

Blended state or state-by-state provision calculation: Which one works for me?

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Introduction



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Al has more than 30 years of experience working with clients to analyze tax accounting methods and tax minimization strategies. He has significant experience in accounting for income taxes and leads the firm's ASC 740 practice. He has helped many large corporate clients in the areas of federal, state, and international taxation; mergers and acquisitions; strategic dispositions, and structuring transactions.



Julia Summerville, Director, Tax Process & Technology

Julia has over 20 years of experience in both Big Four public accounting firms and Fortune 500 tax departments. She has worked with corporate officers on tax matters and managed tax departments including the planning and compliance in all areas of taxation. Julia is a certified implementer of ONESOURCE Tax Provision.

Agenda

- Technical guidance
- Blended state vs. state-by-state considerations
- Technical accuracy
- Data management
- Integration with tax compliance

Technical guidance

Technical accounting rules applicable to state income taxes

- ASC 740-10-55-25 addresses the treatment of deferred state and local taxes
 - Generally, a state-by-state computation of deferred tax assets and liabilities is required
 - However, aggregate (i.e., blended) computations may be acceptable
 - Need to consider differences in tax rates
 - Differences in loss carryback and carryforward periods
- Provisions of ASC 740-10-45-6 must be considered
 - Deferred assets and liabilities of different tax jurisdictions cannot be offset

What we are seeing in practice

- Companies frequently utilize a state-by-state approach for the current calculation
- Many companies use a blended rate to determine deferred state taxes
 - Legal entity blended rate
 - Determine a blended rate for all states in which an entity files
 - Enterprise-wide blended rate
 - Likely to not be accurate

Potential issues with use of a blended rate

Entities entering or leaving a jurisdiction

Scheduling of temporary differences

Changes in assessment of valuation allowances

Blended state vs. state-by-state considerations

Key considerations for evaluating blended state and state-by-state

- Determine the **materiality** of your state tax calculation
- Review existing blended state calculation to evaluate technical **accuracy**
- Consider **pressures** of external auditors to change approach
- Assess expected future state tax **planning**
- Understand **data** management requirements
- Evaluate the process of integrating state provision calculation with the state tax **compliance** calculation

Challenges and benefits of state-by-state calculation

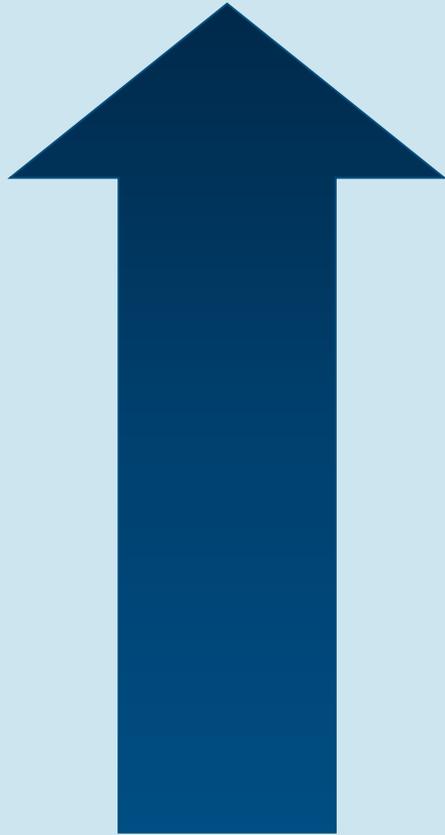
Benefits

- Better accuracy in reporting for both the current and deferred expense
- Detailed current state tax liabilities can be used to accurately roll the net operating loss balances (increased or utilized)
- Detailed current state tax liability calculations can be utilized for estimated payments
- Enables jurisdictional reporting

Challenges

- Access to accurate data
- More detailed, often more cumbersome calculation
- Can cause more volatility in state rates

How material is your state calculation?



Materiality scale

- High state tax rate
- Minimal state tax rate but large state taxable income
- Company is in a loss position with a full valuation allowance

Types of blended state tax calculations

- One blended state tax rate for all units
 - This approach is not seen very often
- Blended state tax rate for each legal entity
 - Includes state modifications
 - Excludes state modifications
- Other examples
 - Different blended state tax rates for unitary and separate states
 - Different blended state tax rates due to acquisitions or state-specific reporting requirements

Technical accuracy

Evaluate technical accuracy

- Accuracy of state data
 - Utilizing prior-year or current-year apportionment
 - Volatility of business presence in various states
 - Incorporation of state tax law changes
 - Approximately **42** states had state income tax law changes during 2012
 - Credits
 - NOL carryforward
 - Apportionment
 - Rates
 - Must evaluate state law changes based on date of enactment of change

Calculating state modifications and attributes

- Incorporation of state modifications
 - Review state tax rules to determine applicability of federal permanent adjustments to each state
 - Municipal interest, section 199 calculations, etc.
 - Calculate the cumulative deferred balances for state items such as bonus depreciation
- Tracking of state tax attributes
 - State net operating losses
 - Separate vs. unitary
 - Tax credits by state
 - State valuation allowances

Financial statement audit concerns

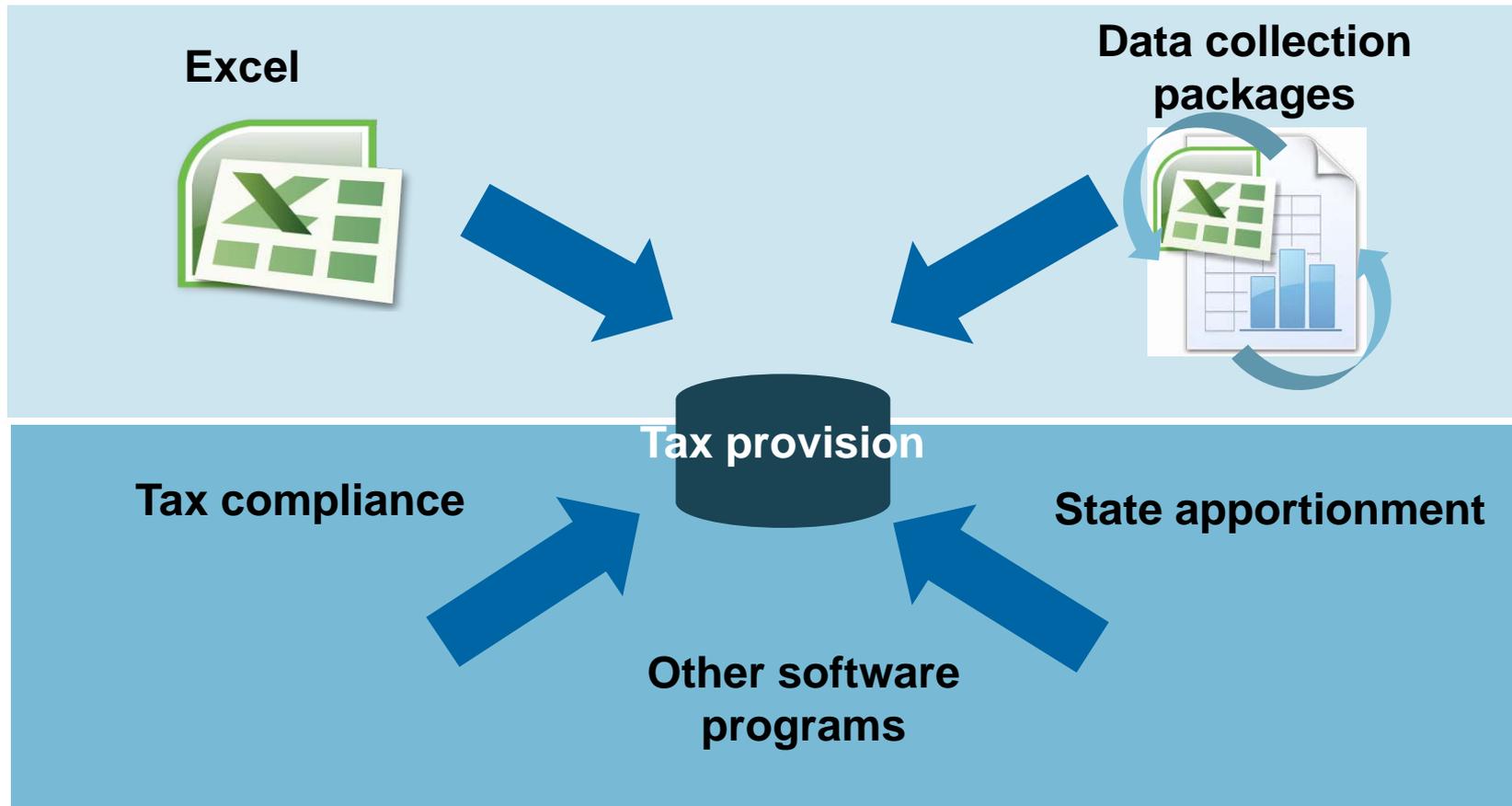
- Historical accuracy of blended rate calculations
 - State return-to-provision adjustments
- Apportionment—is prior year's apportionment appropriate?
 - Any significant changes in business, including new states
- Incorporation of state tax law changes into both current tax rate and deferred tax rate
 - For example, California change to single sales factor apportionment impacting deferred tax rate
- Separate state tax attributes
- Addressed business changes—acquisitions, dispositions, restructuring

State tax planning

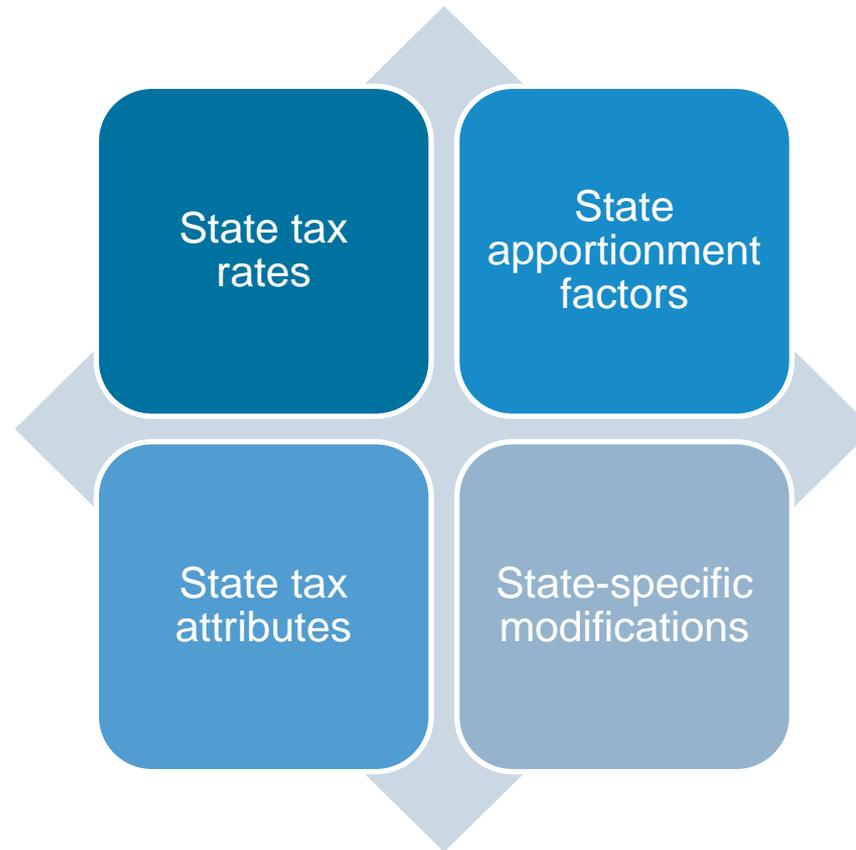
- Restructuring or anticipated transactions
 - Filing methodology changes—unitary, separate, etc.
 - Changes in apportionment
 - New filing requirements
 - Impact of acquisitions and dispositions on apportionment
- Impact on deferred tax rates utilized
 - Could require scheduling of turn of deferred tax assets
- Understand if revaluation of state deferred tax liability based on changes in rate is a discreet event for quarterly reporting
- Critical to understand the impact on a timely basis
- Important to understand impact on deferred tax assets or liabilities

Data management

How is data collected?



Data requirements



More information required for state-by-state, which leads to more planning involved in timely data gathering

Moving from blended state to state-by-state

Review software setup

- Determine additional categories required
 - State subconsolidations for unitary reporting
 - State filing groups
 - State adjustments for state-specific modifications

Determine required data

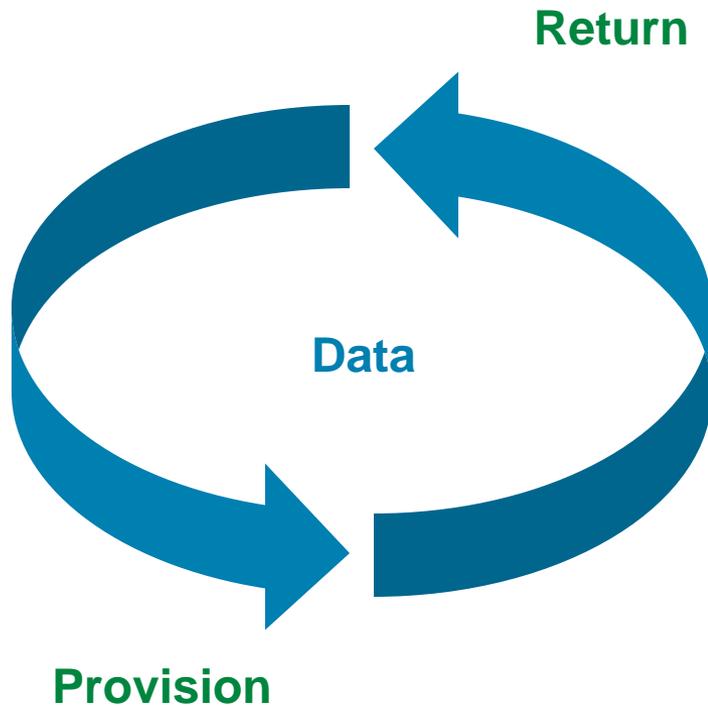
- Determine data that needs to be collected from outside sources
- Understand the number of calculated values that need to be entered
- Categorize list into what can be obtained prior to close and during close

Evaluate technology solutions

- Optimize currently licensed software
- Compare vendor tools

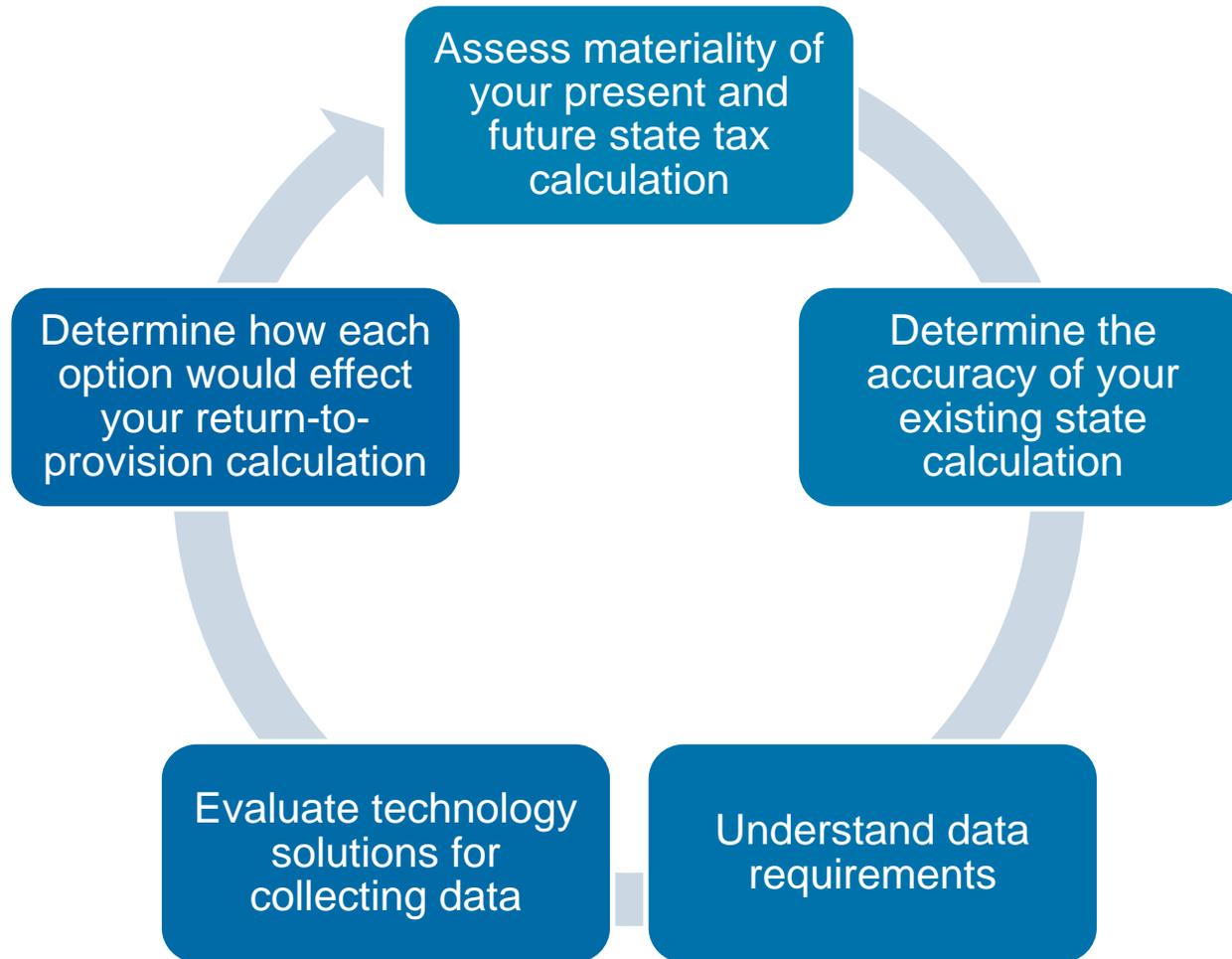
Integration with tax compliance

Key considerations for tax compliance integration



- How will the return-to-provision calculation differ between blended state and state-by-state?
- What are the technology considerations related to integrating using either approach?
 - Unitary calculations
 - State modifications

Summary



Questions

Please use the Q&A tool to submit questions.

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