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Financial Managers Society Accounting Update

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FMS Accounting Update

Agenda

1. Financial Accounting Standards Board
   - Accounting Standards Updates (ASUs)
   - Selected Proposed ASUs
     - Leases
     - Classification & Measurement
     - Impairment [CECL]
2. Private Company Council (PCC) Alternatives
3. SEC
4. Q&A

Financial Accounting Standards Board

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Accounting Standard Updates

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ASU 2014-02, *Intangibles—Goodwill and Other (Topic 350) - Accounting for Goodwill [PCC Alternative]*

ASU 2014-03, *Derivatives and Hedging (Topic 815) - Accounting for Certain Receive-Variable Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach [PCC Alternative - Not available to financial institutions]*

ASU 2014-04, *Receivables - Troubled Debt Restructurings by Creditors (Subtopic 310-40) - Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*

ASU 2014-05, *Service Concession Arrangements (Topic 853)*

ASU 2014-06, *Technical Corrections and Improvements Related to Glossary Terms*

ASU 2014-07, *Consolidation (Topic 810) - Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements [PCC Alternative]*

ASU 2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) - Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*

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Accounting Standard Updates

ASU 2014-10, *Development Stage Entitles (Topic 915) - Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation*

ASU 2014-11,*Transfers and Servicing (Topic 860) - Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures*

ASU 2014-12, *Compensation – Stock Compensation (Topic 718) - Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period*

ASU 2014-13, *Consolidation (Topic 810) - Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity*

ASU 2014-14, *Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure*

ASU 2014-15,*Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*

ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity*

ASU 2014-17, *Business Combinations (Topic 805): Pushdown Accounting*

ASU 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination [PCC Alternative]*

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Accounting Standard Updates

ASU 2015-01, *Income Statement - Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*

ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*

ASU 2015-03, *Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*

ASU 2015-04, *Compensation - Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer's Defined Benefit Obligation and Plan Assets*

ASU 2015-05, *Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*

ASU 2015-06, *Earnings per Share (Topic 260): Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions*

ASU 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*

ASU 2015-08, *Business Combinations (Topic 805): Pushdown Accounting – Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115* *[removes SEC guidance from codification]*

ASU 2015-09, *Financial Services-Insurance (Topic 944): Disclosures about Short-Duration Contracts*

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Accounting Standard Updates

ASU 2015-10, *Technical Corrections and Improvements*

ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*

ASU 2015-12, *Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), and Health and Welfare Benefit Plans (Topic 965) - I. Fully Benefit-Responsive Investment Contracts, II. Plan Investment Disclosures, and III. Measurement Date Practical Expedient*

ASU 2015-13, *Derivatives and Hedging (Topic 815): Application of the Normal Purchases and Normal Sales Scope Exception to Certain Electricity Contracts within Nodal Energy Markets*

ASU 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*

ASU 2015-15, *Imputation of Interest (Subtopic 835-30)*

ASU 2014-01

Investments—Equity Method and Joint Ventures (Topic 323)—Accounting for Investments in Qualified Affordable Housing Projects

- Permits accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met.

- Investor amortizes the cost of its investment, in proportion to the tax credits and other tax benefits it receives, to income tax expense (i.e. net presentation).

- Must follow same policy for new investments

Effective:

- ❖ *Public business entities: FY and interim periods beginning after 12/15/14.*
- ❖ *Other entities: FY beginning after 12/15/14 and interim periods in subsequent year.*
- ❖ *Early adoption is permitted*

ASU 2014-04: Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40)—Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure

- Clarifies when a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan should be derecognized and the OREO recognized. Recording date for OREO is if either

  1. the creditor obtains legal title to the residential real estate property upon completion of a foreclosure, or
  2. the borrower satisfies the loan by conveying all interest in the residential real estate property to the creditor through completion of a deed in lieu of foreclosure or through a similar legal agreement.

- Additional disclosures are required.

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ASU 2014-04: Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40)—Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure

Amends ASC 310-40 to require an entity to disclose at each interim and annual period:

- The carrying amount of foreclosed residential real estate property held by the creditor as a result of obtaining physical possession
- The recorded investment in consumer mortgage loans collateralized by residential real estate property for which formal foreclosure proceedings are in process according to local requirements of the applicable jurisdiction. [New disclosure]

Effective:

- ❖ Public business entities: FY beginning after 12/15/14 and interim periods within.
- ❖ Other entities: FY beginning after 12/15/14 and interim periods in subsequent year.
- ❖ Early adoption is permitted.
- ❖ Prospective or Modified Retrospective transition method

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ASU 2014-08: Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360) — Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity

Changes the criteria for reporting discontinued operations while enhancing disclosures in this area.

- Only disposals representing a strategic shift in operations should be presented as discontinued operations. Those strategic shifts should have a major effect on the organization's operations and financial results.
- Should decrease the number of disposals qualifying for this presentation
- Requires expanded disclosures about discontinued operations that will include more information about the assets, liabilities, income, and expenses of discontinued operations.
- Also requires disclosures for disposals of individually significant components that do not qualify as discontinued operations

Effective:

❖ *Public business entities: 3/31/15.*

❖ *Other entities: FY beginning on or after 12/15/14 and interim periods in subsequent year.*

New Definition of Discontinued Operations

A disposal of a component of an entity or a group of components of an entity shall be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results as determined when the component or group of components: (i) meets the criteria to be classified as held for sale; (ii) is disposed of by sale; or (iii) is disposed of other than by sale.

- The revised standard does not define what constitutes a strategic shift. Such decisions will be entity specific based on qualitative assessment.
- Standard includes examples of strategic shifts that have a major effect on operations and the example thresholds are fairly high.
- Disposing of a reportable segment will usually meet the definition

ASU 2014-09

Revenue from Contracts with Customers (Topic 606)

- FASB recently delayed effective date by one year
- Applicable to entities that enter into contracts to sell goods or services or a nonfinancial asset
- Excludes certain contracts, such as: leases, insurance contracts, financial instruments and contractual rights and obligations, guarantees (other than product or service warranties), and nonmonetary exchanges between entities in the same line of business to facilitate sales to other entities not part of the exchange

Effective:

- ❖ *Public business entities: FY beginning after 12/15/17 and interim periods within. Early adoption permitted for periods after 12/15/16.*
- ❖ *Other entities: FY ending after 12/15/18 and interim periods in subsequent year.*

Main Provisions:

- Identify the contract
- Identify performance obligations
- Determine transaction price
- Allocate transaction price to performance obligations
- Recognize revenue when or as performance obligation met

- Will not impact recognition of interest income in financial instrument contracts

- Will impact real estate sales financed and certain other items of noninterest income

- *Depository and Lending Institutions Revenue Recognition Task Force is identifying implementation issues for financial institutions.*

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ASU 2014-11

Transfers and Servicing (Topic 860) - Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures

- Requires repurchase-to-maturity transactions to be accounted for as secured borrowings and eliminates existing guidance for repurchase financings.
- New disclosures are required for (1) certain transactions accounted for as secured borrowings and (2) transfers accounted for as sales when the transferor also retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction.

Effective:

- ❖ *Public business entities: FY beginning after 12/15/14. Disclosure for secured borrowings effective for interim periods beginning after 3/15/15. Early adoption is not permitted for public.*
- ❖ *Other entities: FY beginning after 12/15/14 and interim periods in subsequent year.*

ASU 2014-11

Transfers and Servicing (Topic 860) - Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures

Transfers of Financial Assets Accounted for as Sales
(Dollars in millions)

	At the Date of Derecognition for Transactions Outstanding		At the Reporting Date		
Type of Transaction	Carrying Amount Derecognized	Gross Cash Proceeds Received for Assets Derecognized	Fair Value of Transferred Assets	Gross Derivative Assets Recorded [(a) (b)]	Gross Derivative Liabilities Recorded [(a) (b)]
Repurchase agreements	$ XX	$ XX	$ XX	$ XX	$ XX
Sale and a total return swap	XX	XX	XX	XX	XX
Securities lending	XX	XX	XX	XX	XX
Total	$ XX	$ XX	$ XX	$ XX	$ XX

(a) Balances are presented on a gross basis, before the application of counterparty and cash collateral offsetting.

(b) $XX of gross derivative assets and $XX of gross derivative liabilities are included as interest rate contracts in footnote X on derivative disclosures. $XX of gross derivative assets and $XX of gross derivative liabilities are included as credit risk contracts in footnote X on derivative disclosures.

ASU 2014-11

Transfers and Servicing (Topic 860) - Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures

Illustration 2 – Example quantitative disclosure requirements for transfers accounted for as secured borrowings

Repurchase Agreements, Securities Lending Transactions, and Repurchase-to-Maturity Transactions Accounted for as Secured Borrowings

(Dollars in millions)

	20XX				
	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Up to 30 days	30–90 days	Greater Than 90 days	Total
Repurchase agreements and repurchase-to-maturity transactions					
U.S. Treasury and agency securities	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
State and municipal securities	XXX	XXX	XXX	XXX	XXX
Asset-backed securities	XXX	XXX	XXX	XXX	XXX
Corporate securities	XXX	XXX	XXX	XXX	XXX
Equity securities	XXX	XXX	XXX	XXX	XXX
Non-U.S. sovereign debt	XXX	XXX	XXX	XXX	XXX
Loans	XXX	XXX	XXX	XXX	XXX
Other	XXX	XXX	XXX	XXX	XXX
Total	XXX	XXX	XXX	XXX	XXX
Securities lending transactions					
U.S. Treasury and agency securities	XXX	XXX	XXX	XXX	XXX
State and municipal securities	XXX	XXX	XXX	XXX	XXX
Corporate securities	XXX	XXX	XXX	XXX	XXX
Equity securities	XXX	XXX	XXX	XXX	XXX
Non-U.S. sovereign debt	XXX	XXX	XXX	XXX	XXX
Loans	XXX	XXX	XXX	XXX	XXX
Other	XXX	XXX	XXX	XXX	XXX
Total	XXX	XXX	XXX	XXX	XXX
Total borrowings	$ XXX	$ XXX	$ XXX	$ XXX	$ XXX
Gross amount of recognized liabilities for repurchase agreements and securities lending in footnote X					$ XXX
Amounts related to agreements not included in offsetting disclosure in footnote X					$ XXX

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ASU 2014-12: Compensation – Stock Compensation (Topic 718) - Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

- Performance target that affects vesting and that could be achieved after the requisite service period is treated as a performance condition.
- The target is not included in the estimate of the award's grant date fair value. Record expense when event is probable.
- Compensation cost would be recognized over the required service period if it is probable that the performance condition will be achieved.
- Issued to resolve diversity in practice but most public entities already account for these awards consistent with the new guidance.

Effective:

- ❖ *FY beginning after 12/15/15 and interim periods within. Early adoption is permitted*
- ❖ *Apply either (a) prospectively to all awards granted or modified after the effective date; or (b) retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the FS and to all new or modified awards thereafter.*

ASU 2014-14

Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure

- Reclassify the loan to “other receivables” upon foreclosure, rather than OREO

- Upon foreclosure, the separate other receivable should be measured based on the amount of the loan balance (principal and interest) expected to be recovered from the guarantor.

Effective:

- ❖ *Public business entities: FY beginning after 12/15/14 and interim periods within.*
- ❖ *Other entities: FY ending after 12/15/15 and interim periods in subsequent year.*
- ❖ *Early adoption is permitted if ASU 2014-04 (OREO timing rule) has been adopted.*
- ❖ *May be applied prospectively or modified retrospective transition as of the beginning of the annual period of adoption.*

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ASU 2014-14: Receivables – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure

Affects creditors that hold government-guaranteed mortgage loans, including those guaranteed by the FHA and the VA.

Requires that a loan be derecognized and a separate receivable be recognized upon foreclosure if the following conditions are met:

1. The loan has a government guarantee that is not separable from the loan before foreclosure.
2. At the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim.
3. At the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed.

ASU 2014-16

Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity

- Does not change current GAAP, just clarifies to reduce diversity in evaluation of hybrid shares

- Distinction *debt versus equity* is important because an embedded derivative requires separate accounting if it is not clearly and closely related to the host contract unless narrow scope exception criteria are met.

Example: If preferred shares are determined to be more akin to equity, then any equity-like embedded features (e.g., conversion features) are clearly and closely related to the host contract and separate accounting is not required. But any debt-like embedded features (e.g. redemption rights) would not be considered clearly and closely related, and those features may need to be bifurcated and accounted for separately.

ASU 2014-16

Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity

All entities are required to use the "whole instrument approach" to determine the nature (i.e. debt vs. equity) of hybrid preferred equity instruments.

Under this approach, the embedded feature(s), such as redemption or conversion options, being analyzed for derivative treatment must be included in the host instrument when determining if the host instrument is akin to debt or equity.

Effective:

- *Public business entities: FY beginning after 12/15/15 and interim periods within.*
- *Other entities: FY beginning after 12/15/15 and interim periods in subsequent year.*
- *Early adoption is permitted. Retrospective application to existing hybrid instruments.*

ASU 2014-17

Business Combinations (Topic 805): Pushdown Accounting

All acquired entities have the option to apply pushdown accounting in separately issued financial statements upon a change in control event.

- Acquired entity will reflect the acquirer's new basis of accounting
- Precludes the acquiree from recognizing bargain gain in income statement, rather it is recorded as an adjustment to APIC.
- Any acquisition related liability incurred by acquirer is recognized by acquiree only if it represents an obligation of the acquiree.

Effective:

❖ Effective on 11/18/14. After the effective date, an acquired entity can make an election to apply the guidance to future change-in-control events or to its most recent change-in-control event.

❖ If the FS already have been issued, the application of this guidance would be a change in accounting principle.

ASU 2015-01

Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items

- Eliminates the separate presentation of extraordinary items, net of tax, and the related earnings per share

- Does not affect the requirement to disclose material items that are unusual in nature or infrequently occurring.

Effective:

- ❖ *FY beginning after 12/15/15 and interim periods within.*
- ❖ *Apply prospectively or retrospectively*
- ❖ *Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption.*

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ASU 2015-02

Consolidation (Topic 810): Amendments to the Consolidation Analysis

Relates to Variable Interest Entities

- Intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures (such as CDO, CLO & MBS transactions).
- New guidance is aimed at asset managers, but all reporting entities involved with limited partnerships or similar entities will have to re-evaluate and revise their documentation.
- If in scope – dive deep and follow decision tree. Consolidation conclusions might change.

Effective:

- *Public business entities: FY beginning after 12/15/15 and interim periods within.*
- *Other entities: FY beginning after 12/15/16 and interim periods in subsequent year.*
- *Early adoption is permitted, including adoption in an interim period and may be applied retrospectively in previously issued FS for one or more years with a cumulative-effect adjustment to RE as of the beginning of the first year restated*

Who is affected by this update?

The amendments in this Update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. The amendments:

- Modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities
- Eliminate the presumption that a general partner should consolidate a limited partnership
- Affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships
- Provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with rules of registered money market funds.

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ASU 2015-03

Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs

Debt issuance costs related to a recognized debt liability should be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts.

ASU 2015-15 issued August 18, 2015

SEC Staff Announcement: Given the absence of authoritative guidance within Update 2015-03 for debt issuance costs related to line-of-credit arrangements, the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement.

Effective:

- ❖ *Public business entities: FY beginning after 12/15/15 and interim periods within.*
- ❖ *Other entities: FY beginning after 12/15/15 and interim periods in subsequent year.*
- ❖ *Early adoption is permitted for financial statements that have not been previously issued.*

ASU 2015-05

Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement

- Clarifies when fees paid in a cloud computing arrangement include a software license, services, or both.

- Hosting arrangement includes a software license if it meets both of the following criteria:

    1. Customer has the contractual right to take possession of the software at any time during the hosting period without significant penalty; and

    2. It is feasible for the customer to either run the software on its own hardware or contract with another party to run software.

ASU 2015-05

Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement

- If license is included, capitalize the software portion and amortize. ASU does not specify method for allocating fees that pertain to both licensing and services components.
- If license is NA, account for the arrangement as a service contract and expense as services are received.
- For arrangements that include a software license and cloud services, the ASU does not provide guidance for allocating the fees between the two elements. Allocation based on a relative fair value basis is likely appropriate.

Effective:

- *Public business entities: FY beginning after 12/15/15 and interim periods within.*
- *Other entities: FY beginning after 12/15/15 and interim periods in subsequent year.*
- *Early adoption is permitted.*

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ASU 2015-07

Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)

- The objective of this Update is to address that diversity in practice related to how investments measured at net asset value with redemption dates in the future (including periodic redemption dates) are categorized within the fair value hierarchy.

- Investments for which fair value is measured at NAV per share using the practical expedient should not be categorized in the fair value hierarchy.

Effective:

- ❖ *Public business entities: Fiscal Year ("FY") beginning after 12/15/15 and interim periods within.*
- ❖ *Other entities: FY beginning after 12/15/16 and interim periods within.*
- ❖ *Early adoption is permitted. Apply retrospectively.*

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ASU 2015-12

Employee Benefit Plan Accounting

Three part standard reduces complexity in employee benefit plan accounting.

1. Designates contract value as the only required measure for fully benefit-responsive investment contracts

2. Eliminates the requirement that plans disclose: (a) individual investments that represent 5 percent or more of net assets available for benefits; and (b) the net appreciation or depreciation for investments by general type requirements for both participant-directed investments and nonparticipant-directed investments.

3. Provides a practical expedient to permit plans to measure investments and investment-related accounts as of a month-end date that is closest to the plan's fiscal year-end, when the fiscal period does not coincide with month-end.

Effective:

I and 2 are effective on a retrospective basis, and 3 is effective on a prospective basis, for fiscal years beginning after December 15, 2015. Early adoption is permitted.

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Accounting Standard Updates

For Reference

ASU 2014-02

Intangibles—Goodwill and Other (Topic 350)—Accounting for Goodwill

PCC alternative for a private company to subsequently amortize goodwill on a straight-line basis over a period of ten years, or less if the company demonstrates that another useful life is more appropriate. It also permits a private company to apply a simplified impairment model to goodwill.

Under the goodwill accounting alternative, goodwill should be tested for impairment when a triggering event occurs that indicates that the fair value of a company (or a reporting unit) may be below its carrying amount.

Effective:

- FYs beginning after 12/15/14 and interim periods in subsequent year.

ASU 2014-03

Derivatives and Hedging (Topic 815)—Accounting for Certain Receive-Variable Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach

PCC alternative for private companies (other than financial institutions) to use a simplified hedge accounting approach to account for interest rate swaps that are entered into for the purpose of converting variable-rate interest payments to fixed-rate payments.

Effective:

- FYs beginning after 12/15/14 and interim periods in subsequent year.

ASU 2014-07

Consolidation (Topic 810) — Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements

PCC alternative allows a private company to elect (when certain conditions exist) not to apply VIE guidance to a lessor under common control and instead provide disclosure. Alternative is permissible when:

1) The lessee and the lessor are under common control;

2) Lease arrangement exists between the two;

3) Substantially all of the activity between the private company lessee and the lessor is related to the leasing activities; and

4) If the lessee explicitly guarantees or provides collateral for any obligation of the lessor related to the asset leased, then the principal amount of the obligation at inception does not exceed the value of the leased asset.

Effective:

- *Non-public: FY beginning after 12/15/14 and interim periods in subsequent year.*

ASU 2014-10: Development Stage Entitles (Topic 915) - Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation

Removes all incremental financial reporting requirements from U.S. GAAP for development stage entities

In addition, the ASU:

a. adds an example disclosure in Topic 275, Risks and Uncertainties, to illustrate one way that an entity that has not begun planned principal operations could provide information about the risks and uncertainties related to the company's current activities; and
b. removes an exception provided to development stage entities in Topic 810, Consolidation, for determining whether an entity is a variable interest entity.

Effective:

- *Public business entities: Presentation requirement is FY beginning after 12/15/14 and revised consolidation requirement FY beginning after 12/15/15*
- *Other entities: Presentation requirement is FY beginning after 12/15/14 and revised consolidation requirement FY beginning after 12/15/16*
- *Early adoption is permitted.*

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ASU 2014-13

Consolidation (Topic 810) - Measuring the Financial Assets and the Financial Liabilities of a Consolidated Collateralized Financing Entity

Provides an alternative to Topic 820, Fair Value Measurement, for measuring the financial assets and the financial liabilities of a consolidated collateralized financing entity to eliminate the difference in the fair value of the financial assets of a collateralized financing entity, as determined under GAAP, when they differ from the fair value of its financial liabilities even when the financial liabilities have recourse only to the financial assets.

Effective:

- *Public business entities: FY beginning after 12/15/15 and interim periods within.*
- *Other entities: FY ending after 12/15/16 and interim periods in subsequent year.*
- *Early adoption is permitted*
- *Modified retrospective approach*

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ASU 2014-15

Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

- Defines management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures.

- Standard defines substantial doubt and items to consider during the evaluation

Effective:

- ❖ *FY ending after 12/15/16 and interim periods in subsequent year.*
- ❖ *Early adoption is permitted.*

ASU 2014-18

Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination

- PCC alternative for a private entity to simplify business combination accounting. Intangible assets are limited to those that can be sold or licensed independently from the other assets of the business.

- No intangible assets for noncompetition agreements.

- If this alternative is adopted, required to elect ASU 2014-02 and amortize goodwill.

- Entities that adopt ASU 2014-02 do not have to adopt this ASU

Effective:

❖ The decision to adopt must be made upon the occurrence of the first transaction within the scope of this accounting alternative in fiscal years beginning after December 15, 2015, and the effective date of adoption depends on the timing of that first transaction.

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ASU 2015-10

Technical Corrections and Improvements

Changes to clarify the Codification, correct unintended application of guidance, or make minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities.

Effective:

Most parts effective upon issuance. Parts with transition guidance are effective for fiscal years beginning after 12/15/15 and early adoption is permitted.

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ASU 2015-11

Inventory (Topic 330): Simplifying the Measurement of Inventory

Requires an entity to measure in scope inventory at the lower of cost and net realizable value. *(as opposed to market)*

Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.

The amendments do not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method.

Effective:

- ❖ *Effective for public business entities for fiscal years beginning after 12/15/16, including interim periods within those fiscal years.*
- ❖ *For all other entities, the amendments are effective for fiscal years beginning after 12/15/16, and interim periods within fiscal years beginning after 12/15/17.*
- ❖ *Apply prospectively*

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Proposed ASUs

- ❑ **Leases**

- ❑ **Financial Instruments**
  - Classification & Measurement
  - Impairment (CECL)
  - Hedging

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Leases

Estimated completion Q4 2015

- First exposure draft issued August 2010 as part of global convergence effort. Revised ED issued May 2013.
- Lessee accounting: balance sheet recognition for most leases.
- Record lease as liability with corresponding right-of-use asset based on the discounted payments required under the lease agreement
- Short-term leases (< 12 months) not in scope

Leases

Dual approach for classifying leases

- Type A is effectively a purchase of the underlying asset with amortization of the asset separate from interest on the lease liability. Similar to capital lease accounting today.
- Type B is similar to operating lease accounting with single total lease expense on a straight-line basis over the lease term.

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Leases

Transition - Modified retrospective approach

- Recorded BS amounts based on remaining lease payments as of the beginning of earliest comparative period presented in FS.

- FASB will permit a lessee to elect the following specified reliefs, which must be elected as a package and must be applied to all of a lessee's leases:

  1. A lessee need not reassess whether any expired or existing contracts are or contain leases.

  2. A lessee need not reassess the lease classification for any expired or existing leases. (i.e. capital leases are assumed to be Type A and operating leases Type B)

  3. A lessee need not reassess initial direct costs for any existing leases (that is, whether those costs would have qualified for capitalization under the new leases standard).

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Accounting for Financial Instruments - Classification and Measurement

Estimated completion Q4 2015

- Decided to retain the current GAAP classification and measurement models for financial instruments (both assets and liabilities), except for certain equity investments
- Retain the fair value option under existing GAAP
- Retain current GAAP for loan commitments, revolving lines of credit, and commercial letters of credit
- Board decided not to retain proposed disclosures on core deposits
- Assess need for valuation allowance on deferred tax assets related to unrealized losses on AFS securities with entity's other DTAs
- Additional fair value disclosures for public business entities

Equity investments

- All equity investments will be recorded at fair value through earnings, except or certain investments that are accounted for under the equity method and those that qualify for the practicability exception

- Transition will be modified retrospective to all outstanding instruments with a cumulative effect recorded to RE.

Accounting for Financial Instruments - Classification and Measurement

Practicability exception for nonmarketable equity investments

- Measure at cost, less impairment, and adjust for observable price changes (positive or negative). Companies are not expected to perform an exhaustive search of price changes.
- Transition is prospective.
- Not available to investment companies and broker dealers
- Not available for instruments that qualify for NAV practicable expedient.

Accounting for Financial Instruments – Impairment (CECL)

Estimated completion Q4 2015

Impairment Project Objective

- Provide financial statement users with more decision-useful information about expected credit losses
- Reduce complexity by replacing the numerous existing impairment models in current U.S. GAAP with a consistent measurement approach

Concerns with current impairment model

- Delayed recognition of losses due to:
  - Probable threshold
  - Incurred loss notion
  - Limitations on ability to incorporate reasonable forward looking information
- Complexity with multiple impairment models
  - ASC 450 - General reserves for loans
  - ASC 310 - Specific reserves for impaired loans
  - ASC 320 - OTTI equity securities
  - ASC 320 - OTTI debt securities
  - ASC 325 - LOCM for cost basis investments

Accounting for Financial Instruments – Impairment (CECL)

Scope

- Apply CECL model for financial assets measured at cost
- Need to measure expected credit losses on assets that have a low risk of loss (e.g. investment grade HTM debt securities)
- AFS debt securities are excluded from CECL model
- Equity securities will be excluded from CECL model
- Loan commitments are in scope

Accounting for Financial Instruments – Impairment (CECL)

Scope

AFS debt securities remain under ASC 320 with some limited changes (modified OTTI approach)

- No longer requires an entity to consider duration of loss or changes in FV after balance sheet date
- OTTI write downs charged to allowance which may be reversed if credit quality improves
- No credit loss if the FV equals or exceeds amortized cost

Measurement of Expected Credit Loss

- Removes the existing "probable" threshold for recognizing loss (expected losses)
- Consider all contractual cash flows over the life of the related financial asset—consider prepayments—don't consider extensions, renewals, and modification unless expect to execute a TDR (Life of Loan).
- Evaluate financial assets on a collective (pool) basis when similar risk characteristics exist. Otherwise evaluate individually and consider available external information such as credit ratings and other credit loss statistics.
- Estimate must include reasonable and supportable forecasts for life of asset.

Measurement of Expected Credit Loss

- Loss estimate is based on internally and externally available information, including:
  - Information about past events, including historical loss experience
  - Current conditions
  - Quantitative and qualitative factors specific to borrowers and the economic environment in which the entity operates
  - Reasonable and supportable forecasts

Measurement of Expected Credit Loss

Revert to unadjusted historical credit loss experience for future periods beyond a reasonable and supportable forecast

Example:

- 30-year mortgage loans with 8 year estimated life
- Management can reliably forecast for 3 years with expected annual loss rate 10 bps
- Unadjusted historical loss experience is 5 bps

	1	2	3	4	5	6	7	8
Expected Losses	10 bps	10 bps	10 bps	9 bps	8 bps	7 bps	6 bps	5 bps

Accounting for Financial Instruments – Impairment (CECL)

Measurement of Expected Credit Losses

- Exposure draft provides flexibility for measurement methodologies.
- In addition to using DCF, can use loss-rate methods, probability-of-default methods, or a provision matrix using loss factors
- Examples provided in exposure draft (subject to change)
  - Loss-rate approach (by risk rating in example)
  - Base component and credit risk adjustment
  - By-vintage
  - Collective estimate and individual estimate
  - Provision matrix

Accounting for Financial Instruments – Impairment (CECL)

Collateral-Based Practical Expedients

- Treatment for collateral-dependent financial assets is the same as current practice

Debt Security Identified for Sale

- Adjust impairment allowance to equal the difference between fair value and amortized cost

Accounting for Financial Instruments – Impairment (CECL)

Purchase Credit Impaired

- Under the new model recognize CECL allowance for expected credit losses (gross-up approach).
- Subsequent accounting for PCI assets is thereafter the same as originated loans.
- Any changes in expected cash flows (favorable or unfavorable) are immediately recognized in earnings.

Accounting for Financial Instruments – Impairment (CECL)

Final standard should include additional guidance on:

- Information that management would consider in determining expected credit losses
- How expected prepayments, extensions, renewals and modifications should be considered
- Estimation on a collective (pool) basis and estimation on an individual basis
- Reversion to historical averages for periods beyond which management is able to make or obtain a reasonable and supportable forecast about the future
- Collateral-based practical expedients for estimating expected credit losses
- Cost-basis adjustments resulting from troubled debt restructurings

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Accounting for Financial Instruments – Impairment (CECL)

- Analyze final standard
- Evaluate current data and methodologies
- Modify existing methodology or wholesale change to incorporate lifetime estimate and forecasted information
- It is expected that the FASB, AICPA, and industry associations will provide guidance to help manage the complexity of implementation.

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Accounting for Financial Instruments – Hedging

Exposure draft expected Q4 2015

The Board is currently in the process of deliberating targeted improvements to the hedge accounting model.

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Private Company Council (PCC) Alternatives

- Bank that meets definition of private company can adopt PCC alternatives

- Banking agencies can disallow a specific alternative with appropriate notice

- ASC 250-10-45 - Once an accounting principle is adopted, it should not be changed in accounting for events and transactions of a similar nature, unless the use of an allowable alternative is justified on the basis it is preferable.

- Late adoption of PCC alternative requires assessment of preferability

➢ FASB endorsed PCC Consensus on 8/31/15 to allow private companies to make an unconditional first-time election of private company accounting alternatives. Proposed ASU to be drafted.

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Private Company Council (PCC) Alternatives

- ASU 2014-02, *Intangibles—Goodwill and Other (Topic 350) - Accounting for Goodwill*
- ASU 2014-03, *Derivatives and Hedging (Topic 815) - Accounting for Certain Receive-Variable Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach [Not available to financial institutions]*
- ASU 2014-07, *Consolidation (Topic 810) - Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements*
- ASU 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*

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Public Business Entity Definition & PCC Alternatives

ASU 2013-02: A public business entity is a business entity meeting any one of the criteria below and is not eligible to use PCC alternatives:

A. Files with SEC
B. Files under the ’34 Act
C. Files with an agency in preparation to sell or issue securities
D. It has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market
E. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

FDICIA stock institutions need to also evaluate criterion E.

See call report instructions for more information.

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Small Bank Holding Companies

- On April 9, 2015, the Federal Reserve Board (Fed) issued a final rule to expand the applicability of the Small Bank Holding Company Policy Statement and also make it available to certain savings and loan holding companies. Rule raises the asset threshold from $500 million to $1 billion.

- BHC with consolidated assets < $1 billion and that meets the following three qualitative factors, is exempt from the Fed's risk-based capital and leverage rules:
  - Does not engage in significant nonbanking activities;
  - Does not conduct significant off-balance sheet activities, including securitizations and asset management of administration; or
  - Does not have a material amount of debt or equity securities outstanding (other than trust preferred securities) that are registered with the SEC.

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SEC

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Amendments to Regulation A

(Release No. 33-9741)

SEC approved new rules for mini public stock offerings to raise funding cap from $5M to $50M and reduce requirements.

Expanded Regulation A into two tiers:

- Tier 1 covers sales of securities up to $20M in a 12-month period and retains many of the existing Reg. A requirements
- Tier 2 covers sales of securities up to $50M in a 12-month period but requires more robust reporting

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Amendments to Regulation A

- Tier 1 will continue to be subject to state securities law registration and qualification requirements
- Tier 2 requires audited financial statements and ongoing reporting requirements
- Tier 2 will have significantly more reporting requirements but will be exempt from state securities laws
- Certain issuers continue to be ineligible, such as existing SEC registrants.
- Eligible issuers include voluntary filers of SEC reports, entities that suspended their Exchange Act reporting obligations, private subsidiaries of SEC registrants and companies with foreign operations managed from the US or Canada

Credit Risk Retention

(Release No. 34-73407)

- Requires sponsors of securitizations of certain asset-backed securities (ABS) to retain at least 5% credit risk in the underlying assets
- Defines a qualified residential mortgage (QRM) and exempts QRMs from the risk retention requirement
- Does not apply to securitizations of commercial, commercial real estate mortgage, and consumer automobile loans that meet specific underwriting standards
- Compliance for securitized residential mortgages begins 12/24/15 and all other asset classes beginning 12/24/16.

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Asset-Backed Securities Disclosure and Registration

(Release No. 33-9638)

- Requires ABS issuers to make new asset-level disclosures in initial and ongoing reporting with the SEC
- Revises the definition of ABS
- Changes process and forms related to shelf offerings for ABS

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Pay Ratio Disclosure

(Release No. 33-9877)

Amends Item 402 of Regulation S-K to include disclosure of the following three elements:

- Median of the annual total compensation of all employees other than the CEO;
- Annual total compensation of the CEO; and
- The ratio of the Median Pay to the CEO Pay, expressed either as a ratio or in narrative as a multiple.

- Does not apply to emerging growth companies, smaller reporting companies, or foreign private issuers.
- Required in any annual report, proxy statement, information statement or registration statement in which executive compensation disclosure is required.
- Initial compliance date is Form 10-K or proxy statement filed with respect to the first fiscal year beginning on or after January 1, 2017.

Other final SEC releases

- Nationally Recognized Statistical Rating Organizations (Release No. 34-72936)
- Money Market Fund Reform: Amendments to Form PF (Release No. 33-9616)
- Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities with Regard To Prohibitions and Restrictions on Certain Interests in, And Relationships with, Hedge Funds and Private Equity Funds (Release No. BHCA-2)

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Financial Managers Society Tax Update

Michael J. Rowe, CPA

September 15, 2015

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Today’s Agenda

- Bad Debt Directive
- Merger & Acquisition Issues
- Captive Insurance Companies
- Tangible Property Regulations
- Federal Credits
- Dealer Reserves (IRS Audit Issue)
- Due Date Changes
- Basel III
- Information Reporting
- Massachusetts Sales Tax Issues
- State Tax Issues
- Unrelated Business Income Tax

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Bad Debt Directive

- Examination guidance issued in October 2014
- Provides for an administrative resolution to controversy regarding worthlessness
- Examiner is not to challenge bad debt deduction if it is the same as the credit-related portion of the charge-off on the financial statements.
- Post-deduction tax basis cannot be less than the post-charge-off book basis of the debt
- Also, inclusion of estimated selling costs is not to be challanged

Bad Debt Directive

- Can be adopted in any year from 2010 through 2014 (if statute of limitations still open)
- Once adopted, the directive provisions must be followed consistently
- First year adjustment – in year of adoption, a bank can adjust the bad debt deduction for the prior year differences between the deduction for tax purposes and the charge offs per the books
- Certification Statement to be completed and signed upon examination
- Also applies to OTTI on debt securities at banks

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Merger & Acquisition Issues

- Deductibility of Expenses
  - "Bright line" test – focuses on the earlier of:
    - The date of execution of the letter of intent, or
    - The date the material terms are approved by the Board
  - Costs before this date are <u>generally</u> investigatory (deductible), costs after this date are <u>generally</u> facilitative (capitalized)
  - Certain costs are "inherently facilitative" and are always capitalized no matter when incurred
  - Certain costs do not facilitate the transaction and are deductible no matter when incurred
  - Success-based fees – generally 70% deductible

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Merger & Acquisition Issues

- Golden Parachute Payments (Section 280G)
  - Deduction disallowed for “excess parachute payments” to “disqualified individuals” pursuant to a change in control
  - Recipient of excess parachute payments must pay a 20% excise tax on that amount
  - “Disqualified individual” – performs services for the bank and is an officer, shareholder, or “highly compensated individual (highest-paid 1% of employees)

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Merger & Acquisition Issues

- Golden Parachute Payments (Section 280G)
  - "Excess parachute payment" – excess of parachute payment over "base amount"
  - "Base amount" – average annual taxable compensation over the previous 5-year period
  - "Parachute payment" – payment in the nature of compensation which is:
    - Contingent on a change in ownership or control of the bank, or of a substantial amount of assets, and
    - The present value of payments equals or exceeds 3 times the base amount
  - Clawback Provisions

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Merger & Acquisition Issues

- Golden Parachute Payments (Section 280G)
  - Example:
    - Base amount $250,000
    - Change in control payment $800,000
  - Because payment exceeds 3 times the base amount, the $800,000 is a parachute payment
  - $800,000 less $250,000 = $550,000 – nondeductible as excess parachute payment
  - Individual pays excise tax of $110,000 (20%)
  - If change in control payment is $700,000, there is no parachute payment, so no disallowed deduction and no excise tax to the individual.

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Merger & Acquisition Issues

- Code Section 382
  - Annual limitation of the amount of carryovers, NOLs, capital losses, credits, and net unrealized built-in losses (“NUBILs”) that can be deducted subsequent to an ownership change
  - Annual limitation – value of target corporation immediately before the ownership change multiplied by the IRS-issued monthly long-term exempt rate
    - Use the highest rate for 3 month period ending with the ownership change
    - Tax exempt rate for September 2015 = 2.82%

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Merger & Acquisition Issues

- Code Section 382
  - NUBIL = the amount of loss recognized in a hypothetical sale of assets immediately before the ownership change
  - If NUBIL does not exceed the lower of 15% of the FMV of assets or $10 million, NUBIL is considered to be zero
  - Recognized built-in loss (“RBIL”) = loss on disposition of assets on which there were unrealized built-in losses at the time of the acquisition
  - RBILs after 5-year period beginning with the acquisition date are not subject to the limitation
  - RBILs related to loans are limited for only 12 months

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Captive Insurance Companies (CICs)

- Addresses gaps in insurance coverage, such as cyber risk, employment claims, legal liability coverage, fraud, deductibles
- Formed as a subsidiary of a bank holding company
- Need more than 50% of the risk exposure from third parties
- Risk pool of 10 CICs
- If qualifications are met, the bank has a deduction for premiums paid, and CIC is only taxed on its investment income – only if “small” captive
- Subject of IRS scrutiny – must have business purpose

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Tangible Property Regulations

- Influences many capitalization or deduction issues, including:
  - Improvement vs. repair
  - Costs to acquire assets
  - De minimis capitalization policy

- Effective tax years beginning on or after 1/1/14

- Form 3115 included with 2014 return to adopt the regulations

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Federal Credits

- Low Income Housing
  - Taken over 10 years with 15 year compliance period (pro-rate in first year)
  - Generally flow through limited partnership investment
  - Recapture occurs if during 15-year compliance period:
    - Project fails to meet rent and income tests
    - Sale of building
    - Sale of p/s interest in p/s that owns the building
  - New method of accounting – writedown booked through tax provision

Federal Credits

- Certified Historic and Other Rehabilitation Credits
  - 20% tax credit for certified rehabilitation of certified historic structures
  - Credits generally claimed during the first year by owner of the property as dollar for dollar reduction in tax liability
  - Five year holding period or subject to recapture – 20% vesting per year
  - Basis in the rehab property is reduced by the amount of the credit
  - Credit is not transferable

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Federal Credits

- Certified Historic and Other Rehabilitation Credits
  - Generally flow through LP or LLC investment
  - *Historic Boardwalk Hall* case
    - Must be bona fide partner to claim credits
    - Must have "meaningful stake in the success or failure of the partnership"
    - IRS Safe Harbor – Rev. Proc. 2014-12. However, may not apply to investment with LIHTC as well

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Dealer Reserves (IRS Audit Issue)

- Bank has an agreement to provide vehicle financing through the dealership
- Bank's interest rate is lower than the rate the customer pays – difference is split between the bank and the dealer using a predetermined ratio
- Bank prepays the dealer it's portion of future payments
- Bank sets up a liability for its share of the difference (dealer reserve)
- Dealer reserve is generally not taken into income for book purposes (kept as cushion against prepaid loans) but is income for tax

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Due Date Changes

- For years beginning after 12/31/15:
  - Partnership and S Corporation returns will be due on the 15th day of the 3rd month after year-end
  - C Corporation returns will be due on the 15th day of the 4th month after year-end (April 15 for calendar year C Corporations)
  - Exception – C Corporation returns with a tax year ending on June 30 will still be due on September 15 until years beginning after December 31, 2025
  - Extensions for 12/31 year-ends – 5 months
  - Extensions for 6/30 year-ends – 7 months
  - Extensions for other year-ends – 6 months

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Basel III

- Effective 1/1/15, except for “advanced approach” banks (greater than $250 billion in assets)
- New type of capital – Common Equity Tier 1 (CET1)
- Changed how deferred tax assets and liabilities (DTAs and DTLs) affect capital calculation

Basel III (Cont.)

- Methodology
  - Carve out DTAs and DTLs related to separately stated items (Goodwill, MSRs)
  - Exclude DTAs and DTLs related to AOCI if opt-out
  - Segregate remaining net DTA into 3 buckets:
    - DTAs from NOLs and credits
    - Other DTAs
    - DTLs
  - Deduct DTAs from NOLs and credits from CET1 (subject to phase-in) – 40% in 2015, 60% in 2016, 80% in 2017
  - Remaining DTA that can't be realized through hypothetical carryback is deducted from CET1 to the extent it exceeds 10% of CET1

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Basel III (Cont.)

- Net DTAs & MSRs deducted from CET1 to the extent they exceed 15% of CET1
- DTAs offset by carryback – 100% risk weighting
- Remaining net DTA subject to 250% risk weighting starting in 2018
- When should DTL netting take place?
  - Before or after hypothetical carryback?
  - Before or after elimination due to NOLs and credits?
  - Generally most advantageous to net up front.
  - Netting methodology must be consistent from period to period

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Information Reporting

- 1099-A and 1099-C
  - 1099-A – Acquisition or Abandonment of Secured Property – filed by taxpayers who lent money in connection with a trade or business to report foreclosure or abandonment of property held as security for debt
  - 1099-C – Cancellation of Debt – filed by a financial institution to report a partial or complete discharge of a debt

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Information Reporting

- 1099-C – debt is cancelled on the date an Identifiable Event occurs
  1. Discharge in Bankruptcy
  2. Cancellation making the debt unenforceable
  3. Statute of limitation for collection expires
  4. Foreclosure remedies that bar the creditor's right to collect
  5. Cancellation making the debt unenforceable under probate
  6. Agreement between the parties
  7. Decision or policy of creditor to stop collection
  8. Expiration of non-payment testing period (36 months)

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Information Reporting

- Coordination of Form 1099-A and Form 1099-C:
  - You May File Only Form 1099-C
    - If in the same calendar year you cancel debt of $600 or more in connection with a foreclosure or abandonment of secured property, it is NOT necessary to file both Form 1099-A and Form 1099-C
    - Complete Boxes 4, 5 and 7 on Form 1099-C to fulfill the filing requirements of Form 1099-A
  - File Form 1099-C for the year in which the Identifiable Event occurs

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Information Reporting

- Personal Use of Company Automobiles
  - Value Reported in Taxable Income
    - Value of Personal Use, less reimbursements
    - 2 Valuation Methods (for vehicle values > $16,000)
      - General Valuation Rule
      - Automobile Lease Valuation
    - General Valuation Rule
      - Cost of an arms-length lease on a comparable car multiplied by percent of personal use
      - Value of company-provided expenses also included in taxable income

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Information Reporting

- Personal Use of Company Automobiles
  - Value Reported in Taxable Income
    - Automobile Lease Valuation Rule:
      - Involves use of an Annual Lease Value ("ALV")
      - Multiply Computed ALV by Percentage of Personal Use
      - Once determined, the ALV must continue to be used until December 31 of the fourth full calendar year after the date that the automobile lease valuation rule was applied unless the car is transferred to another employee.
        - » ALV is redetermined on Jan. 1st following the fourth full calendar year of use
      - Automobile Lease Value Rule may only be used by a taxpayer if the rule has been elected by the corporation when the car is first made available

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Information Reporting

- Form 1098
  - Effective for forms filed after December 31, 2016
  - Requires additional information
    - Outstanding principal at the beginning of the year
    - Date of origination
    - Address of the property securing the mortgage

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Massachusetts Sales Tax Issues

- Maintenance Contracts
  - Upgrades and updates are taxable
  - If maintenance is not separately stated, the entire contract will be subject to tax
  - Recommendation – re-write contracts to separate maintenance costs from software updates
- On-Line Training – not taxable
- Out of State Purchases
  - Many out-of-state vendors do not collect MA sales tax
  - Must self-assess use tax

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State Tax Issues

- Massachusetts – CDC Credits
  - $6 million in credits allocated to Community Development Corporations
  - 50% credit against MA tax liability
  - www.macdc.org/community-investment-tax-credit
- Connecticut
  - Mandatory combined reporting starting in 2016
  - Extends surcharge
  - Changes to utilization of NOLs and credits

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State Tax Issues

- New York
  - Major reform – most provisions effective in 2015
  - Banks will be file the same returns as other corporations but have special bank-only deduction and apportionment provisions
  - Changes in rates, nexus, combined filing, apportionment
- Rhode Island
  - Combined reporting for 2015 (excludes banks)

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State Tax Issues

- In General
  - Most states have credits available, but may require advanced approval
  - More and more states adopting economic nexus standards – run a report of source of income – nexus study?

Unrelated Business Income Tax

- Applies to state-chartered credit unions
- UBIT is applied to activities that do not contribute importantly to accomplishment of exempt purpose
- Can allocate expenses to these activities
- Examples
  - Marketing of most insurance (life, health, dental, AD&D)
  - Nonmember ATM fees
  - Nonmember credit life & credit disability insurance
- Massachusetts also has UBIT requirement

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Questions?

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