CECL optional deferral

Section 4014 of the CARES Act includes optional deferral of the effective date of ASU 2016-13, Financial Instruments - Credit Losses (Topic 326), for certain companies. ASU 2016-13 includes the current expected credit loss (CECL) methodology for estimating allowances for credit losses.

**QUESTION 1 (updated April 9)**

Who can apply the deferral and is it GAAP?

*PwC response*

The optional, temporary deferral of ASU 2016-13 applies to insured depository institutions, bank holding companies, and their affiliates. A registrant would only be eligible to apply this provision if it meets the criteria specified in the CARES Act, which is a legal determination.

At a glance

The Coronavirus Aid, Relief, and Economic Security (CARES) Act became law on March 27. It was a response to the market volatility and instability resulting from the coronavirus pandemic, and includes provisions to support individuals and businesses in the form of loans, grants, and tax changes, among other types of relief.

This *In depth* answers questions regarding the accounting and disclosure implications of certain of the provisions in the stimulus package. Provisions addressed include: relief from certain accounting guidance; tax code changes; below-market loans; and other programs that essentially provide government assistance to businesses. It was most recently updated on May 20 with a new FAQ on how a borrower of funds under the Paycheck Protection Program loan program accounts for the arrangement and an update to Q11 on the disclosure of grants received through the CARES Act. Also, content on public health provisions and Medicare was updated and moved to a healthcare sector newsletter.

This *In depth* should be read in conjunction with the *In depth*, FAQ on accounting for COVID-19 and market volatility, and our other COVID-19 resources, including a podcast on the CARES Act.
With regard to making the law GAAP, the SEC’s Office of the Chief Accountant (OCA) released a statement noting that the SEC staff would not object to a conclusion that delaying the effective date of the CECL standard is in accordance with GAAP for those in scope and for the periods for which the relief is available.

OCA has received inquiries from preparers and auditors where the preparer has concluded that election of these narrow and limited options in Sections 4013 and 4014 of the CARES Act would be deemed to be in accordance with GAAP. For those entities that are eligible for, and elect to apply, either of Sections 4013 or 4014 of the CARES Act, the staff would not object to the conclusion that this is in accordance with GAAP for the periods for which such elections are available.

Sagar Teotia, SEC Chief Accountant

If a registrant elects the deferral, it should disclose the expected impact of the standard as required by SAB 74 and consider the impact to MD&A disclosures, such as in the liquidity and capital resources section.

**QUESTION 1A (added April 9)**
When is the optional, temporary relief of ASU 2016-13 effective and when does it end?

**PwC response**

Per the CARES Act, the relief period begins on March 27, 2020 and ends on the earlier of (1) the date the national emergency related to COVID-19 ends or (2) December 31, 2020.

We understand that the SEC staff would not object to an eligible registrant electing the optional deferral of ASU 2016-13 before issuing its first filing with the SEC that includes the date of enactment of the Act on March 27, 2020. Further, the SEC staff would not object to an eligible registrant reflecting the election to apply the deferral retrospectively to the beginning of its fiscal year. For example, a calendar year-end registrant can make the election in its Form 10-Q for the period ending March 31, 2020 and apply it retrospectively to January 1, 2020.

We also understand that the SEC staff would not object to a registrant adopting CECL at the earlier of the date the national emergency ends or December 31, 2020, with effects applied retrospectively to the first day of the fiscal year. For example, if the national emergency ends on June 5, 2020, the SEC staff would not object to a calendar year-end registrant adopting ASU 2016-13 in the second quarter Form 10-Q and applying its effects retrospectively to January 1, 2020.
QUESTION 1B (added April 9)
Is the optional deferral of ASU 2016-13 available to companies other than those listed in the CARES Act?

PwC response
The deferral of ASU 2016-13 applies only for the types of companies specified in the Act. We understand that the SEC staff would object to a registrant that is not eligible, as defined in Section 4014, applying the deferral.

Additional resources:
- For more on the effective date of and transition to CECL, see PwC’s Loans and Investments guide, Chapter 13
- For more on the impact of COVID-19 on CECL, see PwC’s podcast, COVID-19: CECL consideration questions, answered

Loan modifications
Section 4013 of the CARES Act provides optional relief from accounting for certain short-term modifications due to COVID-19 as troubled debt restructurings (TDR).

QUESTION 2 (updated April 9)
What is the nature of the TDR relief and is it GAAP?

PwC response
The CARES Act provides financial institutions with the option to suspend the accounting requirements within ASC 310-40 for loan modifications related to COVID-19 that would otherwise be TDRs. For a loan to be eligible, the loan modification must be:

1. related to COVID-19,
2. modified between March 1, 2020 and the earlier of
   a. 60 days after the national emergency related to COVID-19 ends, or
   b. December 31, 2020, and
3. executed on a loan that was not more than 30 days past due as of December 31, 2019.

With regard to making the law GAAP, OCA released a statement noting that the SEC staff would not object to a conclusion for SEC registrants that the TDR relief is in accordance with GAAP for the periods for which the relief is available.
OCA has received inquiries from preparers and auditors where the preparer has concluded that election of these narrow and limited options in Sections 4013 and 4014 of the CARES Act would be deemed to be in accordance with GAAP. For those entities that are eligible for, and elect to apply, either of Sections 4013 or 4014 of the CARES Act, the staff would not object to the conclusion that this is in accordance with GAAP for the periods for which such elections are available.

Sagar Teotia, SEC Chief Accountant


Additionally, the US banking agencies released interagency statements in consultation with the FASB on March 22 and on April 7 that interpret GAAP’s TDR guidance and may be applied if an entity (1) elects not to apply or (2) does not qualify for the relief under the CARES Act. The statements interpret whether a borrower is experiencing financial difficulty, which is one of the criteria for a TDR. It notes that the lender may presume that the borrower was not experiencing financial difficulty if:

1. the modification is in response to the COVID-19 National Emergency,
2. the borrower was current on payments at the time a modification program is implemented, and
3. the modification is short-term (for example, less than 6 months).

The interagency statements also provide an interpretation that government-mandated modification or deferral programs related to COVID-19 are not within the scope of ASC 310-40.

**QUESTION 2A (added April 23)**

Which entities are eligible to apply Section 4013 and what types of modifications would qualify for the temporary optional relief?

**PwC response**

The optional, temporary suspension of the TDR guidance only applies to financial institutions. A registrant would only be eligible to apply this provision if it concluded that it was a financial institution, which is a legal determination.

The following provision of the CARES Act defines its applicability to loan modifications:

(a) shall be applicable for the term of the loan modification, but solely with respect to any modification, including a forbearance arrangement, an interest rate modification, a repayment plan, and any other similar arrangement that defers or delays the payment of principal or interest, that occurs during the applicable period for a loan that was not more than 30 days past due as of December 31, 2019; and

(b) shall not apply to any adverse impact on the credit of a borrower that is not related to the coronavirus disease 2019 (COVID–19) pandemic.
Section 4013 also states that to apply its provisions, loan modifications must occur during the applicable period beginning on March 1, 2020 and ending on the earlier of December 31, 2020, or the date that is 60 days after the date on which the national emergency concerning the COVID–19 outbreak declared by the President on March 13, 2020 terminates.

We believe a company should seek the advice of legal counsel if questions arise in determining if a loan modification would meet the criteria in the CARES Act.

**QUESTION 2B (updated April 30)**

Should a financial institution’s election to apply (or not apply) the optional temporary relief provided under Section 4013 of the CARES Act be made on a company-wide basis?

**PwC response**

During a recent webcast, staff from the US banking agencies noted that companies may apply Section 4013 of the CARES Act on a company-wide, product or portfolio, or a loan-by-loan basis. Companies should disclose the basis on which Section 4013 of the CARES Act is applied in sufficient detail that a user can understand to which loans the temporary relief was applied, to which ones it was not, and the accounting ramifications of the elections.

**QUESTION 2C (added April 23)**

Which companies are eligible to apply the US banking agencies’ interpretation of the TDR guidance outlined in the interagency statements?

**PwC response**

The interagency statements were developed in consultation with the FASB and outline an interpretation of GAAP for assessing whether the modification of a loan results in a TDR. We believe any company, even if not subject to the supervision of the banking agencies, may apply the interpretation in the interagency statement. However, we do not believe that non-banking entities are required to apply the guidance issued by the banking agencies as it is an interpretation of GAAP; other acceptable interpretations may be applied.

**Additional resources:**

- For more on loan refinancing, including TDRs, see PwC’s *Loans and Investments* guide, Chapter 10
Below-market rate loans

The CARES Act includes various loan packages, including a provision that caps the interest rate on certain loans to eligible businesses. For certain borrowers, the loan may be below-market.

QUESTION 3
Does interest need to be imputed on a below-market rate loan from the government?

PwC response

ASC 835-30, Imputation of interest, provides guidance for imputing interest when financing is provided or obtained at other-than-market terms. However, ASC 835-30-15-3(e) excludes from the scope of this guidance “transactions where interest rates are affected by the tax attributed or legal restrictions prescribed by a governmental agency (for example, industrial revenue bonds, tax exempt obligations, government guaranteed obligations, income tax settlements).” Thus, a company would not need to impute interest on a loan from the government with a below-market interest rate.

Income taxes

Under US GAAP, the effect of a change in tax law is recorded discretely as a component of the income tax provision related to continuing operations in the period of enactment (March 27, 2020 for the CARES Act). A number of items included in the CARES Act have tax accounting implications, including changes to deferred taxes, valuation allowances, and balance sheet classification. These items should not be evaluated in isolation as there could be interplay between the various changes resulting from the CARES Act and other knock-on effects that impact the tax provision in totality.

Net operating losses

The Tax Cuts & Jobs Act of 2017 (2017 tax reform act) changed the rules related to Federal net operating losses (NOLs) such that NOLs generated after 2017 could not be carried back and utilization was limited to 80% of taxable income in future years.

The CARES Act allows for a five-year carryback of Federal NOLs generated in tax years beginning in 2018, 2019, or 2020 and removes the 80% taxable income limitation for NOL deductions for tax years beginning before January 1, 2021 (i.e., it allows an NOL to fully offset taxable income in the “temporary window,” which is the period of time beginning with the earliest carryback year and ending with the last tax year beginning before January 1, 2021). Overpayments created by carrying an NOL back to a year that includes taxable income from the “toll charge” may be applied to reduce future installment payments that would otherwise be owed, rather than being immediately refundable.
The CARES Act also makes a retroactive technical correction to the 2017 tax reform act to allow NOLs arising in tax years beginning in 2017 and ending in 2018 to be carried back two years.

**QUESTION 4 (updated April 9)**
What are the potential tax accounting implications related to the Federal NOL changes?

**PwC response**
Taxable income in prior carryback years is one of the four sources of taxable income provided by ASC 740 to support realization of deferred tax assets. Valuation allowances may no longer be necessary for existing NOL deferred tax assets if those NOLs can now be carried back to offset taxable income in prior years. The tax effect of releasing the valuation allowance on existing NOL deferred tax assets as a result of the CARES Act should be recorded discretely in the period of enactment.

Companies should consider all impacts of carrying back the NOLs to prior periods.

The Federal tax rate changed from 35% to 21% as a result of the 2017 tax reform act. The tax rate differential should be considered for any NOLs that are expected to be carried back to a year before the tax rate change was effective. This rate differential may impact the tax provision in several ways (see Example 1) including:

- The tax benefit for remeasuring deferred tax assets related to prior year NOLs (i.e., tax years ending in 2018 and 2019) expected to be carried back should be recorded discretely in the period of enactment.

- Any existing temporary differences (currently recorded at a 21% rate) that are expected to reverse during the year and become part of a loss that will be carried back to a 35% year should be remeasured to 35% discretely in the period of enactment.

- The tax benefit for the rate differential related to losses recognized during the current year should be included in the annual effective tax rate (AETR).

Other tax attributes that were utilized in those years (e.g., foreign tax credits, R&D credits) may now be carried forward as deferred tax assets that must be assessed for realizability. In addition, there could be other knock-on effects for items that are impacted by changes in taxable income, including (but not limited to) foreign-derived intangible income (FDII), global intangible low-taxed income (GILTI), base erosion and anti-avoidance tax (BEAT), the domestic production activities (Section 199) deduction, and alternative minimum tax (AMT). These items may impact the amount of the rate differential previously discussed (i.e., the carryback of a loss may result in a reported tax benefit that is less than the 14% rate differential between 35% and 21%).

The 80% taxable income limitation is only waived for NOLs that are utilized (deducted) in tax years beginning before January 1, 2021. Any post-tax reform NOLs that are carried forward because they are not utilized within the temporary window will continue to be limited to 80% of taxable income as a result of the 2017 tax reform act. When assessing NOL-related deferred tax
assets for realizability, companies may need to consider whether taxable income from reversing temporary differences will provide a source of income at 100% or 80% depending on when they are expected to reverse. As a reminder, taxable temporary differences related to indefinite-lived assets (e.g., “naked credits”) are not considered a source of income for finite-lived NOLs. However, they would be a source to consider (subject to the 80% taxable income limitation) if indefinite-lived deferred tax assets exist.

Finally, the balance sheet presentation should reflect when the NOLs are expected to be monetized. For example, a current tax receivable would be recorded if the NOL is expected to generate a cash tax refund within the current year. However, if an NOL is carried back to a toll charge year and will only result in a reduction to a future installment payment, the impact should instead be recorded as a reduction to the outstanding toll charge liability.

EXAMPLE 1 (added April 9)
Discrete vs AETR treatment of accounting for change in NOL carryback tax law

Assume a company with a December 31 year end expects to carry back any 2020 taxable loss to a pre-reform period when the tax rate was 35%. For simplicity, this example ignores any knock-on impacts of carrying back the NOL to a prior period (e.g., freeing up credits initially utilized in the carryback year). The company forecasts book losses of $250 each quarter, for a total book loss of $1,000 for the year. The company has unfavorable permanent differences of $60. The company expects net movement in its temporary differences during the year to reduce taxable income by $200. The composition of the movement in temporary differences is as follows:

<table>
<thead>
<tr>
<th>Deductible/ (taxable) temporary differences</th>
<th>1/1/2020 (beginning of year)</th>
<th>Activity</th>
<th>12/31/2020 (end of year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Temp Diff A (full reversal)</td>
<td>$100</td>
<td>($100)</td>
<td>$ -</td>
</tr>
<tr>
<td>Temp Diff B (partial reversal)</td>
<td>(500)</td>
<td>300</td>
<td>(200)</td>
</tr>
<tr>
<td>Temp Diff C (no reversal)</td>
<td>(300)</td>
<td>-</td>
<td>(300)</td>
</tr>
<tr>
<td>Temp Diff D (originating)</td>
<td>-</td>
<td>(400)</td>
<td>(400)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>($700)</strong></td>
<td><strong>($200)</strong></td>
<td><strong>($900)</strong></td>
</tr>
</tbody>
</table>

Temporary difference A is expected to fully reverse in the current year and Temporary difference B is expected to partially reverse in the current year. Temporary difference C is not expected to reverse in the current year (e.g., already fully amortized tax-deductible goodwill). Temporary difference D originates during the current year and will reverse in subsequent years.
Determine the tax provision for the year

<table>
<thead>
<tr>
<th>Current provision</th>
<th>Deferred provision</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Book loss</strong></td>
<td>($1,000)</td>
</tr>
<tr>
<td><strong>Perms</strong></td>
<td>60</td>
</tr>
<tr>
<td><strong>Temps</strong></td>
<td>(200)</td>
</tr>
<tr>
<td><strong>Taxable loss</strong></td>
<td>(1,140)</td>
</tr>
<tr>
<td><strong>Tax rate</strong></td>
<td>35%</td>
</tr>
<tr>
<td><strong>Current benefit</strong></td>
<td>($399)</td>
</tr>
<tr>
<td>1/1/2020 deferreds</td>
<td>($700)</td>
</tr>
<tr>
<td>@ 21%</td>
<td>(147)</td>
</tr>
<tr>
<td>12/31/2020 deferreds</td>
<td>($900)</td>
</tr>
<tr>
<td>@ 21%</td>
<td>(189)</td>
</tr>
<tr>
<td><strong>Deferred expense</strong></td>
<td>$42</td>
</tr>
</tbody>
</table>

The total tax benefit is $357 ($399 benefit + $42 expense).

Determine discrete impact of remeasuring beginning of year deferreds that will reverse in the current year

<table>
<thead>
<tr>
<th>Reversing temporary difference</th>
<th>Measured @ 21% (A)</th>
<th>Measured @ 35% (B)</th>
<th>Discrete amount (A) - (B)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Temp Diff A — ($100)</td>
<td>$21</td>
<td>$35</td>
<td>($14)</td>
</tr>
<tr>
<td>Temp Diff B — $300</td>
<td>(63)</td>
<td>(105)</td>
<td>42</td>
</tr>
<tr>
<td>Total</td>
<td>($42)</td>
<td>($70)</td>
<td>$28</td>
</tr>
</tbody>
</table>

Note that Temporary difference C is not included in the above calculation because there is no tax impact in the current year (i.e., the rate is 21% at both the beginning and end of the year). Temporary difference D is not included in the above calculation because it originates in the current year and is therefore captured in the next calculation.

Calculate the interim provision

<table>
<thead>
<tr>
<th>AETR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated full year pre-tax loss</td>
</tr>
<tr>
<td>Estimated full year perms</td>
</tr>
<tr>
<td>Estimated full year pre-tax plus perms</td>
</tr>
<tr>
<td>Tax rate for current year loss</td>
</tr>
<tr>
<td>Tax benefit on current year loss</td>
</tr>
<tr>
<td>AETR impact — originating differences(^1)</td>
</tr>
<tr>
<td>Estimated full year income tax benefit</td>
</tr>
<tr>
<td>Estimated AETR</td>
</tr>
</tbody>
</table>

\(^1\) Temporary difference D, which originates in the current year, generates a permanent difference that impacts the rate. This is because the impact on the current provision will be recorded at the 35% carryback rate, but the temporary difference will reverse and impact the deferred provision at a 21% rate. This 14% rate differential, multiplied by the gross originating difference of $400, yields a permanent rate impact of $56.
<table>
<thead>
<tr>
<th>Quarter</th>
<th>YTD loss x AETR</th>
<th>YTD benefit</th>
<th>YTD discrete expense</th>
<th>Total YTD provision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td>($250) x 38.5%</td>
<td>($96)</td>
<td>$28</td>
<td>($68)</td>
</tr>
<tr>
<td>Q2</td>
<td>($500) x 38.5%</td>
<td>($193)</td>
<td>$28</td>
<td>($165)</td>
</tr>
<tr>
<td>Q3</td>
<td>($750) x 38.5%</td>
<td>($289)</td>
<td>$28</td>
<td>($261)</td>
</tr>
<tr>
<td>Q4</td>
<td>($1,000) x 38.5%</td>
<td>($385)</td>
<td>$28</td>
<td>($357)</td>
</tr>
</tbody>
</table>

Additional resources:
- For more on valuation allowances, see PwC’s *Income taxes* guide, Chapter 5
- For more on changes in tax laws and rates in an interim period, see PwC’s *Income taxes* guide, Section 7.4

**QUESTION 4A (added April 16)**
What should a company that has been party to an acquisition or disposition transaction in a carryback year consider when carrying back NOLs as a result of the CARES Act?

**PwC response**
Parties to transactions entered into after enactment of the 2017 tax reform act may not have considered or included language in their legal agreements regarding the carryback of post-reform NOLs generated by the acquired entity to earlier tax years. When a company has been acquired in recent years, NOLs attributable to the acquired company may be carried back to a consolidated tax filing group that is different than the one it currently belongs to. For example, assume an acquirer’s consolidated tax group generates a loss of $100, and $10 of that loss is attributable to the acquired entity. If the acquirer’s consolidated tax group carries back that $100 loss to a year in which the acquired entity was part of the seller’s consolidated tax group, the seller may be the one to receive the refund associated with the $10 of loss generated by the acquired entity. Companies will need to assess their existing legal agreements and elections made at the time of the acquisition to determine whether this situation may be applicable.

Accounting for the acquirer’s income tax impact of carrying back NOLs to a different consolidated tax filing group is similar to accounting for the federal tax rate differential discussed in question 4. Rather than remeasuring related DTAs to a 35% tax rate, however, the DTAs might instead be written off or remeasured to zero.

The acquirer may decide to forgo carryback of its consolidated group NOLs. However, the situation described above is not unique to NOLs, and forgoing carryback is not an option that is available for all attributes (e.g., research and development credits, foreign tax credits). It is possible that carrying back NOLs, even to post-acquisition periods, could “free up” previously utilized attributes that might be required to be carried back to a pre-acquisition period.
Accounting considerations for these attributes would be similar to accounting for the NOLs.

Both the buyer and seller should consider whether it would be appropriate to record an indemnification receivable or payable if the seller will reimburse the buyer for any portion of refunds received. The impact of recording the indemnification would generally be recorded through pre-tax book income rather than tax expense.

Additional resources:

- For more on changes in tax laws and rates in an interim period, see PwC’s *Income taxes* guide, Section 7.4
- For more on indemnification arrangements, see PwC’s *Income taxes* guide, Section 15.8
- For more on the tax law change, see PwC’s *Insight: Global structuring — CARES Act permits NOL carrybacks, increases interest deduction limitation*

Limitations on interest deductions

The 2017 tax reform act also expanded the applicability of the interest limitation rules under Internal Revenue Code (IRC) Section 163(j), which limits a taxpayer’s deductible interest expense to 30% of adjusted taxable income (ATI) for the year. The non-deductible interest expense can be carried forward indefinitely. For tax years beginning in 2019 and 2020, the CARES Act increases the ATI limitation from 30% to 50% and allows a taxpayer to elect to use 2019 ATI in determining the 2020 limitation. Some taxpayers may want to elect out of the increased limitation or choose not to use the 2019 ATI in determining the 2020 limitation because of the interaction of Section 163(j) with other provisions, such as BEAT.

**QUESTION 5**

What are the potential tax accounting implications related to the changes to the Section 163(j) interest expense limitation?

**PwC response**

The current year tax effects resulting from the increased ATI limitation and election to utilize 2019 ATI when determining the limitation for 2020 should be reflected in the current year AETR.

The income tax effects of changes in the prior year ATI limitation should be accounted for discretely in the interim period that includes the date of enactment. These effects might include changes in the valuation allowance and the knock-on effects from the change in taxable income as a result of the increased deduction. For example, there might be a decrease in the valuation allowance because the increased ATI limitation results in less of a Section 163(j) carryforward from 2019. On the other hand, credits that were originally
claimed on the prior return (e.g., foreign tax credits, R&D tax credits) may now be carried forward and require a valuation allowance.

Companies should also consider other impacts of the increased 2019 ATI limitation, such as the impact on FDII, GILTI, and BEAT.

With the legislation enacted so close to the end of the quarterly reporting period for many companies, a question may arise as to whether decisions regarding elections must be made in the current period or if they can be deferred as more work and modeling is performed. Management should make its best estimate as to how it will treat these items based on information that is known or knowable as of the balance sheet date and account for the items in a consistent manner when preparing their financial statements.

Additional resources:

- For more on valuation allowances, see PwC’s *Income taxes* guide, Chapter 5
- For more on changes in tax laws and rates in an interim period, see PwC’s *Income taxes* guide, Section 7.4

**Alternative minimum tax refunds**

The corporate alternative minimum tax (AMT) was repealed as part of the 2017 tax reform act. AMT credits from prior tax years could be carried forward as refundable credits over several tax years through 2021. The CARES Act accelerates the ability of companies to receive refunds of AMT tax credits related to tax years beginning in 2018 and 2019.

**QUESTION 6**

What are the potential tax accounting implications related to the acceleration of refundable AMT credits?

**PwC response**

AMT credits may have been presented as a receivable (classified as current/noncurrent for companies that present a classified balance sheet) or a deferred tax asset in the prior period balance sheet. The presentation of refundable AMT credits in the current balance sheet should be updated to reflect the timing of when the credits are expected to be monetized. For example, if a calendar year company expects to accelerate the refund of the entire AMT credit to 2018 or 2019, it should be presented as a current receivable rather than a noncurrent receivable or a deferred tax asset.
Qualified improvement property

The CARES Act makes a technical correction to the 2017 tax reform act to provide a 15-year recovery period for qualified improvement property (QIP). This technical correction makes QIP eligible for bonus depreciation and is effective as if enacted as part of the 2017 tax reform act.

QUESTION 7

What are the potential tax accounting implications related to the technical correction for QIP?

PwC response

The impact of the QIP technical correction on any position taken in a prior period should be recorded discretely in the interim period that includes the date of enactment.

The technical correction constitutes new information that may allow for recognition of a tax position taken in a prior period that did not previously meet the more-likely-than-not recognition threshold under ASC 740-10-25-6. Any related changes to interest or penalties accrued for the tax position should be accounted for in the same period. Further, companies may plan to file amended returns for prior periods to claim a benefit, which could result in a refund receivable or a reduction in a payable and a change in deferred taxes.

Companies should consider the potential rate impact if additional deductions as a result of the QIP technical correction will create or increase NOLs that can be carried back to a year with a 35% tax rate.

Additional resources:

• For more on changes in recognition and measurement of tax positions, see PwC’s Income taxes guide, Section 15.5

Scope

QUESTION 8

What forms of government assistance are within the scope of ASC 740, Income Taxes?

PwC response

While many forms of government credits and incentives may be codified in tax law and may be claimed on a tax return, they may not be subject to ASC 740. A number of features can make these credits and incentives more akin to a government grant or subsidy. The application of income tax accounting is warranted if a particular credit or incentive can be claimed only on the income tax return and can be realized only through the existence of taxable income. When there is no connection to income taxes payable or taxable income (i.e.,
the credits are realizable in cash by the company regardless of whether the company has an income tax liability), we believe the benefit should be accounted for outside of ASC 740.

For example, a company that qualifies for the Employee Retention Credit in the CARES Act would receive a refundable payroll tax credit for 50% of wages paid to employees during the COVID-19 crisis. Since the credit is calculated based on wages and reduces an employer’s payroll tax, it is not considered a tax based on income and therefore should be accounted for outside of ASC 740 and would likely be treated as a grant (see Question 9).

**Additional resources:**
- For more on the scope of ASC 740, see PwC’s *Income taxes* guide, Chapter 1

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**Payroll taxes**

**QUESTION 8A (added April 16)**
The CARES Act allows employers to defer payment of certain payroll taxes for up to two years. Does this deferral have an impact on a company’s income tax provision?

**PwC response**

Prior to the CARES Act, payroll taxes generally would have been deductible for income tax purposes in the same period that they were expensed for book purposes under the “recurring item exception” of the Internal Revenue Code. However, if a company defers payment of its payroll taxes as a result of the CARES Act such that the recurring item exception no longer applies, accrued payroll taxes would not be deductible until the tax year in which they are actually paid.

If the book expense and tax deduction are expected to occur in different periods, a deferred tax asset would need to be recorded for the deductible temporary difference related to the payroll tax accrual. For companies that are expecting to carry back current-period NOLs to a pre-tax reform year, there could be an unfavorable impact in the annual estimated effective tax rate related to this temporary difference (see Question 4).

**Additional resources:**
- For more on changes in tax laws and rates in an interim period, see PwC’s *Income taxes* guide, Section 3.2
QUESTION 8B (added April 16)
What are the potential state income tax implications of the CARES Act?

PwC response

The potential state income tax implications of the federal CARES Act depend on the manner in which a state conforms to the Internal Revenue Code (IRC) and whether the state has decoupled from or has a modification that impacts the specific federal IRC sections affected by the CARES Act.

The threshold state income tax question is whether and how a state conforms to the IRC. How a particular state adopts the IRC directly affects the application of enacted federal changes to a company’s taxable income computation.

States that begin the determination of state taxable income with federal taxable income generally do so in one of the following ways:

• Rolling conformity (i.e., a state that explicitly conforms to or adopts the IRC changes automatically)

  The state income tax implications of the federal CARES Act should be accounted for within the period that includes the federal enactment date of March 27, 2020. However, companies should review whether a rolling conformity state decouples or modifies a specific IRC section. For example, some states may conform generally to the IRC on a rolling basis but decouple from the interest expense deduction limitation under IRC Section 163(j), which was modified by the CARES Act.

• Fixed date conformity (i.e., a state that explicitly adopts the IRC as of a fixed date)

  These states will need to enact conforming legislation to apply any changes as a result of the CARES Act. For example, consider a fixed date conformity state that has adopted the IRC after enactment of the 2017 Tax Cuts and Jobs Act and does not specifically decouple from Section 163(j). The CARES Act increase in the calculation of interest deductible in a given year to 50% of adjusted taxable income would not be operative without legislation to update the state’s conformity to a post-CARES Act version of the IRC.

  The state income tax implications of the federal CARES Act should not be accounted for until the period that includes the enactment date of the state legislation. The impact of the state legislation would not be accounted for in a period before enactment even if the legislation is enacted before the financial statement issuance date and/or is retroactive to an earlier period.
Grants and employee retention credits

QUESTION 9 (updated April 16)
How should a business entity account for government assistance that is not accounted for under ASC 740 (e.g., grants, employee retention credits)?

PwC response
There is no US GAAP that specifically addresses the accounting by business entities for government assistance. Thus, determining the proper accounting treatment for government incentives by business entities can be challenging and will likely depend on an analysis of the nature of the assistance and the conditions on which it is predicated.

ASC 105, *Generally Accepted Accounting Principles*, describes the decision-making framework when no guidance exists in US GAAP for a particular transaction. Specifically, ASC 105-10-05-2 instructs companies to first look for guidance for a similar transaction or event within US GAAP and apply that guidance by analogy. If no guidance for similar transactions is identified, a company may consider nonauthoritative guidance from other sources (for example, guidance issued by other standard-setters). In this context, IFRS includes a specific standard, IAS 20, *Accounting for Government Grants and Disclosures of Government Assistance*, that may be relevant.

ASC 958-605 contains the US GAAP on grant accounting, including guidance on evaluating whether government grants are exchange or nonexchange transactions (see healthcare newsletter). However, ASC 958-605 excludes from its scope transfers of assets from governments to business entities. As a result, forms of government assistance provided to business entities would not be in the scope of ASC 958-605, but it may be applied by analogy under ASC 105-10-05-2.

Alternatively, companies may look to IAS 20. ASC 958-605 and IAS 20 differ in a few key areas when it comes to accounting for government grants.

Additional resources:

- For more on changes in tax laws and rates in an interim period, see PwC’s *Income taxes* guide, Section 7.2
- For more on state tax implications of the CARES Act, see PwC’s *Insight: State and local tax — State tax implications of phase 3 relief*
<table>
<thead>
<tr>
<th>Recognition when conditions are present</th>
<th>ASC 958-605</th>
<th>IAS 20</th>
</tr>
</thead>
<tbody>
<tr>
<td>When the conditions have been substantially met</td>
<td>When there is reasonable assurance that the entity will comply with the conditions and that the grant will be received</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Timing and pattern of recognition</th>
<th>ASC 958-605</th>
<th>IAS 20</th>
</tr>
</thead>
<tbody>
<tr>
<td>When grant is awarded or, if conditional, immediately once the condition is substantially met</td>
<td>Using a systematic basis over the periods in which the entity recognizes the related expenses or losses that the grants are intended to compensate</td>
<td></td>
</tr>
<tr>
<td>Recipients should also consider whether grantor-imposed restrictions exist.</td>
<td>When the grant becomes receivable if it compensates for expenses or losses already incurred</td>
<td></td>
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<table>
<thead>
<tr>
<th>Presentation of grant income</th>
<th>ASC 958-605</th>
<th>IAS 20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant income is presented on a gross basis (i.e., grant revenue or other income)</td>
<td>May be reported separately as “other income” or deducted from the related expense</td>
<td></td>
</tr>
</tbody>
</table>

With regard to the evaluation of conditions, IAS 20 does not define “reasonable assurance” but it is generally considered to be similar to the notion of “probable” as used in ASC 450, Contingencies. ASC 958-605, however, does not permit a company to consider probability or intent in evaluating whether a condition has been or will be achieved; instead, under ASC 958-605, grant income is recognized only when the condition has been substantially met.

**Education provisions**

The CARES Act provides approximately $14 billion to higher education institutions, including approximately $12.6 billion distributed to institutions using a formula based on student enrollment. Of the amount allocated to each institution under this formula, at least 50% must be granted to students to help cover expenses related to the disruption of campus operations due to coronavirus such as food, housing, course materials, technology, health care, and child-care expenses.
QUESTION 9A (added April 16)
How should higher education institutions account for the funding received that is required to be passed through to students?

PwC response
We believe that higher education institutions receiving this funding should record the grants as contribution revenue in accordance with ASC 958-605-55-76 because they can choose the beneficiary of the funds. The Department of Education states that each institution “may develop its own system and process for determining how to allocate these funds, which may include distributing the funds to all students or only to students who demonstrate significant need.”

Timing of recognition for government assistance

QUESTION 9B (added April 16)
The CARES Act appropriated funding for various government assistance programs; however, additional information about specific grants (such as grant eligibility requirements) was not provided until April 2020 or, in some cases, has not yet been provided. Should companies account for government assistance outside the scope of ASC 740 in the period the CARES Act was enacted (the period that includes March 27, 2020) or in the period when information about specific grants was provided?

PwC response
It depends. Generally, to recognize a government grant under either ASC 958-605 or IAS 20, a company would need to be able to estimate the amount of the grant and have an understanding of grant conditions or restrictions. For some provisions of the Act, sufficient information may have been available to begin accounting for the government assistance in the period that includes March 27, 2020 even if certain clarifying guidance was provided after the end of the period. For example, the CARES Act established the general terms and conditions of the Employee Retention Credit, which is a broad-based credit available to entities impacted by COVID-19. Companies that conclude they have incurred qualifying expenses in March 2020 that entitle them to the Employee Retention Credit should reflect the related credit in the period ended March 31, 2020. As eligible expenses are incurred in future periods, the company should record additional credits to which it is entitled. The income from the grant may be reflected on a gross basis or, if a company is applying IAS 20, as a reduction of the related expense.

For other government assistance, grant eligibility and other key terms and conditions were not specified in the Act. For example, in early April 2020, the US Department of Health & Human Services distributed an initial $30 billion in
payments to healthcare providers from the $100 billion appropriation for the “Public Health and Social Services Emergency Fund” (now referred to as the CARES Act Provider Relief Fund). Although funding for the Provider Relief Fund was appropriated as part of the CARES Act in March, it was not until the further communication of the terms of the allocation in April that providers were able to determine eligibility for the assistance and the amounts to be distributed to individual providers. Therefore, we believe that recipients should not account for the grant prior to April 10, 2020.

Companies that have received or expect to receive grants that do not meet the requirements for recognition in the first calendar quarter should consider disclosure of the grants as a subsequent event in their financial statements for the period ended March 31, 2020.

**Paycheck Protection Program** *(updated May 20)*

One of the programs established by the CARES Act is the Paycheck Protection Program (PPP). The PPP involves a loan originated by a participating Small Business Administration (SBA) lender (generally a financial institution) which is designed to provide an incentive for small businesses to keep employees on the payroll. The loan will be forgiven if the funds are used for payroll, mortgage interest, rent, or utilities (with specified amounts to be used specifically for payroll costs). It is possible that all, none, or a portion of the loan will be forgiven. If all or a portion of the loan is not forgiven, the borrower is responsible for repayment. Each loan has a maturity of two years and carries an interest rate of 1%, with payments deferred for six months, and is guaranteed by the SBA.

**QUESTION 10 (added April 23)**

Should the lender (i.e., bank) account for loans originated under the Paycheck Protection Program as a loan or as a facilitation of a government grant?

*PwC response*

The instrument is legally a loan with a stated principal, interest rate, and maturity date. The bank is expected to collect amounts due from either the borrower or SBA as guarantor. As a result, we believe the bank should account for this arrangement as a loan.
QUESTION 10A (added April 23)
Is the guarantee from the SBA considered “embedded” or is it a “freestanding contract”? Should the guarantee be considered in estimating credit losses on the loan?

PwC response

Our understanding is that the SBA guarantee exists at the inception of the loan and throughout its life. If the loan is transferred, we understand that the guarantee transfers with it and that the arrangement does not contemplate the loan existing without the SBA guarantee.

For companies that have adopted ASU 2016-13 (which includes the CECL model), the guarantee would not meet the definition of a freestanding contract as defined by ASC 326-20-20. ASC 326-20-30-12 requires credit enhancements that mitigate credit losses (other than those that are considered freestanding contracts) to be considered in estimating credit losses. Since the guarantee is considered “embedded,” it should be considered when estimating credit losses on the loan.

The treatment would be similar for companies that have not adopted ASU 2016-13 as in practice, embedded guarantees that are not freestanding financial instruments are generally considered in determining the allowance for credit losses under ASC 450 or ASC 310.

QUESTION 10B (added April 23)
As part of the PPP, lenders will receive a fee from the SBA. How should a lender account for the fee?

PwC response

As noted in Question 10A, the guarantee is “embedded” in the loan and is part of the same “unit of account.” Although it is a single unit of account, the arrangement involves multiple counterparties: (1) the bank, (2) the borrower, and (3) the SBA that will be looked to for payment if the borrower either (a) meets the conditions to have the loan forgiven or (b) defaults on its obligation. The fee was paid to the bank by one of the counterparties. In effect, the SBA is paying a fee on behalf of the borrower that would have ordinarily been paid by the borrower.

The fee received from the SBA should be accounted for as a loan origination fee under ASC 310-20. As a result, it should be deferred and amortized over the life of the loan (or the estimated life, if the company qualifies and elects to apply the guidance in ASC 310-20-35-26 through ASC 310-20-35-32) as an adjustment to yield.
QUESTION 10C (added May 20)

How should a recipient (i.e., a borrower) of funds under the PPP loan program account for the arrangement?

PwC response

A loan obtained through the PPP is, in legal form, a loan from a participating SBA lender that is guaranteed by the SBA. Therefore, borrowers should account for the arrangement as a loan in accordance with ASC 470. As discussed in Question 3, a borrower should not impute interest on the loan if the rate is determined to be a below-market rate due to the scope exception in ASC 835-30-15-3(e) for government-mandated interest rates. If all or a portion of a loan is ultimately forgiven, the borrower should record income from the extinguishment of its obligation when it is legally released from being the primary obligor in accordance with ASC 405-20-40-1.

If a business entity concludes that it is reasonably assured (i.e., probable) that all or a portion of the loan will be forgiven pursuant to the terms of the PPP, we believe it would also be acceptable for an entity to conclude that the amount eligible for forgiveness is an in-substance government grant. In light of evolving guidance from the SBA and US Department of the Treasury, including FAQs updated as of May 19, 2020, we believe there are significant uncertainties that may make it difficult for many companies to assert that forgiveness of the loan is reasonably assured in advance of confirmation of forgiveness by the SBA. For example, the SBA has indicated it will review certain loans following the lender’s submission of the borrower’s application for loan forgiveness for compliance with program requirements, including whether the borrower had an adequate basis for the required certification concerning the necessity of the loan request. Companies should monitor future communications from the SBA that may impact their accounting conclusions.

As discussed in Question 9, there is no specific US GAAP guidance for government grants. However, it may be appropriate for business entities to analogize to IAS 20 within IFRS, which contemplates forgivable loans as one potential form of a government grant. Under that guidance, an entity would recognize grant income for amounts reasonably assured of being forgiven as it incurs the expenses to which the grant relates (i.e., payroll, mortgage interest, rent, or utilities). The income from the grant may be presented in the income statement as a separate line item, such as “other income,” or as a reduction of the related expenses.

If a not-for-profit entity concludes the PPP loan is an in-substance government grant, the entity should account for the loan as a conditional contribution in accordance with ASC 958-605, and would not recognize grant income until the conditions are substantially met.

Borrowers should provide transparent disclosure regarding the accounting conclusions for PPP loans and the resulting impact to the financial statements, and also consider potential impacts to risk factor and liquidity disclosures, when applicable.
Disclosures

QUESTION 11 (updated May 20)
What disclosures should a company include in the financial statements related to government assistance received through the CARES Act?

PwC response
Current US GAAP contains no specific disclosure requirements related to government grants outside of the disclosures in ASC 740 for assistance provided through the income tax regime and ASC 958-605 for not-for-profit entities. However, companies should consider disclosing the impact of any CARES Act provision utilized or expected to be utilized to the extent that it has, or is likely to have, a material impact on the company’s financial statements. Disclosures that may be appropriate include:

• Significant terms and conditions of the government assistance, such as the form of the grant (e.g., refund of taxes paid, cash, or other assets), magnitude of the assistance, duration of the assistance, interest rate (if the form of the assistance is a loan), provisions that require repayment to the government, and other unfulfilled conditions or contingencies

• Accounting policies used to account for the government assistance (for example, whether it is recognized immediately into income or recognized over a period of time, which financial statement line items are affected, and where recognized). This is consistent with a discussion at the FASB’s meeting on May 20.

To have a deeper discussion, contact:

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