Quarterly tax developments

Things to know about this quarter's tax developments and related US GAAP accounting implications

June 2023

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Welcome to our June 2023 Quarterly tax developments *publication.*

Here we describe certain tax developments previously summarized in Tax Alerts or other EY publications or identified by EY tax professionals or EY foreign member firms. These developments may affect your tax provision or estimated annual effective tax rate.

We compile this information because we recognize that, for many companies, the most challenging aspect of accounting for income taxes is identifying changes in tax law and other events when they occur so the accounting can be reflected in the appropriate period. However, this publication is not a comprehensive list of all changes in tax law and other events that may affect income tax accounting.

This edition covers certain enacted and effective tax legislation, as well as regulatory developments, legislative proposals and other items identified through 13 June 2023, except as noted.

We list EY publications that you can access through our ***Tax News Update website****, if you are registered. Anyone interested in registering should contact Joan Osborne at* ***joan.osborne@ey.com****.*

See our ***previous editions*** *for additional tax developments.*

Tax developments

Legislation enacted in the second quarter

Federal, state and territories

Alabama — On 20 April 2023, Alabama enacted legislation extending the expiration dates of the Alabama Jobs Act and the Growing Alabama Act for five years through 31 July 2028. Other legislative changes enacted on 20 April include:

- Modifying the definition of "qualifying project" under the Alabama Jobs Act to include certain renewable energy generation facilities and exclude a commercial enterprise that is open to the public 120 days or more during the year and designed to attract out-of-state visitors
- Modifying provisions related to the transferability of the investment credit
- Removing certain activities from the list of activities under the Growing Alabama Act that an economic development organization can apply for funding to undertake
- Introducing tax credits under the Innovating Alabama Act, which eligible applicants can use to offset their income tax liability by up to 50% and may carry forward up to five years, provided their applications are approved on or before 31 July 2028

The changes are effective upon enactment. See the **State and Local Weekly for 5 May 2023 and 12 May 2023**.

Arkansas — On 10 April 2023, Arkansas enacted legislation decreasing its top corporate income tax rate to 5.1% (from 5.3%) for net income exceeding $25,000. The change is retroactively effective for tax years beginning on or after 1 January 2023.

Other legislative changes enacted on 10 April 2023 include:

- Phasing out the throwback rule, which assigns the sale to Arkansas when the shipment originated in Arkansas and the company is not taxable in the destination state
- Increasing the tax incentive that may be offered to an eligible production company under the production tax incentives program to 25% (from 20%) of all qualified production costs from the production of a state-certified film project
- Increasing the tax credit or rebate for postproduction costs to 25% (from 20%) of all qualified production costs from the postproduction of an approved state-certified film project
- Offering an additional 5% tax incentive for state-certified film projects if certain requirements are satisfied
- Offering an additional 5% credit for producing a multi-project production, including television series and multi-film projects

The changes to the throwback rule are effective for tax years beginning 1 January 2024, with the phaseout to occur over seven years and be completed by tax year 2030. Thus, for 2030 and after, these sales will be sourced 100% outside the state. The incentives for state-certified film projects and multi-project productions are effective for financial incentive agreements signed on or after 1 August 2023. See the **State and Local Tax Weekly for 14 April 2023**.

On 11 April 2023, Arkansas enacted legislation permitting railroads to use one of the provided apportionment formulas. Under the new law, railroads operating partly within and partly outside Arkansas must apportion their net operating income attributable to Arkansas by multiplying their income by either a single sales factor or a double-weighted sales factor. These changes are retroactively effective for tax years beginning on or after 1 January 2023. See the **State and Local Tax Weekly for 21 April 2023 and 28 April 2023**.

On 13 April 2023, Arkansas enacted legislation broadening eligibility for certain economic development incentives to include businesses primarily engaged in operating combustors and incinerators for the disposal of nonhazardous solid waste. The law takes effect 1 August 2023. See **the State and Local Tax Weekly for 19 May 2023 and 26 May 2023**.

Georgia — On 2 May 2023, Georgia enacted legislation decoupling from the changes made by the Tax Cuts and Jobs Act of 2017 (TCJA) to the treatment of research and experimental (R&E) expenditures under Internal Revenue Code (IRC) 174. The change is retroactively effective for tax years beginning on or after 1 January 2022. See the **State and Local Weekly for 5 May 2023 and 12 May 2023**.

Indiana — On 4 May 2023, Indiana enacted legislation decoupling from TCJA changes to the treatment of R&E expenditures under IRC 174. The change is retroactively effective for tax years beginning after 31 December 2021. See **the State and Local Tax Weekly for 19 May 2023 and 26 May 2023**.

Iowa — On 1 June 2023, Iowa enacted legislation conforming its law to federal bonus depreciation and allowing increased expensing under IRC Section 179 for assets placed in service on or after 1 January 2023. See **Tax Alert 2023-1005**, dated 5 June 2023.

Maryland — On 8 May 2023, Maryland enacted legislation narrowing the definition of a captive real estate investment trust (REIT) for purposes of determining state deductions for dividends paid by captive REITs. Thus, the legislation will allow more REITs to deduct, for Maryland corporate tax purposes, dividends paid to shareholders. The change is effective 1 July 2023 and applies to all tax years beginning after 31 December 2022. See **the State and Local Tax Weekly for 19 May 2023 and 26 May 2023**.

Minnesota — On 24 May 2023, Minnesota enacted legislation reducing the percentage of dividends that companies may deduct under the state's dividends received deduction (DRD). For tax years after 31 December 2022, corporations that are at least 20% owned by the dividend recipient may deduct 50% of dividends paid (rather than 80%). Corporations whose dividend recipients own less than 20% may deduct 40% of dividends paid (rather than 70%).

Other changes include:

- Conforming to the federal treatment of global intangible low-taxed income (GILTI), except for the deduction under IRC Section 250
- Classifying GILTI as dividend income for Minnesota income tax purposes, thereby subjecting it to Minnesota's revised DRD provision
- Limiting net operating loss (NOL) deductions for Minnesota purposes to 70% of taxable income in a given year (with unused amounts still being carried forward)

The changes are retroactively effective for tax years beginning after 31 December 2022. See **Tax Alert 2023-0961**, dated 30 May 2023.

Montana — On 22 May 2023, Montana repealed a state law requiring corporations to include affiliates incorporated in so-called tax havens in their water's-edge group for corporate income tax purposes. This change applies retroactively to tax years beginning after 31 December 2022. See **Tax Alert 2023-0931**, dated 23 May 2023.

Nebraska — On 31 May 2023, Nebraska enacted legislation phasing in a flat corporate rate and reducing that rate to 3.99%. For tax years beginning on or after 1 January 2024, the corporate income tax rate will remain 5.58% on the first $100,000 of corporate income and decrease to 5.84% (from 7.25%) for income above $100,000. A reduced flat rate is then phased in as follows:

- 5.2% for tax years beginning on or after 1 January 2025
- 4.55% for tax years beginning on or after 1 January 2026
- 3.99% for tax years beginning on or after 1 January 2027

See **Tax Alert 2023-0991**, dated 2 June 2023.

New Mexico — On 7 April 2023, New Mexico enacted legislation raising the cap on film production tax credits to $10 million for New Mexico film partners using nonresident performing artists, directors, producers, screenwriters and editors in their productions. The aggregate cap on film credits is $40 million for all productions in a fiscal year. The law also:

- Defines New Mexico film partner
- Modifies the calculation of credits for expenditures made in certain areas of New Mexico for television pilots and series
- Modifies the nonresident below-the-line crew credit to exclude certain payments from wage payments used to calculate the credit

These provisions apply to film production companies that commence principal photography for a film or commercial audiovisual product on or after 1 July 2023. See the **State and Local Tax Weekly for 21 April 2023 and 28 April 2023**.

New York — On 3 May 2023, New York enacted legislation extending the 7.25% business income base tax for an additional three years through tax year 2026. Other changes include:

- Extending the empire state film production credit and the empire state film post-production credit through 2034, increasing how much companies may claim and making other enhancements to the credits
- Extending the 100% historic properties tax credit (increased to 150% for small projects) through 2029 and reducing the credit to 30% in 2030
- Extending the empire state commercial production tax credit through 2028

The changes were effective upon enactment. See **Tax Alert 2023-0823**, dated 5 May 2023, and the **State and Local Weekly for 5 May 2023 and 12 May 2023**.

Tennessee — On 11 May 2023, Tennessee enacted legislation adopting a single sales factor apportionment formula for determining excise taxes owed by certain multistate companies. The new formula will be phased in over three years, beginning with tax years ending on or after 31 December 2023. Taxpayers may annually elect to use a triple-weighted receipts factor formula, but the election must result in a higher apportionment ratio than the standard apportionment formula, and the taxpayer must have net earnings (not a net loss).

Other changes include:

- Conforming the excise tax to federal bonus depreciation in the TCJA for assets purchased on or after 1 January 2023 and requiring those assets to be depreciated under IRC Section 168
- Limiting requirements to add back or subtract certain depreciation from assets purchased on or before 31 December 2022
- Allowing a standard excise tax deduction equal to the lesser of net earnings or $50,000, provided the deduction does not create or increase a net loss (for tax years ending on or after 31 December 2024)
- Extending the carryforward period for excise tax credits earned in tax years ending on or after 31 December 2008 to 25 years from 15 years
- Allowing companies to claim a state-paid family leave tax credit against excise taxes, provided certain conditions are satisfied (the credit is allowed for tax years ending on or after 31 December 2023 but before 31 December 2025)

The changes, unless otherwise noted, were effective upon enactment. See **Tax Alert 2023-0866**, dated 11 May 2023.

Virginia — On 12 April 2023, Virginia changed how it conforms to the US IRC. Instead of using a fixed-date conformity (i.e., conforming to the federal law as a specific date), the state will use rolling conformity (i.e., automatically conforming to the federal tax law as it changes), except when a federal law will increase or decrease general fund revenues by a specific amount. The change applies to tax years beginning on or after 1 January 2023. For tax years beginning on or after 1 January 2022, but before 1 January 2023, the conformity date enacted in February 2023 applies (i.e., 31 December 2022). See the **State and Local Tax Weekly for 14 April 2023**.

IRC conformity

The following chart lists the states that enacted legislation this quarter updating their date of conformity to the US IRC. The chart also includes the dates on which the new conformity date was enacted and became effective. Further information on a state's IRC conformity can be found in the cited reference.

State	Enactment date	Date of conformity	Effective date	Reference
Florida	25 May 2023	1 January 2023	Upon enactment	See the **State and Local Tax Weekly for 2 June 2023 and 9 June 2023**.
Georgia	2 May 2023	1 January 2023 (with exceptions)	Tax years beginning on or after 1 January 2022	See the **State and Local Weekly for 5 May 2023 and 12 May 2023**.
Hawaii	5 June 2023	31 December 2022	Tax years beginning after 31 December 2022	See the **State and Local Tax Weekly for 2 June 2023 and 9 June 2023**.
Indiana	4 May 2023	1 January 2023 (with exceptions)	Retroactive to 1 January 2023	See **the State and Local Tax Weekly for 19 May 2023 and 26 May 2023**.
Minnesota	24 May 2023	1 May 2023	Upon enactment, except to the extent Minnesota incorporates federal changes that are retroactively effective	See **Tax Alert 2023-0961**, dated 30 May 2023.
North Carolina	3 April 2023	1 January 2023	Upon enactment	See the **State and Local Tax Weekly for 14 April 2023**.
South Carolina	16 May 2023	31 December 2022, but includes any federal provisions that expired in 2022 and are enacted in 2023	Upon enactment	See **the State and Local Tax Weekly for 19 May 2023 and 26 May 2023**.

International

Brazil — On 15 June 2023, Brazil enacted arm's-length transfer pricing rules that apply to all cross-border intercompany transactions. The new rules broaden the related-parties concept and align transfer pricing methods with the standards of the Organisation for Economic Co-operation and Development (OECD). The changes are effective as of 1 January 2024 but may be early adopted as of 1 January 2023. See **Tax Alert 2023-1078**, dated 16 June 2023.

Canada — On 22 June 2023, Canada enacted legislation making technical amendments to the Income Tax Act and accompanying regulations. The amendments include:

- Narrowing eligibility for an exception to the shareholder loan rules, which generally deem a non-repaid loan from a Canadian company to a nonresident shareholder to be a dividend to which withholding tax applies
- Allowing mining companies to deduct certain provincial and territorial mining taxes (and related interest) that correspond to income reported in a prior tax year that is closed for filing an amended return
- Extending specific anti-avoidance rules denying a deduction for certain dividends received by specified financial institutions (e.g., bank, insurance company) from a Canadian company

1. Strengthening the foreign affiliate rules through various technical changes

The changes have various effective dates. See **Tax Alert 2023-1151**, dated 28 June 2023.

Cambodia – On 16 May 2023, Cambodia enacted legislation aligning its definition of a permanent establishment (PE) with the agency PE provision of the OECD's 2017 Model Tax Convention. Accordingly, a nonresident company will be deemed to have a PE in Cambodia if someone acting on its behalf concludes contracts or plays a principal role in their conclusion without materially modifying them. See **Tax Alert 2023-1014**, dated 6 June 2023.

Denmark[1] – On 13 June 2023, Denmark enacted legislation generally allowing the government to tax nonresident companies that construct, operate and use artificial islands, installations and facilities, including windfarms, more than 12 nautical miles offshore but within Denmark's Exclusive Economic Zone. Activities involving sea cables and pipelines will not trigger tax liability unless certain conditions apply. The new rules apply beginning 1 July 2023.

Ghana – On 3 April 2023, Ghana enacted legislation permitting all companies, not just those in priority sectors, to claim unused losses from the previous five tax years. Companies may also deduct realized, noncapital foreign exchange losses, provided certain conditions are met, but may not deduct unrealized foreign exchange losses or foreign exchange losses from transactions between two residents. Other changes include taxing certain incomes of companies in a free zone enterprise at the general corporate income tax rate of 25%, provided various conditions are met. The changes are effective upon enactment. See **Tax Alert 2023-0763**, dated 26 April 2023.

Kenya – On 26 June 2023, Kenya enacted an additional tax on the repatriated profits of branches/PEs based on the branch's net assets and profitability. The legislation also lowers the corporate tax rate on a branch's income to 30% from 37.5%. Other changes include:

- Taxing gains from sales of shares or partnership interests if the shares or interests directly or indirectly derived more than 20% of their value, within the 365 days preceding the sale, from immovable property situated in Kenya
- Taxing gains from property that is initially transferred in a tax-exempt transaction and then subsequently transferred in a taxable transaction after less than five years, and deeming the cost basis in the taxable transaction to equal the cost basis in the exempt transaction
- Limiting certain tax-free reorganizations to corporate groups that have existed for more than 24 months
- Taxing income from qualified intellectual property (IP) at a lower, unspecified rate but limiting IP that can qualify for that rate (1 January 2024)
- Imposing a 5% withholding tax on income that Kenyan companies receive from local suppliers of sales promotion, marketing and advertising services

Unless otherwise indicated, the changes are effective 1 July 2023. A Tax Alert on the enacted legislation is forthcoming. For discussion of the proposed legislation, see **Tax Alert 2023-0888**, dated 15 May 2023.

Legislation effective in the second quarter

International

India[2] – Effective 1 April 2023, the withholding tax rate for nonresidents on royalties and technical service fees increases to 20% from 10%. Other changes effective 1 April 2023 include:

- Characterizing capital gains from the transfer, redemption or maturity of market-linked debt instruments as short-term capital gains taxable at ordinary rates
- Treating intangible assets or rights acquired without any consideration as having no cost basis for purposes of capital gains taxes

[1] A Tax Alert was not published on the legislation's enactment. For discussion of the proposed legislation, see **Tax Alert 2023-0980**, dated 1 June 2023.

[2] A Tax Alert on the legislation's enactment has not been published. For an Alert discussing the proposals, see **Tax Alert 2023-0211**, dated 3 February 2023.

- Permitting eligible startup companies to carry losses forward 10 years from their year of incorporation, rather than seven years
- Relaxing limits on interest expense deductions for nonbanking financial institutions
- Taxing, as income from other sources, repayment of debt by business trusts (e.g., real estate infrastructure trusts and infrastructure investment trusts) to investors, as well as income from redeeming units in those trusts
- Taxing private companies on the difference between the fair market value of their equity shares and the generally higher share price paid by nonresident investors
- Extending to 31 March 2025, from 31 March 2023, the deadline by which an offshore fund may relocate to an International Financial Service Center (IFSC) without incurring Indian tax
- Exempting income that nonresidents receive from offshore derivative instruments issued by IFSCs, provided certain conditions are satisfied

The changes were enacted 31 March 2023.

Japan[3] — Effective 1 April 2023, changes in the general research and development (R&D) tax credit may permit companies to claim more research credits. Companies may also count certain expenses for new highly skilled labor toward specified experiment and research (E&R) costs, which are used to calculate the open innovation tax credit. Other changes effective 1 April 2023 include:

- Broadening eligibility for open innovation tax credits (i.e., credits based on E&R expenses) to include more R&D-based startup companies and certain joint or consigned research
- Broadening eligibility for the tax incentive to promote open innovation to include share acquisitions, provided certain conditions are satisfied
- Revising the tax rules for spin-offs to treat specific distributions in kind as a share distribution, provided certain conditions are satisfied
- Eliminating mark-to-market valuation for certain crypto assets that are expected to be held long term
- Requiring a gain or loss to be recognized when a corporation borrows crypto assets from a party other than a crypto asset exchange service provider, transfers them and does not repurchase the same type of assets by the end of the tax year in which the transfer occurred
- Extending by two years, to 31 March 2025, the expiration date of special depreciation or tax credits for certain acquired software under the digital transformation investment promotion tax incentive and modifying them to effectively increase the benefit that a company may claim

The changes were enacted 28 March 2023.

United Kingdom[4] — Effective 1 April 2023, the corporate income tax rate increases to 25% from 19%, while the rate of the diverted profits tax increases to 31% from 25%. In addition, the following provisions expired:

- The 130% deduction for costs incurred on certain new plant and machinery assets
- An immediate deduction for 50% of costs incurred on new special-rate plant and machinery assets

The corporate rate increase was enacted 10 June 2021. In place of the expired provisions, the Spring Finance Bill proposes to allow immediate capital expensing for the next three years for firms investing £1m+ a year on plant and machinery. See the Things we have our eyes on section of this publication for discussion of the bill's progress.

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[3] A Tax Alert on the legislation's enactment has not been published. For discussion of the provisions before their enactment, see a **newsletter from EY Japan**.

[4] A Tax Alert has not been published on the enactment of the increased diverted profits tax or the 130% deduction and 50% immediate deduction. For discussion of those provisions when proposed, see **Tax Alert 2021-0476**, dated 3 March 2021. For discussion of the proposals in the Spring Finance Bill, see **Tax Alert 2023-0492**, dated 16 March 2023.

Treaty changes

Tax treaties are agreements between countries that typically address withholding tax rates or exemptions on dividends, interest and royalties paid in multiple jurisdictions. Exceptions may apply based on the tax treaty (for instance, reduced rates may apply to certain categories of investors, capital gains from immovable property or property-rich companies may be taxable). All of the following tax treaty changes were effective in the second calendar quarter, except where indicated.

Countries involved		Summary of changes
Chile	India	Provides general withholding tax rates of 10% on dividends, interest and royalties; exempts capital gains from tax (effective as of 1 January 2023 in Chile).
Kyrgyzstan	United Kingdom	Provides general withholding tax rates of 15% on dividends and 5% on interest and royalties; exempts capital gains from tax (effective as of 1 January 2024 for withholding taxes in Kyrgyzstan and United Kingdom; effective 1 January 2023 for other taxes in Kyrgyzstan).

Other considerations

Court decisions, regulations issued by tax authorities and other events may constitute new information that could trigger a change in judgment in recognition, derecognition or measurement of a tax position. These events also may affect your current or deferred tax accounting.

Federal, state and territories

In a revenue ruling, the US Internal Revenue Service (IRS) obsoleted a 1958 revenue ruling allowing taxpayers to amend prior returns to correct certain missed deductions for R&E expenses under IRC Section 174. The revocation is effective 31 July 2023, but taxpayers may rely on the ruling until then, under certain conditions. See **Tax Alert 2023-0722**, dated 18 April 2023.

In another revenue procedure, the IRS created a safe harbor that taxpayers may use to determine whether they must capitalize expenses to maintain, repair, replace or improve natural gas transmission and distribution property. Taxpayers can either change their method of accounting with an IRC Section 481(a) adjustment or make the change using the cut-off basis if they make the change for their first, second or third tax year ending after 1 May 2023. See **Tax Alert 2023-0742**, dated 20 April 2023.

In a notice, the IRS described what it intends to include in proposed rules on "energy communities" for purposes of the production tax credit (PTC) under IRC Sections 45 and 45Y and the investment tax credit (ITC) under IRC Sections 48 and 48E for certain clean electricity generating facilities. Taxpayers with qualifying projects located in energy communities can get up to an increase in the tax credit. See **Tax Alert 2023-0675**, dated 6 April 2023.

In a separate notice, the IRS indicated that other countries' recognition of cryptocurrency as legal tender "for a limited purpose" does not change its position that digital currency is not currency for US tax purposes. See **Tax Alert 2023-0839**, dated 8 May 2023.

In another notice, the IRS previewed what upcoming proposed regulations may require for taxpayers to qualify for the 10% domestic content bonus for credits under IRC Sections 45 and 48 for qualified facilities, energy projects and energy storage technology. The notice outlines how to break down the project into its components and subcomponents to determine if it meets the standard and becomes eligible for bonus tax credits. See **Tax Alert 2023-0809**, dated 18 May 2023.

In another notice, the IRS clarified the requirements that brownfields must meet to qualify as "energy communities" for purposes of claiming increased PTCs under IRC Sections 45 and 45Y and ITCs under IRC Sections 48 and 48E. See **Tax Alert 2023-1083**, dated 16 June 2023.

In a separate notice, the IRS explained how to determine if project areas qualify as statistical areas or coal closure census tracts for purposes of claiming PTCs under IRC Sections 45 and 45Y and ITCs under IRC Sections 48 and 48E. See **Tax Alert 2023-1083**, dated 16 June 2023.

The Tax Court held that a service provider (the Taxpayer) did not have unreported income from its receipt of an indirect interest in a partnership, where the Taxpayer had provided services to a different entity than the issuing partnership. The Tax Court reasoned that Revenue Procedure 93-27 applied, and that the issued partnership interest qualified as a profits interest excludable from income. See **Tax Alert 2023-0917**, dated 19 May 2023.

Colorado — The Department of Revenue amended its NOL rules to limit Colorado NOLs to federal NOLs and to preclude corporations without a federal NOL from claiming a Colorado NOL. Other changes to the NOL rules address the carryforward of Colorado NOLs, limitations on Colorado NOLs and NOLs claimed on combined, consolidated and combined-consolidated returns.

The department also amended its rules on the foreign-source income inclusion. The amended rule defines foreign-source income and outlines how to calculate the amount of foreign-source income considered in a corporation's allocated and apportioned net income. Finally, the department adopted a new rule limiting the IRC Section 78 dividends that a corporation may subtract from its Colorado tax base to the amount treated as dividend and included in a C corporation's federal taxable income under IRC Section 78. See **Tax Alert 2023-0833**, dated 5 May 2022.

Illinois — The Department of Revenue amended its guidance for when receipts from certain sales-inducing payments from vendors to retailers, such as buying allowances and merchandising allowances, should be included or excluded from the state's formula for apportioning nonresident income to Illinois. Under the amended rule, the department will exclude rebates and other buying allowances, which generally are considered reductions to cost of goods sold, from the formula. Merchandising allowances, which are part of the product's selling price, will be included in the sales factor to the extent it promotes sales. The amended guidance also addresses payments received under a cost-sharing agreement and includes examples. See the **State and Local Weekly for 5 May 2023 and 12 May 2023**.

Pennsylvania — In new guidance, the Department of Revenue stated that it will treat sales of electricity for purposes of apportioning income under the corporate net income tax (CNIT) as sales of tangible personal property. Previously, the department stated that electricity sales more closely resembled the sale of a saleable commodity and that it was inappropriate to use the sourcing rules for intangibles. The treatment of electricity sales as tangible personal property applies to all open periods. For partnerships with corporate partners, the partnership's receipts from sales of electricity will flow up to its corporate partners. See the **State and Local Weekly for 5 May 2023 and 12 May 2023**.

International

Canada — The Supreme Court held that a company could not claim noncapital losses and other tax carryover balances following a series of transactions that effectively shifted control of the company to a third party without triggering the general restriction on the use of the noncapital losses and other deductions after a change in corporate control. The Supreme Court reasoned that the transactions were abusive under the general anti-avoidance rule (GAAR). See **Tax Alert 2023-1048**, dated 13 June 2023.

Chile — The Court of Appeals of Santiago, Chile (Court) held that the Chile-Spain income tax treaty precluded Chile from taxing a Spanish resident's indirect transfer of stock in a Chilean company. Disagreeing with the Chilean IRS, the Court reasoned that the treaty provision permitting taxation of direct transfers of stock did not apply to indirect transfers. See **Tax Alert 2023-0769**, dated 27 April 2023.

Denmark — The Supreme Court concluded that a Danish company must pay withholding tax on interest that accrued from 2007 to 2009 on a loan funded by the company's ultimate parent in Luxembourg but funneled through intermediate holding companies in Sweden. Agreeing with the lower court and the Danish tax authority, the Supreme Court reasoned that neither the Interest and Royalty Directive of the European Union (EU) nor the Danish-Luxembourg income tax treaty applied to exempt the company from withholding tax. The Supreme Court also concluded that neither the Swedish holding companies nor the Luxembourg ultimate parent qualified as beneficial owners. See **Tax Alert 2023-0835**, dated 8 May 2023.

In a binding tax ruling, the Danish Tax Board concluded that a German company did not create a PE in Denmark by storing unsold gasoline in a Danish warehouse. The Tax Board reasoned that gas storage was preparatory or auxiliary to the company's business of buying and selling gas through digital gas trading platforms. See **Tax Alert 2023-0864**, dated 11 May 2023.

India — The Delhi Tribunal held that consulting fees paid by an Indian airport to a global airport operator in Germany will not be taxable as technical services fees under the India-Germany income tax treaty. The Tribunal reasoned that the underlying services were connected to the operator's Indian PE, so India could not tax the fees as technical services fees. The Tribunal then remanded the case to the lower tax authority to determine whether any of the fees could be taxed as business profits under Article 7 of the treaty. See **Tax Alert 2023-0864**, dated 11 May 2023.

Israel — In a response letter, the Tax Authority outlined when a startup technology company is not required to treat the difference between an investor's early stage investment under a Simple Agreement for Future Equity and the value of the future shares to which the investor is contractually entitled as interest income that is subject to withholding tax. See **Tax Alert 2023-0924**, dated 22 May 2023.

Mexico — In a presidential decree, the government granted tax benefits to eligible companies that are domiciled and operating in the "welfare development corridor" within the Isthmus of Tehuantepec. The benefits include:

- A 100% credit against tax on income from performing productive economic activities in the welfare development corridor, which applies for the first three fiscal (i.e., tax) years, and a 50% credit for the next three years, which can increase to 90% if the company exceeds certain minimum employment thresholds

- Accelerated depreciation of 100% of investments, during the first six years, in qualified new fixed assets used in the performance of productive economic activities (excludes office furniture and equipment, automobiles, and other non-individually identifiable assets)

See **Tax Alert 2023-1053**, dated 13 June 2023.

OECD — The following jurisdiction deposited its instrument of ratification for the multilateral convention to implement tax treaty related measures to prevent base erosion and profit shifting (BEPS) (MLI) this quarter:

- Vietnam (enters into force 1 September 2023)

See **Tax Alert 2023-1014**, dated 6 June 2023.

Peru — In a ruling, the Tax Authority outlined how to determine the fair market value of shares that were indirectly transferred between a foreign company and a Peruvian company when the foreign company's shares are listed on a stock exchange and the Peruvian company's shares are not (or vice versa). See **Tax Alert 2023-1047**, dated 13 June 2023.

Qatar — In the amended Executive Regulations, the Council of Ministers outlined activities that would create a PE in Qatar, as well as situations in which some activities would not result in a PE. It also specified the conditions under which an insurance PE and an agency PE are deemed to exist in Qatar. Other topics addressed in the regulations include:

- Determining a PE's taxable income
- Exempting certain capital gains from tax
- Expanding Qatar's economic substance rules

See **Tax Alert 2023-0932**, dated 24 May 2023.

Saudi Arabia — In a circular, the Zakat, Tax and Customs Authority (ZATCA) clarified that Saudi Arabia's income tax treaties deem a service PE to exist in Saudi Arabia when a nonresident company's employees are physically present in Saudi Arabia and perform services for the specified period. The clarification follows the agency's prior findings of "virtual service PEs," which were deemed to exist based on the length of the service contract, rather than how long the nonresident company's employees were physically present in Saudi Arabia performing services. See **Tax Alert 2023-0967**, dated 31 May 2023.

In a public consultation, the ZATCA proposed amending Saudi Arabia's force-of-attraction rules to tax income that nonresident companies with Saudi Arabian PEs earn outside their PEs if they cannot substantiate the reasons for not conducting their income-earning activities through the PE. See **Tax Alert 2023-1014**, dated 6 June 2023.

United Arab Emirates (UAE) — In a decision, the Ministry of Finance outlined when an individual's presence in the UAE does not create a PE for a nonresident employer. See **Tax Alert 2023-0864**, dated 11 May 2023.

Things we have our eyes on

National, state and local governments continue to seek to increase their revenues. Companies should continue to monitor developments in this area. Some of these potential tax law changes are summarized here.

Federal, state and territories

Pillar Two — House Ways and Means Committee Chairman Jason Smith (R-MO) introduced legislation aimed at discouraging countries from adopting an Undertaxed Profits Rule (UTPR) under Pillar Two of the OECD's BEPS initiative. The legislation would increase taxes on the US businesses of companies headquartered in countries that enact the UTPR. Increased taxes would also apply if other foreign taxes imposed on US businesses qualified as either extraterritorial or discriminatory under certain criteria. See **Tax Alert 2023-0948**, dated 25 May 2023.

TCJA cliffs — The House Ways and Means Committee approved a bill that would retroactively extend, through 2025, some TCJA provisions that expired as of 1 January 2022, including:

- The IRC Section 174 deduction for R&E expenses
- The IRC 163(j) limitation on interest expense deductions (using earnings before interest, taxes, depreciation and amortization (EBITDA) as the threshold, instead of earnings before interest and tax (EBIT))
- 100% bonus depreciation

The bill would also repeal or modify certain tax credits enacted under the Inflation Reduction Act. See **Tax Alert 2023-1054**, dated 14 June 2023.

Repatriations — In proposed regulations, the US Treasury and IRS include a taxpayer-favorable rule that would allow companies to forgo any remaining gain inclusions from previously "outbounded" intangible property upon repatriation to the United States. See **Tax Alert 2023-0843**, dated 9 May 2023.

Energy tax credits — In proposed rules, the IRS addressed questions on energy credit transferability under new IRC Section 6418. The proposed rules lay out the steps for transferring a tax credit, along with issues such as which entity is liable if there is a recapture event, the ability to transfer part of the tax credit, examples concerning when there are "excess credits" and how partnerships may deal with tax credit transfers. Taxpayers may rely on the proposed rules for tax years beginning after 31 December 2022, if they follow the proposed rules in their entirety and in a consistent manner. See **Tax Alert 2023-1103**, dated 20 June 2023.

In a separate set of proposed regulations, the IRS addressed questions on direct-pay elections for certain energy credits. The proposed rules address issues such as including state agencies and instrumentalities as applicable entities, calculating the direct-pay eligible amount, the process for making elections, and the timing for elections and refunds. Taxpayers may rely on the proposed rules for tax years beginning after 31 December 2022, if they follow the proposed rules in their entirety and in a consistent manner. See **Tax Alert 2023-1102**, dated 20 June 2023.

Another set of proposed regulations clarifies how to elect to treat the advanced manufacturing investment credit (AMIC) as a payment of federal income tax for a tax year, instead of a credit against federal income tax liability. The proposed regulations also outline how a taxpayer making the election should apply IRC Section 48D(d)(3), which prevents taxpayers from claiming the AMIC as a credit after electing to treat it as a payment. See **Tax Alert 2023-1080**, dated 16 June 2023.

Electric vehicles — In proposed regulations, the IRS outlined the critical mineral and battery component requirements that manufacturers of electric vehicles must satisfy before purchasers may claim the IRC Section 30D clean vehicle credit. See **Tax Alert 2023-0660**, dated 4 April 2023.

Life insurance — The IRS proposed regulations that would preclude an insurance policy's death benefits from becoming taxable following an IRC Section 1035 exchange of life insurance contracts. See **Tax Alert 2023-0879**, dated 12 May 2023.

International

Australia — In its 2023/24 Federal Budget, the government proposed implementing the Global Anti-Base Erosion (GloBE) rules under Pillar Two of the OECD's BEPS initiative. The new regime would incorporate a multinational income inclusion rule (IIR) and a UTPR, as well as a domestic minimum tax (DMT). The IIR and DMT would apply to income years (i.e., tax years) commencing on or after 1 January 2024, and the UTPR would apply to income years commencing on or after 1 January 2025. Draft legislation implementing the rules is expected shortly.

Other changes proposed in the budget include:

- Allowing small businesses with less than AU$10 million per year in aggregated turnover to expense up to $20,000 per asset for assets acquired and installed from 1 July 2023 through 30 June 2024
- Allowing certain business to deduct an additional 20% of the cost of switching to electric power or improving their energy efficiency up to AU$20,000 for eligible assets or upgrades first used or installed ready for use from 1 July 2023 through 30 June 2024
- Reducing the withholding tax rate for eligible fund payments from a managed investment trust (MIT) to foreign residents in exchange-of-information countries to 15% from 30%, beginning 1 July 2024, provided certain conditions are satisfied
- Expanding the scope of GAAR so it applies to schemes that create Australian tax benefits by accessing a lower withholding tax rate on income paid to foreign residents or achieve an Australian tax benefit even where the dominant purpose of the scheme was to reduce foreign income taxes (effective for tax years beginning on or after 1 July 2024, even if the taxpayer entered into the transaction before that date)

See Tax Alerts **2023-0860**, dated 10 May 2023, and **2023-0868**, dated 11 May 2023.

In draft legislation, the government proposed denying companies with global revenue of at least AU$1 billion a tax deduction in Australia for cross-border payments for the use of intangibles if those payments were made to entities in low- or no-tax jurisdictions. If enacted, the denial of deductions is expected to apply to payments made on or after 1 July 2023.[5] See **Tax Alert 2023-0064**, dated 4 April 2023.

Chile — The Parliament passed a bill on the taxation of mining royalties that would:

- Introduce a new mining royalty with a 1% ad valorem component and an operating margin component (8% to 26% for big mining companies) based on the company's level of sales and the minerals exploited
- Set a mining company's overall tax burden (mining royalty, corporate income tax and final taxes) at 46.5% (45.5% for producers of less than 80,000 metric tons of fine copper)
- Allow companies to amortize startup and operation expenses over six years when calculating the taxable base of the royalty's margin component
- Require certain additions to the corporate income tax base (e.g., carryforward losses, deductions for accelerated depreciation)
- Allow corporate income tax deductions for all income not derived directly from mining
- Allow annual depreciation that would have been deducted if the taxpayer had not opted for accelerated depreciation

The bill will be enacted for purposes of US General Accepted Accounting Principles (GAAP) when signed by Chile's president and published in the official gazette. See **Tax Alert 2023-0956**, dated 30 May 2023.

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[5] This development did not occur in the second quarter of 2023, as the exposure draft was released on 31 March 2023.

Costa Rica — The government introduced legislation that would replace Costa Rica's schedular corporate tax regime (which taxes income from different Costa Rican sources separately) with a 30% corporate tax on all Costa Rican-source income, including passive income from foreign sources. Taxpayers could lower their Costa Rican tax liability by deducting taxes paid in other countries. The new regime would also:

- Double the tax rate for capital income and capital gains to 30% from 15%
- Eliminate the 2.25% rate for capital gains on assets acquired before the 2018 tax reform entered into force
- Eliminate the exclusion for bank interest when calculating the limitation on deductible interest
- Eliminate the exemption for companies' dividend distributions within the Free Trade Zone Regime

The legislation would tax a nonresident's Costa Rican-source income, such as capital gains or income, from a PE. A 30% withholding tax rate would apply to PE-related income, while a 15% withholding tax rate would apply to income obtained without a PE. See **Tax Alert 2023-0957**, dated 30 May 2023.

Hong Kong — In a consultation paper, the government proposed creating a safe harbor that would consider Hong Kong-sourced disposal gains from equity interests to be nontaxable capital gains in Hong Kong, provided certain conditions were met. See **Tax Alert 2023-0788**, dated 1 May 2023.

In a separate consultation paper, the government proposed expanding the scope of disposal gains to cover more asset classes under Hong Kong's foreign-sourced income exemption regime. The government also outlined the conditions for the revised tax exemption and relief measures. Stakeholder comments are requested on:

- Defining covered assets and whether specific assets should be cited as examples
- Potential transitional protection on the computation of disposal gains and losses and other exemption or relief
- Implementation timeline of the revised regime

See **Tax Alert 2023-0851**, dated 9 May 2023.

Netherlands — The government sent legislation to Parliament that would implement the GloBE rules. The new regime would include a qualified domestic minimum top-up tax (QDMTT), an IIR, a domestic IIR and a UTPR. The QDMTT and the IIRs are proposed to apply for financial reporting years (i.e., tax years) starting on or after 31 December 2023, while the UTPR is proposed to apply for financial reporting years beginning on or after 31 December 2024. See **Tax Alert 2023-0972**, dated 31 May 2023.

New Zealand — The government plans to implement the GloBE rules, including an IIR and a UTPR. A domestic income inclusion rule would also apply to New Zealand headquartered multinational entities. While no exact implementation date has been set, the IIR would not apply before 1 January 2024, while the UTPR would not apply before 1 January 2025.

Top-up tax paid overseas under either the IIR or UTPR would not give rise to foreign tax credits in New Zealand. The new rules would also override existing income tax treaties with New Zealand (unless the treaty specifically referenced the GloBE rules). See **Tax Alert 2023-0941**, dated 25 May 2023.

Switzerland — The Swiss public voted in favor of amending the Swiss constitution to allow the implementation of Pillar Two in Switzerland. Consequently, the Federal Council can continue working on a draft ordinance that would implement the GloBE rules in Switzerland. Under the ordinance, companies could use any accounting standard allowed under the GloBE rules when calculating their Swiss QDMTT. Companies could also deduct fines of up to EUR50,000 from the Swiss QDMTT. Other proposals include:

- Deferring the effective date of the UTPR in Switzerland until 1 January 2025 at the earliest
- Introducing a safe harbor, which would align with the OECD's transitional country-by-country reporting safe harbor under Pillar Two

- Applying a "one-stop shop" approach under which global minimum tax (QDMTT, IIR or UTPR) in Switzerland would be handled by only one of the Swiss constituent entities (CEs) of a multinational group
- Holding all Swiss CEs jointly liable for the payment of global minimum taxes
- Disallowing, for corporate income tax purposes, deductions of global minimum taxes

See Tax Alerts 2023-0949, dated 25 May 2023, and 2023-1094, dated 20 June 2023.

Thailand — The Board of Investment proposed new tax incentives designed to alleviate the possible effects of Pillar Two on Thailand's existing tax incentives. Under the proposed incentives, companies could choose between a 10% (normally 20%) corporate income tax rate or an income tax exemption, with the option to convert to a 10% rate at a later time. The length of both incentives would depend on the underlying activity, but the 10% rate would last a maximum of 10 years. See **Tax Alert 2023-1037**, dated 9 June 2023.

United Kingdom — The Parliament passed the Spring Finance Bill, which includes the GloBE rules under Pillar Two. The Pillar Two rules include a QDMTT and would be effective for tax years beginning on or after 1 January 2024.

In addition to implementing the Pillar Two rules, the Spring Finance Bill would allow immediate capital expensing for the next three years for firms investing £1m+ a year on plant and machinery. The bill would be enacted for US GAAP purposes on the date of Royal Assent, which is expected in early July 2023.

Appendix I

FASB proposes improvements to income tax disclosures

Overview

The Financial Accounting Standards Board (FASB or Board) issued an exposure draft proposing to require entities to provide more information in the rate reconciliation table and about income taxes paid, including certain disclosures that would be disaggregated by jurisdiction and other categories.

The proposal is intended to address investors' calls for more information about income taxes, particularly related to the rate reconciliation and income taxes paid information. The FASB had proposed broader changes to the income tax disclosure requirements in 2016 and 2019 but decided to focus on the rate reconciliation table and disclosures about income taxes paid after evaluating feedback on those proposals and responses to its 2021 *Invitation to Comment, Agenda Consultation*.

The proposal would align the rate reconciliation requirements in Accounting Standards Codification (ASC) 740, *Income Taxes*, with certain requirements of the Securities and Exchange Commission (SEC) Regulation S-X, and should reduce diversity in practice by prescribing the categories of information entities need to present in the table.

The proposal would also eliminate certain existing requirements related to uncertain tax positions and unrecognized deferred tax liabilities and would replace the term public entity with public business entity (PBE) in ASC 740.

Key considerations

Rate reconciliation

The proposal would require PBEs to disclose, on an annual basis, in their rate reconciliation table both percentages and amounts in their reporting currency for the following categories, with accompanying qualitative disclosures:

- State and local income tax in the country of domicile, net of federal income tax effect
- Foreign tax effects, including any state or local taxes in foreign jurisdictions
- Enactment of new tax laws
- Effect of cross-border tax laws
- Tax credits
- Valuation allowances
- Nontaxable or nondeductible items
- Changes in unrecognized tax benefits

The last six categories in the list would apply to federal (national) income taxes imposed by the country of domicile.

For foreign tax effects,[6] the effect of cross-border tax laws, tax credits and nontaxable or nondeductible items, the proposal would require further disaggregation when the individual reconciling items in the categories equal or exceed a threshold of 5% of the amount computed by multiplying the income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate.

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[6] That is, taxes imposed by countries other than the country of domicile of the reporting entity.

Reconciling items in the foreign tax effects category that meet the threshold would have to be disaggregated by both jurisdiction (country) and nature. Reconciling items in the effect of the cross-border tax laws, tax credits and nontaxable or nondeductible items categories that meet the threshold would have to be disaggregated by nature. To determine the nature of a reconciling item, an entity would consider the item's fundamental or essential characteristics, such as the event that caused the reconciling item and the activity with which the reconciling item is associated.

If a foreign jurisdiction meets the 5% threshold, the tax impact for that category would be separately disclosed as a reconciling item in the foreign effects category. An entity would then evaluate whether any reconciling items in that jurisdiction should be separately disclosed based on the 5% threshold. In some cases, a jurisdiction may not meet the 5% threshold, but there could be individual reconciling items in that jurisdiction that meet the 5% threshold. Reconciling items in a foreign jurisdiction would be separately disclosed by nature (consistent with the categories listed above) if the gross amount of the individual reconciling item (positive or negative) meets the 5% threshold.

Any other reconciling item that meets the 5% threshold but does not fall in one of the listed categories would have to be disaggregated by nature. A PBE would also have to disclose the states and local jurisdictions that contribute to the majority of the effect of the state and local income tax category.

In addition, a PBE would have to provide an explanation, if not otherwise evident, of the individual reconciling items disclosed, such as the nature, effect and year-over-year changes of the reconciling items.

The Board acknowledged that the proposed categories do not cover all possible income tax effects, and judgment could be required to determine how to categorize income tax effects that would not clearly be in one of the prescribed categories. The Board said companies would need to consider the proposed disclosure objective and consider making additional disclosures to explain the categorization of individual reconciling items.

On an interim basis, a PBE would be required to provide a qualitative disclosure about the reconciling items that cause significant year-to-date changes of the estimated annual effective tax rate from the effective tax rate of the prior annual reporting period.

Entities that are not PBEs would be required to provide qualitative disclosures about specific categories and individual jurisdictions that result in a significant difference between the statutory federal tax rate and the effective tax rate.

Income taxes paid

The proposal would require all entities to disclose income taxes paid, net of refunds received, disaggregated by federal (national) taxes in the country of domicile, state taxes and foreign taxes. As with the rate reconciliation, the state and local taxes category would reflect those paid in the country of domicile while foreign taxes would include all state and local taxes paid in the foreign jurisdictions. This disclosure would be required for the year-to-date amount of income taxes paid on both an interim and annual basis.

All entities would be required to disclose annually income taxes paid, net of refunds received, by jurisdiction if the amount equals or exceeds a quantitative threshold of 5% of total income taxes paid (net of refunds).

Disaggregated domestic and foreign income statement disclosures

The proposal would require all entities to disclose the following income statement information in addition to what is already required:

- Income (or loss) from continuing operations before income tax expense (or benefit), disaggregated between domestic and foreign
- Income tax expense (or benefit) from continuing operations, disaggregated between federal or national, state and foreign

The proposed guidance to disclose this information is similar to the guidance applied by public companies required by SEC Regulation S-X 210.408(h)1.

The proposal would require income tax expense and income taxes paid on foreign earnings that are imposed by the jurisdiction of domicile to be included in the amount for that jurisdiction of domicile. For example, income taxes on global intangible low-taxed income of a US reporting entity would be classified as federal because the income tax is imposed by the US government.

Undistributed earnings of subsidiaries and corporate joint ventures

The proposal would eliminate the requirement to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to comprehensive recognition in ASC 740-30 related to subsidiaries and corporate joint ventures. For example, an entity would no longer be required to disclose the cumulative amount of undistributed earnings when it asserts that it is indefinitely reinvesting foreign earnings. However, the entity would still be required to make disclosures about unrecognized deferred tax liabilities under ASC 740-30-50-2(c).

Unrecognized tax benefits

The proposal would eliminate for all entities the requirement to disclose certain information when it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date.

Use of the term PBE

The proposal would eliminate references to a public entity in ASC 740 and replace them with the term public business entity, which is defined in the ASC Master Glossary.

How we see it

The proposal would require entities to provide more disclosures than are currently required for the rate reconciliation and income taxes paid. Entities should evaluate whether additional processes and controls would be necessary to obtain all of the information they would need to provide the new disclosures.

Effective date and transition

The guidance would be applied retrospectively for all periods presented. The FASB said it would determine an effective date and whether early adoption would be permitted after it receives feedback on the proposal.

Appendix: Illustration of rate reconciliation disclosure under proposal

The proposal includes the following illustration[7] of a rate reconciliation to be disclosed by a PBE in accordance with paragraph 740 10-50-12A. In the illustration, the entity is domiciled in the United States and presents comparative financial statements. For the disclosure of foreign tax effects in accordance with paragraph 740-10-50-12A(b)(2), it is assumed that the 5% threshold, computed by multiplying the income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate of the jurisdiction of domicile, is met:

a. For Ireland, both at the jurisdiction level and for certain individual reconciling items of the same nature within Ireland

b. For the United Kingdom, for certain individual reconciling items of the same nature within the United Kingdom, but not at the jurisdiction level

c. For Switzerland and Mexico, at the jurisdiction level, but not for any individual reconciling items of the same nature within each jurisdiction

[7] ASC 740-10-55-231

	Year Ended December 31, 20X2			Year Ended December 31, 20X1			Year Ended December 31, 20X0		
	Amount	Percent		Amount	Percent		Amount	Percent	
US Federal Statutory Tax Rate	$ AA	aa	%	$ BB	bb	%	$ CC	cc	%
State and Local Income Taxes, Net of Federal Income Tax Effects*	AA	aa		BB	bb		CC	cc	
Foreign Tax Effects									
United Kingdom									
Tax rate differential	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Share-based payment awards	AA	aa		BB	bb		CC	cc	
Changes in unrecognized tax benefits	(AA)	(aa)		(BB)	(bb)		CC	cc	
Other	(AA)	(aa)		BB	bb		(CC)	(cc)	
Ireland									
Tax rate differential	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Valuation allowances adjustments	(AA)	(aa)		(BB)	(bb)		CC	cc	
Enactment of new tax laws	-	-		BB	bb		-	-	
Other	AA	aa		(BB)	(bb)		(CC)	(cc)	
Switzerland	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Mexico	AA	aa		BB	bb		CC	cc	
Other foreign jurisdictions	(AA)	(aa)		(BB)	(bb)		CC	cc	
Enactment of New Tax Laws									
Change in tax rate	-	-		-	-		(CC)	(cc)	
Effect of Cross-Border Tax Laws									
Global intangible low-taxed income	AA	aa		BB	bb		CC	cc	
Foreign-derived intangible income	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Base erosion and anti-abuse tax	AA	aa		BB	bb		CC	cc	
Other	AA	aa		-	-		-	-	
Tax Credits									
Research and development tax credits	-	-		(BB)	(bb)		(CC)	(cc)	
Energy-related tax credits	(AA)	(aa)		-	-		-	-	
Foreign tax credits	(AA)	(aa)		(BB)	(bb)		(CC)	(cc)	
Other	-	-		(BB)	(bb)		-	-	
Valuation Allowances	AA	aa		(BB)	(bb)		(CC)	(cc)	
Nontaxable or Nondeductible Items									
Share-based payment awards	AA	aa		BB	bb		CC	cc	
Goodwill impairment	AA	aa		BB	bb		-	-	
Other	AA	aa		(BB)	(bb)		CC	cc	
Changes in Unrecognized Tax Benefits	(AA)	(aa)		BB	bb		(CC)	(cc)	
Other Adjustments	AA	aa		(BB)	(bb)		(CC)	(cc)	
Effective Tax Rate	$ AA	aa	%	$ BB	bb	%	$ CC	cc	%

* State taxes in California and New York contributed to the majority of the tax effect in this category.

Appendix II

Expanded use of the proportional amortization method for equity investments in tax credit programs

Overview

The Financial Accounting Standards Board (FASB or Board) amended[8] Accounting Standards Codification (ASC) 323, *Investments — Equity Method and Joint Ventures*, to expand the use of the proportional amortization method to equity investments in all tax credit programs that meet the conditions in ASC 323-740-25-1, including the New Market Tax Credit (NMTC) program, the Historic Rehabilitation Tax Credit program and Renewable Energy Tax Credit programs.

Previously, entities were permitted to apply the proportional amortization method only to investments in qualified affordable housing projects that generated low-income housing tax credits (LIHTC) and met the conditions in ASC 323-740-25-1.

The amendments, which are based on a consensus reached by the FASB's Emerging Issues Task Force (EITF or Task Force), also modified the conditions in ASC 323-740-25-1 that need to be met to apply the proportional amortization method. Entities with investments in tax equity structures that were not in the scope of the legacy guidance should evaluate these investments to determine whether the investments meet the conditions to use the proportional amortization method and whether they want to elect to apply the method to eligible investments.

Entities that have existing investments in LIHTC programs need to evaluate the changes the FASB made to the conditions for using the proportional amortization method and other changes that will affect investments in LIHTC programs accounted for using the equity method or cost method.

For more information on the legacy guidance on proportional amortization, refer to section 4.2.8.7, of our Financial Reporting Developments publication, *Income Taxes*.

Key considerations

Under the proportional amortization method, the equity investment is amortized in proportion to the income tax credits and other income tax benefits received, with the amortization expense and the income tax benefits presented on a net basis in income tax expense or benefit on the income statement. The decision to apply the proportional amortization method is an accounting policy election that is made on a tax-credit-program-by-tax-credit program basis and should be applied consistently to all investments in an elected tax credit program that meet the conditions in ASC 323-740-25-1.

The proportional amortization method may only be applied to equity investments made through limited liability entities that are flow-through entities for tax purposes (e.g., a limited liability partnership or a limited liability company). The method cannot be applied to investments in tax credit structures the investor is required to consolidate. In addition, the election would not apply to investments in tax credit structures that are classified as debt.

Changes to conditions to be eligible to use the proportional amortization method

The amended guidance allows investors to elect to use the proportional amortization method to account for equity investments in income tax credit programs through limited liability entities if the following conditions are met:

- It is probable that the income tax credits allocable to the investor will be available. (ASC 323-740-25-1(a))

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[8] Accounting Standards Update (ASU) 2023-02, *Investments — Equity Method and Joint Ventures, (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method.*

- The investor does not have the ability to exercise significant influence over the operating and financial policies of the underlying project. (ASC 323-740-25-1(aa))
- Substantially all of the projected benefits are from income tax credits and other income tax benefits. This condition is determined on a discounted basis. (ASC 323-740-25-1(aaa))
- The investor's projected yield based solely on the cash flows from the income tax credits and other income tax benefits is positive. (ASC 323-740-25-1(b))
- The investor is a limited liability investor in the limited liability entity for both legal and tax purposes, and the investor's liability is limited to its capital investment. (ASC 323-740-25-1(c))

The amended guidance under condition ASC 323-740-25-1(aa) requires that an investor determine it does not have the ability to exercise significant influence over the operating and financial policies of the underlying project, rather than the limited liability entity through which it receives tax benefits as was required under the legacy guidance.

The Task Force said this change was needed to address multitiered structures that may exist in tax credit programs (e.g., NMTC tax structures). In multitiered structures, there are several flow-through entities between the tax equity investor and the project itself, and without this amendment it was unclear which entity in the structure should be the focus of the evaluation. The Task Force also wanted to eliminate opportunities to structure a project to achieve a desired result (i.e., structuring opportunities).[9]

Projected benefits under ASC 323-740-25-1(aaa) include all the benefits that will be received from the equity investment, including income tax credits, other income tax benefits (e.g., the investor's share of tax benefits from the operating losses of the project) and non-income-tax-related benefits. The amended guidance clarifies that when determining whether substantially all of the projected benefits are from income tax credits and other income tax benefits, an entity includes tax credits accounted for outside of ASC 740[10] (e.g., refundable tax credits or other non-income-based credits) in the total projected benefits (denominator) but not in the amount of income tax credits and other income tax benefits (numerator).

The amended guidance also requires an entity to use discounted amounts when assessing whether ASC 323-740-25-1(aaa) is met (i.e., substantially all of the projected benefits are from income tax credits and other income tax benefits). The discount rate selected should be consistent with the cash flow assumptions used by the investor for purposes of making a decision to invest in the project. The legacy guidance does not address whether the projected benefits should be based on a discounted basis when assessing this condition.

Consistent with legacy guidance, the amended guidance in ASC 323-740-25-1(b) requires the investor's projected yield based solely on the cash flows from the income tax credits and other income tax benefits to be positive. This assessment requires an entity to make sure the income tax credits and other income tax benefits provides a positive yield when compared to its initial equity investment. When an entity determines the initial equity investment to include in this assessment, we believe the entity should use an amount consistent with the initial measurement in accordance with ASC 323-10-30-2, using a cost accumulation model in which the investment is recognized based on the cost to the investor. This cost is generally based on the fair value of the consideration paid, including transaction costs.

The eligibility conditions in ASC 323-740-25-1 are assessed at the time of the initial investment. A reporting entity is required to reevaluate the conditions if there is a change in the nature of the investment or in the relationship with the underlying project that could result in the conditions no longer being satisfied. For example, this may occur when a project no longer qualifies for the income tax credits or the investor determines it might not realize some or all the expected income tax benefits.

Entities with existing investments in LIHTC programs that are accounted for using the proportional amortization method will need to consider the changes to the conditions in the legacy guidance when

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[9] BC17 from ASU 2023-02.

[10] ASC 740, *Income Taxes*.

adopting the amendments (i.e., determine whether they will still qualify to use the proportional amortization method).

How we see it

ASC 323-740-25-1(aaa) does not address whether a quantitative threshold needs to be met to satisfy the "substantially all" condition. We generally believe an entity has met this threshold in ASC 323-740-25-1(aaa) when 90% or more of the projected benefits of the tax equity investment results from income tax credits or other income tax benefits. The Task Force indicated that it did not intend to change practice regarding the application of the "substantially all" condition.[11]

Other considerations for entities that applied the legacy guidance

The amendments eliminate certain guidance on the accounting for investments in LIHTC programs to align it with the accounting for investments in other types of tax credit equity investment structures. The amendments will affect investments in LIHTC programs that were accounted for under the legacy proportional amortization guidance, as well as investments accounted for under the legacy guidance using the equity method or cost method.

Entities applying the legacy equity or cost method guidance to their investments in LIHTC programs will need to consider the following amendments which:

- No longer permit the use of the cost method to account for equity investments in income tax credit structures (including LIHTC structures) but require entities that do not either qualify or elect to use the proportional amortization method and do not qualify for the use of the equity method to apply the guidance in ASC 321, *Investments — Equity Securities*
- Eliminate an alternative method to measure impairments for investments accounted for using the equity method in ASC 323-740-55-8 through ASC 323-740-55-9 and require entities to apply the impairment guidance in ASC 323 to their income tax credit investments accounted for under the equity method
- No longer permit entities with investments in LIHTC structures that did not use the proportional amortization method (e.g., those that applied the equity method or cost method) to use the delayed equity contribution guidance in ASC 323-740-25-3 and now will require entities to apply the delayed equity contribution guidance if they account for the investment (including LIHTC investments) using the proportional amortization method

Applying the proportional amortization method

Under the proportional amortization method, the amortization of the investment is calculated by multiplying:

- The initial investment balance minus any expected residual value of the investment, by
- The percentage of actual income tax credits and other income tax benefits allocated to the investor in the current period divided by the total estimated income tax credits and other income tax benefits expected to be received by the investor over the life of the investment

The amortization of the investment is recognized in the income statement as a component of income tax expense or benefit, which results in the net presentation of the amortization of the investment, income tax credits and other income tax benefits. Non-income tax-related benefits received from operations of the investment should be included in pretax earnings when realized or realizable. Gains or losses on the sale of the investment, if any, should be included in pretax earnings at the time of sale.

ASC 323-740-35-4 provides for a practical expedient to amortize the investment in proportion to only the income tax credits allocated to the investor (i.e., other income tax benefits are not included in the calculation) if the investor reasonably expects that doing so would produce a measurement that is substantially similar to the measurement that would result from the inclusion of other income tax benefits in the calculation.

Under the proportional amortization method, an investment must be tested for impairment when events or changes in circumstances indicate that it is more likely than not that the carrying amount of the

[11] BC19 from ASU 2023-02.

investment will not be realized. An impairment loss is measured as the amount by which the carrying amount of the investment exceeds its fair value.

The amendments require entities to apply the flow-through method to investments in tax credit structures that qualify and are accounted for using the proportional amortization method. That is, entities that use the proportional amortization method will no longer have the option to apply the deferral method under ASC 740.[12] Entities that have applied the deferral method to existing tax equity structures (LIHTC and other than LIHTC tax structures) and elect to use the proportional amortization method will need to change to the flow-through method.

The following illustration shows how the proportional amortization method would be applied by an investor that has elected to apply the method and has met the conditions in ASC 323-740-25-1. It is based on the illustration in ASC 323-740-55-11 through ASC 323-740-55-15:

Illustration: Application of the proportional amortization method

Facts:

- The investor contributed $102,000 at the beginning of the first year of eligibility for the income tax credit.
- Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 10-year life.
- The investor's tax rate is 40%.
- The partnership will receive income tax credits from a tax credit program. The income tax credits will be received over a four-year period.
- The investor will receive cash proceeds based on a fixed percentage of the project's cash generated during the life of the project (i.e., non-income-tax-related cash returns).
- After 10 years, the investor has a right to require that the project sponsor purchase the investor's equity interest for a nominal amount. It is assumed that the option will be exercised. This amount is assumed to be zero for simplicity, resulting in a residual value of the investment of zero.

The following table shows the calculation of the amounts recognized each period as a component of income tax expense and the non-income tax related benefits that are required to be presented on a pre-tax basis:

Year	Net Investment[(a)]	Amortization of Investment[(b)]	Income Tax Credits[(c)]	Net Losses/Tax Depreciation[(d)]	Other Income Tax Benefits from Tax Depreciation[(e)]	Income Tax Credits and Other Income Tax Benefits[(f)]	Income Tax Credits and Other Income Tax Benefits, Net of Amortization[(g)]	Non-Income Tax-Related Cash Returns[(h)]
1	$ 81,600	$ 20,400	$ 20,000	$ 10,000	$ 4,000	$ 24,000	$ 3,600	$ 200
2	61,200	20,400	20,000	10,000	4,000	24,000	3,600	200
3	40,800	20,400	20,000	10,000	4,000	24,000	3,600	200
4	20,400	20,400	20,000	10,000	4,000	24,000	3,600	200
5	17,000	3,400	-	10,000	4,000	4,000	600	200
6	13,600	3,400	-	10,000	4,000	4,000	600	200
7	10,200	3,400	-	10,000	4,000	4,000	600	200
8	6,800	3,400	-	10,000	4,000	4,000	600	200
9	3,400	3,400	-	10,000	4,000	4,000	600	200
10	-	3,400	-	10,000	4,000	4,000	600	200
Total		$ 102,000	$ 80,000	$ 100,000	$ 40,000	$ 120,000	$ 18,000	$ 2,000

(a) End-of-year carrying amount of the investment net of amortization in Column (b).

(b) Initial investment of $102,000 x (total income tax credits and other income tax benefits received during the year in Column (f)/ total anticipated income tax credits and other income tax benefits over the life of the investment of $120,000).

(c) Represents the income tax credits allocated to the investor.

(d) Income tax losses, principally from depreciation, passed on to the investor

(e) Column (d) x 40% tax rate.

(f) Column (c) + Column (e).

(g) Column (f) − Column (b).

(h) Non-income-tax-related benefits recognized in current-period pretax earnings when received. This represents the cash

[12] BC20 from ASU 2023-02.

proceeds received by the investor based on the cash generated from the project.

Based on the schedule above, the investor will recognize an annual income tax benefit of $3,600 in years 1-4 of the investment (comprising of gross income tax benefit of $24,000 less the amortization of the initial investment $20,400) and $600 in years 5-10. The non-income tax-related benefits would be included in pretax income.

Disclosures

The amendments require entities to make disclosures about all investments in a tax credit program(s) that they have elected to account for using the proportional amortization method, including those investments in an elected tax credit program(s) that do not meet the conditions to use the proportional amortization method.

For example, an entity may have multiple investments in tax equity structures that generate tax credits under a tax program for which it has elected to use the proportional amortization method, but not all investments meet the conditions to use the proportional amortization method (i.e., they are accounted for using the equity method or ASC 321). The disclosure requirements in ASC 323-740-50 would apply to all investments in the tax credit program, regardless of whether the proportional amortization method is applied to the individual investment.

ASC 323-740-50-1 requires an entity to disclose the following:

- The nature of its investments
- The effect of the recognition and measurement of its investments and the related income tax credits and other income tax benefits on its financial position and results of operations

ASC 323-740-50-1A requires the following additional disclosures to meet the objectives in ASC 323-740-50-1:

- The amount of income tax credits and other income tax benefits recognized during the period, including the line item in the statement of operations and statement of cash flows in which it has been recognized
- The amount of investments and the line item in which the investments are recognized in the statement of financial position
- For investments accounted for using the proportional amortization method, the amount of investment amortization recognized as a component of income tax expense (benefit)
- For investments accounted for using the proportional amortization method, the amount of non-income tax-related activity and other returns received that are recognized outside of income tax expense (benefit) and the line item in the statement of operations and statement of cash flows in which it has been recognized
- For investments accounted for using the proportional amortization method, significant modifications or events that resulted in a change in the nature of the investment or a change in the relationship with the underlying project

Additionally, ASC 323-740-50-2 states that an entity may consider disclosing the following:

- For investments accounted for using the equity method, the amount of investment income or loss included in pretax income
- Any commitments or contingent commitments (e.g., guarantees or commitments to provide additional capital contributions), including the amount of delayed equity contributions and the year or years in which contingent commitments are expected to be paid
- The amount and nature of impairment losses during the year resulting from the forfeiture or ineligibility of income tax credits or other circumstances (e.g., in a qualified affordable housing project investment, impairment losses based on actual property-level foreclosures, loss of qualification due to occupancy levels, compliance issues with tax code provisions or other issues)

Entities should also consider whether additional disclosures are required for investments in tax credit programs where the entity elected to apply the proportional amortization method, but the investments did not meet the eligibility conditions required to apply ASC 323-740 and accounted for them using other US GAAP (i.e., ASC 321 and ASC 323).

Effective date and transition

Entities may apply the guidance on a retrospective or modified retrospective basis. In addition, entities that hold investments in LIHTC programs are flow-through entities for tax purposes and need to make changes to their accounting because they are no longer permitted to apply (1) the cost method, (2) the impairment guidance included in the legacy example in ASC 323-740-55-8 through ASC 323-740-55-9 or (3) the delayed equity contribution guidance may do so using a prospective approach. Entities that elect to apply these specific amendments prospectively are still required to apply all other amendments on a retrospective or modified retrospective basis, if applicable.

For both the retrospective and modified retrospective approaches, an entity that elects to apply the proportional amortization method should determine whether the investment qualifies for the proportional amortization method as of the date that investment was originally entered into and considering any modifications (including those that would require the reassessment in ASC 323-740-25-1C).

Retrospective approach

An entity applying a retrospective approach should identify all investments in tax credit structures that are still expected to generate either income tax credits or other income tax benefits as of the beginning of the earliest comparative period presented. To make this determination, the entity should use the actual tax credits and other income tax benefits received and the remaining benefits expected to be received as of the beginning of the earliest period presented. For those identified investments, the entity will need to determine whether those tax credit investments qualify for the proportional amortization method as of the date the investment was originally made. An entity should record a cumulative-effect adjustment to the opening balance of retained earnings in the earliest period presented for the difference caused by applying the amended guidance.

Modified retrospective approach

An entity applying a modified retrospective approach should identify all investments in tax credit structures that are still expected to generate income tax credits or other income tax benefits as of the adoption date. To make that determination, the entity should use the actual tax credits and other income tax benefits received and the remaining benefits expected to be received from a tax credit investment as of the adoption date. For those identified investments, the entity will need to determine whether those tax credit investments would qualify for the proportional amortization method as of the date the investment was originally made. An entity would record a cumulative effect adjustment to the opening balance of retained earnings at the beginning of the fiscal year of adoption for the difference caused by applying the amended guidance.

Other transition considerations

Entities electing to use the proportional amortization method for investments in tax credit structures and that did not apply the legacy delayed equity contribution guidance will need to include both the actual equity contributions made and the expected equity contributions to be made in accordance with ASC 323-740-25-3.

Entities that have investments in LIHTC programs that are not accounted for using the proportional amortization method and are no longer permitted to use (1) the cost method, (2) the alternative equity method impairment guidance in ASC 323-740-55-8 through ASC 323-740-55-9 or (3) the delayed equity contribution guidance, may apply the guidance by using either (1) the modified retrospective or retrospective methods or (2) a prospective transition method (as of the beginning of the fiscal year of adoption).

If a prospective approach is applied, a cumulative effect adjustment as a result of applying the new guidance would be recognized as an adjustment to current-period earnings, the balance sheet or both on the date of adoption. An entity may individually select a transition method for each of the three adjustment types (i.e., the cost method, the alternative equity method impairment guidance and the delayed equity contribution guidance), and the transition method selected should be applied consistently for that adjustment type.

An entity that has investments in LIHTC programs that are not accounted for using the proportional amortization method in ASC 323-740 should do the following in the period of adoption:

- If the delayed equity contribution method was used, the entity should derecognize any liability related to delayed equity contributions and adjust the corresponding LIHTC investment and other accounts as necessary.

- If the cost method was used, the entity should make necessary changes to account for the investment in accordance with ASC 321.
- If the alternative impairment method was used, the entity should make necessary changes to account for the investment in accordance with the impairment guidance in ASC 323.

An entity is required to provide the transition disclosures in ASC 250-10-50-1 through 50-2 upon adoption.

Effective date

The guidance is effective for public business entities for fiscal years beginning after 15 December 2023, and interim periods within those fiscal years. For all other entities, the guidance is effective for fiscal years beginning after 15 December 2024, and interim periods within those fiscal years.

Early adoption is permitted for all entities, including early adoption in any interim period. If an entity adopts the amendments in an interim period, it needs to adopt them as of the beginning of the fiscal year that includes that interim period.

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