

BDO KNOWS: REVENUE RECOGNITION

TOPIC 606, REVENUE FROM CONTRACTS WITH CUSTOMERS – TAX IMPLEMENTATION ROADMAP

Introduction

FASB ASU 2014-09, *Revenue from Contracts with Customers* (ASC 606), comes into effect for public business entities for annual reporting periods beginning after December 15, 2017, including interim periods within that year. All other entities will adopt the standard for annual reporting periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019.

ASC 606 sets out a single and comprehensive framework for revenue recognition. It addresses virtually all industries in U.S. GAAP, including those that previously followed industry-specific guidance. For many entities, the timing and pattern of revenue recognition will change. In some areas, the changes will be significant and will require careful planning.

A comprehensive overview of the standard is available [here](#).

This practice aid provides tax and financial reporting professionals, as well as auditors, with a roadmap for considering tax implications during the ASC 606 implementation process.

CONTACTS

U.S. GAAP

YOSEF BARBUT
National Accounting Partner
212-885-8292 / ybarbut@bdo.com

JENNIFER KIMMEL
National Accounting Senior Manager
617-239-7019 / jkimmel@bdo.com

ANGELA NEWELL
National Accounting Partner
214-689-5669 / ajnewell@bdo.com

ADAM BROWN
National Accounting Partner
214-665-0673 / abrown@bdo.com

INCOME TAX

JONATHON GEISEN
Tax Senior Associate
616-802-3385 / jgeisen@bdo.com

YUAN CHOU
Tax Managing Director
703-336-1446 / ychou@bdo.com

CONNIE CUNNINGHAM
Tax Managing Director
310-557-8544
cccunningham@bdo.com

DAVE HAMMOND
Tax Partner and Tax Accounting
Methods Practice Leader
616-802-3433
dhammond@bdo.com

MICHAEL WILLIAMS
Tax Partner and ASC 740
Practice Leader
617-239-4174 / mwilliams@bdo.com

Tax ASC 606 Implementation Process



STEP 1¹ – OBTAIN AN UNDERSTANDING OF THE FINANCIAL ACCOUNTING PRE-TAX BOOK IMPLICATIONS

- ▶ Prepare and/or obtain the ASC 606 implementation memorandum
- ▶ Discuss and understand the financial accounting pre-tax implications of implementing ASC 606 including understanding of:
 - Amount and timing of revenue recognition;
 - Performance obligations;
 - Transaction price allocation to performance obligations;
 - Timing of when control is transferred to the customer;
 - Treatment of licenses;
 - Treatment of payments received in advance of satisfaction of the related performance obligation;
 - Effect of variable consideration on transaction price;
 - Accounting treatment of contract costs, and more



STEP 2² – ASSESS THE IMPACT ON TAX REPORTING AND TAX ACCOUNTING METHODS

- ▶ Identify material jurisdictions (domestic and foreign jurisdictions) by tax filing status (i.e., consolidated, combined, and separate) and assess the expected changes in tax reporting of revenue
- ▶ Identify where (entities and jurisdictions) contracts with customers exist and the impact on revenue recognition
- ▶ Determine which entities and jurisdictions have revenue from customers vs. intercompany revenue such as cost-plus operation, commissionaire arrangements and other arrangements (tax reporting impact may vary depending on the status of the operation or entity)
- ▶ Assess the impact on financial accounting (“book method”) related to revenue recognition relative to the particular tax filing structure (consolidated, combined, separate return) and determine if the book method is changing or stays the same as under current accounting
- ▶ Evaluate and determine whether tax reporting of revenue remains unchanged or should conform to any change(s) in book method
- ▶ Evaluate and determine whether a change in tax accounting method is required/appropriate
 - In the U.S. federal jurisdiction, consider whether the change is “automatic” or “non-automatic”
 - In foreign jurisdictions, follow the tax filing administrative procedures (if any) for a particular jurisdiction
 - Determine timeline for filing of any tax administrative forms (e.g., Form 3115)
 - Evaluate potential existence of uncertain tax benefits (FIN 48) related to revenue recognition tax reporting filing positions
- ▶ In the U.S. federal jurisdiction, monitor the proposed IRS guidance within Notice 2017-17 for potential procedures for filing a method change related to ASC 606

¹ The tax implementation “steps” do not align with the five steps outlined in the ASC 606 model.

² Tax departments need to understand the impact adopting the standard will have on each tax jurisdiction and tax filing structure (i.e., consolidated return vs. stand-alone separate return). This effort requires close collaboration of accounting and tax departments.



STEP 3 – ASSESS THE IMPACT ON TEMPORARY DIFFERENCES

- ▶ Consider information obtained through Steps 1-2 and assess impact on temporary differences for all material tax filing jurisdictions
- ▶ Consider all revenue-related assets and liabilities (e.g., contract assets and liabilities, customer receivables, etc.) and determine whether relevant deferred taxes should be adjusted or eliminated altogether (e.g., deferred revenue, which has already been recognized in taxable income, might be recognized sooner for book purposes under ASC 606, causing the elimination of a deferred tax asset)
- ▶ Assess whether there are new temporary differences created by the adoption of ASC 606 (e.g., variable consideration might be includible in book revenue if it is not probable that significant reversal of revenue would occur, whereas for tax reporting it is not includible until all performance obligations have been satisfied and the revenue is considered “fixed and determinable”)



STEP 4 – ASSESS THE IMPACT ON OTHER AREAS OF TAX

State & Local Taxes

- ▶ Assess impacts on state apportionment (particularly revenue-based apportionment factors)
- ▶ Evaluate and determine whether a state apportionment tax rate adjustment is effectively triggered and the impact on **current** and **deferred** taxes
- ▶ Assess impacts on non-income taxes such as sales/use tax or gross receipts tax

Foreign Taxes and U.S. Taxation of Foreign Operations

- ▶ Assess impact on foreign **current** and **deferred** taxes in jurisdictions and tax filing structures where revenue recognition will change for book purposes (i.e., entities with contracts with customers)
- ▶ Assess impact to Goods and Services Tax (GST), Value-Added Tax (VAT), and other indirect tax regimes
- ▶ Assess impacts on controlled foreign corporations including impact on outside-basis difference (NOTE: The proposed U.S. tax reform, if passed in 2017, could have a significant impact on the accounting and should be closely monitored)
- ▶ Consider all investments in controlled foreign corporations (CFCs) in which the U.S. parent does not maintain indefinite reinvestment assertion (a/k/a “APB 23 assertion”) and currently recognizes outside-basis deferred tax liability
- ▶ Consider impact on U.S. deferred tax related to investments in foreign branches

Transfer Pricing

- ▶ Assess impacts on current transfer pricing and determine if current strategies and documentation needs to be amended to account for the effects of the new revenue standard
 - Transfer pricing policies linked to revenue or profit-based formulas could be affected the most
 - Consider the manner by which the entity is “bookkeeping” transfer pricing: i.e., transfer pricing is reflected in the general ledger or is “top side” entry to reconcile pretax income to taxable income
 - Transfer pricing changes could affect valuation allowance accounting (e.g., U.S. subsidiary of a foreign parent is earning its income via intercompany payments of cost plus markup)
- ▶ Assess impacts on payments made under intercompany IP transfer and licensing arrangements (e.g., deemed royalties under Code Sec. 367(d))



STEP 5 – REMEASUREMENT OF DEFERRED ASSETS AND LIABILITIES

- ▶ Quantify impacts (by material jurisdiction and tax filings status – i.e., federal, state, foreign) of changes in temporary differences and related deferred assets and liabilities
- ▶ Assess potential impacts on valuation allowance considerations
- ▶ Quantify potential impacts on outside-basis difference deferred tax liabilities



STEP 6 – RECOGNIZE TAX IMPACTS IN FINANCIAL STATEMENTS

Modified Retrospective Method

- ▶ Recognize tax impacts in the financial statements as part of the cumulative effect adjustment recorded into the opening balance of retained earnings as of the first day of the year of implementation (e.g., 1/1/2018 for calendar year public entities)
- ▶ The cumulative income tax adjustment includes any change in valuation allowance caused by ASC 606 implementation
- ▶ Under ASC 606, cumulative adjustment is applied either:
 - To all contracts with customers at the date of initial application; or
 - Only to contracts with customers that are not complete (not fully recognized as revenue) as of the date of initial application (i.e., no adjustment is required for contracts that have already been fully recognized as of that date)
 - No restatement of prior period comparative figures

Full Retrospective Method

- ▶ Recognize tax impacts in the financial statements as part of the cumulative effect adjustment recorded into the opening balance of retained earnings as of the first day of the first year presented (i.e., 1/1/2016 for calendar year public entities that report two comparative years)
- ▶ Restatement of comparative figures required and will necessitate restatement of total income tax provisions (current and deferred) in comparative periods



STEP 7 – TAX PROCESSES & INTERNAL CONTROLS

- ▶ Assess whether tax processes and controls need to be modified to ensure the current and future tax accounting methods can be supported (i.e., perform a risk assessment)
- ▶ Assess the income tax provision system(s) to ensure the new revenue standard can be supported
- ▶ Understand and evaluate changes made to internal controls over financial reporting (ICFR) related to income tax due to ASC 606 implementation
- ▶ Auditors and tax advisors should consider audit procedures and testing of income tax provisions in light of changes made due to ASC 606 implementation

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