Tax Accounting Update

Year-end 2020 virtual meeting

December 17, 2020

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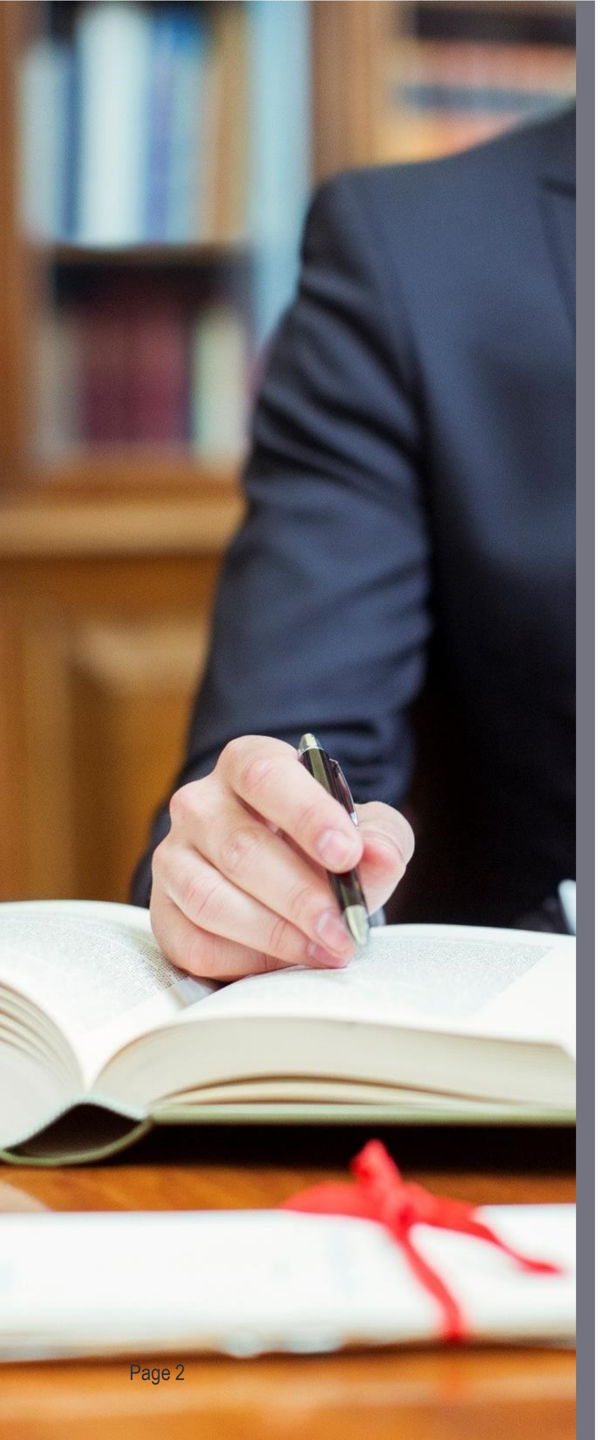

Today’s agenda

1. Discussion on tax accounting developments – recent guidance
2. Tax accounting implications of the of Coronavirus Aid, Relief, and Economic Security (CARES) Act (for COVID-19 relief)
3. Other topics
4. Questions and wrap up

Update on income tax accounting developments for year-end

FASB update

POLLING QUESTION #1

FASB agenda
Select projects

Project	Status
Accounting by a joint venture for nonmonetary assets contributed by investors	Initial deliberations
Disclosure framework — interim reporting	Initial deliberations
Improving accounting for business combinations and asset acquisitions	Initial deliberations
Income taxes — changes to the disclosure requirements	Revised Exposure Draft (ED) redeliberations
Intangible assets and subsequent accounting for goodwill	Initial deliberations
Leases – targeted improvements	ED Comment Period
Reference rate reform — Accounting Standards Codification (ASC) 848 scope refinement	Exposure draft

Simplifying the accounting for income taxes

Simplifying the accounting for income taxes – ASU 2019-12

Transition – key amendments

	Effective dates	
	Fiscal years beginning after	**Interim periods within fiscal years beginning after**
Early adoption permitted	Yes	Yes
Public business entities	15 December 2020	15 December 2020
All others	15 December 2021	15 December 2022

Reminders

- For public companies that have not yet adopted ASU 2019-12, disclose the effect of adoption on future periods.
- Entities that elect early adoption must adopt all the amendments in the same period.

FASB agenda
Select projects

ASU 2019-12 amendment	Effect
Retrospective	
Allocation of consolidated tax expense to separate financial statements	Entities may elect to allocate consolidated tax expense to separate financial statements of certain legal entities not subject to income tax
Modified retrospective	
Elimination of exceptions to recognition of deferred taxes when control of a foreign entity changes	Parent accounts for the tax effects of the entire outside basis difference as if the entity had always been an equity method investment or foreign subsidiary
Retrospective or modified retrospective	
Recognition of income-based portion of franchise taxes that are calculated using the greater of two tax computations	Identify portion of the tax based on income and account for it under ASC 740; any residual is a non-income-based tax. Deferred taxes measured using applicable statutory rate.

FASB agenda
Select projects

ASU 2019-12 amendment	Effect
Prospective	
Elimination of exception to calculation of income tax for an interim period (i.e., the ceiling rule)	Income tax benefit is not limited to the benefit based on year-to-date ordinary loss if realizable
Elimination of exception to allocation of income tax expense (benefit) when allocating income tax expense to continuing operations	When allocating income tax expense (benefit) to continuing operations, only consider income (loss) from continuing operations
Align principle to include effects of new tax laws in the interim period that includes enactment date	All effects of tax law changes are recorded in the interim period that includes the enactment date, which accelerates the recognition of effects of a rate change in an interim period
Clarification of the determination of whether step-up in tax basis of goodwill relates to either: (1) Initial recognition of book goodwill (2) A separate transaction	(1) Deferred tax asset would be recorded only to extent tax deductible goodwill exceeds balance of book goodwill (2) Deferred tax asset would be recorded for amount of newly deductible goodwill

Simplifying the accounting for income taxes — ASU 2019-12
Transition — key amendments

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Simplifying the accounting for income taxes — ASU 2019-12

Transition — key amendments

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Retrospective or modified retrospective	
Franchise taxes that are calculated using the greater of two tax computations	Identifying portion of the tax that is based on income and accounting for it under ASC 740; any residual is a non-income-based tax. Deferred taxes measured using applicable statutory rate.

Simplifying the accounting for income taxes — ASU 2019-12

Transition — key amendments

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Disclosure framework: disclosure review — income taxes

Exposure draft — key proposed new disclosures

- Income statement
  - Income/loss and income tax expense/benefit from continuing operations disaggregated between domestic and foreign:
  - Domestic and foreign based on jurisdiction imposing tax (e.g., GILTI)
  - Income or loss from continuing operations before intra-entity eliminations
- Income tax expense compared with statutory expectations
  - For public business entities only
  - Rate reconciliation items > 5% expected federal (or national) statutory income tax expense and explanation of year-to-year change
- Income taxes paid
  - Annual period disaggregated between federal (or national), state and foreign
  - Income taxes on foreign earnings imposed by the jurisdiction of domicile shall be included in that jurisdiction of domicile (e.g., taxes on GILTI or Subpart F will be considered a federal tax for a US-domiciled entity)
  - Interim periods — total income taxes paid during period
- Line item in balance sheet where unrecognized tax benefits are recorded

Disclosure framework: disclosure review — income taxes
Exposure draft

- Key proposed **removals** from existing guidance:
  - Cumulative amount of temporary differences not recognized under exceptions to ASC 740
  - Nature and estimate of the range of the reasonably possible change in the unrecognized tax benefits balance in the next 12 months

- Key proposals removed from the initial exposure draft:
  - Cash, cash equivalents and marketable securities held by foreign subsidiaries
  - Disaggregated tax information at the country level

POLLING QUESTION #2

CARES Act – select topics

CARES Act
Paycheck Protection Program (PPP) loans

- The CARES Act provided an estimated $2.2 trillion to fight the COVID-19 pandemic and stimulate the US economy.
  - Includes $349 billion that was earmarked for the PPP to be administered by the Small Business Administration (SBA)
  - An additional $310 billion was later authorized for the PPP
- The PPP was created to provide certain small businesses with liquidity to support their operations during the COVID-19 pandemic.
- Entities have to meet certain eligibility requirements to receive PPP loans, and they must maintain specified levels of payroll and employment to have the loans forgiven.
  - The conditions are subject to audit by the US government, but entities that borrow less than $2 million will be deemed to have met the initial eligibility requirements.

CARES Act
PPP loans

- **Recognize as debt** – under ASC 470, an entity would recognize a liability for the full amount of PPP proceeds received and accrue interest over the term of the loan.
  - If any amount is ultimately forgiven (i.e., the entity is legally released from being the loan's primary obligor in accordance with ASC 405-20), income from the extinguishment of the liability would be recognized in the income statement as a gain on loan extinguishment.
- **Recognize as government grant (by analogy to IAS 20)** – if an entity expects to comply with the PPP eligibility and loan forgiveness criteria, it may account for the forgivable PPP loan as, in substance, a government grant that is earned through the entity's compliance with the loan forgiveness criteria.
  - An entity will need to continually reassess its ability to meet the forgiveness conditions, and it may have to reverse income if it can no longer support a conclusion that it expects to meet the conditions.

Entities that receive PPP loans should carefully evaluate the eligibility and forgiveness criteria, as well as closely monitor program developments because the SBA continues to release additional information and requirements.

CARES Act — Employee Retention Credit (ERC)

Key provisions

- General provisions
  - Refundable payroll tax credit against the employer share of the Social Security Tax, federal Old Age, Survivors and Disability Insurance tax (OASDI) on wages or the equivalent amount of Tier 1 taxes under the Railroad Retirement Act
  - The credit is not allowed for any employee for any period in which the work opportunity tax credit (WOTC) is claimed with respect to any such employee
  - Wages used for the credit may not be used for the Section 45S credit or COVID-19 paid leave credits. The deduction for wages and salaries must be reduced by the amount of the credit
- Credit amount and recovery process
  - Refundable credit equal to 50% of qualified wages paid or incurred, including certain health plan expenses during the covered period (after 12 March 2020 and before 1 January 2021)
  - Maximum credit of $5,000/employee (50% of maximum $10,000 qualified wages)
  - Claimed on the current quarter Form 941 or Form 941-X or Form 7200 for advance payments

CARES Act — ERC
Key provisions

- Eligible employer
  - Employers that carried on a trade or business during 2020 and either:
    1. Suspended operations fully or partially as a result of a COVID-19-related governmental order
    2. Experienced at least a 50% year-over-year decline in calendar quarter gross receipts

- Qualified wages
  - For eligible employers that had an average number of full-time employees in 2019 greater than 100, wages paid to employees with respect to which an employee is not providing services due to reasons (1) or (2) above
  - For eligible employers that had an average number of full-time employees in 2019 of 100 or less, wages paid to employees with respect to an employee (regardless of whether employee provides services)

CARES Act — ERC

Tax/accounting considerations

- Federal and state treatment
  - For federal tax purposes, neither the portion of the ERC reducing the employer's applicable employment taxes or the refundable portion of the ERC is included in the employer's gross income.
  - Also, employers must reduce their deductions by the amount of the ERC in accordance with Section 280C.
  - Careful consideration of the state conformity rules and the particular state's adoption of the CARES Act provisions should be applied.
- Accounting treatment
  - Because the assistance received is not an income tax credit in the scope of ASC 740, it is appropriate to account for the credit as a government grant by analogy to IAS 20.
  - No book/tax difference due to Section 280C reduction of related expenses.

Other accounting considerations for the effects of the COVID-19 pandemic

Accounting for the effects of the COVID-19 pandemic
Other accounting considerations

- Asset impairments
  - Indefinite-lived intangible asset – annually, or more frequently if impairment indicators exist
  - Long-lived assets to be held and used – when impairment indicators exist
  - Goodwill – annually or more frequently if impairment indicators exist
- Revenue recognition – changes to existing contracts
  - Evaluate whether changes to existing contracts, not known at contract inception, are contract modifications
  - Update estimates of variable consideration (including the constraint) at each reporting date

Accounting for the effects of the COVID-19 pandemic
Other accounting considerations

- Loan modifications – troubled debt restructuring (TDR) relief
  - Financial institutions may suspend TDR accounting for loan modifications if certain eligibility requirements are met
- Credit impairment
  - Consider reasonable and supportable forecasts of future economic conditions in estimate of expected credit losses
  - Assess degree to which economic effect of market disruption changes forecast of future economic conditions
- Going concern
  - Evaluate ability to continue as a going concern within one year after date the financial statements are issued

POLLING QUESTION #3

Considerations for the effects of the coronavirus outbreak and CARES Act

Tax accounting for the CARES Act

- Current and deferred tax effects of five-year carryback of NOLs generated in 2018, 2019 and 2020, including the following:
  - Recognition of tax receivables at 21%, or 35% if carrying back to years beginning before January 1, 2018
  - Impact of carryback on other tax calculations, including foreign tax credits, foreign-derived intangible income (FDII), GILTI, base erosion and anti-abuse tax (BEAT), and Section 965 transition tax calculations
  - Changes in deferred tax assets and, if necessary, valuation allowances related to NOL carryforwards
  - Assess deferred tax assets and valuation allowances for attribute carryforwards
- Current and deferred tax effects of removing the 80% limitation on the use of NOLs in 2018, 2019 and 2020, including valuation allowance considerations

Tax accounting for the CARES Act

- Reclassification of deferred tax assets or long-term receivables for alternative minimum tax (AMT) credit carryforwards to current receivables if refund expected within the next 12 months
- Current and deferred tax effects of increasing the adjusted taxable income (ATI) limitation from 30% to 50% for business interest deductions for 2019 and 2020, including valuation allowance considerations
- Current and deferred tax effects of retroactively clarifying the immediate recovery of QIP costs rather than over a 39-year recovery period
- Current tax effects of increase in 2020 charitable contribution deductions

Regulatory Capital Examples

Baseline

Sample Non-Advanced Approaches Bank Example

Data	
GAAP common equity (static)	$ 200.00
Tax credit DTAs @ 12/31/20	$ 27.75
Temp difference DTAs (static)	$ 50.00
DTLs (static, no reg adjustments)	$ (4.00)

Tax History	2014	2015	2016	2017	2018	2019	2020	2021
TI	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00
Rate	35%	35%	35%	35%	21%	21%	21%	21%
Tax before credits	$ 35.00	$ 35.00	$ 35.00	$ 35.00	$ 21.00	$ 21.00	$ 21.00	$ 21.00
GBC Limit	$ 25.00	$ 25.00	$ 25.00	$ 25.00	$ 15.75	$ 15.75	$ 15.75	$ 15.75
Net tax	$ 10.00	$ 10.00	$ 10.00	$ 10.00	$ 5.25	$ 5.25	$ 5.25	$ 5.25

	2014	2015	2016	2017	2018	2019	2020	2021
Available GBCs	$ 25.00	$ 25.00	$ 25.00	$ 25.00	$ 25.00	$ 34.25	$ 43.50	$ 52.75
75% Limitation	$ 26.25	$ 26.25	$ 26.25	$ 26.25	$ 15.75	$ 15.75	$ 15.75	$ 15.75
Excess GBC/<Limit>	$ -	$ -	$ -	$ -	$ 9.25	$ 18.50	$ 27.75	$ 37.00

Regulatory capital (CET1)	2020	2021
Book common equity	$ 200.00	$ 279.00
Less: attribute DTAs	$ (24.28)	$ (35.19)
CET1 before thresholds	$ 175.72	$ 243.81
Less: temp DTAs > 25%	$ -	$ -
CET1	$ 175.72	$ 243.81

RWA:	2020	2021
DTAs subject to 100%	$ 45.75	$ 5.25
DTAs subject to 250%	$ 24.28	$ 35.19

2022 Rate Change Benefit (assume 28%)	$ 3.22

Basel III DTA Buckets	2020	2021
Temp DTAs	$ 50.00	$ 50.00
Less: hypo c/b	$ (45.75)	$ (5.25)
Net Temp DTAs	4.25	$ 44.75
Attribute DTAs	$ 27.75	$ 37.00
Total DTAs	$ 32.00	$ 81.75
Attribute DTAs	$ 27.75	$ 37.00
Less: % of DTLs	$ (3.47)	$ (1.81)
Net Attribute DTAs	$ 24.28	$ 35.19
Net Temp DTAs	$ 3.72	$ 42.56
Net Reg Cap DTAs	$ 28.00	$ 77.75

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Sample Non-Advanced Approaches Bank Example

Data	
GAAP common equity (static)	$ 200.00
Tax credit DTAs @ 12/31/20	$ -
Temp difference DTA @ 12/31/19	$ 50.00
DTLs (static, no reg adjustments)	$ (4.00)
New 2020 Temp DTA	$ 42.00

Tax History	2014	2015	2016	2017	2018	2019	2020	2021
TI	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00
New 263(a) temp							$ 200.00	
New TI	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 100.00	$ 300.00	$ 100.00
Rate	35%	35%	35%	35%	21%	21%	21%	21%
Tax before credits	$ 35.00	$ 35.00	$ 35.00	$ 35.00	$ 21.00	$ 21.00	$ 63.00	$ 21.00
GBCs	$ 25.00	$ 25.00	$ 25.00	$ 25.00	$ 15.75	$ 15.75	$ 43.50	$ 15.75
Net tax	**$ 10.00**	**$ 10.00**	**$ 10.00**	**$ 10.00**	**$ 5.25**	**$ 5.25**	**$ 19.50**	**$ 5.25**

Available GBCs	$ 25.00	$ 25.00	$ 25.00	$ 25.00	$ 25.00	$ 34.25	$ 43.50	$ 25.00
75% Limitation	$ 26.25	$ 26.25	$ 26.25	$ 26.25	$ 15.75	$ 15.75	$ 47.25	$ 15.75
Excess GBC	$ -	$ -	$ -	$ -	$ 9.25	$ 18.50	$ -	$ 9.25

Regulatory capital (CET1)	2020	2021
Book common equity	$ 200.00	$ 279.00
Less: attribute DTAs	$ -	$ (5.26)
CET1 before thresholds	$ 200.00	$ 273.74
Less: temp DTAs > 25%	$ -	$ (14.55)
CET1	$ 200.00	$ 259.18

Basel III DTA Buckets	2020	2021	
Temp DTAs	$ 92.00	$ 92.00	
Less: hypo c/b	$ (60.00)	$ (5.25)	
Net Temp DTAs	$ 32.00	$ 86.75	
Attribute DTAs	$ -	$ 5.50	*excess GBC can be carried back to 2020*
Total DTAs	$ 32.00	$ 92.25	

RWA:		
DTAs subject to 100%	$ 60.00	$ 5.25
DTAs subject to 250%	$ 28.00	$ 68.43

Attribute DTAs	$ -	$ 5.50
Less: % of DTLs	$ -	$ (0.24)
Net Attribute DTAs	$ -	$ 5.26
Net Temp DTAs	$ 28.00	$ 82.99
Net Reg Cap DTAs	$ 28.00	$ 88.25

2022 Rate Change Benefit (assume 28%)	$ 6.16

POLLING QUESTION #4

Open discussion

- Q&A
- Wrap-up

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