

FAS 123R: DTA and APIC for Dummies

Susan Garvin, CEP
Education Director, NASPP

Disclaimer

I am not an accountant, nor do I desire to be.
As such, this presentation is strictly from a
“layman’s” point of view and should not be
construed as anything other than one
person’s attempt to make a certain amount of
sense out of “accounting ease.”

Agenda

- Tax implications of expensing share-based payments
- DTA
- APIC
- Historic APIC pool
- Additional Considerations
- Planning

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Definitions

- SEC
 - Securities and Exchange Commission
- FASB
 - Financial Accounting Standards Board
- IASB
 - International Accounting Standards Board
- GAAP
 - Generally Accepted Accounting Principles
- FAS# / SFAS#
 - Statement of Financial Accounting Standard #
- APIC
 - Additional Paid-in-Capital
- DTA
 - Deferred Tax Asset

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Tax implications of expensing

- Not a new requirement
- Given less consideration under FAS 123
- With mandatory expensing, major impact
- FAS 123R
 - Paragraphs 58-63
- SFAS 109 is the accounting standard concerning the treatment of stock compensation for purposes of calculating Tax Expense/Provision for Income Taxes.

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Tax implications of expensing

- Companies must recognize expense
 - Expected tax deduction can reduce expense
 - Expected Deduction <> Tax Deduction
 - Timing/Amounts
 - IRS vs. Accounting
 - IRS: When income recognized
 - Accounting: Record early, conservative, recognize over time
 - Differences accounted for in financial statements
 - "Book/Tax Difference"

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DTA

■ Deferred Tax Asset

- Asset
- Tax
- Deferred
- At the time a share based payment is granted, if the company can expect a later tax deduction, a Deferred Tax Asset is booked.
 - NQ
 - RSA/RSU

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DTA

■ Example

- NQ stock option for 1,000 shares with Fair Value of \$10 per share
- Corporate Tax Rate is 40%
- DTA of \$4,000
- Both expense (\$10,000) and DTA (\$4,000) recognized over “service period”
- Effectively reduces “cost” of option to \$6,000

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DTA

- NQ
 - Assume later deduction
 - “Temporary Difference”
 - Record a Deferred Tax Asset (DTA)
 - At deduction event, compare

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DTA

- ISO & 423 Plans
 - Cannot assume later deduction
 - No “Temporary Difference”
 - Do not record a Deferred Tax Asset (DTA)
 - At deduction event, compare what “would have been expected” to what is
 - Higher after tax cost of ISO/423 plans

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DTA

- International Considerations
 - Tax rates
 - Chargeback
 - Deduction?
 - Differences between FASB and IASB
 - Use of APIC pool
 - DTA calculation
- Section 162(m)
 - May limit deductability

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DTA (Summary)

- At grant, calculate expense
- If tax deduction can be “expected,” a DTA is set up
 - Expense x corporate tax rate
- Both expense and DTA recognized over service period
- SPA will need to generate reports

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APIC

- APIC
 - Additional Paid in Capital
 - Capital
 - Paid in
 - Additional
 - FAS 123R APIC vs. generic APIC

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APIC

- Compare Fair Value to actual tax deduction
 - Events causing comparison
 - NQ
 - Exercise, expiration, and cancellation
 - ISOs and 423 ESPPs
 - Disqualifying disposition
 - Restricted stock/units
 - Vesting/Release

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APIC

- Tax deduction exceeds expense
 - Excess increases additional paid-in-capital (APIC)
- Tax deduction is less than expense
 - Use existing APIC “pool” to offset
 - If amount needed exceeds remaining APIC “pool” it becomes an additional tax expense

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APIC

- Reconciling “Estimated” to “Actual” Tax Benefit
 - Estimated = DTA
 - Booked as deferred tax asset as expense is accrued
 - FAS 123R expense * corporate tax rate
 - Actual
 - Recognized at taxable event (or lack of)
 - Tax deduction * tax rate

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APIC

- If Actual Tax Benefit > Estimated Tax Benefit
 - "Excess"
 - More benefit to company than originally projected
 - Posted to Additional Paid-in Capital (APIC)
- If Actual Tax Benefit < Estimated Tax Benefit
 - "Shortfall"
 - Less benefit to company than originally projected
 - Must either increase Tax Expense (Income Statement) or decrease APIC (Balance Sheet) to account for shortfall
 - Most companies will want to decrease APIC
 - Only permitted to decrease APIC pool to the extent it exists
 - *Possible* Tax Expense
 - Offset against existing APIC Pool
 - Then recognize extra as tax expense

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APIC

- Example 1 – Estimated > Actual
 - NQ granted for 1,000 shares, price = \$10
 - FAS 123R Expense = \$4 per share (total = \$4,000)
 - Deferred tax asset = 40% * \$4,000 = \$1,600
 - Shares exercised when market value = \$15
 - Tax Deduction = 1,000 shares * \$5 gain per share = \$5,000
 - Actual Tax Benefit = \$5,000 * 40% = \$2,000

Actual	Estimated	
Tax Benefit	Tax Benefit	Result
\$2,000	\$1,600	Excess = \$400 (APIC)

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APIC

■ Example 2 – Expected < Actual

- NQ granted for 1,000 shares, price = \$5
- Expense = \$4.00 per share (total = \$4,000)
- Deferred tax asset = 40% * \$4,000 = \$1,600
- Shares exercised when market value = \$7
 - Tax Deduction = 1,000 shares * \$2 gain per share = \$2,000
 - Actual Tax Benefit = \$2,000 * 40% = \$800

Actual	Estimated	
Tax Benefit	Tax Benefit	Result
\$800	\$1,600	Shortfall = \$800

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APIC

■ ISOs & 423 ESPP

- Assume there is NO later tax deduction
- “Permanent” difference
- No deferred tax asset booked (\$0)
- IF disqualifying disposition occurs
 - Compare “estimated” to “actual”
 - “Estimated” is FAS 123R Expense * Current Tax %
- “Estimated” > “Actual”- APIC AND reduction in Tax Expense
- “Estimated” < “Actual” – reduction in Tax Expense

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APIC (Summary)

- Pool of available amount to help offset later expenses
- Compare DTA to actual tax deduction
- If $DTA < Deduction$, excess to APIC
- If $DTA > Deduction$, decrease APIC (if available)
 - Additional Tax Expense

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Historic APIC Pool

- All grants/transactions since under SFAS 123
 - Up to 11 years worth of data
- APIC pool can never go negative
 - Work from beginning
 - Sequential periods

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Historic APIC Pool

- Team effort
 - Equity Comp
 - Legal
 - Tax
 - Accounting
 - Audit
 - External
 - IT

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Historic APIC Pool

- Possible Issues
 - Lack of data
 - Data adjustments
 - i.e., does the data in your system match the tax records?
 - Repricings (or 6 +1 exchanges)
 - International
 - Section 162(m)
 - M&A
 - NOL

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Historic APIC Pool

- **TIME!!!!**
 - Start now
 - Don't have to disclose, or even do until needed, but....
- “More art than science”

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Planning

- **New (?) Administrative Burdens**
 - Should have been doing
 - SOX
 - Data integrity
 - Better employee data (mobility)
 - Sorting/grouping/analyzing data
 - Reporting
 - Better communication between departments
 - International compliance
 - Challenges
 - Tracking transactions, especially dispositions

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Planning

- Coordination between SPA and accounting and tax
- Data integrity
- International issues
 - Institute “Chargeback”
 - Tax and Legal issues
 - Tracking
 - Mobility
- Add to procedures/document (SOX)

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Planning

- Period Close
 - Verify All data is entered
 - Recon Item list
 - Run data integrity check
 - Transaction Reports
 - Plan Summary
 - Balance to prior period
 - Detail differences
 - Balance with TA
 - Balance with Broker
 - Value grants
 - Accounting Reports!!!!

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Additional Consideration

- NOL
 - Net Operating Loss
 - When is tax deduction “realized”
- M&A
 - Purchase vs. Pooling
 - Historical Records
- Adoption of 123R
 - Grants issued/expensed before adoption but transacted after
- Mobility

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DTA and APIC for Dummies

- Questions??????

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