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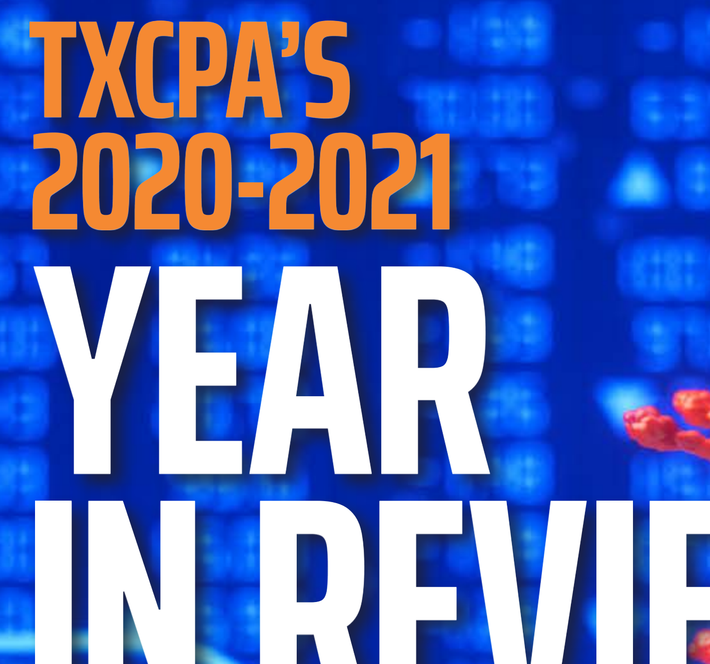

AMERICAN RESCUE PLAN ACT CONTINUES THE PATTERN OF STIMULATING THE ECONOMY THROUGH TAX POLICY

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NEW PARTNERSHIP TAX BASIS REPORTING REQUIREMENTS

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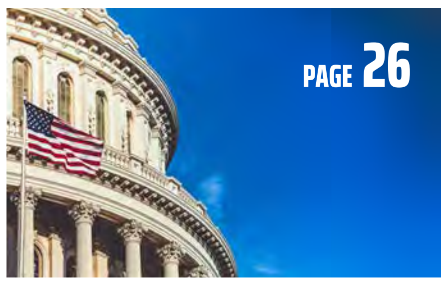

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VIRTUALLY BETTER THAN EVER

By TXCPA Chairman Jerry Spence, CPA-Corpus Christi

Share Your Thoughts

I'd love to hear your feedback and answer your questions. Drop me a note at chairman@tx.cpa.

Welcome to your digital May/June issue of *Today's CPA*. I feel like we're using the words digital and virtual much more now than ever before. It's amazing how far we've come and how fortunate we are at TXCPA to be able to continue to deliver benefits to members, like *Today's CPA*, in a format they can access no matter where or how they do their work. I'm sure the delivery of the value and benefits you offer to your clients and employers has also been transformed over the last 12 months.

Our cover story shines the spotlight on what we have accomplished together as a professional community this past year. I hope you'll take the time to explore some of the benefits mentioned and be sure you are getting the most value from your engagement in TXCPA. One of the greatest benefits provided by TXCPA is the protection and advocacy for our CPA license. As the 2021 legislative session draws to a close this May, take a moment to read Capitol Interest and be informed about how TXCPA has been keeping a watchful eye during the strangest of sessions on issues affecting CPAs, our clients and our companies.

It has been a pleasure to serve as TXCPA chairman in 2020-2021, alongside nearly 800 dedicated volunteers – even when that service has been mostly virtual. Digital delivery of our events allowed me to "see" many more of you than I would have had the chance to visit if we'd been limited to in-person events with carefully coordinated calendars and travel time involved.

I'm honored that so many of you are engaged and give so freely of your time and experience to benefit all Texas CPAs, especially during challenging times. If you haven't taken the opportunity to volunteer in your chapter or at the Society level, I encourage you to raise your hand and let us help you get involved. It's through the dedication of our volunteers that we continue to thrive and serve the profession so well.

Thank you for your membership, your trust in TXCPA and the opportunity to serve with you this past year!

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By Don Carpenter, MSAcc/CPA

IT MIGHT BE A GOOD TIME TO 'DUST OFF' THAT ERM DOCUMENTATION

Spring cleaning! Granted, it does not generally make the list of the top five things most people enjoy about this time of year, but it does serve a purpose. And we do enjoy the benefits that result from a little elbow grease and a little polish! This spring particularly might be a good time to pull out your organization's ERM documentation and spiff it up.

First, let's start by assuming your organization has an ERM. If you are asking yourself, what is an ERM, that's not a good sign. Enterprise Risk Management is a methods-based process of determining and managing business risk.

ERM really came into its own with the enactment of the Sarbanes-Oxley Act (SOX) in 2002 requiring that public companies maintain and certify that a system of internal controls was in place and functioning to accurately manage and report key business processes. This was followed in 2004 with the COSO Enterprise Risk Management – Integrated Framework that outlined a structure for identifying key areas of risk, identifying an organization's appetite for these risks and assigning responsibility for managing risk within the framework.

The ERM has served as a foundational step to developing the internal control systems that satisfied the requirements of SOX.

The COSO framework requires that an organization systematically identify and prioritize risks. Once risks are identified, they must be assessed in a four-step process:

1) Develop assessment criteria – this involves determining a ranking scale, which generally ranks individual risks by magnitude of impact and likelihood of occurrence.
2) Assess risks – risks are qualitatively identified and then the more important or material risks are quantified based on the step 1 criteria.
3) Assess risk interactions – the relationship of individual risks is determined, which may entail a re-ranking of these risks after step 2.
4) Risks are then prioritized based on their potential impact on the goals of the organization.

The ERM is intended to be a living process, regularly revised and updated to reflect the evolving nature of the business and the environment in which it operates. Unfortunately, many organizations shelved the exercise once the internal control framework was established and only pay it lip

service when the topic of risk comes around on the board agenda.

This spring offers a unique opportunity to revisit the ERM and test some of the assumptions and judgments that are implicit in the process. The past few years (2018 – 2021) have seen several major occurrences that individually and in combination pressure test an enterprise's assumptions with regard to identified risks and the effectiveness of its risk mitigation strategies.

The tariffs imposed by President Donald Trump in 2018 as part of the effort to renegotiate the North American Free Trade Agreement quickly escalated and ultimately focused on trade with China. Cybersecurity lapses tested the integrity of technology, particularly within our financial systems. Then COVID-19 forced closure of large sections of the economy and stressed both supply chains and distribution channels as businesses were forced to make difficult decisions to maintain liquidity. Social unrest stemming from police actions in Minnesota and Georgia added further tensions to the marketplace.

These events occurring in rapid succession created a unique environment in which to review the ERM, as well as risk management strategies that evolve from it.

The COSO framework delineates four objective categories within which to classify organizational risk. Working within that framework, it might be beneficial to explore how this sequence of recent events could alter the evaluation of risk and how it is managed.

Strategy

The first objective category entails the high-level goals of the organization and their alignment with the overall mission statement. These are risks at the highest level and involve strategy rather than tactics. For example, is the organization positioning itself as a cash yield investment or as a growth company? Are acquisitions an important component of the company's strategy? Is vertical integration desirable?

With these goals in mind, those responsible for maintaining the ERM should consider how recent events have affected the organization's reputation in the marketplace. The tariff wars have radically altered cross border relationships while the focus on social justice has brought an intense spotlight on the practices of many organizations. This should cause a review of potential merger candidates, major suppliers and service providers, and the organization's advertising and marketing strategies.

This spring particularly might be a good time to pull out your organization's ERM documentation and spiff it up.

Operations

A major focus of internal controls is the effective and efficient use of the enterprise's resources. The disruption of the market caused by the trade disputes and COVID-19 are a good testing ground for any organization's risk assumptions regarding its supply chain and distribution channels. The disruptions in the spring of 2020 in staple food items and hard goods highlighted just how vulnerable operations can be.

The organization's workforce is an area that should not be overlooked. As many companies were forced to furlough workers last year, this would be a good time to assess how staff responded and the degree to which such extreme measures put the operations at risk.

Financial Reporting

The requirement of shelter in place for several months tested contingency planning for financial reporting and stressed compliance within the control environment. This coupled with the increased risk of cybersecurity breakdowns should cause organizations to review how these risks are managed. It could also change whether processes are managed in-house or outsourced as the organization determines its appetite for risk and how to most effectively mitigate it.

Compliance

Finally, as organizations were required to react to rapidly changing conditions, compliance with applicable laws and regulations can often be compromised. In addition, weaknesses in the compliance structure may be revealed. This may call for a review of standard contracts and terms with both suppliers and customers. For example, do contracts have adequate provision for force majeure and have claims arisen that were not foreseen prior to recent past events?

In summary, before the confluence of these major events fade, management owes it to the organization, its investors, creditors and other constituents to take a fresh look at its appetite for business risk and how it manages the risk.

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New Partnership Tax Basis Reporting Requirements

By Stephanie Morgan, CPA, MBA

In January, the IRS published a second early draft of the 2020 instructions for Form 1065. The original early draft was released on October 21, 2020 with a 30-day request for comment that was to end on November 20 and with the intention of releasing final instructions in December. At the time of this writing, final instructions have not been published.

Under the most recent draft instructions for tax year 2020, all partnerships must report each partner's tax basis capital using the transactional method. Partnerships that have not previously used the tax basis method to maintain capital accounts may determine each partner's beginning tax basis capital account balance using one of three methods:

- the modified outside basis method,
- the modified previously taxed capital method, or
- the Sec. 704(b) method.

This article discusses how the reporting requirements for partners' capital accounts have changed over recent years and walks through each method for recalculating beginning tax basis capital.

Background

Beginning in tax year 2018, the instructions for Form 1065 included a new tax basis capital reporting requirement for certain partnerships stating:

"If a partnership reports other than tax basis capital accounts to its partners on Schedule K-1 in Item L, and tax basis capital, if reported on any partner's Schedule K-1 at the beginning or end of the tax year would be negative, the partnership must report on Line 20 of Schedule K-1, using code AH, such partner's beginning and ending shares of tax basis capital.[1]"

The 2018 instructions defined tax basis capital as:
1.) the amount of cash plus the tax basis of property contributed to a partnership by a partner minus the amount of cash plus the tax basis of property distributed to a partner by the partnership, net of any liabilities assumed or taken subject to, in connection with such contribution or distribution; plus
2.) the partner's cumulative share of partnership taxable income and tax-exempt income; minus
3.) the partner's cumulative share of taxable loss and nondeductible, noncapital expenditures.[2]

Draft instructions to the 2019 Form 1065 included the new tax-basis-only reporting requirement, but for all partnerships regardless of the balance, negative or otherwise, of the individual partner's capital accounts. Due to concern that partnerships would not have adequate time to comply with the new reporting requirements, the IRS issued Notice 2019-66 to defer implementation to tax year 2020. Additionally,

notice 2019-66 indicated that additional guidance on the definition of partner tax basis capital would be forthcoming.

On June 5, 2020, the IRS issued Notice 2020-43, in which they sought public comment on two methods for maintaining tax basis capital accounts for use on Schedule K-1 if the tax basis method was not previously used. They are the modified outside basis method and the modified previously taxed capital method.

In late October 2020, the IRS released drafts of the 2020 instructions for Form 1065 and simultaneously published a news release in which they stated: "The IRS and the Treasury Department received numerous comments from taxpayers requesting that the tax basis method approach be retained. At the same time, the IRS did not receive practical alternative approaches to partner capital account reporting."

They went on to explain that by putting all tax filers on the same method, they expect ultimately to reduce the likelihood of compliant returns undergoing examination.[3] As such, the draft instructions follow pretty closely to the provisions laid out in Notice 2020-43 with a few additions.

The draft instructions require the use of the transactional approach to calculate the partners' tax basis method capital accounts balances. Going forward, all partnerships will be required to use the transactional tax basis method to report partner's capital accounts on Schedule K-1. For one year only, in 2020, partnerships that have not historically used the tax basis method can refigure a partner's beginning capital account balance using either the modified outside basis method, the modified previously taxed capital method, or the Sec. 704(b) method.

The instructions also describe certain disclosure requirements stating: "You must also attach a statement to the partners' Schedules K-1 indicating the method used to determine each partner's beginning capital account. If the modified previously taxed capital method is used, the statement must also include the method used to determine the partnership's net liquidity value (fair market value, section 704(b) book value, etc.)."[4]

Transactional Method

The transactional method is really a general rule put forth by the IRS that requires a partnership to consistently maintain tax basis capital accounts by applying the provisions of the Internal Revenue Code to each item of contribution and distribution between a partner and a partnership, as well as all allocated items of income, gain, loss and deduction. The instructions describe it as "a manner generally consistent with figuring the partner's adjusted tax basis in its partnership interest (without regard to partnership liabilities), taking into account the rules and principles of sections 705, 722, 733 and 742, and by reporting the amount on the line for other increase (decrease)."

Going forward, all partnerships will be required to use the transactional tax basis method to report partner's capital accounts on Schedule K-1.

The instructions then describe the way to complete various lines of Item L depending on whether the organization previously used the tax basis method or not. If it used the tax basis method, then things continue to operate pretty normally and the instructions provide some guidance on how to report changes in partnership interest that occur during the year.

If, for some reason, the partnership reported a negative ending tax basis capital account to any partner on the 2019 tax return, and a different amount is reported for the beginning tax basis capital account on the 2020 tax return, then an explanation is required.

Capital contributed during the year will consist of the amount of cash plus the adjusted tax basis of all property contributed to the partnership during the tax year. The basis in any such property should be reduced for the amount of liabilities assumed by the partnership. Note that this amount could be negative. The line for current year net income (loss) obviously reports each partner's distributive share of taxable partnership income, gain and loss.

The line for other increase (decrease) can be used to report all other items that affected each partner's capital account for the year. An explanatory statement for each adjustment must be attached. The instructions provide several examples, including the partner's share of excess depletion and Section 743(b) adjustments.

Here the IRS notes that Section 743(b) basis adjustments are not taken into account under the tax basis method. Therefore, if Section 743(b) adjustments were included in the ending capital account balance reported on the 2019 return, those amounts, whether positive or negative, should be removed from each partner's capital account

for the 2020 tax year and reported as another increase or decrease.

Withdrawals and distributions will consist of the amount of cash received by the partner plus the adjusted tax basis of any property received from the partnership reduced by any liabilities assumed by the partner. Again, this number might be negative. The ending capital account will, as expected, be the sum of the amounts from all lines in item L.

Modified Outside Basis Method

Using the modified outside basis method, a partner's tax basis capital account is essentially equal to its outside basis in the partnership interest less the partner's share of partnership liabilities and Section 743(b) adjustments. The instructions describe the method in the following terms:

> **"The amount to report as a partner's beginning capital account under the modified outside basis method is equal to the partner's adjusted tax basis in its partnership interest as determined under the principles and provisions of subchapter K including, for example, sections 705, 722, 733 and 742; and subtracting from that basis (1) the partner's share of partnership liabilities under section 752 and (2) the sum of partner's section 743(b) adjustments (that is, net section 743(b) adjustments). For purposes of establishing a partner's beginning capital account, you may rely on the adjusted tax basis information provided by your partners."[5]**

While this method is simple enough on paper, it may prove more difficult in application for partnerships, which have not historically kept this data in their records. However, the draft instructions do state "you may rely on the adjusted tax basis information provided by your partners."

Modified Previously Taxed Capital Method

On the other end of the spectrum is the vastly more complex, modified previously taxed capital method. Though more cumbersome, it might be a necessary evil for those partnerships that do not have access to large amounts of historical data. Under this method,

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a partner's capital account balance is calculated by applying modified principles to the rules described in the regulations for computing a partner's share of previously taxed capital.

Section 1.743-1(d)(1) provides that generally a partner's share of the adjusted basis of partnership property is equal to the sum of the partner's interest in the partnership's previously taxed capital, plus the partner's share of partnership liabilities.

The regulations define previously taxed capital as 1.) the amount of cash that the partner would receive on a hypothetical fully taxable liquidation of the partnership at fair market value, plus 2.) the amount of tax loss that would be allocated to the partner from the hypothetical transaction, less 3.) the amount of tax gain that would be allocated to the partner from the hypothetical transaction.[6]

One of the modifications made to the regulations in the instructions is the allowance for substituting net liquidity value for the assets' fair market value in the hypothetical transaction, stating "assets bases as determined under Section 704(b); as determined for financial accounting purposes; or on the basis set forth in the partnership agreement for purposes of determining what each partner would receive if the partnership were to liquidate."[7]

The other modification is that when calculating the amount of gain or loss that would be allocated to each partner in the hypothetical liquidation, all liabilities are treated as non-recourse. In Notice 2020-43, the IRS explains that this was done to "avoid the burden of having to characterize the underlying debt and to simplify the computation."

Section 704(b) Method

Generally, Section 704(b) capital account balances reflect each partner's share of the economic interest in the entity. The instructions describe the method as follows:

> **"The amount to report as a partner's beginning capital account under the Section 704(b) method is equal to the partner's Section 704(b) capital account, minus the partner's share of Section 704(c) built-in gain in the partnership's assets, plus the partner's share of Section 704(c) built-in loss in the partnership's assets."**

It is important to note here that Section 743(b) basis adjustments are not taken into account when calculating the partner's basis under this method. The instructions further provide that:

> **"Property contributed to a partnership is Section 704(c) property if, at the time of the contribution, its fair market value differs from its adjusted tax basis. Section 704(c) property also includes property with differences resulting from revaluations (reverse section 704(c) allocations). For more information, see Sections 704(b) and 704(c) and Regulations sections 1.704-1 through 1.704-3."**

What's Next?

We continue to await a final version of the instructions and must stay tuned for further developments. Some comfort is provided by the IRS granting relief to partnerships for certain penalties due to incorrect reporting of partner beginning capital account balances on the partner's 2020 K-1 forms.

Notice 2021-13 grants relief for penalties under Code Sec. 6698, Code Sec. 6721 or Code Sec. 6722 if the partnership can show that it took "ordinary and prudent business care in following the 2020 Form 1065 Instructions to report its partners' beginning capital account balances using any one of the following methods, as outlined in the instructions: the tax basis method, modified outside basis method, modified previously taxed capital method, or section 704(b) method."[8]

Relief provided by the notice is in addition to the reasonable cause exception to penalties; however, a partnership that fails to timely file a 2020 Form 1065 or omits a partner's beginning capital account balance on the Schedule K-1 will not be eligible for relief under the notice.

ABOUT THE AUTHOR: Stephanie Morgan, CPA, MBA, is a Manager in the Business Tax Services Group of RubinBrown LLP. She can be reached at Stephanie.Morgan@RubinBrown.com.

FOOTNOTES

[1] 2018 Instructions for Form 1065
[2] 2018 Instructions for Form 1065
[3] IRS News Release – IRS - 2020-240, October 22, 2020, IRS Releases Draft Form 1065 instructions on partner tax basis capital reporting
[4] Draft 2020 Instructions for Form 1065
[5] Draft 2020 Instructions for Form 1065
[6] 1.743-1(d)(1)
[7] Draft 2020 Instructions for Form 1065
[8] Notice 2021-13

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A SLOW START AND A FAST FINISH

By Kenneth Besserman, JD, TXCPA Director of Government Affairs and Special Counsel

(Author's Note: This article was written the first week of April 2021 with approximately seven weeks left in the legislative session. A supplemental article will be published this summer detailing the final weeks of session.)

The 87th session of the Texas Legislature is beginning its final stretch of one of the most interesting sessions in recent memory and history. With just under two months remaining, we have witnessed everything from pandemic-related health and safety protocols in the Capitol to extended (more than usual) early session recesses to battles over power grid reform to partisan battles over social issues and access to the ballot box.

What we have not seen (at least as of the time of this writing) is a battle over the state budget and redistricting. The decennial battle over redistricting has largely been in the shadows during this legislative session because of the delay associated with states receiving Census numbers with which to draw new state and congressional maps. The latest news from Washington, D.C., is that states will receive their Census numbers in fall 2021, thereby starting the special session and litigation whirlwind that we have become accustomed to in recent decades. Texas is projected to gain three new congressional seats, which will put the pressure on state leaders to balance their party's interests against the growing population centers. Hold on for an interesting fall special session(s).

The debate about the state budget battle is not quite as heated and controversial as had been predicted. The Comptroller's somewhat dire budget predictions of summer 2020 (a possible $4-5 billion deficit) are now just a distant memory.

When the legislature gaveled in on January 12, Comptroller Glenn Hegar's Biennial Revenue Estimate had whittled down the budget deficit to about $1 billion – barely a blip on a $210 billion two-year state budget. The significant uptick in sales tax revenue in the last half of 2020 (online shopping and more retail in-store openings) had brought the state budget predictions back in line and gave the legislature some breathing room to avoid budget cuts or tax increases to close the deficit.

The big unanswered question related to the state budget is the amount, timing and use of federal funds that were allocated to Texas in the 2021 American Rescue Plan Act (ARPA). Projections indicate that Texas is set to receive over $16 billion (some estimates are showing Texas could receive $30+ billion) in federal funds. There are some significant strings attached to the use of those funds – funds cannot be used to supplant or offset any state or local taxes.

Currently, there is no provision in the state budget that addresses the use of ARPA funds. State budget leaders are continuing their conversations with federal officials to better understand the use of these funds.

Bottom line – the large budget cuts of past budget deficit sessions seem to be off the table. The Senate has passed the budget and we are awaiting debate on the House

floor before the bill heads to a conference committee to hammer out a final version of the budget.

Beyond the state budget and redistricting, there are quite a few hot-button issues that are being debated and starting to move through the legislative process. Issues such as abortion restrictions, penalizing cities that decrease police budgets (defunding), election reform, social media censorship prohibitions, transgender restrictions, and permitless/constitutional gun carry have risen the temperature considerably in the legislature and once again placed Texas in the national spotlight on social issues.

Governor Greg Abbott has placed some of these issues on the emergency items list, and Speaker of the House Dade Phelan and Lt. Governor Dan Patrick have also made many of these issues high priority items. In the Senate, legislation has passed to prohibit an abortion after a fetal heartbeat is detected, allowed lawsuits against doctors and providers for providing abortion services, and further limits on funds and information that can be shared with health care providers about abortion services.

In addition, the Senate passed legislation restricting social media companies from censoring or restricting access of a person with whom they may not share the same views. The Senate has also passed "election integrity" legislation, Senate Bill 7, which will tighten up mail-in ballot access, limit early voting locations, prohibit drive-through voting, and allow non-governmental poll watchers to film voters and raise concerns with law enforcement.

As of the time of writing this article, the House has not yet debated these issues on the House floor, but hearings have begun on permitless gun carry legislation, penalizing local jurisdictions for decreasing police budgets and election integrity reform. Hearings in the House tend to be longer and more contentious, making the process of getting to the House floor a little less certain. It is very likely that most of these contentious and highly partisan issues will make it to the House floor in the final months of the session, which will engender long nights on the House floor.

The session got off to a very slow start (even compared to the usual slow start of all Texas legislative sessions). The COVID-19 pandemic and the large increase of positive test results during the winter holiday season pushed the House and Senate to slow down the legislative process during the opening months of the session until vaccines were more widely available and the positivity rate started to decline. That did start to happen in March and April, which was exactly when the pace of the session picked up considerably.

TXCPA Priority Legislation

Thus far, the 87th session has been very good news for TXCPA. On the tax front, there has been no movement on legislation to impose a state sales tax on professional services. The state budget does not appear to need more revenue nor is there an appetite amongst the legislators to raise taxes.

TXCPA has been working closely with our professional colleagues (architects, engineers, realtors and others) to educate and remind the legislature of the reasons why it is not a good idea to tax professional services. During TXCPA's Advocacy Day in January, we had a very good response to maintaining that professional services remain untaxed.

Be sure to watch the session page on the TXCPA website for updates and look for programs and articles in the coming months for a complete recap of the session.

Senate Bill 297 (Sen. Perry), which extends the fingerprinting requirement for CPA license renewals until August 31, 2022, has passed the Senate unanimously and is making its way through the House. TXCPA advocates pushed this issue with legislators during the TXCPA Advocacy Day and during Senate and House hearings, ensuring that the issue was not controversial and had wide support. All signs are positive that this bill will make it to the governor's office.

TXCPA has also been very successful in pushing to make sure that loans forgiven under the Paycheck Protection Program (PPP) are not taxed under the state franchise tax law. House Bill 1195 (Rep. Geren) is extremely important to TXCPA and to businesses that have PPP loans forgiven. Unforeseen and unintended tax consequences could arise if this legislation is not passed. The legislation has passed the House and is predicted to have smooth sailing through the Senate as well.

TXCPA has also been watching for any efforts to deregulate the accounting profession or to lessen any licensing requirements that we have fought so hard for in the past. The good news is that there has been no legislation or talk about any deregulatory efforts of the accounting profession, which will benefit the public and ensure that the profession is being properly and effectively regulated.

Civil liability reform relating to COVID-19 litigation has been front and center this session for TXCPA and the wider business community, and the governor has made this issue a priority. Businesses, business groups, trade associations and the trial bar have been meeting and negotiating on pandemic liability reform.

SB 6 (Hancock) is a priority piece of legislation for TXCPA. It passed the Senate on April 8. Senate Bill 6 is common-sense pandemic liability protection that represents stakeholder consensus on the best way to move forward during and post-pandemic. SB 6 does not provide blanket immunity, nor does it protect bad actors. Instead, SB 6 provides much-deserved protection from litigation for businesses that have acted in good faith during the pandemic. TXCPA has been involved in the stakeholder process.

Since the governor has made this issue a priority, we can look forward to legislation moving toward the end of the session.

This session has been memorable for many reasons – COVID-19, no redistricting debates, an abundance of federal money available and a myriad of controversial issues moving through the legislature. The final weeks are sure to be controversial and interesting.

ABOUT THE AUTHOR: Kenneth Besserman, JD, is TXCPA's Director of Government Affairs and Special Counsel. Contact him at kbesserman@tx.cpa.

Renew Your TXCPA Membership

Thank you for trusting TXCPA as your resource for critical updates and up-to-the-minute news through the last year of change. We have additional programs and services planned for the 2021-2022 membership year and look forward to the opportunity to continue to serve your needs! You can renew online on our website. Please reach out to our member service team if you need assistance or would like to discuss your options for membership renewal.

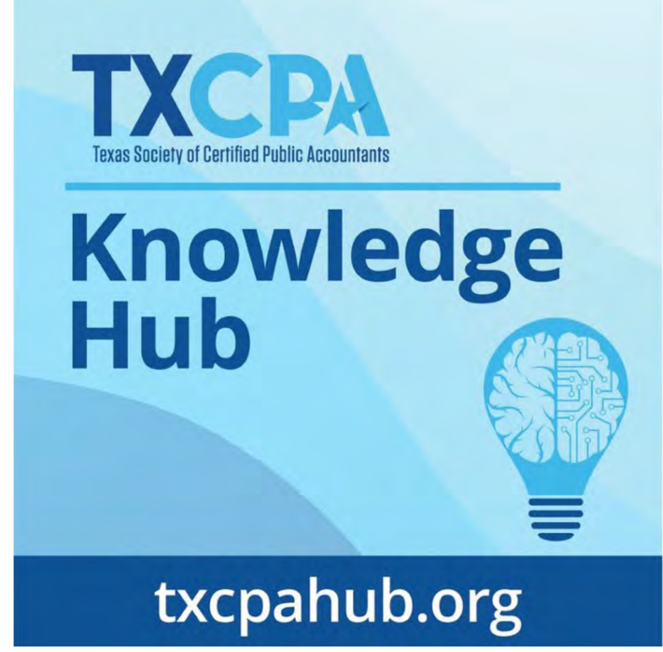
Do you have several TXCPA members who work in your organization? Take advantage of our convenient Group Billing Program. Group billing allows renewal of all memberships within your organization at one time with a single dues invoice. If you'd like to participate in group billing, please contact Stephanie King at sking@tx.cpa or 800-428-0272, ext. 8533.

Thank you for your membership! We are grateful for the opportunity to work with and for you in 2021-2022.

TXCPA Passport: On-demand Webcast Subscription

The TXCPA Passport is an easy, affordable and convenient way to get your CPE hours. For only $199, the one-year subscription gives you unlimited access to one- and two-hour CPE programs that cover a variety of topics, such as tax, accounting, assurance, not-for-profit, and fraud.

Hours and titles are constantly added and refreshed, including 80 new programs that have been added in the last few months! Learn more and purchase your TXCPA Passport now.



Knowledge Hub is an Information Resource for Members

TXCPA's Knowledge Hub provides you insights and thought leadership resources designed to be helpful in your business, practice area or career. You'll find vendor-sponsored white papers, product guides, case studies, industry analysis and much more.

Visit the TXCPA Knowledge Hub today for an extensive library of free downloadable content provided by experts and vendors within fields of accounting.

Exclusively for the Accounting Profession – Reserve Your .CPA Domain!

TXCPA is excited about the launch of the .cpa domain and our partnership with CPA.com, a subsidiary of AICPA. The .cpa domain is a restricted domain available only to CPA firms and individually licensed CPAs.

By adopting a .cpa domain, your digital footprint can now reflect the distinction of being a CPA. This exclusive digital space will also make it more difficult for cyber criminals and malware to carry out malicious attacks, allowing your online interactions to be conducted with a higher degree of integrity and trust.

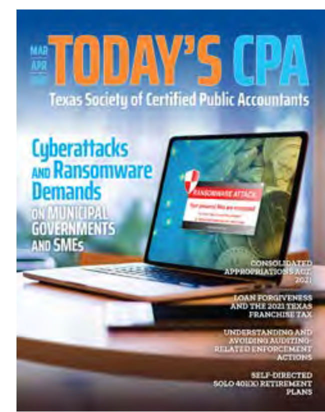
To view a short video about a .cpa domain, please click here. For more information, please visit domains.cpa.

Building Community on TXCPA Exchange

More than ever, members across the state are building community and connecting on TXCPA Exchange! The impacts of COVID-19 on your organization make it important to maintain the connection to your professional community. In addition to our general All Member Forum, there are three interest-area communities – Tax Issues, CPA Practice Management and Nonprofit Accounting.

Log in today to join the conversation, discuss critical issues and actively exchange ideas with your fellow TXCPA members. Don't miss out on this valuable member benefit.

Submit an Article to *Today's CPA* Magazine



The editors of ***Today's CPA*** are seeking article submissions for the magazine. ***Today's CPA*** is a peer-reviewed publication with an Editorial Board consisting of highly respected CPA practitioners.

The publication features articles and columns that focus on issues, trends and developments affecting CPAs in all facets of business. If you would like to submit an article for consideration or to learn more, please contact Managing Editor DeLynn Deakins at ddeakins@tx.cpa or Technical Editor Brinn Serbanic, CPA, CFP™, at technicaleditor@tx.cpa.

Post or Find a Job on TXCPA's Career Center

TXCPA's online Career Center is an outstanding resource for members who are searching for a new job or looking to hire the right candidate. TXCPA members receive exclusive savings on postings and can select options that provide enhanced visibility of their openings. Check out the Career Center for job opportunities aimed specifically at accounting and finance professionals.

AICPA Credentials: Increase Opportunities, Credibility and Earning Power

To succeed in an increasingly crowded marketplace, many CPAs are leveraging the rapid growth of advisory services by choosing to offer specialized knowledge to their clients or employers.

AICPA offers exclusive credentials for qualified financial professionals – Certified in Financial Forensics (CFF®), Personal Financial Specialist (PFS™), Accredited in Business Valuation (ABV®), Certified Information Technology Professional (CITP®) and the Certified in Entity and Intangible Valuations (CEIVTM) – that can differentiate you as having knowledge and expertise in a specialty practice area, giving you, your firm or your organization a competitive advantage.

Many firms seek out employees with AICPA credentials because they are able to do more for their clients, serving them in new ways. Likewise, organizations reward their employees who can provide in-house expertise that helps meet business and operational goals.

For Jolene Fraser, CPA/CFF, CFE, managing director at EisnerAmper LLP, pursuing an AICPA specialized credential was second nature. She's always been good with numbers and worked as an auditor in a Big 8 firm. After 10 years in public accounting, a colleague

introduced her to forensic accounting. Right away, she knew this specialty was something she wanted to pursue as a career.

"Testifying as an expert requires a huge amount of credibility. The CFF credential, and the fact that it's backed by AICPA, gives me that credibility," she said. It has also led to many referrals from attorneys, who are much more likely to call on CFF credential holders than non-credential holders.

Adding one of these credentials can broaden your career options, expand your practice, increase client retention, strengthen your credibility and help you stand out within the accounting profession. To learn more, go to AICPA's website.

Become a

PEER REVIEWER

Grow your practice and lead the profession!

Visit aicpa.org/BeAReviewer to learn more about the requirements

-OR-

Call 800-428-0272 (option 2) to find out how you can be a peer reviewer in Texas

TXCPA

Adding peer review as a practice area provides distinct advantages for firms:

- Increases the visibility of your firm statewide
- Keeps peer reviewers on staff up-to-date on standards and exposes them to various audit processes that may enhance your firm's work in auditing
- Provides a prime new revenue opportunity, allowing you to charge your standard fee for this new line of service

TXCPA Virtual Annual Meeting of Members

TXCPA's Annual Meeting of Members is again moving to an online format this year. All members are invited to participate in this interactive meeting. Hear updates on professional issues and Society business, participate in a virtual networking session and help us honor our 2020-2021 award recipients.

Mark your calendar:
Thursday, June 24, 2021 - 9 a.m. - 12:30 p.m.
Friday, June 25, 2021 - 9 a.m. - 12:30 p.m.
Virtual Networking - June 24, 2021 - 4-5 p.m.

Watch your email and TXCPA member communications for registration details coming soon!

TXCPA thanks our meeting sponsor Goodman Financial and award presentation sponsor CPACharge!

TXCPA'S 2020-2021 YEAR IN REVIEW

By DeLynn Deakins, *Today's CPA* Managing Editor

In a year shaped by the global pandemic and fast-moving change, there has never been a more pressing need for the support of TXCPA and your professional community. The impact of COVID-19 on businesses, individuals and their livelihoods brought a rigorous and far-reaching legislative response, making it critical for CPAs to understand compliance, navigate the complexity, identify opportunities, and prepare for what comes next.

Through these times, TXCPA remained vigilant to deliver on our charge to empower members to lead and succeed. With the continued commitment and dedication of our leaders and members, TXCPA and our chapters focused on our three pillars of success to promote Community and Connection, Professional Excellence and Advocacy for Texas CPAs. As we look back at the 2020-2021 year at TXCPA, the value of belonging to this organization is more apparent than ever.

Community and Connection

COVID-19 brought an accelerated transformation in how and where we work. In a series of surveys, TXCPA and several other state CPA societies surveyed members to learn more about how the pandemic was impacting them and how we could better serve members' needs. TXCPA and our 20 chapters used the feedback to develop programming and resources that would allow members to stay connected at a time when we could not be together in person.

TXCPA took advantage of technology to help members stay informed and engaged. Conversations on the TXCPA Exchange member communities were dynamic and informative as CPAs actively exchanged ideas, asked questions, discussed important issues, and offered

COMMUNITY & CONNECTION
Provide members with opportunities and resources to connect, serve and lead.

PROFESSIONAL EXCELLENCE
Provide resources to assist members in the achievement of professional and personal success.

ADVOCACY
Be the voice of our members before public policy makers and the public.

their feedback, leveraging the knowledge of thousands of members to find what they needed to know.

Our social media communities also grew, giving members a sense of connection to their professional community during a time of social distancing. Our popular Facebook Live Fridays covered critical updates and the latest news of the week. More than 16,000 viewers had access to 18 hours of content provided on Facebook over the past year. Members can join us on our Facebook page at 10 a.m. on Fridays or watch the replay to hear these lively discussions.

Community service also remained strong despite the pandemic. TXCPA's Month of Service in December shone the spotlight on our members, chapters and firms who found ways to safely give back to the communities where they live and work. With a statewide focus on financial literacy education and service, resources were extended to various organizations across the state to help Texans build a stronger financial foundation.

Professional Excellence

TXCPA continued to expand digital learning opportunities, with hundreds of course offerings delivered virtually to keep members updated and educated on all the changes that have impacted the accounting profession.

We provided a host of highly rated free and low-cost learning opportunities during the year. Members receive at least 20

Article continues on page 23

POWERING PAYMENTS
FOR ACCOUNTING PROFESSIONALS

CPACHARGE
AN AFFINIPAY SOLUTION

THE WAY CPAs GET PAID

CPACharge is specifically designed to help CPAs, enrolled agents, and accountants accept credit, debit, and eCheck payments from their clients.

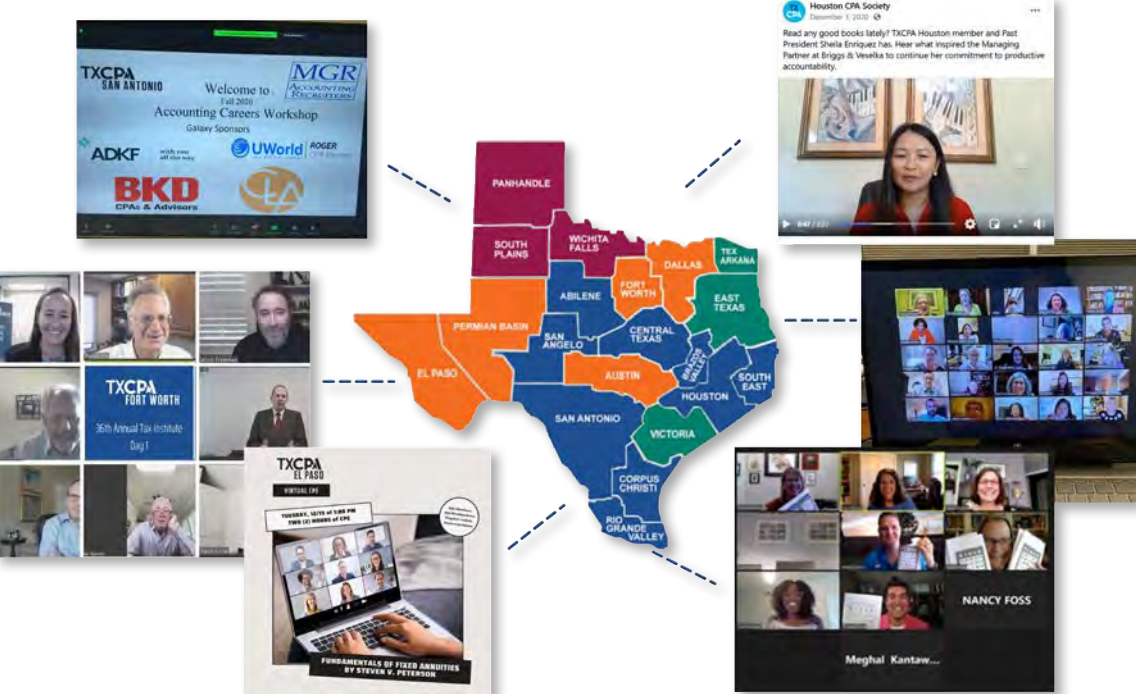
As the ability to accept payments digitally becomes a critical piece of your practice, CPACharge provides the most proven solution for your firm. We are trusted by over 150,000 professionals and a vetted member program through 30+ state CPA societies and the AICPA.

Affordable and easy-to-use, CPACharge exceeds standards for internet security and PCI Level 1 compliance. In addition, there are no long-term contracts or setup fees to get started. Your firm benefits from simplified reporting and reconciliation created specifically for how financial professionals run their offices. CPACharge has the right features and functionality needed to help ensure your firm's success.

TXCPA
Texas Society of Certified Public Accountants

TXCPA MEMBERS CAN VISIT:
cpacharge.com/txcpa
877-618-4668

CPACharge is a registered agent of Wells Fargo Bank N.A., Concord, CA and Synovus Bank, Columbus, GA.



hours of free CPE included with their annual renewal, resulting in even greater membership value. More information about these free learning opportunities is available on our website.

Our member communications ramped up with timely updates and alerts as new guidance was issued and questions were answered. The focus remained on helping our members stay informed so they can better serve their clients and employers.

IN THE MIDST OF A GLOBAL PANDEMIC, **TXCPA'S MEMBERSHIP IN 2020-2021 HELD STEADY** WHEN COMPARED TO THE PRIOR YEAR.

The availability of online learning became critical when we were not able to provide traditional classroom courses and the need for the latest information was higher than ever before. The TXCPA Passport, a subscription for on-demand CPE, was even more valuable for members during a time when live programming was not available. For only $199, you receive unlimited access to one- and two-hour CPE programs that cover a variety of topics, including 80 new programs added in the last several months.

Diversity and Inclusion – A Community for All CPAs in Texas

The Diversity and Inclusion Committee engaged with others across the Society to help educate, inform and work to effect change so that TXCPA can truly be a community for ALL CPAs in Texas, where ALL feel a sense of belonging. Our statement on diversity and inclusion was updated this year:

Our Commitment to Diversity, Equity, Inclusion and Belonging

"TXCPA values the diverse contributions and talents of all its members. We are committed to promoting diversity, equity, inclusion and a sense of belonging in the workplace, in membership and in the accounting profession. Diversity includes, but is not limited to, race, gender, generations, abilities, orientation, and religious beliefs."

- Adopted by the TXCPA Executive Board, 2020

TXCPA also supported at least 14 TXCPA chapters as they also transitioned their programming to a virtual environment.

MEMBERS RECEIVE AT LEAST 20 HOURS OF FREE CPE INCLUDED WITH THEIR ANNUAL RENEWAL.

In response to how the impacts of COVID-19 could potentially affect firm peer reviews, the AICPA Peer Review Board (PRB) temporarily relaxed the requirements for system reviews performed at a location other than the reviewed firm's office. TXCPA's Peer Review team worked tirelessly with firms and reviewers to manage extensions, reschedule review dates and help manage the review backlog created by the pandemic.

Advocacy

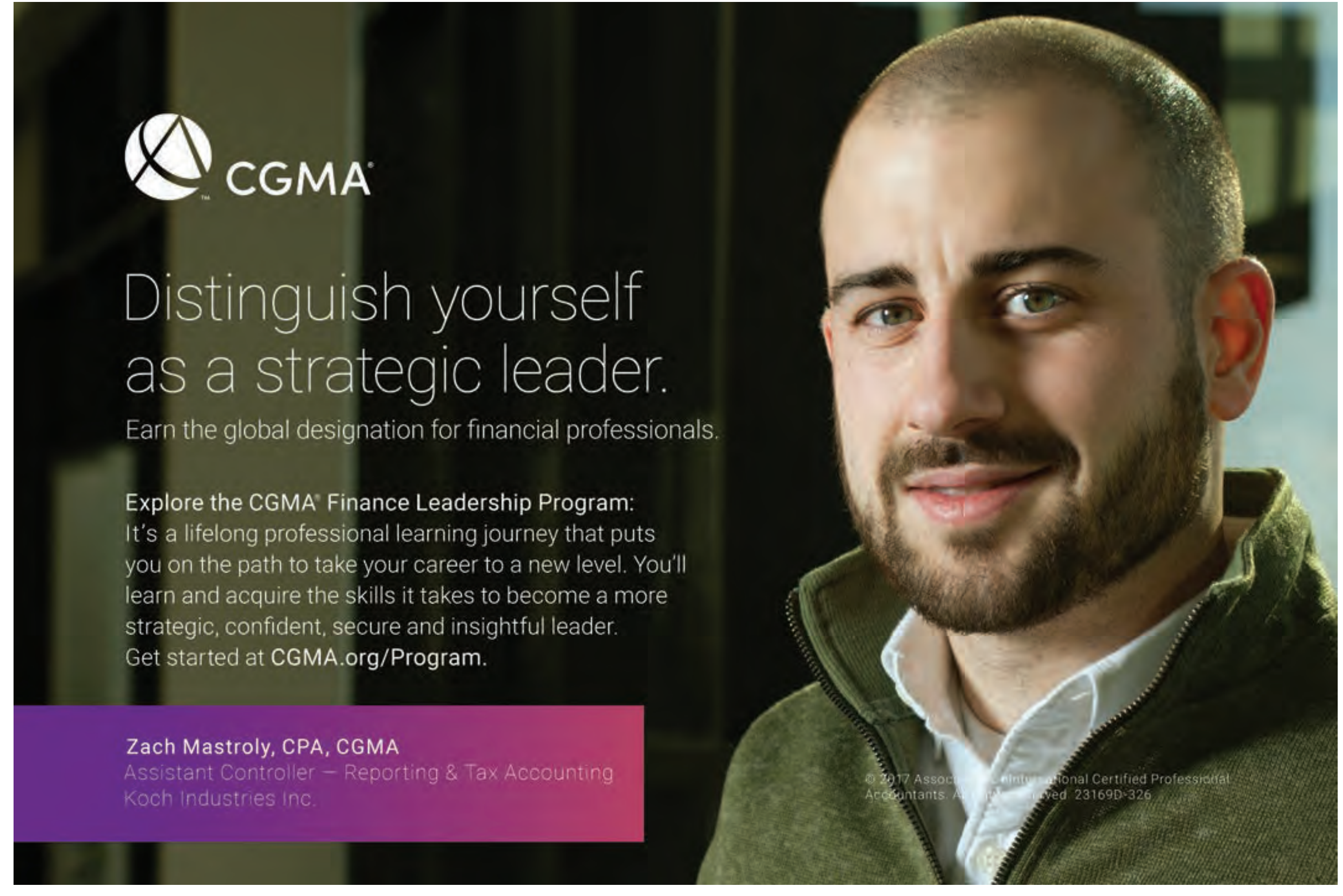
Legislative advocacy remains a central part of protecting the value of your CPA license and promoting the interests of Texas CPAs. As the state's largest association of CPAs and finance professionals, we serve a critical role by defending against legislation and requirements that might be detrimental to you.

The 87th session of the Texas Legislature began on January 12 and ends on May 31. In preparation for the session, our Government Affairs staff and volunteers identified opportunities to cultivate relationships and bolster our connection with like-minded licensed professions, other professional associations and members of the legislature so we could start strong with our messages and our representation of Texas CPAs.

With the session well underway, our volunteers are moving our legislative agenda ahead, watching out for the issues that impact the profession and we're keeping members engaged along the way.

To stay informed on the latest announcements from Austin throughout the session, make sure to check out our legislative session page and ***Last Week in the Legislature*** for up-to-the-minute news, TXCPA legislative agenda successes, notable dates, volunteer information and more. **The Capitol Interest article** in this publication provides an informative discussion and insights from the session.

In addition to representing our interests with governing and legislative bodies in Texas and nationally, TXCPA promotes the value of CPAs to the public and the opportunities in accounting to students across the state. Digital advertising campaigns and virtual career



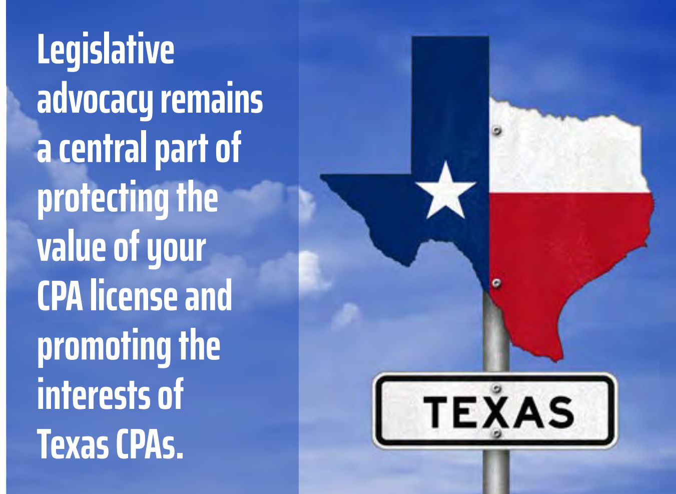
education resources are being utilized so we can keep our momentum and focus on attracting students to the profession and promoting CPAs' services to businesses and individuals across Texas.

Looking Ahead

TXCPA's Strategic Planning Committee developed the 2020-2024 Strategic Plan during the summer of 2020. In the new Strategic Plan, work continues under our three pillars of success. Goals and related progress updates are regularly provided to the TXCPA Executive Board and progress will be reported to the Board of Directors at our Annual Meeting in June 2021. We'll keep you updated on the Strategic Plan through our member communications.

The events of the past year have shown that we are stronger and better when we work as part of a community. TXCPA will remain focused on providing the greatest value, benefit and support to our members.

We're also here to help you get engaged and make the most of your membership. Please reach out to the TXCPA team if you're looking for a way to be connected at the state or chapter level.



Thank you for your membership and for trusting TXCPA as a resource for you and your profession.

Activity in TXCPA's Social Media Communities

June 1, 2020 - March 31, 2021

TXCPA Exchange

Over 1,800 discussion posts across four member communities

Top 5 most searched terms:

- PPP/PPP Loan Forgiveness
- Employee Retention Credit
- CPE
- 7200
- EIDL

Facebook

Total number of followers: 4,163
Number of followers gained: 536

Twitter

Total number of followers: 3,274
Number of followers gained: 73

LinkedIn

Total number of followers: 4,533
Number of followers gained: 785

Instagram

Total number of followers: 1,041

2021 Legislative Priorities

The TXCPA Legislative Advisory Committee and Executive Board approved the 2021 Legislative Priorities in the fall of 2020. The Government Affairs staff and volunteers are focusing on these priorities during the session to make sure that your voices are heard in the Capitol. The priorities include:

- **Sales tax on professional services;**
- **Proper and rigorous regulatory oversight of the accounting profession (opposing the deregulation of the accounting profession);**
- **Extending the fingerprinting deadline for CPA licensees beyond August 2021;**
- **Tax reform (monitoring all tax changes – whether tax rates, deadlines or new taxes – proposed by the legislature); and**
- **Business liability issues.**

Significant progress is being made on our legislative priorities and advocacy efforts. Go to the legislative session page on our website for the latest updates on our successes in advancing our legislative agenda.

FEATURE

$1.9 Trillon American Rescue Plan Act Continues the Pattern of Stimulating the Economy Through Tax Policy

By Don Carpenter and Tim Thomasson

President Joe Biden signed the American Rescue Plan Act of 2021 (ARPA) into law on March 11. Positioned as a necessary financial relief package to aid families disadvantaged by the economic fallout of the pandemic, several major provisions distribute the benefits through changes in tax policy and administration.

This is consistent with the earlier relief contained in the Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 and the Consolidated Appropriations Act of 2021. And although some of the provisions are similar to provisions in these earlier acts, there are modifications that are worth noting.

Recovery Rebates

Likely the most notable provision in the ARPA is the $1,400 economic impact payment to qualified individuals. The impetus for this payment is consistent with the motivations behind the earlier $1,200 payments in the CARES Act and the $600 payments made earlier this year under the Consolidated Appropriations Act. However, significant changes have been made. While this third payment provides a more inclusive definition of a dependent, the income threshold qualifications are more restrictive in response to objections by some senators.

Phase-out of the payment for single taxpayers begins with AGI of $75,000, with complete phase-out at $80,000. Phase-out ranges for married taxpayers and heads of household are $150,000 to $160,000 and $112,500 to $120,000 respectively.

Individuals who are claimed as dependents by another taxpayer are not eligible for direct payment, but the taxpayer who claims the dependent should receive the full $1,400 for each dependent claimed on their return. The prior bills defined dependents as children age 16 or younger and provided reduced amounts for these dependents. Now any dependent with a Social Security number is included in the calculation.

A major revision from the earlier payments relates to mixed-status households. In the current round of distributions, both spouses receive $1,400 if either spouse has a Social Security number. Prior payments required each spouse to have a Social Security number. Further, the ARPA makes clear that incarcerated individuals also qualify for the recovery rebate. This conforms to court decisions on the earlier rebates which overturned an IRS interpretation that disallowed these individuals.

The payments will be based on the most recently filed income tax return. Taxpayers may be advised to delay filing the 2020 tax return if 2019 AGI is lower than the more recent year and phase-out thresholds would be operative. But this must be balanced by how many qualifying dependents are reported on each return.

If the full payment is not received, any balance may be claimed as a credit on the 2021 tax return. For instance, this will occur if a child is born in 2021. Conversely, any excess payment will not have to be repaid.

Unemployment Benefits

The ARPA extends the federal unemployment insurance assistance originally put in place under the CARES Act through September 6, 2021. It increases the total number of weeks of benefits available to individuals who cannot return to work safely from 50 to 79 and continues the federal supplement at the current level of $300 a week beginning March 14 and ending September 6, 2021.

The Senate adopted an amendment to the original House version of the ARPA providing that the first $10,200 of an individual's unemployment income received in 2020 would be exempt from income tax. If married filing jointly, each spouse is allowed the $10,200 exemption for their individual unemployment compensation. The exemption does not apply if AGI exceeds $150,000.

It should be noted that the AGI limit is a cliff without any phase-out range and applies regardless of filing status. Similarly, any exemption amount in excess of actual unemployment compensation received by one spouse cannot be utilized by the other spouse. Taxpayers who have already filed their 2020 income tax returns do not need to file an amended return to claim this benefit. The IRS will refigure the tax liability of a taxpayer under this new provision and will issue additional refunds where appropriate.

Child Tax Credit

The child tax credit for 2021 has been significantly modified to increase and accelerate payments to families with dependent children. To understand the changes, it is helpful to first understand the pre-ARPA credit structure. In 2020, a maximum credit of $2,000 (up to $1,400 of which could be refundable) applied for each dependent child who was 16 or younger at the end of the year. A $500 credit was available for dependents who did not qualify for the child tax credit. Phase-out of the credit began at $200,000 of AGI for single taxpayers ($400,000 for married filing jointly).

For 2021, the credit amount has been increased to $3,600 for any child under six at the end of the year and $3,000 for children from six to 17 years old (an increase from the 16 years-old age limit in prior years). The refundable portion of the credit will increase to $1,500 or $1,800 per child depending on age.

The increased credit is only available for single taxpayers with AGI of less than $75,000 (married filing jointly with AGI of less than $150,000 or head of household of less than $112,500). Those earning more than these limits can still claim the existing $2,000 credit up to the previous phase-out limits. In addition, the prior requirement that the credit could only be claimed by those earning at least $2,500 per year has been eliminated.

Previously, the credit was claimed in total by filing the annual income tax return. This has been modified by allowing taxpayers to elect to receive half of the credit in equal monthly payments spread over

Table 1

Max Earnings, Single/ Head of Household	Max Earnings, Married Jointly	Number of Children	Max EITC
$15,980	$21,920	0	$543
$32,158	$48,108	1	$3,618
$47,915	$53,865	2	$5,980
$51,464	$57,414	3 or more	$6,728

the second half of 2021. The advance payment amount will have to be reconciled with the actual credit determined on the 2021 tax return. The reconciliation includes a safe harbor for taxpayers earning less than an AGI limit.

The thresholds for phase-out range of AGI are between $40,000 to $80,000 for single taxpayers, $60,000 to $120,000 for married filing jointly and $50,000 to $100,000 for heads of household. Qualifying taxpayers can exempt overpayments of up to $2,000 per child.

It should be noted that although the enhanced child tax credit is only effective for 2021, there is discussion within Congress of extending this provision indefinitely.

Child and Dependent Care Credit

In addition to changes in the child tax credit, modifications were made to the credit for the costs of third-party child and dependent care. These changes are effective for 2021 only.

The credit was increased to 50% of up to $8,000 of childcare costs for a child under 13 and up to $16,000 of childcare costs for two or more children. This is a significant increase in both the percentage and the ceiling on allowable costs. The credit can also apply to a spouse or other dependent without age limitations if the individual is physically or mentally incapable of caring for themselves.

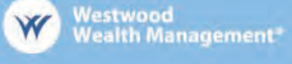
To qualify for the credit, the taxpayer must have earned income of at least $2,500. In addition, the amount of qualified expenses begins to be reduced with AGI of $200,000 for single taxpayers and $400,000 for married filing jointly.

The ARPA also makes the 2021 credit refundable, another change from prior years.

Although not part of the credit, the ARPA increases the amount of employer-provided dependent care assistance that can be excluded from an employee's gross income to $10,500 from $5,000 ($5,250 for married filing separately from $2,500).

Earned Income Tax Credit (EITC)

For 2021, the EITC ranges from $543 to $6,728 (increased from $538 to $6,660) dependent on filing status, number of children and level of



earned income. Table 1 details the interplay between earned income and number of children.

As with the EITC in 2020, taxpayers may calculate their 2021 credit using their 2019 taxable income if it results in a higher credit. The amount of allowable investment income has also been increased from $2,200 to $10,000 before the credit is disallowed.

The qualification for the credit for filers without children has been expanded to include filers 19 or older except for students who must be 24. Qualified former foster or homeless youth qualify if 18 or older. There is no maximum age for the 2021 credit. Previously, taxpayers had to be at least 25 and less than 65 years old.

Also note that the previous law disallowed the EITC to an otherwise eligible individual who could not meet the identification requirements for any qualifying children. Under the ARPA, a qualifying individual who cannot meet the identification requirements for any qualifying children can claim the EITC as a qualifying individual with no children.

Assistance for Health Care

In addition to direct payments and the credits mentioned above, two of the provisions focus on health care. First, the ARPA extends the advance health insurance premium tax credit through 2022. In addition, any excess payment of the 2020 advance premium credit will not have to be repaid. Taxpayers who have received or are approved to receive unemployment in 2021 will be treated as having income no greater than 133% of the federal poverty level, thus providing for the maximum credit.

Further, the ARPA eliminated the cap on credits for taxpayers whose earnings are more than 400% of the federal poverty level. Credits are therefore available to higher income earners purchasing insurance on the public exchanges.

The ARPA also provides for 100% COBRA premium assistance from April 1 to September 30, 2021. The provision does not extend the period of eligibility for COBRA coverage however.

Student Loans

Although the forgiveness of student loans has been a topic of discussion stemming from the election campaigns, the ARPA takes only a small step in that direction. Any discharge of student loan indebtedness after December 31, 2020 and before January 1, 2026 will not result in gross income from forgiveness of debt. The definition of student loans eligible for this exclusion is broad and includes (but is not limited to) those guaranteed by a federal, state or local governmental entity or education institution, and also private education loans (among others).

Employment Credits Extended

The credit for employee retention enacted under the CARES Act has been extended under the ARPA until the end of 2021. The qualifications for the credit have not changed but the reduction in payroll taxes has been expanded to include the Medicare tax.

The ARPA also extends the period for credits for paid sick leave and paid family leave to employers for COVID-19 related absences originally granted in the Families First Coronavirus Response Act. The fully refundable credits offset payroll taxes related to the compensation for the leaves. The limit on the credit for paid family leave has been increased to $12,000.

As part of the extension of the credits, paid time away from work related to vaccination now qualifies. The number of days taken into account for paid sick leave will reset after March 31. In addition, the number of days self-employed individuals can qualify for family leave has been increased from 50 to 60.

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Several Miscellaneous Business Provisions Also Included

Likely the most notable miscellaneous provision is the expansion of Section 162(m) of the Code that generally denies a corporate tax deduction for compensation in excess of $1 million paid to top executive officers of publicly traded companies, known as covered employees. Current regulations apply the limitation to the CEO, CFO and the three next highest paid employees. Beginning in 2027, the limitation will be expanded to include the next five highest paid employees after the current list, bringing the total to 10 employees. The ARPA also repealed the worldwide interest expense allocation, which is generally favorable to corporations in the determination of foreign source income for purposes of the foreign tax credit. The repeal is effective for tax years beginning after December 31, 2020.

The limitation on excess business losses for noncorporate taxpayers under Sec. 461(l) was extended for another year to years ending before January 1, 2027. Losses are limited to $250,000 with indexation for inflation.

Finally, the ARPA provided that Economic Injury Disaster Loan grants or restaurant revitalization grants from the Small Business Administration will not be included in gross income of the recipient nor will any deductions be denied for items funded by the grants. When combined with the CARES Act of 2020 and the Consolidated Appropriations Act of 2021, the American Rescue Plan continues the trend of providing economic relief to a broad section of the population through both direct payments and modification to tax credits.

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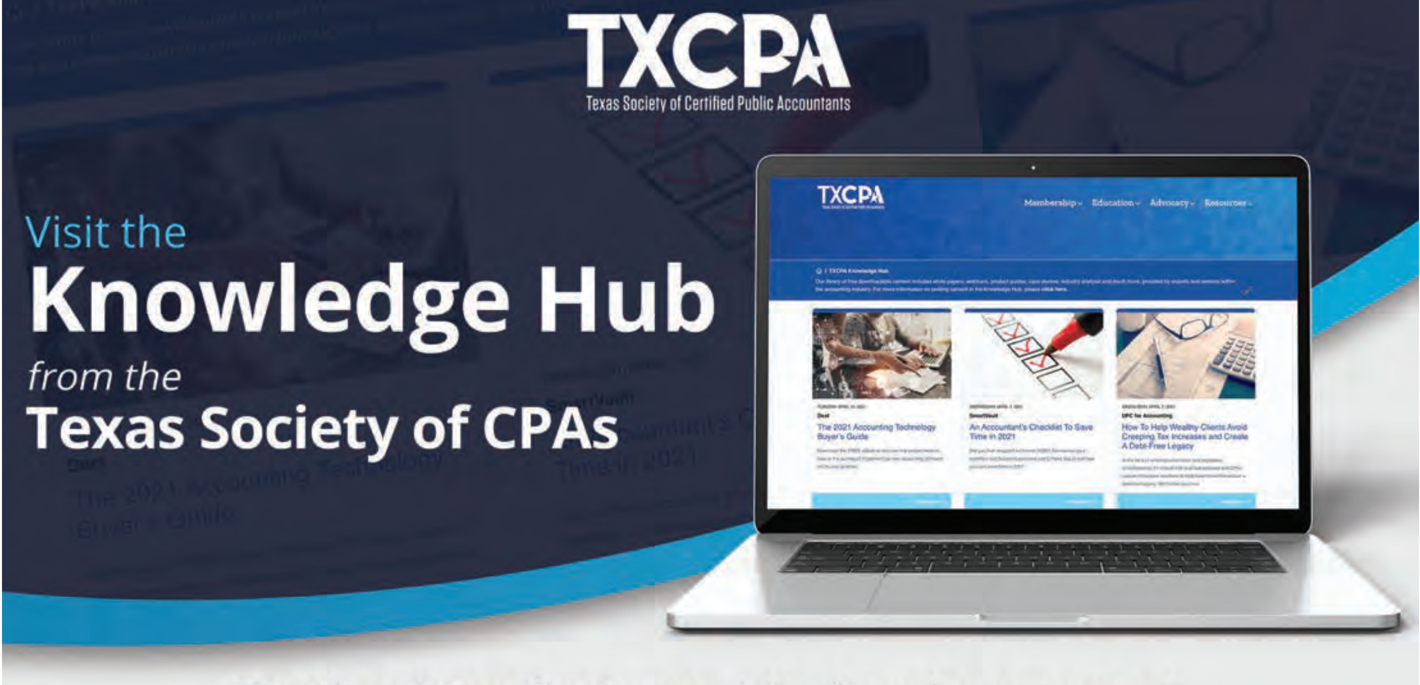

Dread Feedback Conversations?

Try Flipping Them Inside-Out

By Sarah Elliott, PCC, CPA

Do you ever dread giving feedback … even when you know it's important? In the accounting profession, we have a contentious relationship with feedback. Deep down, we know that exchanging feedback, which is simply information regarding prior behavior, can serve as a catalyst for performance improvement.

Yet, if we know this, why do we dread it so much? Why do we see it as something we have to suffer through, rather than the benefits it provides?

When we asked accountants to share the first words that come up for them when they think of exchanging feedback in the workplace, here are some of the positive responses we received:

- Motivating,
- Helpful, and
- Important.

Here are the negative responses we received to the same question:

- Uncomfortable,
- Awkward,
- Ambiguous,
- Inconsistent,
- Time-consuming, and
- Scary.

Isn't this interesting? Feedback is an exchange of information designed to improve performance. Yet, more people view the feedback process as having a negative impact on their life. Something that should be supportive for growth is instead perceived as negative.

It gets worse. Too often, we hear the following: "If I'm not receiving feedback, I assume I'm doing OK" or "No news is good news." These comments are usually shared in a disappointed, deflated tone.

Why do they sound so sad? Statements like these usually indicate the following aspects of a feedback culture:
- Most, if not all, feedback exchanged is negative. "Since feedback is bad, I'm glad I haven't received any."
- Open communication is discouraged. "I'd rather not talk, so I can continue to assume I'm doing OK."
- In the absence of communication, people make assumptions. "I don't know how I'm doing, but since I haven't heard anything, I assume I'm doing OK."
- People feel disempowered and demotivated, since all they have to aim for is "doing OK."

Feedback does not have to be awkward, ambiguous or sad. These conversations can provide amazing opportunities to:
- Embrace our humanity by welcoming vulnerability,
- Practice coaching techniques that empower growth in others, and
- Connect at a deeper level with one another through shared learning.

However, to unlock these opportunities, you must change the way you see and do feedback. Here are four ideas to do just that.

1. Embrace a More Empowering Mindset

A mindset is a set of beliefs or attitudes. These beliefs are manufactured by the mind based on your upbringing, experiences and the accumulation of (mostly unchecked) thoughts you've assimilated over time. A mindset is a lens through which you see the world. It is the birthplace of your actions. How you see the world (your mindset) affects what you do in the world. Therefore, your mindset creates your reality.

If you tend to view it through a negative lens, let's start by examining your beliefs about feedback with the following questions:
- How do you view feedback?
- How do you view others with whom you exchange feedback?
- How do you view your role in feedback?

Thinking that feedback is difficult, awkward and problematic brings negative energy to your conversations about it. If you see other people and their challenges as problems that need to be fixed, you will want to get the conversation with them over with as quickly as possible. The person on the receiving end will feel like they are a problem.

When you see yourself as the bearer of bad news, you may procrastinate on checking this unpleasant task off your to-do list. To provide better feedback, you must first see it differently. You must shift your mindset to one of an investor. Two core beliefs comprise the investor mindset. The first is:

I believe in every person's ability to continually learn and grow (including my own).

When we value all experiences – the successes and the struggles – as an opportunity to learn and grow, we realize them as the gift they truly are. We welcome mistakes as vehicles for learning and progress. This belief strengthens our resilience when times get tough.

This belief also challenges us to notice how we view our colleagues. If you view a colleague as a problem, or as someone who is broken or incapable of change, you limit the possibility of growth for them.

Think of someone you believe is incapable of change. How does this belief impact your interactions with this person? Does it create friction? Does it limit what you talk about with them?

When you show up to a conversation with judgment about the other person, they will sense this and close themselves off to you and your message. Whether consciously or unconsciously, they will resist you and the feedback you are proposing. (Isn't this fascinating? The way we view someone actually perpetuates the beliefs we have about them.)

Instead, what if you simply accept that we are all flawed and also capable of making improvement? How might this new belief impact your feedback conversations?

Take a moment to reflect on your own experience. Has there ever been someone who believed in you – someone who believed you could do hard things, things that you may not have believed you could? (I hope so.) What difference did that make for you?

The greatest gift we can give another human being is to accept them as they are and believe in their potential for growth.

The second core belief of the investor mindset is:

I am committed to my colleagues' growth and will have regular conversations about their performance.

An investor invests time and energy today to pave the way for a better future. An investor cares about how others are doing and actively supports them today to ensure they receive the development they need to thrive for the long-term.

Think about someone who has invested in you and your career. Did you deeply appreciate that person? Don't we all need people who are willing to invest in us?

Imagine how embracing an investor mindset could shift your thoughts and approach to feedback. It could enhance the dynamics of your relationships dramatically, creating

a deeper level of collaboration and trust. By investing, you can make a significant difference in the lives of others!

2. Model Effective Feedback Relationships at the Top

Nothing crushes a culture of feedback more than a group of executive leaders who don't seem to acknowledge the need for it. How often do your executives talk about it and its importance at your organization? What kind of energy and passion do they exude when they talk about it?

Words must be followed by meaningful action. Do executive leaders invest in others by engaging fully in feedback conversations? Do they openly solicit it on their own performance? When executive leaders get vulnerable and participate fully in the process, they create the psychological safety for others to do the same.

3. Start With What's Working Well

Why should we start feedback conversations with the positive? Because it's where the good stuff is!

Correcting someone's mistakes is helpful, but helping them understand what they do well can be even more helpful. You can help them identify their strengths. Our human potential lies in our zone of strength. It's where we feel most alive, do our best work and expand our positive impact.

An investor helps the performer identify what they're doing well because it:

- *Helps them understand what they should continue doing.* Human beings do not automatically repeat what they do well in every situation. We must shine the light on the positive behaviors, so they notice and intentionally continue them.
- *Challenges them to stop seeing feedback as something negative.* CPAs are often hired to find things that are wrong. You're trained to find the errors. (Just think about the last time you received review notes. How many said something positive?) Seeking out errors can become a mindset – a mindset that damages the feedback process. You must focus on what is going well, too, so your feedback provides a complete picture of performance.
- *Eases the way for constructive observations.* If I know you're seeing all of me (not just my errors), I'm much more open to learning where I can improve. I will be less defensive because I understand you're not blaming or judging me. We're learning together. We're on the same team. You're investing in me.

4. Stop Delivering Feedback and Coach Instead

Traditional models focus on the deliverer of feedback (the person who delivers it to the performer of the work). The deliverer does most of the talking by sharing their

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observations and insights. The deliverer must provide insights that are timely, specific and digestible. When the deliverer feels 100% responsible for feedback, if they are feeling unprepared or uncertain of how the receiver will react, they will likely delay or even neglect providing their comments. Valuable learning opportunities are lost.

We propose turning this traditional model inside-out. Shift the responsibility for feedback from the deliverer to the performer. Shift the role of the deliverer from teller to coach.

Thanks to the mindset shift you've made, show up as an investor who believes in the performer's ability to grow and learn. Now, as a coach, facilitate a process for the performer to share their own perspective.

Let go of the pressure to get it perfect. Instead, simply show up as a partner in learning to help the performer uncover their opportunities for growth.

Start with the performer. Instead of feeling like you need to have all the answers, simply ask questions to help the performer reflect on their own performance.

Step 1: Start with what worked well

Ask open-ended, performer-centric questions focused on what worked well, such as:
- **What did you do well on this project?**
- **What did you specifically do to make that happen?**
- **What did you learn?**

Seek to understand the performer's perspective about their performance. Actively listen, repeat what you heard and encourage further observations. Continue asking questions from a place of curiosity.

After the performer shares their perspective, share yours. At this point, the performer has done most of the work, so simply endorse their observations where appropriate and add your own. Note any instances where you may see things differently.

Step 2: Identify opportunities for growth

Then, ask open-ended, performer-centric questions focused on areas for growth, such as:
- **Where did you get stuck on this project?**
- **What did you find most challenging? Why?**
- **What would you do differently next time?**

Allowing the performer to uncover their own challenges takes some of the pressure off you. It also encourages ownership, as the performer takes responsibility for their challenges and the related solutions.

Just as before, actively listen, repeat what you are hearing and encourage further observations on these challenges.

When the performer has shared all their observations, share your own – endorsing, adding to, and revising their observations where appropriate.

Step 3: Summarize the learning and identify action steps

Next, ask the performer to clarify what they learned and uncover the action steps needed to improve their performance:
- **What are you taking away from this conversation?**
- **What are you going to do next?**

As before, actively listen and encourage further observations. Then, endorse, add to, or revise their observations where appropriate.

This step ensures the conversation moves from insight to action. By asking the performer what comes next, you empower them to take responsibility for their further development. After all, it's their career, isn't it?

Step 4: Plan for the next conversation

Before wrapping up the conversation, ask the performer, "When should we meet again?" Remember, as an investor, you committed to having regular conversations with them to support their continued growth. Asking this question creates momentum, consistency and accountability for continued feedback conversations.

Be sure to allow yourself and the performer time to adjust to these new ways of being and doing. This performer-based approach should awaken the performer's observation muscles, so they will be more aware of their own successes and struggles for the next conversation you hold.

By flipping feedback inside-out – using a coaching approach that starts with the performer's perspective – you not only change the process, you transform your relationship with the performer. You become an investor in their success and move from a hierarchical relationship to a partnership, learning together. Opportunities are created to connect at a deeper level, building trust. Individual and collective potential is unlocked at your organization.

Just imagine ... instead of dreading feedback, you can create a culture where you and your colleagues actually look forward to these conversations!

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Embedded Components in Lease and **Non-Lease Arrangements**

By Josef Rashty

CURRICULUM: Accounting and Auditing

LEVEL: Intermediate

DESIGNED FOR: CPAs in industry and public practice

OBJECTIVES: To provide an analytical review of embedded transactions in lease and non-lease arrangements and a general framework that CPAs can reference to research the complexity of the issues involved in an emblematical lease transaction

KEY TOPICS: Latest guidance from the Financial Accounting Standards Board; multiple arrangements as a single contract; related party arrangements; embedded derivatives; lease, non-lease and not contract components; and lessor and lessee accounting

PREREQUISITES: None

ADVANCED PREPARATION: None

This article provides an analytical review of embedded transactions in lease and non-lease arrangements based on ASC 842, *Leases*; ASU 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors;* and ASU 2018-11, *Leases (Topic 842): Targeted Improvements*. There is significant management judgment involved to identify lease and non-lease components of an arrangement, and lessees and lessors may need to probe the nature of an arrangement and often rely on other standards to properly account for them.

Latest Guidance

In July 2018, the Financial Accounting Standards Board (FASB) issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, that provides guidance for separating lease and non-lease components in a contract and allocates the contract consideration into separate components. This ASU provides companies with an additional (and optional) practical expedient transition method to adopt the new lease standard.

In December 2018, FASB issued ASU 2018-20, *Leases (Topic 842): Narrow-Scope Improvements for Lessors*, that requires lessors to analyze sales taxes and other similar taxes on

a jurisdiction-by-jurisdiction basis to determine whether those taxes are the primary obligation of the lessor as owner of the underlying asset being leased or whether the lessors have collected those taxes from the lessees on behalf of third parties. This ASU provides entities with an additional (and optional) practical expedient transition method to adopt the new leases standard.

Embedded Leases

In lease arrangements, one party obtains the right to use an asset legally owned by another party for a period of time. Lease contracts often create a "Right of Use" (ROU) for the lessee that distinguish them from other contracts. However, the right to control the use of an asset may not be necessarily evident in a contract. An embedded lease in a non-lease transaction may have an *ipso facto* claim to be a lease within the scope of ASC 842.

Multiple Arrangements

FASB requires that companies consider multiple arrangements as a single contract for the purpose of identifying embedded leases. Therefore, companies need to expand the scope of their reviews and include any additional contracts that a company has entered into simultaneously or within a short span of time with the lease arrangement to identify any embedded leases (e.g., a service arrangement may contain both lease and non-lease components).

ASC 842 accounting for embedded leases is as follows:

- Lessee classifies the embedded lease component as an operating or finance lease and reflects the ROU and the corresponding lease liability on its balance sheet.
- Lessor classifies the embedded lease component as a sales-type, direct financing or operating lease.

ASC 842-10-25-19 specifies the following criteria to consider in making this determination:

An entity shall combine two or more contracts, at least one of which is or contains a lease, entered into at or near the same time with the same counterparty (or related parties) and consider the contracts as a single transaction if any of the following criteria are met:

a. The contracts are negotiated as a package with the same commercial objective(s).

b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.

c. The rights to use underlying assets conveyed in the contracts (or some of the rights of use conveyed in the contracts) are a single lease component in accordance with paragraph 842-10-15- 28.

Related Party Arrangements

Related parties need to analyze an agreement for its legally enforceable rights to determine if an embedded lease exists. ASC 842-10-55-12 requires that companies perform such analyzes as if the contract was between unrelated parties:

Leases between related parties should be classified in accordance with the lease classification criteria applicable to all other leases on the basis of the legally enforceable terms and conditions of the lease. In the separate financial statements of the related parties, the classification and accounting for the leases should be the same as for leases between unrelated parties.

Embedded Derivatives in Lease Arrangements

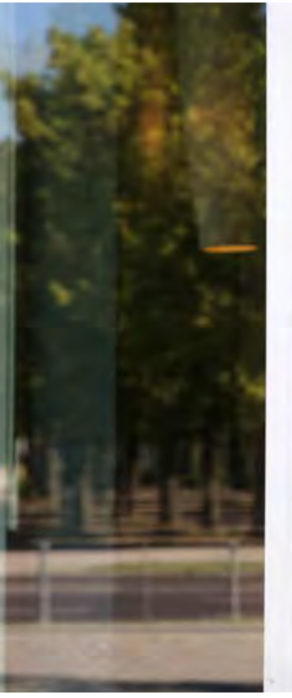
There may be other transactions embedded in a lease arrangement that may need to be priced or bifurcated and accounted for separately. ASC 815, *Derivatives and Hedging*, excludes leases from its scope, but nevertheless lease arrangements may contain embedded derivatives. If so, companies may need to bifurcate and account for them based on ASC 815 (ASC 815-10-15-79).

For example, a residual value guarantee grants holder a put right, which can potentially be an embedded derivative. ASC 815-10-15-80 excludes residual value guarantees that are subject to the requirement of Topic 840 from the scope of Topic 815, but ASC 815-10-15-81, on the other hand, includes residual value guarantees that has a third-party residual value guarantor within the scope of Topic 815. As a result, lessors must determine whether such residual guarantees are derivative instruments and if they qualify for any scope exception under Topic 815.

If a lease arrangement contains an embedded derivative, the embedded derivative should be separated from its host contract if the following two conditions exist:

- It is not "clearly and closely related" to its host contract pursuant to ASC 815-15-30.
- ASC 815 would consider it a derivative if it were a separate instrument.

FASB requires an analysis of both quantitative and qualitative considerations to arrive at "clearly and closely related" criterion (ASC 815-15-31). If the embedded derivative is not "clearly and closely related" to the lease agreement, it must be bifurcated and accounted for separately from the contract (possibly as a derivative under ASC 815).



The following examples illustrate partial application of a "clearly and closely related" criterion:

- FASB considers inflation-indexed lease arrangements that vary based on increases in CPI (customer price index) or PCE (personal-consumption expenditures) as "clearly and closely related." Thus, no bifurcation is required unless there are additional factors involved (e.g., rent payments escalate at a much faster rate than the inflation index).
- FASB does not require any bifurcation for lease arrangements with variable lease payments based on the sales volume. (ASC 815-10-15-59 has an exception for non-exchange-traded contracts.)
- Similarly, FASB does not require any bifurcation for lease arrangements with lease payments based on variable interest rates.

The following examples partially illustrate the situations that the elements of a lease arrangement are not "clearly and closely related:"

- Leveraged inflation indexes that are, for example, two times greater than CPI (ASC 815-15-25 (Q&A 31)).
- Inflation index adjustments that are different from the indexes in the environment that the company is operating in (e.g., a U.S.-based company with operations based solely in the U.S. uses Venezuelan inflation rate).
- Certain lease payables in foreign currency (a currency other than the company's functional currency) (ASC 815-15-25 (Q&A 02)).

The following is a partial list of potentially embedded derivatives:

- Option arrangements for purchase or repurchase of a lease item or options for renewal of lease arrangements.
- Certain indexed rental payments.
- Additional payments contingent on the occurrence of certain outside events or achieving a certain outside threshold.
- Rental payments dominated in a foreign currency.

Companies must analyze the terms of any lease arrangement that contains the above and similar provisions to determine whether they meet the definition of a derivative under ASC 815-10-15-83 and, if so, FASB requires that companies follow Topic 815 accounting.

Lease Components, Non-Lease Components and Not Contract Components

Lease components are elements of arrangement that provide lessees with ROU of leased assets, whereas non-lease components do not provide lessees with any ROU. For example, if the lessor of a real estate property provides landscaping services for the property that it leases, the arrangement has two components: the lease component that provides ROU to the lessee and the non-lease component for landscaping services that lessee subsequently reimburses the amount to the lessor (ASC 842-10-15-30).

FASB requires companies to account for the non-lease components of their lease contracts under their relevant applicable standards. Therefore, lease arrangements

may contain payments for lease components, non-lease components and items that are not considered contract components:

- Lease components are elements of the arrangement that provide the customer with the right to use an asset (e.g., lease of equipment or real estate).
- Non-lease components are distinct elements of an arrangement that are not related to securing the use of the leased asset (e.g., training or maintenance services for the leased asset).
- Not contract components of an arrangement are not related to lease services (e.g., reimbursement of certain lessors' costs such as property taxes and insurance) (ASC 842-10-15-30).

Once lessors and lessees have determined the components of an arrangement, they should allocate the value of the contract between different components based on ASC 842-10-15-28 through ASC 842-10-15-42.

Lessor Accounting

Practical Expedient

Lessors can follow a practical expedient, which, if elected, allows them to aggregate lease and non-lease components, if the following conditions exist, and account for them as a single component (ASC 842-10-15-37 and ASU 2018-20):

- Lease and non-lease components have similar timing and pattern of transfer.
- The standalone lease is classified as an operating lease if accounted for separately (i.e., the lessor does not perform a lease classification test).

In this practical expedient, if the non-lease component of an arrangement is predominant, lessor accounts for the arrangement as a single performance obligation based on ASC 606, *Revenue from Contracts with Customers* (including the variable consideration guidance). However, if the lease component is predominant, lessor accounts for the arrangement as a single component based on ASC 842, *Leases*.

Non-Practical Expedient

Fixed Payments. Lessors allocate fixed payments that include both lease and non-lease components to each component based on their relative standalone prices.

Variable Payments. Lessors allocate (rather than recognize) certain variable payments to lease and non-lease components of an arrangement. After the allocation, lessors recognize the amount of variable payments allocated to the lease components as income (ASC 842-10-15-40) as they are earned, while they recognize the amount of variable payments allocated to non-lease components in accordance with Topic 606 based on an estimate.

Lessors allocate variable payments that are based on a rate or index and include both lease and non-lease components to each component based on their relative standalone prices (similar to fixed payments discussed earlier based on the applicable rate and index at the commencement date) (ASC 842-10-30-5).

However, for the variable payments that are not based on rate or index and relate to non-lease components, lessors allocate the amount of transaction to specific non-lease components based on ASC 606, *Revenue from Contracts with Customers*. If feasible and consistent with ASC 606, lessors estimate the amount of variable consideration of different components based on their expected values or most likely amounts (ASC 606-10-32-8 through 32-41).

FASB requires companies to account for the non-lease components of their lease contracts under their relevant applicable standards.

If the variable payments are not based on rate or index and relate to lease components, lessors do not include the variability at lease commencement for initial measurement, but allocate the variability to all components based on components' relative standalone prices once variability is eliminated.

Lessee Accounting

Practical Expedient

Lessees can follow a practical expedient, which, if elected, allows them to allocate the aggregate lease and non-lease components as a single lease component (ASC 842-10-15-37). Otherwise, the lessees allocate the consideration in the contract to the separate lease components (ASC 842-10-15-28 through 15-31) based on observable or estimated standalone prices (ASC 842-10-15-33).

Non-Practical Expedient

Fixed Payments. Lessees allocate the lease payments that include both lease and non-lease elements to each component based on their relative standalone prices and account for them under ASC 842. Lessees, unlike lessors, do not have the option of accounting for these transactions under other GAAP Topics (such as ASC 606).

Variable Payments. Lessees allocate variable payments and include both lease and non-lease components to each component based on their relative standalone prices (similar to fixed payments discussed earlier).

Illustration

The following illustration reflects the accounting process for a multi-component arrangement.

Lessor agrees to lease equipment to a lessee for $22,000 for two years. Lessor also provides for two years maintenance services of the equipment for as long as lessee operates the equipment at 80% of its capacity or lower. Lessee reimburses lessor for $22,000 at the beginning of the arrangement and does not expect to exceed the 80% utilization stipulated in the contract.

Lessor concludes that the lease arrangement has a non-lease component as a distinct element. Therefore, it allocates the amount of the agreement to lease and non-lease components based on their relative standalone prices since the payments are fixed.

The standalone components of the arrangement are as follows: $11,000 per year for a total of $22,000 for two years. Maintenance amounts to $1,100 per year for a total of $2,200 for two years. Table 1 reflects the additional information.

Lessee classifies the lease arrangement as an operating lease and, similar to lessor, allocates the lease payments that include both lease and non-lease components to each component based on their relative standalone prices. Therefore, it reflects the journal entry in Table 2 for the first year (ignoring the ROU and the corresponding lease liability journal entry) (ASC 842-10-55-150 through 842-10-55-151 and ASC 842-20-25-6 and 842-20-55-1 through 55-2).

Lessor's allocation of the consideration is the same as lessee (ASC 842-10-55-152 and ASC 842-10-15-39 through 15-40). Lessor's journal entry for the first year for the lease transaction, accounted for as an operating lease, is shown in Table 3.

Embedded Not Contract Components (e.g., Sales Tax and Other Similar Taxes)

The guidance in Topic 842 requires lessors to analyze sales taxes and other similar taxes on a jurisdiction-by-jurisdiction basis to determine whether those taxes are the primary obligation of the lessor as owner of the underlying asset being leased or whether those taxes are collected by the lessor on behalf of third parties.

Table 1.

	Standalone Price	Relative Standalone Price
Equipment	$22,000	$20,000
Maintenance	$2,200	$2,000

Table 2.

Lease expense	$10,000	
Prepayment	$11,000	
Maintenance expense	$1,000	
Cash		$22,000

Table 3.

Cash	$22,000	
Lease revenue (ASC 842)		$10,000
Advance receipts		$10,000
Maintenance revenue (ASC 606)		$1,000
Deferred maintenance revenue		$1,000

Lessor Accounting

Lessors frequently incur certain costs (e.g., sales and property taxes) that they typically recover from lessees. These payments do not result in transfer of any goods or services to the lessee in addition to the lease or any non-lease goods and services included in the lease arrangements (ASC 842-10-15-30(b)).

ASU 2018-20 provides relief to lessors similar to ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*, whereby an entity can make an accounting policy election to exclude or include from revenue amounts collected from customers for sales taxes. ASU 2018-20 provides an accounting policy election for lessors similar to the accounting policy election in ASU 2016-12.

Practical Expedient

Pursuant to ASU 2018-20, lessors, as an accounting policy election (applicable to all of their leases), may choose the practical expedient to present consideration that they receive from lessees or variable payments that they receive from them net of all taxes (ASC 842-10-15-39A).

Thus, lessors do not need to evaluate whether certain sales taxes and other similar taxes are lessors' costs (as described in paragraph 842-10-15-30(b)) or lessees' costs. Instead, lessors account for such taxes as if they were lessees' costs. If so, the lessors need to disclose that election in their financial reports (ASC 842-30-50-14). This is similar to the practical expedient for sellers under Topic 606 (ASC 606-10-32-2A).

Non-Practical Expedient

Lessors make a determination about who has the responsibility for the payment of taxes on jurisdiction-by-jurisdiction basis (i.e., lessee or lessor) and subsequently record the transaction on a gross or net basis:

- On a gross basis, when the lessor is responsible and recovers its costs from the lessee through fixed leased payments, it recognizes its costs and lessee's fixed lease payments separately (on a gross basis) as operating expenses and lease income.
- On a net basis, when lessee is responsible and remits the costs, lessor presents the cost and the lessee's payment on a net basis.

Lessors frequently incur certain costs (e.g., sales and property taxes) that they typically recover from lessees.

Collection for Third Parties

When a lessor collects sales (or other similar) taxes from a lessee on behalf of third parties (that is, the lessor is acting as an agent), the lessor excludes that amount from the (lease) revenue. If the lessor is primarily obligated for payment of the taxes paid by the lessee on behalf of the lessor, the lessor accounts for the payment as a lessor cost and includes that amount in (lease) revenue and costs (ASC 842-10-15-40A).

Embedded Taxes in Non-Lease Components

ASC 842 requires lessors to record revenues and expenses (e.g., taxes and insurance) for the embedded non-lease components at gross level because the costs are the lessor's costs of owning the assets.

This is applicable regardless of whether the expenses are embedded in lease payments, paid by the lessee directly to taxing authorities or service provider directly, or paid by the lessor and subsequently reimbursed by the lessee. This results in higher revenues and expenses for lessors and may also create an administrative burden for them to obtain certain information from lessees.

Lessee Accounting

The treatment of tax payments, assuming that the lessee is the primary obligator for tax, depends on whether the tax is incurred at or before lease commitment or over the lease term (ASC 842-20-25-5 or ASC 842-20-25-6):

- If a lessee makes tax payments at or before lease commencement, consistent with its accounting policy, it can either capitalize it as part of the cost of the RSU asset by analogy to the guidance in Topic 360, *Property, Plant and Equipment*, or it can expense is as incurred.
- If a lessee commits to pay taxes over time, it must recognize the tax obligation at the commencement of the lease in a separate account as a financial liability and as part of the cost of the RSU asset, by analogy to the guidance in Topic 360, *Property, Plant and Equipment*. As an alternative, it can expense the tax obligation as incurred.
- If the lessee makes variable non-lease tax payments, it should recognize it as any other period cost. In other words, it should not recognize it as part of the cost of the ROU asset.

Complexity of Embedded Lease Transactions

Management needs to exercise significant judgment to identify the embedded transactions in an arrangement. For example, a service arrangement that involves the use of a device may contain an embedded lease if the device can be identified implicitly or explicitly and the customer controls this device. Furthermore, an arrangement may contain lease, non-lease or other components. In these scenarios, both lessees and lessors need to identify separate components and properly account for them based on relevant accounting guidance.

The lease guidance and its amendments adduce to several other standards to account for embedded transactions in lease and non-lease arrangements. As a result, it would be challenging for practitioners to navigate through the labyrinth of multiple guidance and decipher all the nuances involved. This article provided a general framework that CPAs can reference to research the complexity of the issues involved in an emblematical lease transaction.

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CPE ARTICLE: EMBEDDED COMPONENTS IN LEASE AND NON-LEASE ARRANGEMENTS

By Josef Rashty

Today's CPA offers the self-study exam for readers to earn one hour of continuing professional education credit. The questions are based on technical information from the preceding article. If you score 70 or better, you will receive a certificate verifying you have earned one hour of CPE credit – granted as of the date the test arrived in the TXCPA office – in accordance with the rules of the Texas State Board of Public Accountancy (TSBPA). If you score below 70, you will receive a letter with your grade.

1. The following guidance is within the scope of this article:
a. ASC 842
b. ASU 2018-11
c. ASU 2018-20
d. All of the above

2. FASB requires that companies consider multiple arrangements as a _______ contract for the purpose of identifying embedded leases if a company has entered into these arrangements simultaneously or within a short span of time.
a. Single
b. Voided
c. Confusing
d. Fraudulent

3. FASB considers inflation-indexed lease arrangements that vary based on increases in CPI (customer price index) or PCE (personal-consumption expenditures) as _______.
a. Irrelevant
b. Clearly and closely related
c. Non-GAAP arrangement
d. Irregular

4. Lessees can follow a practical expedient, which, if elected, allows them to allocate the aggregate lease and non-lease components _______.
a. As multiple leases
b. As they wish
c. Arbitrarily
d. As a single lease component

5. Lessees allocate the fixed lease payments that include both lease and non-lease elements to each component based on their _______ and account for them under ASC 842.
a. Fair values
b. Book values
c. Relative standalone prices
d. None of the above

6. ASU 2018-20 provides relief to lessors similar to the new revenue guidance in ASU 2016-12 that they:
a. Include in revenue amounts collected from customers for sales taxes
b. Exclude from revenue amounts collected from customers for sales taxes
c. Make a policy election to exclude or include from revenue amounts collected from customers for sales taxes
d. None of the above

7. Pursuant to ASU 2018-20, lessors may choose the practical expedient to present consideration that they receive from lessees or variable payments that they receive from them _______.
a. Net of all taxes
b. Gross of all taxes
c. As they wish
d. None of the above

8. On non-expedient cases, when lessee is responsible and remits the costs, lessor presents the cost and the lessee's payment on _______.
a. A gross basis
b. An arbitrary basis
c. A net basis
d. A partially net basis

9. When a lessor collects sales taxes from a lessee on behalf of third parties, the lessor _______ that amount from the (lease) revenue.
a. Includes
b. Excludes
c. Incorporates
d. Either a or b

10. The article claims that lease guidance and its amendments ________ several other standards to account for embedded transactions in lease and non-lease arrangements.
a. Do not rely on
b. Ignore
c. Criticize
d. Adduce to

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$445,000 gross. Heart of Texas CPA firm. 80% tax, (78% inv., 13% bus., 9% other), 11% bkkpng, 9% audits/reviews, cash flow around 43%, staff in place, owner available to stay on as employee after sale if needed. TXC1078

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$209,000 gross. NE Texas CPA firm. 70% tax, 30% acctng, ideal size for marketing-oriented buyer to tap existing client base and grow substantially. TXN1491

$705,000 gross. NW of Dallas CPA firm. Tax (55%), audits (24%), acctng (21%), strong fees, solid cash flow to owner, tenured staff, turn-key practice. TXN1526

$608,000 gross. SW of Ft. Worth CPA firm. Accntng (15%), tax (75%), payroll/compliance/misc. 10%, great location, quality clients, dedicated staff. TXN1534

$158,000 gross. Colony/Frisco, TX area CPA firm. Specializes in tax work, cash flow over 80%, quality client base, incredible growth potential, strong fees, turn-key. TXN1549

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$283,000 gross. SE Texas CPA firm. Tax 60%, bkkpg 40%, turn-key practice with staff in place, friendly clients, owner available to assist through tax season. TXS1232

$423,000 gross. N. Houston CPA firm. Bkkpng, 45%, tax 38%, reviews 13%, other 4%, prime location, great cash flow, loyal client base, seller available for transition. TXS1269

$190,000 gross. NW Houston CPA firm. Tax 76%, bkkpng 24%, staff in place, established client base, great cash flow, office available. TXS1270

$2,441,388 gross. West TX CPA firm. 80% tax (42% individual, 40% business, 18% other), 20% bkkpng, payroll and limited consulting engagements, cash flow over 60%, turn-key practice with staff in place and one partner open to staying on long term. TXW1028

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