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U.S. business update for Japanese companies

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KPMG's U.S. Japanese Practice

Contents

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On the 2016 Agendas

The KPMG Board Leadership Center and Audit Committee Institute (AC) have just published "On the 2016 Board Agenda" and "On the 2016 Audit Committee Agenda," highlighting items that boards and audit committees should keep in mind as they consider and carry out their 2016 agenda.

The road ahead for companies in 2016 will be particularly challenging given the level of global volatility and uncertainty—e.g., the geopolitical environment, commodity prices, interest rates, currency fluctuations, slowing growth on emerging markets—as well as technology advances disrupting established industries and business models. In this environment, the spotlight on corporate directors will continue to intensify as investors and regulators scrutinize the board's involvement in strategy, risk, and compliance.

Drawing on insights from our interactions with directors and business leaders over the past year, "On the 2016 Board Agenda" highlights six items for boards to keep in mind as they consider and carry out their 2016 agendas.

- Deepen the board's engagement in strategy and assess the continuing validity of assumptions at the core of the strategy.
- Make talent development a strategic priority.
- Reassess the company's vulnerability to business interruption and its crisis readiness.
- Refine and broaden boardroom discussions about cyber risk and security.
- Promote effective engagement with shareholders, including the activists.
- Keep board composition front and center.

"On the 2016 Audit Committee Agenda" points to key challenges and critical areas of focus for audit committees in the year ahead:

- Maintain (or regain) control of the committee's agenda.
- Quality financial reporting starts with the CFO and finance organization; maintain a sharp focus on leadership and bench strength.
- Monitor fair value estimates, impairments, and judgments of key assumptions underlying critical accounting estimates.
- Assess the company's readiness for FASB's new revenue recognition standard and for new country-by-country tax reporting.
- Reinforce audit quality and set clear expectations for the external auditor.
- Consider how the company's disclosures can better tell the company's story—and the audit committee's.

For more information, download the full report below.

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https://home.kpmg.com/content/dam/kpmg/pdf/2016/03/us-jnet-on-the-2016-board-agenda.pdf

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On the 2016 Audit Committee Agenda > (PDF/107KB)

https://home.kpmg.com/content/dam/kpmg/pdf/2016/02/us-jnet-on-the-2016-audit-committee-agenda.pdf

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Should You Consider an Advance Pricing Agreement?

Introduction

In 1991 the Internal Revenue Service ("IRS") established the Advance Pricing Agreement ("APA") program, allowing a taxpayer to request that the IRS, and potentially other countries, prospectively approve its transfer pricing facts, transfer pricing methodology and arm's length range of results. The certainty provided by this prospective approach, combined with the attendant potential time and cost savings, has been attractive to many companies. The APA process has become the dispute resolution process of choice for difficult transfer pricing issues.

The transfer pricing landscape has changed considerably in the quarter century since the APA program was launched. Although an APA will not make sense for every company, substantial increases in global transfer pricing enforcement and the anticipated transfer pricing disputes from BEPS-created changes have made APAs more desirable than ever before. Further, IRS changes to the APA program structure, staffing and procedures are expected to improve the APA process. The increased desirability of APAs is already reflected in a substantial recent increase in taxpayer requests for APAs—by September of 2015, taxpayers have already filed as any APA requests as were filed in the full year of 2014 [1].

Is an APA right for your company? Two types of factors influence every company's decision whether to pursue an APA:

1) the company-specific factors that make an APA more or less appropriate, and

2) the specific benefits that company is seeking through the APA process.

Relevant company-specific factors include the company's industry, risk tolerance, involved countries, type of issues, and examination history. Most companies are seeking certainty (freedom from penalty, double tax, tax adjustment or tax reserves), as well as time and cost savings over the regular examination and dispute resolution process. Further, the opportunity to use a bilateral APA as a benchmark for similar intercompany transactions within the multinational group is a benefit newly available to a larger set of companies. The weight assigned to these (and other) factors will vary significantly from company to company.

Impact of Recent Changes to Global Enforcement and the APA Process

Each year more countries initiate active transfer pricing enforcement, inevitably increasing the number of transfer pricing disputes. The global inventories of disputes between treaty partners, largely composed of transfer pricing issues, have increased over 60% in four years, from 3,328 cases in 2010 to 5,423 cases in 2014 [2]. Further, the OECD has acknowledged that the BEPS-related changes to transfer pricing, especially the country–by-country "(CbyC") reporting requirements, are likely to produce a large incremental increase in the number of transfer pricing disputes between treaty countries [3].

The IRS APA program and process has undergone significant changes over the last five years in an effort to enhance its effectiveness. In 2012, the APA program moved to the IRS Large Business and International ("LB&I" division and merged with the competent authority ("CA") function to create the Advance Pricing and Mutual Agreement ("APMA") program. This move, coupled with substantial new hiring, increased staffing to 55 team leaders and 26 economists responsible for APA and CA cases by the end of 2012 [4]. In an effort to speed resolution of APAs, the APMA program has recently hired 11 new team leaders and two additional economists [5]. Under Rev. Proc. 2015-41, which updates APA procedures, a taxpayer may be required to expand its APA request to cover interrelated issues and extend the statute of limitations [6]. The required content of APA requests has been "front-loaded" and the taxpayer may also be required to submit a pre-filing memorandum or have a pre-filing conference prior to filing the APA request [7]. These changes are not expected to materially increase taxpayer efforts and should allow APMA to efficiently make decisions with respect to the case.

These changes are expected to have a strong positive effect on the desirability of the APA process. The increased global enforcement and BEPS CbyC reporting is expected to have the largest impact, by increasing the risk of transfer pricing examination and double tax. Further, recent changes to the APMA program and the APA process are expected to improve efficiency, thus increasing APA desirability.

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1 *Alex Parker, McComber: 2015 U.S. APA Requests Already Tops 2014 Total,* 24 Tax Mgt. Transfer Pricing Report 669 (10/1/15).
2 http://www.oecd.org/ctp/dispute/map-statistics-2014.htm.
3 http://www.oecd.org/ctp/dispute/discussion-draft-action-14-make-dispute-resolution-mechanisms-more- effective.pdf
4 Announcement 2013-17, IRB 2013-16, 911 (Rev. April 15, 2013).
5 *Alex Parker, McComber: 2015 U.S. APA Requests Already Top 2014 Total,* 24 Transfer Pricing Rpt. 669 (9/25/2015).
6 Rev. Proc. 2015-41, I.R.B. 2015-35, Sec. 2.02(4)(a) and 2.03(3).
7 Id at 3.02 and Appendix.

Company-Specific Factors

The ease with which a company can pursue an APA and the overall benefit that company can achieve through the APA process is influenced by a number of company-specific factors:

A. The Company's Industry

The industry in which the company operates usually has some effect upon the decision whether to pursue an APA. Some industries, notably the automotive and pharmaceutical industries, are encouraged by the inherent size and uncertainty of transfer pricing outcomes to seek the certainty of an APA to avoid the negative effects of uncertainty. Other industries (e.g., electronics) are encouraged by the relatively high levels of experience of the IRS APMA program and other tax authorities with the industry and its issues [8]. Industries where the governments have little or no experience may be less inviting, since the initial APA in an industry may require more time and effort to complete.

B. The Company's Risk Tolerance

The risk tolerance of the company's management strongly affects the decision whether to pursue an APA. Given the cooperative nature of the APA process and the information requirements, companies with arguably aggressive transfer pricing positions should likely avoid the APA process. The APA process works best with taxpayers that have taken reasonable positions but still value the benefit of certainty around those positions.

C. Involved Countries

The involved countries, and the negotiating relationship between those countries, can sometimes affect the decision whether to pursue an APA. Unless a treaty exists, no bilateral APA would be possible. A lack of negotiating experience between the affected countries may indicate that the APA process might take longer than one between more experienced countries. Also, the efficacy of the core negotiating relationships between the affected countries sometimes produces periods of greater and lesser effectiveness [9].

D. Type of Issues

The type of transfer pricing issue can affect the decision whether to pursue an APA. Some issues, like royalty determinations, may be inherently difficult to resolve without a bilateral negotiation; in the long run, a bilateral APA may be the most effective way to eliminate the exposure to a transfer pricing examination in either country. In other circumstances, the issues and likely outcome of an APA for US distribution may be relatively straightforward, but the time and cost of negotiating a bilateral APA may still be cost effective because of a desire for additional certainty.

E. Examination History

"Examination fatigue" is a common driver for the decision to pursue an APA. The company may have experienced multiple examination cycles without the development of any controlling principle to guide its transfer pricing determinations. The taxpayer may be looking for a fresh perspective from the government and an approved approach regarding the transfer pricing issue. Although the examination team will be involved in an APA, jurisdiction for the issue rests with APMA [10].

Benefits Sought

The next set of factors that will influence the decision whether to pursue and APA will be the benefits sought by the company through the APA process and the likelihood of achieving those benefits. The following list in not intended to be exclusive, but is intended to address the most common benefits sought through the APA process.

A. Certainty

1. Freedom from Substantial Understatement Penalty

After the taxpayer and the IRS negotiate an APA, the taxpayer is only required to create documentation sufficient to demonstrate compliance with the APA [11]. Thus, an APA eliminates of the need to update annually the comparable company information used in preparing the taxpayer's transfer pricing documentation [12]. Taxpayers that have requested, but not yet executed, an APA, generally do not prepare documentation for the proposed APA period. According to Section 3.07 of the Rev. Proc. 2015-41, the submission of a complete APA request, updated and supplemented in accordance with APA procedures, "will be a factor taken into account in determining whether the taxpayer has met the documentation requirements of Treas. Reg. §1.6662-6(d)(2)(iii) for the proposed APA years." Taxpayers that were previously covered by an APA can rely for penalty purposes on the agreed APA methodology for a few years afterwards [13].

2. Freedom from Double Tax

Taxpayers generally experience inconsistent interpretation and enforcement of transfer pricing rules from country to country, with the attendant risk of double taxation. This exposure can be prospectively eliminated by negotiating a bilateral APA. Given the current transfer pricing landscape, the benefit of avoiding double tax exposure through negotiation of a bilateral APA may become more valuable in the post-BEPS global enforcement environment.

To be sure, following the BEPS project, the benefit of a unilateral APA may be diminished. Action 5 of the OECD BEPS Action Plan focuses on addressing harmful tax practices more effectively, taking into account transparency and substance [14]. To increase transparency, the BEPS project recommends a compulsory spontaneous exchange of unilateral advance pricing agreements with "affected countries." [15] Given APMA's strong stance in favor of bilateral and multilateral APAs wherever possible, U.S. APAs may not represent substantial exposure on this point.

8 Announcement 2014-16, I.R.B. 2014-16 Table 4(a).
9 Kevin Bell,"IRS Official: Challenges in U.S. Relationship With China Include View of Location Savings", 23 Tax Mgt. Transfer Pricing Rpt. 1339 (3/5/2015).
10 Rev. Proc. 2015-41, I.R.B. 2015-35, Sec. 2.02(4)(a) and 2.03(3).
11 Rev. Proc 2006-9,2006-1 C.B. 278, §11.03.
12 Treas. Reg. §§1.6662-6(b)(3); 1.6662-6(c)(6).
13 Treas. Reg. § 1.6662-6(d)(2)(ii).

3. No Uncertain Tax Position

For tax years beginning after January 1, 2010, corporations are required to report uncertain tax positions, including transfer pricing determinations, on Schedule UTP if those positions would affect U.S. federal income tax liabilities. [16] Taxpayers have a similar financial reporting requirement under ASC 740-10 (formerly known as FASB Interpretation No. 48). Taxpayers have been able to achieve certainty after the resolution of an APA, and some level of certainty after filing an APA request, thereby obviating UTP reporting.

4. Time and Cost Savings v. Examination and Dispute Resolution

Transfer pricing examinations can be time-consuming and expensive. Transfer pricing disputes involve complex factual and economic issues requiring subjective judgment. The tax authorities often request information that requires the taxpayer to expend significant time and money providing great quantities of information, only some of which may ultimately be relevant to the transfer pricing issues.

The APA process is intended be more focused and take less time than a transfer pricing examination and dispute resolution efforts. It is difficult to evaluate the relative time and effort involved in negotiating an APA, but the average "months to complete" APAs has only dropped approximately ten percent from 2010 to 2014, despite substantial staffing additions [17]. Rev. Proc. 2015-41 requires taxpayers to "front load" information into the APA request that could be expected to be requested during the APA process. Therefore, the ultimate effort expended by taxpayers is likely to be the same, and the frontloading of the information is expected to expedite the APA process itself.

B. Broader Application of Benchmark APAs

Since the early days of the APA program, a small group of very large multinational companies have found it useful to negotiate a bilateral APA between two experienced treaty partners to set a "benchmark" for the appropriate transfer price for similar transactions with related parties in other countries.[18] The company can share the bilateral APA and supporting information with any new examining country to demonstrate that the likely outcome of a principled negotiation would produce no adjustment. This "benchmark" approach has been desirable because those very large companies had exposure with regard to similar transactions in multiple countries that actively pursue transfer pricing enforcement [19].

In the aftermath of BEPS and the implementation of CbyC reporting, many more companies will likely find benchmark APAs to be a viable option. The anticipated increase in transfer pricing examinations and potential double tax following the adoption of CbyC reporting is expected to subject many new companies to transfer pricing scrutiny in multiple jurisdictions. In this environment, a benchmark APA to address similar transactions may be desirable for many more companies.

Conclusion

Recent changes in the global transfer pricing enforcement environment have made APAs generally more desirable. However, the decision by a company to pursue an APA should still entail a review of the taxpayer-specific factors that make an APA more or less appropriate and the benefits sought by the company through the APA process.

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Questions?

If you have any questions about this article please reach out to your KPMG engagement team or the contacts listed with this article.

[14] OECD (2015), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance,* Action 5-Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. *http://dx.doi.org/10.178/9789264241190-en.*

[15] Id.

[16] *2011: Instructions for Schedule UTP (Form 1120),* Cat. No.55028G.

[17] 42.5 months to 38.3 months. Announcement 2014-16, I.R.B., 2014-16, Table 7.

[18] *Tax Officials From Four Countries Tackle Challenges to MAP Process,* 20 Tax Mgt. Transfer Pricing Rpt. 686 (1/12/ 2012). Proctor & Gamble Co. executive explained the negotiation of similar advance pricing agreements in multiple jurisdictions.

[19] S. Wrappe and K. Fujimori, *The Best Transfer Pricing Defense is a Good Offense: Using a Bilateral U.S. APA to Benchmark Reasonable Results,* 23 Transfer Pricing Rpt. 629 (Sept. 4, 2014).

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The Clockspeed Dilemma

Profound impact on vehicle sales, car ownership models, energy demand, and infrastructure

Innovations in autonomous vehicles, connectivity, and mobility-on-demand will have a profound impact on consumers, particularly among younger and older people, according to a new study by KPMG. With these age groups set to embrace these technological and transformational changes, vehicle miles traveled (VMT) in the U.S. will soar by approximately one trillion additional miles per year by 2050.

According to KPMG's research, which consisted of consumer focus groups in Atlanta, Chicago and Denver, two generations will largely drive consumer demand in the future, the millennials and the "baby boomers plus"— ranging from 45 to 75 years. However, in every age group, participants showed significant attraction to mobility on demand for specific conditions or circumstances, including safety, weather, premium experience, and leisure time.

According to Gary Silberg, National Automotive Leader for KPMG, the increasing desire for mobility options will present "huge opportunities for new entrants and business models in the auto industry."

"Think of it this way: 10 years ago, how many of us would have predicted that most 10-year-olds would be walking around with smartphones?" asked Silberg. "We grossly underestimated that trend. The automotive landscape will significantly change as a result of autonomous vehicles, and consumer behavior will dictate the rate of adoption. Like the smartphone, let's not underestimate the power of these changes and the vast potential for new business models to satisfy them."

The 45-to-75-year-olds

Among the boomers plus, people are living longer, delaying retirement, and moving to cities. Older boomers, however, have concerns about the safety of their driving as they age. So do their children. They are not going to stop being active, however, and won't be intimidated by mobility options. They want their freedom of mobility. Silberg noted that "their almost-instant attraction to mobility services comes from a common concern expressed in the focus groups. With mobility services, people don't have to worry about taking the keys away from older parents, and don't have to worry about their driving."

The 10-to-15-year-olds

Children and the parents of children share the boomers' interest in mobility-on-demand services but for different reasons. For the children, it's all about freedom without having to get their parents or someone else to drive. Relying on Uber? Via? Lyft? An autonomous vehicle in the future? No problem. They've grown up not only tech savvy but instinctively trusting in technology. In fact, the only limitation on their use of mobility-on-demand services will be their parents view on when they are old enough to put them in an Uber or Lyft on their own. "Parents like the idea of not having to play taxi for their kids," said Silberg. "And mobility-on-demand will be especially attractive for parents in the future who will hesitate less to use these services."

Impact to vehicle miles

These increases in personal miles traveled (PMT) can ripple into even larger fluctuations in vehicle miles traveled (VMT) as vehicle occupancy rates change. For example, if more people started to select new self-driving options in the future—then we could see twice as much demand. And if we moved into a scenario occupancy rates fell below one person per car—for example, many self-driving cars without passengers—then the increase could be a staggering three to four trillion additional miles by 2050.

"Those increases would have a profound but unknown impact on vehicle sales, car ownership models, energy demand, and infrastructure," said Silberg. "To be quite frank, I'm not sure people understand the enormity of the change, nor are we ready for it."

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Uncharted Waters: LNG Demand in a Transforming Industry

There are major uncertainties over demand in the global liquefied natural gas (LNG) market. And, according to the latest in a series of LNG-focused reports from KPMG's Global Energy Institute (GEI), this transforming industry is navigating through uncharted waters.

Indeed, the global LNG market is going through a massive period of change. It is globalizing as the buyer and seller numbers and types expand; pricing models are changing under the stress of increased supply and lower energy prices and there are major uncertainties over demand where participants' expectations on price and plans for new supply hinges on anticipated demand.

The KPMG GEI report, entitled 'Uncharted waters: LNG demand in a transforming industry', highlights and discusses the short-, medium- and long-term demand uncertainties:

- Short-term: Japanese nuclear restarts, Ukraine crisis, LNG storage, trading house vertical integration
- Medium-term: New buyer alliances (JERA), Japanese deregulation, Chinese economic growth, new Russian pipelines, new importers
- Long-term: Asian urbanization, LNG in transport, renewable energy, climate policy.

Looking ahead, global LNG demand is forecast to rise from 238 million tonnes per annum (Mtpa) to between 365 and 420 Mtpa in 2020 and up to 500 Mtpa in 2025 [1].

Mary Hemmingsen, Global Leader LNG, KPMG in Canada, comments:

> "The massive build-up of LNG supply in recent years was predicated on growing Asian demand, which was anticipated to be 70 to 80 percent of global growth. It was expected this demand could be sustained at high prices. But emerging factors cast some doubt on these short- and medium-term rosy demand forecasts. Of the estimated 2020 global demand, 365 Mtpa is firm, while 55 Mtpa is 'floating' – moving between different markets, depending on price."

In the long-term, the outlook for LNG demand is naturally more uncertain, but more promising. The KPMG GEI report outlines five main factors that are anticipated to shape LNG demand out to 2030 and beyond:

- Asian economic growth and environmental pressures: By 2025, depending on gas consumption growth and success in sourcing pipeline supplies, China's LNG demand could be between 45.6 and 73.5 Mtpa – the difference between a South Korea or Japan-sized importer [2]. Indian imports of 33 Mtpa would be comparable to South Korea's today, with smaller Asian buyers taking 35 Mtpa collectively.
- Supply diversification: LNG is becoming available from more sources, with the US, Canada and East Africa entering the fray. This increases the confidence of buyers in relying on it as a secure energy source, and reducing dependence on shipping routes through the Strait of Hormuz or South China Sea. But LNG has to compete with proposed new pipelines, for instance from Russia, the Middle East and Caspian to Europe; and from Russia, Central Asia and Myanmar to China. Domestic unconventional gas is emerging in countries such as China, Argentina and Australia – depending on the setting, it may feed domestic demand and displace LNG imports or it may feed LNG export plants.
- Commoditization of LNG: The greater diversity of suppliers and buyers, the growing installation of floating regasification, and the growing liquidity of tradable LNG, tend to push it towards becoming a commodity like oil. Lower oil prices allow LNG to compete more widely in coal-to-gas switching, but conversely lessen the incentive for gas-to-oil substitution in transport. Despite this commoditization, major strategic players will seek to maintain LNG as a premium fuel, at least in some suitable markets.

1 Roberts (2014); BG Group (http://files.the-group.net/library/bggroup/files/doc_592.pdf) AND BG Group (http://www.bg-group.com/480/about-us/lng/global-lng-market-outlook 2014-15/),
2 Howard Rogers, 'The Impact of Lower Gas and Oil Prices on Global Gas and LNG Markets' – Oxford Institute for Energy Studies, 2015

- New markets: Geographic niches include the Middle East, Latin America and isolated island markets in South-East Asia and the Caribbean, now more accessible due to smaller, more flexible floating storage and regasification units. Sub-Saharan African markets such as South Africa, Kenya, Ghana and Benin are also emerging as possibilities. Sector niches include transport, with growing interest in LNG as a bunker fuel for ships. LNG trucking has also been attracting attention.
- Geopolitical upsets and other wild cards: Wars, sabotage, environmental disasters and political upheavals may emerge at unpredictable intervals to constrain LNG exports, interrupt shipping, damage economic growth in LNG importers or knock out vital pieces of energy infrastructure. At the same time, political transformations and technological breakthroughs can open up new areas of gas exploration and LNG development.

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Auditing & Accounting Update

In this section, we provide brief updates on regulatory developments in auditing and accounting that may impact Japanese companies in the United States. Further discussion of the issues can be found in KPMG's Department of Professional Practice's Defining Issues
http://search.kpmginstitutes.com/?bigi=1&q=Defining+Issues&x=0&y=0

Revenue TRG Discussions in its November 9, 2015 meeting

On November 9, 2015, the Joint Transition Resource Group for Revenue Recognition (TRG) had discussions which may be helpful to preparers when making the critical judgment about whether additional goods and services in a revenue contract should be treated as customer options or as variable consideration.

Go to Defining Issues 15-49 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-49-revenue-trg.pdf

FASB Sets 2019 Effective Date for New Leases Standard

At its November 11, 2015 meeting, the FASB set the effective dates of the new leases standard and decided to permit early adoption. The FASB also discussed cost-benefit considerations and a follow-up issue related to lease classification to complete its due process.

Go to Defining Issues 15-50 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-50-leases.pdf

SEC Permits Crowdfunding and Proposes Rules for Regional Securities Offerings

On October 30, 2015, the SEC recently adopted final rules to permit companies to offer and sell securities through crowdfunding. Selling securities through crowdfunding allows startups and small businesses to raise capital from non-accredited investors, and would alleviate some of the regulatory burden that a company faces when it raises capital by selling its securities. The SEC also voted to propose rule amendments that would facilitate intrastate and regional securities offerings.

Go to Defining Issues 15-51 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-51-sec-crowdfunding.pdf

FASB Proposes Disclosures about Government Assistance

On November 12, 2015, the FASB issued proposed ASU, Disclosures by Business Entities about Government Assistance, which would require business entities to disclose certain types of government assistance that they receive. The ASU would exclude transactions in which the government is solely a customer and those in which an entity receives a nondiscretionary amount of assistance solely because it met legal eligibility requirements. The proposed ASU does not affect the accounting for government assistance. The Board will determine the effective date after it considers comments received about the proposal.

Go to Defining Issues 15-52 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-52-government-assistance.pdf

EITF Reaches Final Consensus on Three Issues

At its November 12, 2015 meeting, the FASB's Emerging Issues Task Force (EITF) reached final consensuses about recognizing breakage for certain prepaid stored-value cards, the effect of derivative contract novations on existing hedge accounting relationships, and contingent put and call options in debt instruments. The EITF also reached a consensus-for-exposure on certain cash-flow statement issues.

Go to Defining Issues 15-53 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-53-eitf.pdf

FASB Nears Completion of Financial Instruments Standards

At its November 11, 2015 meeting, the FASB reached decisions on the financial instruments standards related to the accounting for troubled debt restructurings, impairment of available-for-sale debt securities, and the effective dates for the impairment and classification and measurement standards.

Go to Defining Issues 15-54 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-54-financial-instruments.pdf

FASB Changes Balance Sheet Classification of Deferred Taxes

On November 20, 2015, as part of its simplification initiative, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, which requires entities with a classified balance sheet to present all deferred tax assets and liabilities as noncurrent.

Go to Defining Issues 15-55 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-55-deferred-taxes.pdf

FASB Proposes to Clarify the Definition of a Business

On November 23, 2015, the FASB issued proposed ASU, Clarifying the Definition of a Business, which proposes a new framework for determining whether a set of assets and activities is a business. An entity would apply the proposed, narrower definition prospectively to transactions that occur on or after the effective date. The Board will determine the effective date after it considers comments received about the proposal.

Go to Defining Issues 15-56 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-56-business-definition.pdf

SEC May Consider Supplementary Reporting under IFRS in 2016

Nearly six years after the SEC last made a formal statement about achieving a single set of high-quality, global accounting standards, it will consider a staff recommendation about how to further incorporate IFRS into the U.S. financial reporting system. This may lead to a proposed rule in the first half of 2016.

Go to Defining Issues 15-57 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-57-ifrs-us.pdf

FASB and IASB Reaffirm Amendments to Principal-Agent Guidance in Revenue Standard

The FASB and the IASB met on December 16 and redeliberated their proposed amendments to the principal versus agent guidance in their respective revenue recognition standards. The Boards instructed their staffs to draft final standards to incorporate the proposed amendments with only minor changes, and expect to issue those standards in the first quarter of 2016.

Go to Defining Issues 15-58 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-58-principal-agent.pdf

FAST Act Legislation Impacts SEC Filing Requirements

The Fixing America's Surface Transportation (FAST) Act finalized on December 4, 2015 requires, among other things, the SEC to amend its rules and regulations to make it easier for emerging growth companies to conduct initial public offerings and to modernize and simplify the disclosure requirements of Regulation S-K.

Go to Defining Issues 15-59 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-59-small-offerings.pdf

FASB Changes Accounting for Equity Investments and Financial Liabilities

On January 5, 2016, the FASB issued a new accounting standard, ASU No. 2016-1, Recognition and Measurement of Financial Assets and Liablities, that will significantly change the income statement effect of equity investments held by an entity, and the recognition of changes in fair value of financial liabilities when the fair value option is elected.

For financial statements that have not yet been issued, certain entities may immediately adopt two provisions of the standard:

- Entities may early adopt the provisions related to the recognition of changes in fair value of financial liabilities for which the fair value option has been elected; and
- Entities that are not public business entities may early adopt the provisions of the standard that eliminate certain previously required fair value disclosures.

Go to Defining Issues 16-1 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-16-1-classification-measurment-asu-2016-01.pdf

SEC Proposes Rules for Extractive Industry Payments

On January 21, 2016, the SEC proposed rules that would require resource extraction issuers to disclose certain payments made to the U.S. federal government or foreign governments for the commercial development of oil, natural gas, or minerals.

Go to Defining Issues 16-2 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2016/defining-issues-16-2-sec-extractive.pdf

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Questions?
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KPMG

Jnet newsletter

U.S. business update for Japanese companies

Tax Update

In this section of Jnet, we provide brief updates on legislative, judicial, and administrative developments in tax that may impact Japanese companies operating in the United States.

December 2015

Highway Bill Enacted

President Obama on December 4 signed into law the "Fixing America's Surface Transportation (FAST) Act"— a bill extending authorization for spending from the highway trust fund and other related funds through September 30, 2020.

The legislation includes tax provisions and measures that extend a variety of highway-related taxes such as the taxes imposed upon gasoline, diesel fuel and kerosene, and certain tires through September 30, 2022. It also extends the heavy vehicle use tax through September 30, 2023.

In addition, the legislation also contains a number of tax enforcement provisions including:

- Creation of a "Special Compliance Personnel Program Account" within Treasury to fund the hiring and training of additional IRS collections personnel
- Requirement for the Treasury Department to contract with qualified tax collection agencies for the collection of certain outstanding inactive tax receivables
- Authorization for the revocation or denial of passports to certain individuals without social security numbers or with "seriously delinquent" tax debts in excess of $50,000
- Repeal of a change enacted earlier this year to the automatic extension of the due date for filing Form 5500, Annual Return/Report of Employee Benefit Plan (effective for returns for tax years beginning after December 31, 2015)
- Annual adjustment of certain customs users fees for inflation using a consumer price index calculation (the first adjustment will occur on April 1, 2016)

Proposed Regulations on Country-by-Country Reporting

On December 21, the Treasury Department and IRS released proposed regulations (REG-109822-15) that would require annual country-by-country (CbyC) reporting for parent entities of large U.S.-based multinational groups (U.S. MNE groups).

These proposed regulations generally are designed to coordinate with the model CbyC reporting template and instructions set forth in Action 13 of the OECD/G20 base erosion and profit shifting ("BEPS") project. However, some aspects of the proposed regulations represent a more detailed or slightly different approach from the approach delineated in Action 13.

The preamble notes that the proposed regulations, while generally consistent with international standards, are tailored to be consistent with the information reporting requirements applicable to U.S. persons under the relevant Code sections pursuant to which they were issued.

The proposed regulations contain the operative provision, relevant definitions, the reporting period, contents of the return, method for reporting financial amounts, time and manner for filing, maintenance of records, exceptions to furnishing information, and effective/applicability dates.

As noted in the preamble, the form to be used for CbyC reporting is currently under development by the IRS and is not officially numbered. Nonetheless, the form will be based on the Action 13 model template CbyC report.

The regulations are proposed to be applicable to tax years of ultimate parent entities of MNE groups beginning on or after the date of publication of the final regulations. Given the late publication date for the proposed regulations, final regulations would not be expected until sometime during 2016, pushing the first reportable period for of calendar year MNE groups to 2017.

The proposed regulations provides a general exception to CbyC reporting in cases when the annual revenue for the U.S. MNE group for the immediately preceding annual accounting period was less than $850 million. The Action 13 threshold for reporting is €750 million.

California Supreme Court Reverses Appellate Court on Apportionment Case

On December 31, the California Supreme Court reversed the findings of an appellate court and held that several taxpayers could not elect to apportion their income to California using the allocation and apportionment provisions contained in the Multistate Tax Compact in lieu of the apportionment formula mandated under state law (Gillette Co. v. Franchise Tax Board, S206587).

In the high court's view, the Multistate Tax Compact is not a binding reciprocal agreement among states, and the legislature's 1993 repeal of the election was effective even if California had not withdrawn from the Compact entirely.

Standard Mileage Rates Decrease for 2016

On December 17, the IRS released Notice 2016-1 providing the standard mileage rates for taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes in 2016.

Notice 2016-1 provides that beginning January 1, 2016, the standard mileage rates for the use of a car (also vans, pickups or panel trucks) will be:

- 54 cents per mile for business miles driven (down from 57.5 cents per mile for 2015)
- 19 cents per mile driven for medical or moving purposes (down from 23 cents per mile for 2015)
- 14 cents per mile driven in service of charitable organizations (no change)

Revised IRS Position: No 1% Excise Tax on Foreign Reinsurance

On December 23, the IRS released Rev. Rul. 2016-3 announcing that the IRS will no longer apply the one percent (1%) excise tax imposed by section 4371(3) to premiums paid on a policy of reinsurance issued by one foreign reinsurer to another foreign insurer or reinsurer. With the new revenue ruling, prior IRS guidance, Rev. Rul. 2008-15, is revoked.

Rev. Rul. 2016-3 states that the IRS reconsidered Rev. Rul. 2008-15, in light of a May 2015 decision of the U.S. Court of Appeals for the District of Columbia Circuit that section 4371 does not impose federal excise tax on foreign-to-foreign retrocession transactions.

The IRS has not indicated when it will finish processing pending refund claims on cascading excise taxes that were previously paid.

Federal Agencies Prohibited from Contracting with Tax-Delinquent Corporations

On December 3, the U.S. Defense Department, General Services Administration, and National Aeronautics and Space Administration jointly released an interim rule that prohibits the federal government from entering into a contract with any corporation having a delinquent federal tax liability or felony conviction under federal law (unless the agency has determined that suspension of the corporation is not necessary to protect the interests of the government).

The interim rule has an effective date of February 26, 2016, and includes a certification requirement regarding tax matters for contracts having a value greater than $5 million.

November 2015

Senate Foreign Relations Approves the U.S.-Japan Income Tax Treaty Protocol

On November 11, the Senate Foreign Relations Committee has approved the Protocol to amend the U.S.-Japan Income Tax Treaty and the following income tax treaties and Protocols with Switzerland, Luxembourg, Hungary, Chile, Spain, Poland, and OECD. All but the Protocol with Japan had been previously approved and reported by the Foreign Relations Committee, but have not been considered by the full Senate.

President signs "Budget Act," Partnership Reforms Enacted

President Obama on November 2 signed into law H.R. 1314, the "Bipartisan Budget Act of 2015."

The legislation suspends the limit on public debt (the "debt ceiling") through March 15, 2017, and increases defense and discretionary spending for fiscal years 2016 and 2017 above the levels set by the Budget Control Act of 2011.

The revenue offsets include changes to two partnership-related tax provisions:

- Changes to the rules for partnership audits and adjustments
- Amendments relating to the determination of who is a partner in a partnership

The revenue table shows that the new rules for partnership audits and adjustments would raise approximately $9.325 billion over the 10-year budget period while the amendments relating to the definition of a partner would raise approximately $1.894 billion over that period.

Congressional Hearings on BEPS

On November 24, the Senate Finance Committee and the House Ways and Means Committee's Subcommittee on Tax Policy both announced hearings relating to the OECD's base erosion and profit shifting ("BEPS") project.

The Senate Finance Committee's hearing will examine the BEPS project final recommendations, and the European Union's "state aid" investigations. In announcing the hearing, Chairman Hatch stated:

"In today's global economy, many nations, including the United States, are facing tax base erosion as multinational companies shift profits, activities and property from high-tax to low-tax jurisdictions. With the

California Supreme Court Reverses Appellate Court on Apportionment Case

OECD's BEPS project, the Obama Administration and the international community have sought to find solutions to address taxation challenges in an increasingly globalized and digital economy. And while such efforts are laudable, the recommendations contained in the OECD's BEPS reports raise a number of serious concerns about taxpayer confidentiality

and the Treasury Department's statutory authority to implement regulations as envisioned by the project. At the same time, the EU has launched investigations into American multinationals that have resulted in increased uncertainty and foreign tax liabilities for our businesses abroad. Given these concerns and developments, I expect a robust discussion at this hearing on what the OECD BEPS project means for U.S. taxpayers and our tax system moving forward, as well as how the EU State Aid investigations could potentially affect tax revenues paid to the U.S. Treasury."

The witnesses at the hearing will include Robert Stack from the U.S. Treasury Department and Dorothy Coleman from the National Association of Manufacturers.

The hearing of the House Ways and Means Subcommittee on Tax Policy will focus on the OECD BEPS project final recommendations and their effect on U.S. multinational companies. In announcing the hearing, Rep. Boustany (R-LA), the chairman of the subcommittee, stated:

"The direction of the OECD's BEPS project final reports has sent a troubling indication of a desire to target American companies, in an unprecedented attempt to erode the U.S. tax base. The effect on U.S. jobs and U.S.-based research and development activities will have dire consequences for our economy and for our continued ability to compete with foreign corporations. We must take swift action to fix our broken tax code so that American companies and their employees can continue to be leaders in the global marketplace."

Witnesses have not yet been announced.

Notice on Corporate Inversions

Notice 2015-79 — released November 19, 2015, by the Treasury Department and IRS — announces their intention to issue regulations relating to inversion transactions and post-inversion restructuring transactions.

Notice 2015-79 provides for rules that:

- Limit the ability of domestic companies to effect an inversion
- Limit the advantages of certain post-inversion restructuring transactions
- Clarify certain aspects of previously issued anti-inversion guidance in Notice 2014-52

Of significant importance, Notice 2015-79 does not include earnings stripping guidance, but does provide that Treasury and the IRS are still considering such guidance and other anti-inversion guidance.

Pennsylvania: Court Holds NOL Cap Violates "Uniformity Clause"

The Pennsylvania Commonwealth Court held that the net operating loss (NOL) deduction limit, as in effect in 2007, violated the "Uniformity Clause" of the Pennsylvania Constitution as applied to the taxpayer. The court concluded that the appropriate remedy was to allow the taxpayer to apply an uncapped NOL deduction and to refund the tax paid as a result of the unconstitutional cap (Nextel Communications Inc. v. Pennsylvania, No. 98 F.R. 2012 (Pa. Commw. Ct. November 23, 2015).

For corporate net income (CNI) tax purposes, Pennsylvania has limited the amount of net NOL deductions for many years. Under Pennsylvania law in effect for the tax year at issue (2007), the NOL deduction was limited to the greater of 12½% of taxable income or $3 million.

The taxpayer, a telecommunications company doing business in Pennsylvania and other states, carried forward $150 million of NOLs to the 2007 tax year in which it had $45 million in Pennsylvania income. Applying the 12½% limitation rule resulted in a deduction of $5.6 million NOL.

The taxpayer subsequently requested a refund of tax paid for 2007 on the basis that the NOL cap, asserted that the cap violated the Uniformity Clause of the Pennsylvania Constitution. After the Board of Appeals and the Board of Finance and Revenue determined that they lacked authority to rule on the taxpayer's constitutional challenge and thus denying the taxpayer's claim for refund, the case went before the Commonwealth Court.

Before the court, the taxpayer argued that the limitation on the net loss deduction favored businesses with taxable income of $3 million or less and was therefore unconstitutional under the Commonwealth's Uniformity Clause, which provides that: "All taxes shall be uniform, upon the same class of subjects, within the territorial limits of the authority levying the tax . . . ." In the taxpayer's view, the net loss deduction limitation worked in favor of small taxpayers in a positive net loss carryover position and against similarly-situated larger taxpayers. Accordingly, the taxpayer asserted that the limitations create an unconstitutional progressive CNI tax structure, where small taxpayers pay a lower effective tax rate than larger, similarly-situated, taxpayers, even though the statutory rate is fixed at 9.99 percent.

The Commonwealth Court agreed with the taxpayer and held that the NOL cap violated the Uniformity Clause. Tax professionals believe it is likely that the case will be appealed and that the legislature may also attempt to design a remedy.

Questions?

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