



SOS Solutions Webcast: The Newest Balancing Act: Proving Your DTA Balance

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Materials

<http://www.sos-team.com/PDFS/balance.pdf>

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Agenda

Intro to Deferred Tax Asset (DTA) & Tax Accounting

Intro to Balance Issue

SOS Custom Report Solution

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General Concepts – Deferred Tax Asset

For certain types of equity instruments, a tax deduction is expected in the future

- Non-Qualified Option = Tax Deduction at Exercise
- Restricted Stock/Unit = Tax Deduction at Release

Deferred Tax Asset (“DTA”)

- Accounting way to anticipate future tax deduction
- Accrued over time instead of being “booked” all at once when event actually occurs
- Booked as expense is accrued (i.e., over vesting or service period)
- T718/FAS 123 expense x applicable corporate tax rate
- DTA not booked for ISO/ESPP (more later)

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General Concepts

Topic 718 (formerly FAS 123(R))

- Requires that:
 - Record deferred tax asset (DTA) as expense is booked
 - Reconcile at time of tax deduction (or lack thereof)
 - Excess tax benefits be recognized as an addition to paid-in capital, NOT as a reduction in income tax expense
 - Unrealized tax benefit recognized as income tax expense
 - Unless there are excess tax benefits from previous equity awards in paid-in capital to which it can be offset (run it through APIC pool)

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General Concepts – Deferred Tax Asset (cont'd)

Example of journal entries for expense and deferred tax asset (both booked over “requisite service period”):

- Expense for NQ = \$10,000
- Vesting annually over 4 years, straight-line accrual used (\$10,000 / 4 years = \$2,500 per year of expense)
- 40% statutory tax rate for that country
- Debits/credits for each year of service period:

Debit: Compensation Expense	2,500	
Credit: Additional Paid-in Capital		2,500
Debit: Deferred Tax Asset	1,000	
Credit: Deferred Tax Benefit (part of Income Tax Expense)		1,000

Note: Expense should be reduced by the estimated forfeiture rate up until shares vest.

General Concepts

Translation

- Deferred Tax Asset <> Actual Tax Deduction
- If windfall/excess = increase to APIC
- If shortfall/deficiency =
 - Reduction to APIC pool (if sufficient) or
 - Potential tax expense (if APIC pool not available to offset)

A – D = if positive, excess (good)
 = if negative, deficiency (bad)

Actual - DTA

Journal Entry Oversimplification

Very generally speaking, when the tax deduction occurs, you will make three entries to your General Ledger:

- Decrease taxes payable
 - Company receives a tax deduction
- Reverse previously booked DTA (if any)
 - No longer “anticipated” – DTA should be reversed
- Post the difference (the “plug”) to “APIC” or to Income Tax Expense

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ISOs/ESPPs

NO DTA Booked for ISOs/ESPPs

Tax Accounting performed if/when there is a Disqualifying Disposition

Excess:

- If actual tax benefit greater than “estimated tax benefit”, excess treated as APIC and “estimated tax benefit” reduces tax expense, but only in year of disqualifying disposition
 - If actual > estimated
 - Excess tax benefit = APIC
 - Estimated tax benefit (expense * tax rate) = reduces tax expense

Deficiency:

- No DTA booked, so no real deficiency
- If actual tax benefit <= “estimated tax benefit”, no APIC and actual tax benefit reduces tax expense

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DTA Balance

1. Accrue Expense = Book DTA
(if Forfeiture = Reverse previously booked DTA)
2. Exercise / Release / Expire = Reverse DTA, Calculate Tax Windfall/Shortfall (Excess/Deficiency)

1. Booked – 2. Reversed = Balance

If shares outstanding = zero, then DTA should be zero

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DTA Balance Custom Report

Expense Report

- DTA Booked
- DTA Reversed for forfeitures
- Some tax personnel want it “pre-tax-affected” (use tax rate of 100%)
- Often shows one row per tranche

Tax Accounting Report

- DTA Reversed at Exercise, Release, Expiration, etc.
- Often shows one row per TRANSACTION

Shares Outstanding

- Shares outstanding by tranche
- Not every system has this, if so, perform comparison on grant level

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Apples to Oranges (tranche to transaction)

Tranche – Expense/ Book DTA

Transaction – Reverse DTA



Exercise



Expiration

\$100

\$75

\$100

\$25

= Balance = \$100 Incorrect!

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DTA Balance Custom Report

Tax Accounting Report

- One row per transaction
- Database function summarizes data to one row per tranche
- Allows link (like a vlookup) from Expense to tax accounting report based on number + vest date
 - Problems if grants with SAME vest date for multiple tranches
 - Can be performed on grant level instead

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DTA Balance Custom Report

DTA Booked – DTA Reversed = DTA Balance

- Tranche by Tranche
- (Expense/DTA less actual forfeitures) – DTA Reversed = Balance
- # of shares outstanding provides “reality check”

Sample DTA Balance Report

TEST Database

Tax Report
(DTA Reversed)

Expense Report
(DTA Booked)

Shares
Outstanding

EXPENSES																	
Number	Type	Grant/Begin Date	Expense Service Date	Total Days	Rate (%)	Total Expense (\$)	To Date Amortized Expense (\$)	To Date Forfeitures (\$)	To Date Expense Incl. Forfeitures (\$)	To Date Recognized Expense (\$)	Adjustment (\$)	To Date Net Expense (\$)	Tax Rate Booked (\$)	DTA Booked (\$)	DTA Reversed (\$)	DTA Balance (\$)	Outstanding
00000834	NQ	01/01/07	01/01/08	365	100.00	100.00	100.00	100.00	100.00	100.00	0.00	100.00	40.00	40.00	40.00	0.00	0
00000834	NQ	01/01/08	01/01/09	366	100.00	100.00	100.00	100.00	100.00	100.00	0.00	100.00	40.00	40.00	20.00	20.00	50
00000834	NQ	01/01/09	01/01/10	365	100.00	100.00	100.00	100.00	100.00	100.00	0.00	100.00	40.00	40.00	0.00	40.00	100
00000834	NQ	01/01/10	01/01/11	365	100.00	100.00	100.00	100.00	100.00	100.00	0.00	100.00	40.00	40.00	0.00	40.00	100
00004716	PSU	01/01/11	01/15/12	379	95.39	150.00	39.97	38.13	39.97	39.97	0.00	38.13	40.00	15.25	0.00	15.25	150
00004716	PSU	01/01/11	06/15/12	531	93.41	150.00	28.53	28.53	28.53	28.53	0.00	28.53	40.00	10.68	0.00	10.68	75
00004716	PSU	01/01/11	12/15/12	714	91.04	225.00	31.83	28.98	31.83	31.83	0.00	28.98	40.00	11.58	0.00	11.58	75
10000850	NQ	01/01/05	01/01/08	365	100.00	250.00	250.00	250.00	250.00	0.00	0.00	0.00	40.00	0.2	0.00	0.27	0
10000850	NQ	01/01/06	01/01/07	365	100.00	250.00	250.00	250.00	250.00	250.00	0.00	250.00	40.00	100.00	60.00	40.00	100
10000850	NQ	01/01/07	01/01/08	365	100.00	250.00	250.00	250.00	250.00	250.00	0.00	250.00	40.00	100.00	0.00	100.00	250
10000850	NQ	01/01/08	01/01/09	366	100.00	250.00	250.00	250.00	250.00	250.00	0.00	250.00	40.00	100.00	0.00	100.00	250
Totals						1,925.00	1,560.33	1,493.76	1,250.33	0.00	1,243.76	497.76	120.00	377.76	1,150		

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