Financial Reporting Brief: Tax Effects of ASU 2014-09

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers* (Topic 606), and the International Accounting Standards Board (IASB) issued International Financial Reporting Standards (IFRS) 15, *Revenue from Contracts with Customers*. The FASB and IASB have basically achieved convergence with these standards.

Prior to this new standard, over 200 specialized or industry-specific pieces of revenue recognition guidance could be found under U.S. GAAP. However, even with countless pages of guidance for certain industries and transactions, certain types of transactions lacked guidance, causing differences in reporting and confusion to financial decision makers. The new standard improves revenue recognition guidance by providing a clearer framework to adddress revenue recognition questions, regardless of industry-specific or transaction-specific situations.

Clearly this standard will have a large impact on the financial reporting standards of almost every company (public, private, and not-for-profit). But, what tax consequences could also result?

The exact tax impact will vary from business to business. Although tax professionals have some time before the new rule will be effective, now is the time to think about the impacts. Here are some tax-related questions to ask today:

- Will larger or different book/tax differences now result from the change in revenue recognition? How might these differences impact schedules M-1 and M-3 on tax returns? Could a large tax liability be approaching that needs to be planned for?
- How will the company's current reporting of deferred taxes be impacted (both for the balance sheet and income statement)?
- Are there certain instances in which revenue recognition for tax purposes depends on revenue recognition for financial accounting purposes? Consider advance payments, for example. Consider what would happen if the company previously excluded payments from taxable income (by following the book method), but now some of the recognition of these payments will be accelerated.
- How might allowances for doubtful accounts be impacted? Companies may need to reconsider their allowance for doubtful accounts calculations as the new standards are slightly different in terms of terminology.
- How are costs for obtaining a contract impacted? The new standards address when the costs of obtaining a contract must be capitalized versus expensed, and may differ slightly from the federal income tax treatment of those costs.

- How might state and local taxes be impacted? The presentation and treatment of certain state and local taxes may also vary based on the principal versus agent guidance.
- For multi-state companies, are allocation and appointment of revenues impacted? Consideration must be given to the allocation and apportionment of revenues for multi-state companies. While many states follow the federal rules, there are subtle differences, and appropriate advance research should be done to ensure compliance.
- Is the percentage of completion method being calculated and used correctly? Certain industries are currently required to use the percentage of completion method of accounting under the federal income tax rules and may need to pay special attention to the new standard.
- Could there be any transfer pricing implications that need to be addressed? Companies with foreign subsidiaries may need to reconsider their pricing methods if they are currently tied to the timing of revenue recognition. This can lead to substantial additional work in order to perform pricing studies and prepare the necessary documentation to support the new policy.
- How might investments in foreign subsidiaries be impacted? Companies with investments in foreign subsidiaries may determine that they have an outside or "tax basis" that differs from the "book basis" investment that they expect to recognize in the current year. The new standard could produce a difference in how the expected transaction must be recorded.
- Could there be any benefits in adopting a new accounting method for tax purposes (Form 3115, *Application for Change in Accounting Method*)? For example, could conformity in book/tax methods (if allowable) be beneficial? Further, whether or not the requested method is currently allowed and automatic will also determine whether the need for an uncertainty in future taxes or liability accrual must be included in the current financial statements.

As mentioned above, this document is meant to provide a general overview of how the new revenue recognition standards under ASU 2014-09 may have tax implications. It is by no means an exhaustive analysis of all potential effects, and each company must hire a competent professional for assistance in interpreting and applying the new guidance.