or exempt the expenses from UBTI
- Aggregating lots — If a TEO owns or leases more than one parking facility in a single city, they may aggregate the number of spots in those parking facilities
- QTFs include any transit pass and qualified parking excluded from an employee’s gross income up to an indexed monthly limit (in 2018, this limit is $260/month)
- Notice 2018-99 specifically deems the use of fair market value of employee parking to determine expenses allocable to employee parking in a parking facility owned or leased by a taxpayer to be unreasonable
Pre-2018 vs. post-2017 NOL considerations

- NOLs from a separate TOB generated in tax years beginning after December 31, 2017 (post-2017 NOLs) may only offset UBTI from the TOB from which those losses arose, and are limited to offsetting a maximum of 80% of UBTI.
- NOLs arising in a tax year beginning before January 1, 2018 (pre-2018 NOLs) can be carried forward to a tax year beginning after such date are not subject to either the separate TOB or 80% limitations, and can be applied against the aggregated UBTI from all TOBs.
  - Pre-2018 NOLs that were reported on the 2017 Forms 990-T of our tax-exempt organizations may be applied against aggregate UBTI for 20 years.
- NOL carryforwards will need to be tracked separately for each TOB for tax years beginning after December 31, 2017.
  - Tax provision workpapers should reflect these NOL considerations.
DTA considerations

- DTAs represent future tax deductions (or tax carryforwards/tax credits) and are reduced by a valuation allowance if it is more likely than not (>50%) that some portion, or all, of the DTAs will not be realized.
- All available evidence, both positive and negative, should be considered when evaluating whether a valuation allowance is needed.
- The four sources of income include:
  - Carrybacks
  - Reversal of temporary differences
  - Tax planning strategies
  - Projections of future income
- For alternative investments, the audit evidence typically provided is based upon the prior-year Schedules K-1 because current-year Schedules K-1 are not yet available. Evidence must be provided to support provision prepared even in the absence of current-year Schedules K-1. Consider whether an organization made a material first-year investment within a fund structure that is likely to produce UBTI.
Polling question

- For the year ended December 31, 2018, Mayfield Memorial Hospital incurred both $1 million of income from unrelated laboratory activities and a $1 million loss from outpatient pharmacy activities. Assuming a 25% blended income tax rate, what should the exempt organization record for unrelated business income taxes?
  1. $250,000 current income tax expense
  2. $250,000 DTA
  3. Both 1 and 2
  4. Neither 1 or 2
Tax provision leading practices
Tax provision leading practices

• Accelerate work during quarters and interim:
  • Evaluate and record return-to-provision adjustments
  • Prove out deferred tax assets/liabilities and current taxes payable/receivable
    • Prepare analysis before filing tax return to identify errors in the return
  • Document/analyze state tax rates, including apportionment changes and the impact on deferred taxes, and foreign tax rates for changes
  • Document outside-basis differences, including indefinite reinvestment assertions, and prepare outside-basis difference calculations (consider previously taxed income and unrecaptured Subpart F income)
  • Document valuation allowance considerations (four sources of taxable income) and prepare position paper
  • Document uncertain tax positions
    • Consider tool to improve efficiency and accuracy of computations
Tax provision leading practices (continued)

- Institute regular meetings with external auditors regarding contemporaneous issues (significant transactions, changes in business, etc.)
- Annually challenge prior-year processes to identify areas for improvement
- Simplify, standardize and add controls to existing Excel templates
- Address technical issues early and prepare white papers for consideration by management and external audit
- Implement standardized global procedures
- Consider the tax provision process a year-round area of continued focus
- Obtain assistance to prepare or review the tax provision (pre-audit review) or co-source/outsource to free up internal time for review
- Obtain assistance researching and documenting issues or preparing white papers on tax accounting positions
Accounting standards update
Not-for-profit (NFP) financial statements
ASU 2016-14

• Net asset classification
  • Required to present two classes of net assets (net assets with donor restrictions, net assets without donor restrictions) rather than three (unrestricted, temporarily restricted, permanently restricted)

• Available resources and liquidity
  • Disclose qualitative information about how an NFP manages its liquid resources available to meet cash needs for general expenditures within one year of the balance sheet date, in addition to current disclosures required about liquidity
  • Provide quantitative information (and qualitative information, as necessary) about the availability of financial assets at the balance sheet date to meet cash needs for general expenditures within one year of that date

• Reporting expenses by nature and function
  • Present an analysis that disaggregates functional expense classifications by their natural classifications in one location (statement of activities, separate statement or notes)

• Effective date:
  • Fiscal years beginning after December 15, 2017
### Income taxes: intra-entity asset transfers

**ASU 2016-16**

<table>
<thead>
<tr>
<th>Current GAAP</th>
<th>ASU 2016-16</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inventory</strong></td>
<td></td>
</tr>
<tr>
<td>Defer income tax effect on intercompany sales or transfers of assets until asset leaves consolidated group</td>
<td>No change</td>
</tr>
<tr>
<td><strong>Non-inventory</strong></td>
<td></td>
</tr>
<tr>
<td>Defer income tax effect on intercompany sales or transfers of assets until asset leaves consolidated group</td>
<td>Recognize income tax effect in the period the intercompany sale or transfer occurs</td>
</tr>
</tbody>
</table>

**Public business entities (PBEs): Effective for annual periods beginning after December 15, 2017**

**All other entities (e.g., NFPs): Effective for annual periods beginning after December 15, 2018**
Balance sheet classification of deferred taxes
ASU 2015-17

• Requires DTAs and DTLs to be classified as non-current on the balance sheet
• Does not affect the current requirement that DTAs and DTLs of a tax-paying component of an entity be offset and presented as a single amount
• Effective date:
  • Entities other than PBEs (e.g., private companies and NFPs) —annual periods beginning after December 15, 2017
  • May elect to use prior to effective date
Revenue from contracts with customers
ASC 606

• ASC 606 became effective for PBEs and NFP conduit bond obligors for fiscal years beginning after December 15, 2017
  • ASC 606 will be effective for private companies for fiscal years beginning after December 15, 2018
• Full retrospective or modified retrospective adoption
• New disclosures include those on contracts with customers, disaggregation of revenue, contract balances, performance obligations and significant judgments
Contributions received and contributions made
ASU 2018-08

- Clarifies how entities determine whether to account for a transfer of assets (e.g., a grant) as an exchange transaction or a contribution
  - The distinction is important because they have different accounting frameworks (e.g., ASC 958-605, ASC 606), which may impact the timing of recognition
- Clarifies that a contribution is conditional if the agreement includes both:
  - A barrier (or barriers) that must be overcome for the recipient to be entitled to the resources
  - A right of return for the assets transferred (or a right of release of the promisor’s obligation to transfer assets)

<table>
<thead>
<tr>
<th>Effective for annual periods beginning after...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource recipients (grantees)</td>
</tr>
<tr>
<td>PBEs or NFP conduit bond obligors</td>
</tr>
<tr>
<td>June 15, 2018</td>
</tr>
</tbody>
</table>
You should now be able to ...

- Recognize legislative updates affecting exempt organizations
- Recognize the basic principles of accounting for income taxes
- Identify pertinent tax accounting matters that apply to exempt organizations
- Calculate several examples of income tax provisions
- Determine the tax accounting impact of the TCJA
- Identify new accounting pronouncements that may affect exempt organizations
- Recognize leading practices for preparing and reviewing the income tax provision
Key takeaway

- The income tax provision has many complex factors and at times unclear guidance. The provision should be undertaken with care so it is clear and accurate for the financial statements.
Questions?
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