Changes to Tax Accounting for Intra-Entity Asset Transfers

Intra-entity asset transfers between tax jurisdictions often are taxable events that create current and deferred income tax consequences in the period in which the transfer occurs. Under current standards, entities are prohibited from recognizing the tax consequences on such transactions until the transferred asset is sold to a third party or otherwise recovered through use.

In October 2016, the Financial Accounting Standards Board (FASB) issued final guidance requiring companies to recognize the income tax consequences of an intercompany asset transfer when the transfer occurs. The amendments included in Accounting Standards Update (ASU) No. 2016-16, Income Taxes (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory, align intercompany sales transactions with the principle of comprehensive recognition of current and deferred income taxes in Topic 740.

Intra-entity transfers of assets other than inventory may give rise to taxable and deductible temporary differences. The amounts recognized are computed on the difference between the asset’s tax basis in the buyer’s tax jurisdiction and the asset’s carrying value, e.g., the transferred asset’s cost, reported in the consolidated financial statements. The buying entity—or entity receiving the transfer—will recognize a deferred tax asset in its tax jurisdiction for any basis difference on the transferred asset. These amounts will result in taxable or deductible amounts in future years when the asset is recovered by the consolidated entity. The selling—or transferring—entity will recognize any tax expense and taxes paid or payable in its tax jurisdiction at the time of transfer.

Common examples of asset transfers that could be particularly affected include those involving intellectual property, and property, plant and equipment.

The amendments in ASU 2016-16 do not change accounting for the pre-tax effects of intra-entity asset transfers under Topic 810, Consolidation, and do not apply to intra-entity inventory transfers.

By eliminating the exception, the economic consequences of intra-entity asset sales—other than inventory—will be recognized in the period in which the transaction occurs and no longer deferred. A reporting entity’s effective tax rate likely will be affected due to the immediate recognition of the seller’s taxes and buyer’s deferred taxes, particularly when the transaction has no effect on consolidated pre-tax net income. Under current standards, the seller’s tax was deferred and generally recognized in the same period as the current tax effects in the buyer’s jurisdiction—when the asset is sold to a third party or otherwise recovered through use.

Effective Date & Transition

For public business entities, the amendments are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. For all other entities, the amendments are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual periods beginning after December 15, 2019. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements—interim or annual—have not been issued or made available for issuance, i.e., in the first interim period if an entity issues interim financial statements.

Entities are required to apply the amendments on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the adoption period.
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The adjustment would include immediate recognition of any unamortized deferred taxes attributable to the asset at the time of transfer. In addition, entities should assess for realizability, in accordance with Topic 740, deferred tax assets recognized as a result of applying the amendments. A deferred tax asset valuation allowance, if any, also should be recognized through a cumulative-effect adjustment to retained earnings.

**Disclosure Requirements**

ASU 2016-16 does not change the disclosure requirements for income taxes. Topic 740 requires public entities to disclose a numeric reconciliation—commonly referred to as the rate reconciliation in practice—and nonpublic entities to disclose the nature of significant reconciling items. The tax effects of significant intra-entity asset transfers accounted for under ASU 2016-16 should be apparent in those disclosures. In a separate project, FASB is evaluating Topic 740 disclosure requirements. Refer to BKD’s article, “Proposed Changes to Income Tax Disclosures.” It is important to note that the proposal, if finalized, would replace the term “public entity” with “public business entity” (PBE) in Topic 740, *Income Taxes*, and differentiate disclosure requirements for PBEs and organizations other than PBEs. Companies meeting the broader PBE definition will need to comply with income tax disclosures—both existing and proposed—for PBEs, as opposed to non-PBEs.

At transition, entities are required to disclose the nature of and reason for the accounting principle change and certain quantitative information about the accounting change’s effects. This includes the cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the adoption period. Entities also should disclose the effect on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item(s) and any affected per-share amounts for the current period. These disclosures are particularly useful where an entity’s net income is significantly different because the entity is applying former generally accepted accounting principles for intra-entity asset transfers.

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