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KPMG's U.S. Japanese Practice

JNET NEWSLETTER

U.S. business update for Japanese companies

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Contents

2015 M&A Outlook Survey Report

Foreword

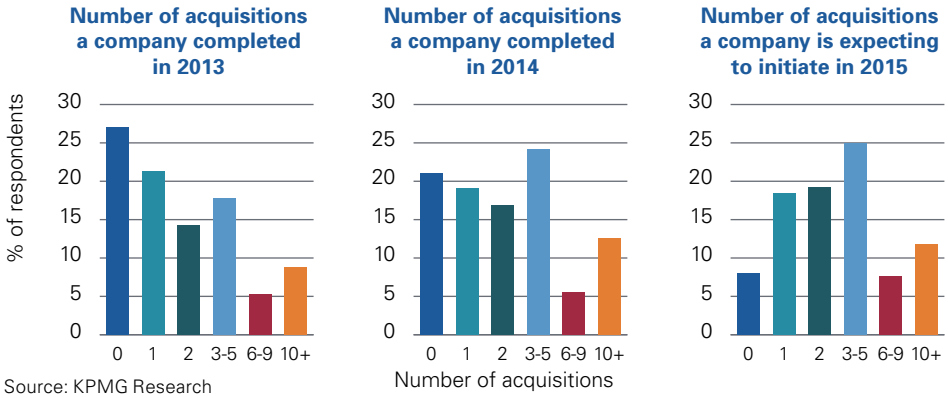
M&A in the U.S. has finally reached pre-recession levels. Deal value in the first three quarters of 2014 reached almost $1 trillion. The 5,843 deals announced during the period are among the highest on record and represent a seven percent increase in volume and a 33 percent increase in value from 2013.[1] The current deal environment is characterized by a large number of mega-deals, including the $71 billion consolidation by Kinder Morgan Inc. of several related entities and the $43 billion acquisition of Covidien Plc. by Medtronic Inc. It appears that deal-makers are willing to pay a significant amount for targets that meet their strategic and growth objectives.

Despite global concerns, U.S. deal makers are encouraged by low interest rates, record stock prices, improving employment numbers, and an abundance of cash.

In order to gain a more precise understanding of where the M&A market is heading, KPMG and Mergers & Acquisitions magazine have conducted a survey of over 735 M&A professionals from U.S. corporations, private equity (PE) firms, and investment banks. Survey respondents mirrored an optimistic marketplace and also indicated they would be active investors in the year ahead. Seventy-nine percent of respondents said their companies or funds had made at least one acquisition in 2014 (compared to 66 percent last year); 17 percent said they had made two acquisitions; 12 percent said they made three acquisitions; and a very acquisitive 13 percent said they made ten or more acquisitions this year.

Acquisition momentum is building

Anticipating that economic and market conditions will remain positive in the U.S., an impressive 82 percent of respondents said they were planning at least one acquisition in 2015; 19 percent planned to make two acquisitions; 11 percent planned three acquisitions and ten percent planned 11 or more deals for the coming year. Respondents plan on doing multiple deals in 2015, reporting considerably more expected acquisitions than in previous years.

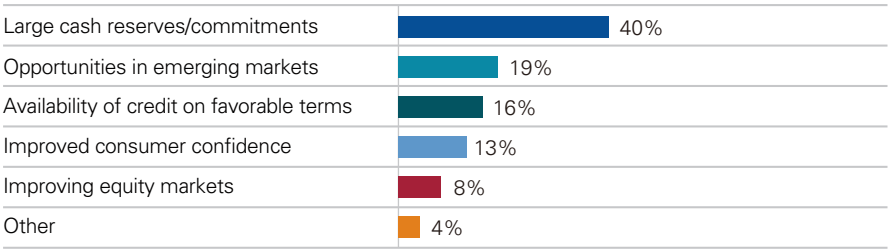


Source: KPMG Research

Survey results point to several macro-economic factors facilitating M&A activity in the coming year. Dan Tiemann, KPMG's National Leader, Transactions & Restructuring, explains, "With growing consumer confidence, favorable credit markets, and limited prospects for organic growth, U.S. companies and sponsors are very comfortable using their balance sheet cash and private equity dry powder to achieve growth through acquisitions."

[1] Thomson Reuters.

Q: Which factor do you think will most drive deal activity in 2015?



Deals will increase because there is "a lot of dry powder and very favorable financing," according to one deal advisor.

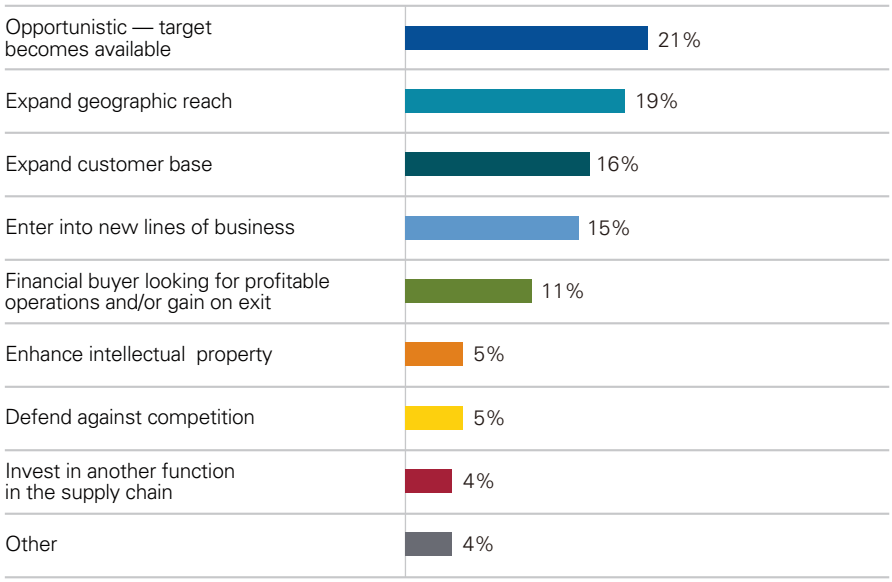
Strategic Opportunities motivate buyers

U.S. companies are always on the lookout for growth. In order to find the right targets, 35 percent of respondents review their portfolio of business units, products, and/or assets for potential acquisition targets on a monthly basis and 27 percent do so quarterly.

Interestingly, when asked what exit strategies companies will prefer in 2015, 64 percent said a sale to a strategic buyer. About 18 percent thought the preferred exit would be a sale to a financial buyer, 10 percent cited an IPO, and 8 percent said companies would choose to refinance or raise debt. However, PE funds do expect to be active in the coming year and 85 percent of those surveyed expect to make at least one investment next year. Marc Moyers, KPMG's National Sector Leader for Private Equity, says "PE investors are encouraged by today's general economic trends, favorable debt terms and available capital. The challenge PE investors face is sourcing quality assets at a reasonable price to generate meaningful returns."

In 2014, global deal value increased at a much higher rate than deal volume, largely caused by a large number of mega-deals. When asked about this phenomenon, several respondents noted that acquirers have learned the lessons of the past and are paying more attention to finding the right strategic fit. As one technology investment advisor noted, "We are seeing clients be more selective with their targets. Hence, while the deal volume has not increased as anticipated, they are willing to pay a premium for targets that meet their selection criteria/growth plans." An industrial manufacturing executive noted that "companies are getting more cautious on the quality of deals; quality trumps quantity as investors also get more critical and request more robust growth strategies."

Q: What is the primary reason for the acquisitions you intend to initiate in 2015?



Despite the enthusiasm for M&A, respondents also intend to pursue additional strategies to increase revenues moving forward. The largest percentage (38 percent), plan to increase revenues through new product development. A significant percentage (28 percent) intend to use geographic expansion or plan to enter new market segments (18 percent).

Deal value expected to climb

Despite the large, headline grabbing deals, such as Facebook's $19 billion acquisition of What'sApp, most respondents continue to believe that the M&A environment will be dominated by smaller and middle-market deals. However, deal values are expected to increase from last year. For their companies, 50 percent of all respondents said that the average enterprise value per acquisition would be less than $250 million. About 27 percent said they anticipated average deal value to be between $250 million and $499 million, 16 percent anticipated average deal value to be between $500 million and $999 million, six percent thought average deal value would be between $1 billion and $5 billion, and less than one percent expected average deal value to be greater than $5 billion. Interestingly, in last year's survey, 77 percent of respondents said they thought the average enterprise values for their acquisitions would be less than $250 million. Deals are getting larger, in part, because corporate profits and corresponding valuations are increasing.

Phil Cioffi, the National Leader of M&A Tax at KPMG, agrees that tax issues remain complex. "Understanding and addressing tax issues as early as possible in the deal process can have a significantly positive effect on deal values," he says. "Do not wait until key deal terms are set. Acquirers should not lose an opportunity to address tax risks and implement the most efficient acquisition structure and most effective post-acquisition integration process."

Deal risks require focus

As deal size increases, the risks associated with deal success become more significant. When asked which factor was most important for success, the largest percentage of respondents (43 percent) cited a well-executed integration plan. "Developing a 100 day plan with a road map for the first few months can greatly improve integration results and enhance the chances of deal success," says KPMG's Tiemann. Other important criteria were correctly valuing the deal (26 percent) and having an effective due diligence plan (18 percent). In terms of integration, the most challenging issues included cultural and human resources issues (53 percent), products and services integration and rationalization (32 percent), accounting and finance transformation (25 percent), and customer and supplier integration and rationalization (23 percent). The most consistently challenging due diligence issues included assessing future revenue streams (51 percent), issues surrounding the quality of earnings (42 percent), cultural and HR issues (28 percent), and cost synergy analysis and quality of assets (both 24 percent).[2]

Divestitures pose their own set of challenges. According to respondents, the most important separation issue that arises during a divestiture is clarifying the operational links/entanglements (28 percent). Other key separation issues included understanding the deal parameters (17 percent), agreeing on the scope of the transition services agreement (16 percent), and helping the buyer quantify stand-alone costs (13 percent). Tiemann notes, "Buyers should be aware that data driven due diligence can mitigate many challenges, including execution issues. Additionally, sellers can use a data driven analysis to enhance the sales process, obtain a higher sales price, and minimize value loss post-close."

Tax implications have had a significant impact on some of this year's larger deals, remain important and should always be considered as early as possible to increase deal benefits. The vast majority of survey respondents (70 percent) said that they do consider tax issues from the outset. About 26 percent look at tax implications after key deal terms have been structured and just four percent said they do not consider tax issues at all. About 42 percent of executives thought that tax issues were currently about the same in terms of level of complexity, but 39 percent thought there were more tax "traps" for the unwary.

[2] Multiple responses permitted.

Industry trends and challenges

Not surprisingly, the industries that were expected to be the most active in terms of M&A are those that are undergoing the most transformation.

Q: Which industries do you think will be the most active in M&A in 2015?

Respondents predict that the most active industry will be healthcare related (84 percent). Other industries that were expected to dominate deal making include technology/media/telecom (62 percent), energy, oil & gas (36 percent), and consumer markets (34 percent).[3]

Predicted M&A by Industry

Each industry is dealing with its own specialized deal environment, as well as industry-specific challenges and opportunities.

[3] Similarly, last year, the most active industries were predicted to be technology/media/telecom, healthcare/pharmaceuticals/life sciences, financial services, and energy. According to Mergermarket, for the first three quarters of 2014, deals were dominated by energy, mining and utilities, consumer markets, industrials and chemicals, financial services, and technology.

Healthcare

As expected, an extremely large percentage of healthcare sector respondents (74 percent) said that the industry response to the Affordable Care Act would be the most significant driver for next year's deal activity. Other important drivers were consolidation of core businesses/competition (45 percent) and the need for consumer growth (26 percent). The most active healthcare subsectors are anticipated to be hospitals (66 percent), managed care (37 percent), diagnostics (21 percent), and pharmaceuticals/biotechnology (21 percent). The most challenging issues for deal makers in this sector include regulatory/political issues, the ability to identify suitable targets, and valuation disparities between buyers and sellers (all at 42 percent).[4]

Technology

The key trends that will drive M&A in this sector include mobile technology (54 percent), cloud (48 percent), data analytics (47 percent), and security (38 percent). Beyond increasing revenues and cutting costs, the primary motivators for technology deals are access to intellectual property and/or talent (50 percent), bolt on acquisitions to enhance new products (42 percent), the acquisition of innovative technologies or products (41 percent), the desire to enter into markets (41 percent), and the desire to expand existing technology platforms (40 percent). The technology executives in the survey overwhelmingly said that the most common challenge to deal making in the year ahead was the valuation disparity between buyers and sellers (67 percent). They were also concerned with the identification of suitable targets (39 percent) and the buyer/target alignment on post- deal execution strategy (25 percent).

Energy

Energy respondents said that deals in their sector were being driven by the consolidation of core businesses and a response to competition (54 percent), the need for geographic growth (39 percent), and the need for new technologies and product and service growth (both 35 percent). The most common M&A challenges are anticipated to be uncertainty in the regulatory environment (48 percent), valuation disparities between buyers and sellers (46 percent), the ability to forecast future performance (35 percent), and volatile energy prices (33 percent).

[4] Multiple responses permitted.

Consumer Markets

Consumer markets respondents believe that the most important M&A trends are consolidation and the response to competition (41 percent), the need for product and service growth (39 percent), and the need for customer growth (36 percent). In terms of divestiture activity, the key trends are the opportunity to sell a non-core business (58 percent), the opportunity to monetize a successful business (43 percent), and the opportunity to sell an unprofitable business (30 percent). The biggest challenges are anticipated to be valuation disparities between buyers and sellers (52 percent), the identification of suitable targets (30 percent), and the ability to forecast future performance (27 percent).

Financial Services

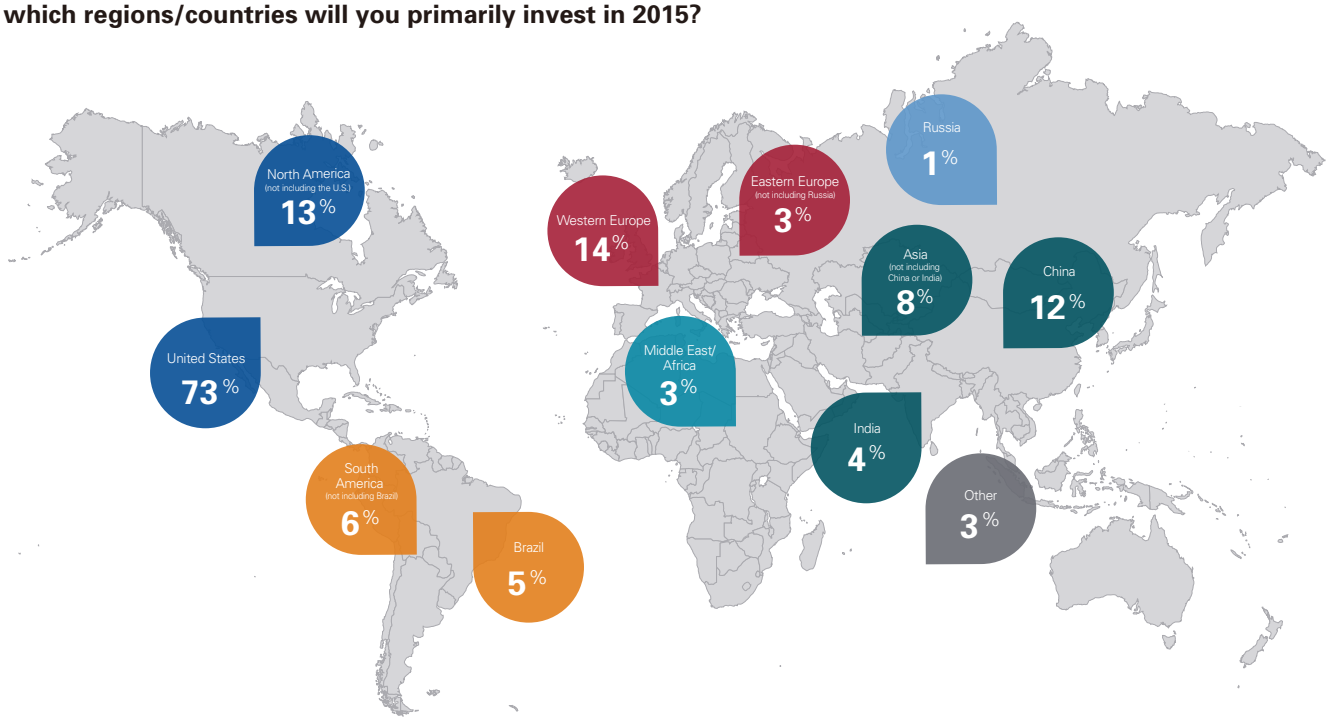
Executives in this sector said that the most important trends driving M&A will be the need for customer growth (42 percent), increasing regulations that favor scale (40 percent), and the need to consolidate core businesses or respond to competition (38 percent). The financial subsectors that are expected to be most attractive include: financial technology (26 percent), banking (21 percent), and insurance (17 percent). The financial services industry continues to receive increased government attention and executives said the number one challenge for dealmakers was uncertainty in the regulatory environment and increased government scrutiny (58 percent). They also cited valuation disparities between buyers and sellers (50 percent) and the identification of suitable targets (40 percent).

Industrial Manufacturing

Respondents in industrial manufacturing said the main trends driving acquisition activity will be the need for market access (51 percent), the need for technology advancement (31 percent), and the need to cut costs (28 percent). Divestitures will be driven by the opportunity to sell non-core businesses (73 percent), the opportunity to monetize a successful business (38 percent), and the opportunity to sell an unprofitable business (32 percent). The most common challenges to deal making are anticipated to be a valuation disparity between buyers and sellers (61 percent), the challenges of identifying suitable targets (39 percent), and the difficulty of forecasting future performance (36 percent).

U.S expected to lead deal activity

Q: In which regions/countries will you primarily invest in 2015?

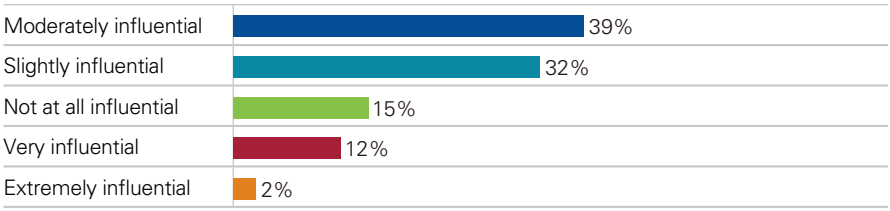


To date, this year the U.S. received over 44 percent of global deal value — one of the largest shares on record. Investors are attracted to the U.S.'s relatively healthy growth rate, improving economy, and open credit markets. Respondents also expect the U.S. to be a popular deal destination in the next year. Phil Isom, KPMG's Global Head of M&A, commented, "although acquirers are always focused on cross-border opportunities, global uncertainty is impacting investment decisions. While U.S. markets remain attractive and stable versus other options, the continued strengthening of the U.S. dollar may negatively impact foreign buyers looking for assets in the U.S."

Government monetary policy only moderately important

While headlines concerning interest rates and Fed policy are a constant, survey respondents said that government policy has only a limited impact on their deal strategies. When asked how the anticipated increase in interest rates would affect M&A in the next two years, 46 percent said that it was too early to tell, 34 percent said there would be no meaningful effect, and 20 percent thought deal volume would decrease. The importance of the Federal Reserve's monetary policy on a company or fund's decision to raise or refinance capital is also mixed. Thirty-nine percent of respondents said Fed policy was moderately influential, 32 percent thought it was slightly influential, and 15 percent said it had no influence.

Q: How influential is the Federal Reserve's monetary policy in your decision to raise or refinance capital?



Over half (54 percent) of respondents expect interest rates to increase in the second half of next year; 23 percent expect rates to increase in the first half of 2015 or in 2016. The current low rate environment has had a positive effect on the stock market; the S&P 500 celebrated multiple record closing prices this year. Is the current market overpriced? The answer is "yes," according to a majority of respondents. Fifty-nine percent of respondents thought so, in contrast to the 41 percent who disagreed. Isom added, "The capital and debt markets outlook remains positive and M&A activity has still not consumed the significant amount of liquidity in the debt markets. This liquidity is leading to lower borrowing costs and more flexible debt packages for M&A transactions, which is supporting accelerated M&A growth in the market."

Conclusion

M&A professionals have waited for several years for the malaise of the recession to pass. It appears that in 2014, deal makers embraced M&A with enthusiasm, and respondents expect 2015 to also be an extremely active year. The fundamentals of healthy credit markets, abundant cash reserves and improving employment numbers all indicate that respondents should be right. Despite the enthusiasm, deal makers recognize that successful deals require superior strategies, comprehensive due diligence, and well-developed integration plans. Once these very complex processes have occurred, deal makers should be on their way to increasing shareholder and investor returns through acquisitions.

About KPMG's M&A Practice

We have structured our approach through an investor's lens to help ensure we are focused on those same characteristics to help our clients identify, evaluate, and successfully implement growth strategies. We use techniques such as benchmarking, strategic profitability insights, and other data and analytics techniques in order to help clients sort through the vast amount of information from a potential target and the marketplace. KPMG's Transactions and Restructuring practice assists clients with evaluation and execution of investments, including M&A transactions, from pre-deal planning and target identification to due diligence and business integration.

Every transaction has tax implications. Whether you are contemplating an acquisition, disposition, merger, or restructuring, understanding and planning for these implications can mitigate transaction risks and enhance opportunities. KPMG's M&A Tax practice assists clients by creating tax efficiencies throughout the life cycle of a client's business.

The private equity industry has become a significant alternative to capital market investments. Value enhancement, performance improvement, and accountability of existing assets have raised the bar for firms to achieve excellence beyond financial engineering. KPMG's Private Equity practice can assist with the unique challenges the industry faces and help deliver on critical aspects of the private equity cycle. The depth of KPMG's Private Equity practice's experience and global network of professionals allows us to be a meaningful value- added partner to our fund clients and their portfolios on an array of service capabilities.

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Questions?

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KPMG Internal Audit - Top 10 in 2015 for Technology Companies

Our annual compilation of Internal Audit considerations for technology companies, "Top 10 in 2015," focuses on the critical role Internal Audit can play in helping companies manage some of their leading risks more effectively in today's challenging environment.

In this year's publication, you will notice the continuing importance of disruptive technologies in determining the focus areas of Internal Audit—both in terms of presenting opportunities and new sources of risk.

Top 10 in 2015:

1. Cybersecurity
2. Intellectual property protection
3. Evolving business models
4. International operations
5. Vendor management
6. Government contracting
7. System implementations and upgrades: Transitioning to the cloud
8. Mergers, acquisitions, and divestitures
9. Revenue from contracts with customers
10. Use of data analytics and continuous monitoring in Internal Audit

The often overlapping relationships among these areas demonstrate how tightly connected our organizations have become in today's global markets. For example, relationships with key business partners often include the exchange of intellectual property, highlighting the importance of monitoring our partners' security frameworks and procedures, as well as performance and contractual compliance.

Similarly, evolving business models are frequently enabled, and supported, by emerging technologies, such as cloud initiatives that can enhance business performance while reducing costs and risk.

These connections highlight the value Internal Audit can provide in helping organizations address these risks holistically, as well as individually.

KPMG LLP's (KPMG) selection of risk areas is based on a number of inputs, including:

- Discussions with chief audit executives at technology companies
- KPMG's Technology Internal Audit share forum
- Insights from KPMG's professionals who work with technology companies
- KPMG survey data.

The top 10 focus areas on the following pages explore the leading risks technology companies face as they evaluate their strategies and make investments. All of these areas highlight the leading exposures companies are working to address as they enter 2015.

Note: Every technology company is unique and it is important that Internal Audit rely on a company-specific analysis of its risks in developing its Internal Audit plan.

For more information, download the full report below.

Download Now

KPMG Internal Audit: Top 10 Considerations in 2015 for Technology Companies >

https://www.kpmg.com/US/en/industry/technology/Documents/top10-in-2015.pdf

Questions? If you have any questions about this article please reach out to your KPMG engagement team or email us at us-kpmg-jp@kpmg.com.

Commodity Trading Companies – Meeting the Challenges of Tax and Regulatory Changes

For companies in the energy and natural resources (ENR) industry, regionally and globally centralized commodity trading companies offer tremendous competitive advantages. But sustaining these advantages is becoming increasingly difficult in the face of increasing regulation, changing market conditions and international tax reforms.

Commodity trading companies – Meeting the challenges of tax and regulatory change is a follow-up to the 2012 report, Commodity trading companies: Centralizing trade as a critical success factor, where ENR tax and management consulting professionals with KPMG International's network of member firms explored the growing popularity of these models and outlined their benefits and risks, commercially and from a tax perspective.

Since 2012, the global landscape for the oil, gas, mining and agricultural industries and commodity traders has changed dramatically. Regulatory changes are taking hold, the direction of international tax reforms is becoming somewhat clearer, and the long-term impact of current pricing volatility, especially for crude oil is unknown - all of which make this an opportune time to take stock of the trends and developments that are transforming the commodity trading sector.

To this end, we sought the views of KPMG ENR professionals around the world to answer these questions:

- How are commercial and regulatory pressures influencing commodity trading business models?
- What aspects of the global movement to address base erosion and profit shifting are creating the biggest challenges for international commodity trading structures?
- How can commodity trading companies meet these challenges and position themselves to thrive in the years to come?

In summary, we describe how global companies can continue to reap substantial benefits from their centralized commodity trading operations - but how their success depends on their ability to navigate and manage a dynamically changing global marketplace.

For more information, download the full report below.

Download Now
Commodity Trading Companies – Meeting the Challenges of Tax and Regulatory Changes >

http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/ENR-tax-commodities-trading-2015.pdf

Questions?
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Auditing & Accounting Update

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

FASB and IASB Propose Clarifications to Revenue Standard

On February 18, 2015, the FASB and the IASB agreed to publish proposed amendments to the new revenue standard in the areas of licenses and identifying separate performance obligations. The changes are intended to address implementation issues in a wide variety of industries, including media, pharmaceuticals, software, and telecommunications. While the FASB proposes to make more extensive and more detailed changes than the IASB, the Boards agreed that the proposed amendments would represent clarifications to the new standard and are not intended to alter its underlying principles.

Go to Defining Issues 15-5 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-5-revenue-clarifications.pdf

FASB Issues New Consolidation Guidance

On February 18, 2015, the FASB issued ASU No. 2015-02, Amendments to the Consolidation Analysis, which changes the way reporting enterprises evaluate whether (a) they should consolidate limited partnerships and similar entities, (b) fees paid to a decision maker or service provider are variable interests in a variable interest entity (VIE), and (c) variable interests in a VIE held by related parties of the reporting enterprise require the reporting enterprise to consolidate the VIE. The ASU eliminates the ASU 2010-10 deferral of the ASU 2009-17 VIE consolidation requirements for certain investment companies and similar entities. In addition, the ASU excludes money market funds that are required to comply with Rule 2a-7 of the Investment Company Act of 1940 or that operate under requirements similar to those in Rule 2a-7 from the U.S. GAAP consolidation requirements. The ASU also significantly changes how to evaluate voting rights for entities that are not similar to limited partnerships when determining whether the entity is a VIE, which may affect entities for which the decision making rights are conveyed though a contractual arrangement.

The ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2015. The effective date is one year later for all other entities. Early adoption is allowed, including early adoption in an interim period. A reporting enterprise may apply a modified retrospective approach or full retrospective application.

Go to Defining Issues 15-6 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-6-consolidation.pdf

FASB Proposes Disclosures for Hybrid Financial Instruments

The FASB invited constituents to comment on a proposed ASU that would require entities to disclose new information about hybrid financial instruments in their financial statements.

Go to Defining Issues 15-7 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/di-15-7-hybrid-financial.pdf

Lease Accounting Discussions Near Completion

Defining Issues 15-8 discusses the FASB and the IASB's significant decisions about lease accounting since October 2014 and provides KPMG's observations about the potential effects of those decisions. In January, the Boards jointly discussed lessee disclosures and subsequently met separately to discuss transition and other topics. As has been the case with each joint meeting since March 2014, the Boards reached converged decisions in the reconsideration of some of their proposals, but they disagreed on other key areas.

Both Boards have substantially concluded their discussions and have directed their respective staffs to begin writing final standards. The standards will contain numerous points of divergence, the most significant of which relate to lessee accounting. Neither Board has decided when the new standards will become effective, but both plan to issue their final standards by the end of 2015.

Go to Defining Issues 15-8 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-8-lease.pdf

FASB Makes Impairment Transition and Disclosure Decisions

At its meetings in February and March 2015, the FASB reached decisions about (1) transition methods for purchased-credit impaired financial assets and other-than-temporarily impaired debt securities and (2) the disclosure requirements under the proposed standard on financial instrument impairment. The FASB directed the staff to draft the final standard, and plans to discuss the effective date at a later meeting.

Go to Defining Issues 15-9 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-9-impairment.pdf

EITF Reaches Two Final Consensuses and Three Consensuses-for-Exposure

On March 19, the FASB's Emerging Issues Task Force met and discussed five issues and reached Final Consensuses on Issue 14-A, "Effects on Historical Earnings per Unit of Master Limited Partnership Dropdown Transactions," and Issue 14-B, "Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)." The Task Force also reached Consensuses-for-Exposure on Issue 15-A, "Application of the Normal Purchases and Normal Sales Scope Exception to Certain Electricity Contracts within Nodal Energy Markets," Issue 15-B, "Recognition of Breakage for Prepaid Stored-Value Cards," and Issue 15-C, "Employee Benefit Plan Simplifications."

Go to Defining Issues 15-10 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-10-eitf-two-final.pdf

FASB and IASB to Propose Additional Revenue Clarifications

At their joint March 18 meeting, the FASB and IASB each proposed amendments to its respective standard about revenue recognition to provide additional practical expedients for transition. The FASB also will propose a practical expedient to allow entities to elect as an accounting policy presenting sales taxes on a net basis, and decided to clarify the guidance about noncash consideration and collectibility. The FASB directed its staff to continue to explore possible clarifications to the principal versus agent guidance. The IASB will monitor the FASB's standard setting to determine whether it needs to change its standard to maintain convergence.

Go to Defining Issues 15-11 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-11-revenue-clarifications.pdf

FASB to Propose One-Year Deferral of Revenue Standard

At its April 1 meeting, the FASB decided to propose a one-year deferral of the effective date of the revenue recognition standard for all entities. Entities should use the extra year to more effectively implement changes to their accounting systems, processes, and controls that will be driven by the standard.

Go to Defining Issues 15-12 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-12-revenue-deferral.pdf

Revenue Transition Group Discusses Consideration Payable to a Customer, Series Guidance

The FASB and IASB's Transition Resource Group for Revenue Recognition met on March 30, and discussed several issues related to the new revenue recognition standard. The Transition Resource Group members agreed with the FASB staff that stakeholders can understand and apply the guidance in the new revenue standard for the majority of the issues discussed. However, for certain issues, the Board may issue additional guidance or undertake standard setting to reduce diversity in practice. The FASB and IASB also are considering how much longer they will accept Transition Resource Group topic submissions.

Go to Defining Issues 15-13 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-13-trg-consideration.pdf

FASB Changes Presentation of Debt Issuance Costs

On April 7, 2015, the issued Accounting Standards Update No.2015-03, Simplifying the Presentation of Debt Issuance Costs.

Upon adoption of this ASU, entities will present debt issuance costs related to a recognized debt liability on the balance

sheet as a direct deduction from the debt liability, similar to the presentation of debt discounts. Entities will no longer record the cost of issuing debt as a separate asset, except when the cost is incurred before receipt of the funding from the associated debt liability. This change will align the presentation of debt issuance costs under U.S. GAAP more closely with the presentation under comparable IFRS.

The ASU is effective for public business entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. It is effective for all other entities for fiscal years beginning after December 15, 2015, and interim periods within fiscal years beginning after December 15, 2016.

Go to Defining Issues 15-14 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-14-presentation-debt.pdf

FASB Issues Guidance on Customer's Accounting for Cloud Computing Fees

On April 15, 2015, FASB issued ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, which clarifies when fees paid by a customer in a cloud computing arrangement relate to the acquisition of a software license, services, or both. The ASU provides criteria for customers in a cloud computing arrangement to determine whether the arrangement includes a license of software. The ASU may affect certain financial metrics such as EBITDA and classifications within the statement of cash flows.

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

SEC Finalizes Revisions for Exempt Offering Rules

On March 25, 2015, the SEC finalized revisions to Regulation A that raise the limit on exempt offerings from $5 million to $50 million within a 12-month period and create a two-tier framework for eligible issuers to follow. The revisions required by the Jumpstart Our Business Startups (JOBS) Act are designed to make it easier for small companies to raise capital while providing meaningful investor protection.

Go to Defining Issues 15-16 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-16-sec-exempt.pdf

FASB Issues Practical Expedient for Measurement Date of an Employer's Defined Benefit Plan

On April 15, 2015, the FASB issued guidance to provide a practical expedient to allow employers with fiscal year-end dates that do not fall on a calendar month-end to adopt a policy to measure pension and postretirement benefit plan assets and obligations as of the calendar month-end date closest to the fiscal year-end.

The FASB also provided a similar practical expedient to allow all employers performing interim remeasurements in response to significant events (e.g., a plan amendment, settlement, or curtailment) that do not fall on a calendar month-end to use the closest month-end date as the measurement date.

The financial statements of employee benefit plans are outside the scope of the amendments.

Go to Defining Issues 15-17 >
http://www.kpmg-institutes.com/content/dam/kpmg/financialreportingnetwork/pdf/2015/defining-issues-15-17-expedient-measurement.pdf

Questions?

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Tax Update

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

April 2015

White House Transmits Japan Protocol to Senate

On April 13, the White House announced that a new Protocol to amend the income tax treaty between the United States and Japan has been transmitted to the Senate.

The Protocol was signed in January 2013 and, once ratified and with its entry into force, would amend the existing United States-Japan income tax treaty (2003) so as to bring that agreement into closer conformity with the current tax treaty policies of both the United States and Japan. The Protocol with Japan now joins other tax treaties and Protocols that are pending action by the Senate — agreements with Switzerland, Luxembourg, Hungary, Chile, Poland, and Spain, and a Protocol amending the OECD convention on mutual administrative assistance in tax matters.

The Senate Foreign Relations Committee has approved and reported five tax treaties and Protocols (agreements with Switzerland, Luxembourg, Hungary, Chile, and the OECD) for action by the full Senate. Historically, unanimous consent motions are the customary procedure for Senate approval of tax treaties, so any senator may prevent approval by objecting. A two-thirds vote after unlimited debate is otherwise required by the Treaty Clause of the U.S. Constitution for ratification. In May 2014, Sen. Rand Paul (R-KY) objected to unanimous consent motions concerning Senate approval of the Protocol to amend the income tax treaty with Switzerland.

NYC Conformity Provisions Enacted

A package of legislation that conforms New York City corporate and banking tax laws to reforms enacted for State purposes last year and makes technical corrections to last year's New York State tax reforms was signed into law by New York State Governor Cuomo. The new legislation is effective retroactively to tax years beginning on or after January 1, 2015.

Like in case of New York State tax reform last year, New York City's general corporate taxis merged with its bank tax. The new City corporate tax, to a considerable extent, mirrors the revised New York State Corporate Franchise Tax and includes the following:

- Taxpayers will pay the highest of (1) tax on business income allocated to New York City, (2) tax on business capital allocated to New York City, or (3) fixed-dollar minimum tax based on New York City source receipts. The subsidiary capital tax is repealed.
- Entire net income tax base and net operating loss (NOL) provisions are substantially revised.
- New customer-based sourcing rules and an 8% election for receipts from qualified financial instruments for receipts factor apportionment purposes are introduced.
- Unitary combined reporting provisions are introduced. The "substantial intercorporate transactions" requirement as a prerequisite to filing a combined return is repealed.

There are certain areas, however, where the City will not conform to New York State law. Most of the areas of non-conformity involve rates.

House Passes Permanent Sales Tax Deduction, Estate Tax Repeal

On April 16, the House of Representatives passed bills that would (1) make permanent a provision to allow individual taxpayers to elect to deduct state and local sales taxes (H.R. 622, State and Local Sales Tax Deduction Fairness Act of 2015) and (2) repeal the federal estate tax (H.R. 1105, Death Tax Repeal Act of 2015).

H.R. 622, which passed the House with a 272-152 vote, would make permanent the ability to elect to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction for state and local income taxes. A version of this provision was made part of the Code on a temporary basis in 2004 and has been the subject of a number of extensions since. Most recently, the provision was made applicable to taxable years beginning before January 1, 2015, as part of the Tax Increase Prevention Act of 2014.

The Death Tax Repeal Act of 2015 was passed by the House with a 240-176 vote. The bill would repeal the estate and generation-skipping transfer (GST) taxes for decedents dying after or transfers made after the enactment of the bill. The bill would not repeal the gift tax but would lower the top marginal gift tax rate to 35%. The lifetime exemption would remain at $5 million (as adjusted for inflation for years after 2011). The bill would not change the current rules for determining tax basis of property received from a decedent or by gift; thus, the basis of property acquired from a decedent's estate generally would continue to be stepped-up.

While the U.S. Senate's plans regarding these bills are unclear at this time, the Obama Administration released Statements of Administrative Policy stating that the administration "strongly opposes" both bills.

Regulations - Allocation of Research Credit Among Members of Controlled Group

On April 2, the Treasury Department and IRS released temporary regulations (T.D. 9717), and by cross-reference, proposed regulations (REG-133489-13) concerning allocation of the research credit to members of a controlled group.

All members of a controlled group are treated as a single taxpayer for purposes of computing the research credit. As the research credit is computed on a group-wide basis, the group credit must be allocated among its members.

For tax years beginning prior to January 1, 2012, regulations required an allocation of the group credit in a two-step procedure:

- First, in proportion to each member's stand-alone entity credit, to the extent that the group credit does not exceed the sum of the stand-alone entity credits of all of the members; and
- Second, if the group credit exceeds this sum, by allocating the excess group credit in proportion to the "qualified research expenses" or QREs of the members of the controlled group.

A provision of the American Taxpayer Relief Act of 2012 (enacted January 2, 2013) requires the allocation of the group credits to each controlled group member based on its share of the QREs for tax years ending after December 31, 2011. In March 2013, the IRS issued Notice 2013-20 providing that controlled groups must allocate the group credit to each member in proportion to each member's contribution of QREs for the tax year without regard to the stand-alone credit amounts of the members.

The temporary regulations released at this time follow the allocation approach in Notice 2013-20. Group members are no longer required to calculate a stand-alone entity credit. The temporary regulations are effective for tax years beginning on or after April 3, 2015 and are scheduled to expire on April 2, 2018. A taxpayer may apply the temporary regulations for tax years beginning after December 31, 2011 but before April 3, 2015. If a taxpayer decides not to apply the temporary regulations for a tax year beginning after 2011 and before April 3, 2015, the provisions of Notice 2013-20 are to apply.

March 2015

2014 APA Statistics Released

On March 30, the IRS released the advance pricing agreement (APA) statistics for calendar year 2014.

Number of Cases:

		2014				Cumulative (Since 1991)
		Unilateral	Bilateral	Multilateral	Total	
Applications Filed		31	74	3	108	1,964
Executed	New	11	42		53	885
	Renewal	9	39		48	516
Pending Requests	New	34	149	4	187	N/A
	Renewal	28	119	2	149	N/A
Canceled or Revoked		0	0	0	0	11
Withdrawn		0	1	0	1	190

Average Number of Months to Complete:

	New	Renewal	Cumulative
Unilateral	26.7	36.9	31.3
Bilateral	44.2	35.7	35.7
Combined	40.5	35.9	35.9

From 2013 to 2014, the number of applications filed slightly decreased from 111 to 108 while the number of cases executed significantly decreased from 145 to 101, resulting in slight increase in the number of pending cases from 331 to 336.

Of the total number of bilateral APAs executed in 2014, 47% of the cases were agreed between the U.S. and Japan, with the other three treaty countries with significant activity being Canada (15%), the United Kingdom (10%), and Korea (8%).

Budget Resolutions Approved by House and Senate

Both the House and the Senate passed their respective versions of the budget on a mostly party-line basis, congressional leaders have set in progress a bicameral negotiation which will begin when an expected conference committee is convened after Congress returns to Washington in early April 2015. The Budget Act provides for final action on the resolution by May 15 although there are no consequences for failure to meet that deadline.

A congressional budget resolution, provided the House and Senate agree to a final version, would establish revenue targets for future appropriations and tax legislation. A budget resolution does not appropriate funds or change tax law, and it is not signed by the president.

The House passed its budget on March 26, after considering several alternative budgets offered by a number of members. The final budget adopted by the House was very similar to the budget approved by the House Budget Committee and include the following tax reform proposals:

- Lower rates for individuals, corporations, and passthrough entities (with a goal of reducing the top individual and corporate tax rates to 25%)
- Repeal of the alternative minimum tax
- Transitioning away from a worldwide tax system to "a more competitive international tax system"
- "Broadening the tax base by closing special interest loopholes that distort economic activity"

- Repeal of "Obamacare" in its entirety, including all the tax increases, mandates, and subsidies included in that legislation

The House budget calls on the Ways and Means Committee to report legislation within its jurisdiction that would have the effect of reducing the deficit $1 billion over 10 years (using macroeconomic estimates), but without increasing revenue relative to current law.

The Senate passed its version of a budget on March 27. During the long floor deliberation, the Senate adopted several dozen amendments to the version of the bill passed by the Senate Budget Committee, including a few amendments that were focused on tax-related matters.

The original proposed budget resolution released by the Senate Budget Committee included the following:

- A $5.1 trillion reduction in spending over the 10-year budget window
- Revising spending and revenue targets of various Senate committees to take into account legislation relating to tax reform, extending certain (unspecified) expired tax provisions, and repealing the medical device excise tax
- Repealing "Obamacare"
- Requiring the Joint Committee on Taxation to provide a macroeconomic estimate of "major" tax legislation—in addition to the "conventional" revenue estimate
- Changing certain Senate procedural rules relevant to tax legislation

Among the amendments to the budget resolution adopted by the Senate were those addressing the following tax-related issues:

- Support for extending and expanding refundable tax provisions that benefit working families, childless workers, and the middle class
- Opposition to federal taxes or fees imposed on carbon emissions from any product or entity that is a direct or indirect source of emissions
- Support for permanently increasing the maximum amount of the section 179 small business expensing allowance to $1 million and the investment limitation to $2.5 million and indexing them both for inflation
- Support for an undefined decrease in the corporate income tax as a method for preventing U.S. jobs from being moved overseas
- Repeal of the federal estate tax

Democratic Report on Tax Avoidance Strategies

On March 3, coinciding with a Senate Finance Committee hearing focusing on "tax fairness," ranking member Senator Ron Wyden (D-OR) released a report that identifies the six strategies identified by his staff as "tax avoidance" as well as broad policy and regulatory recommendations by his tax staff to address some of these strategies. Among the items listed in Senator Wyden's report as tax avoidance strategies are the following:

- Using collars to avoid paying capital gains taxes
- Using wash sales to time the recognition of capital income
- Using derivatives to convert ordinary income to capital gains or convert capital losses to ordinary losses
- Using derivatives to avoid constructive ownership rules for partnership interests
- Using basket options to convert short-term gains into long-term gains
- Avoiding income taxes under nonqualified deferred compensation plans

February 2015

Tax Proposals in FY 2016 Budget

On February 2, President Obama transmitted to Congress his fiscal year (FY) 2016 budget, containing the administration's recommendations to Congress for spending and taxation for the fiscal year that begins on October 1, 2015.

Overview:

The president proposes expenditures for discretionary programs $74 billion above the spending caps set in the Budget Control Act of 2011, divided roughly equally between defense ($561 billion) and nondefense ($530 billion) discretionary programs.

The president also proposes a six-year $478 billion program for transportation infrastructure, the cost of which would be offset in part by a one-time tax on the unrepatriated foreign earnings of U.S. multinational corporations. The tax on unrepatriated earnings would be part of a transition to a proposed fundamental change in the taxation of the future foreign earnings of U.S. corporations, which would be taxed on a current basis at a reduced rate.

The president proposes reducing the corporate income tax rate to 28%, but the budget does not provide revenue to offset the cost of such a reduction. Instead, the budget refers only to eliminating tax expenditures, such as accelerated depreciation and "reducing the tax preference for debt financed investment."

For individuals, the president proposes to increase the rate of tax on capital gains for certain high earning individuals. In addition, bequests and gifts would be treated as realization events for purposes of taxing capital gains—a fundamental change in the taxation of estates.

Business tax provisions:

Many business tax proposals in the FY 2016 budget are familiar, having been included in previous budgets, such as:

- Reforms to the international tax system
- Limiting the ability of domestic entities to expatriate
- Repeal of natural resources production preferences
- Repeal of LIFO and LCM accounting
- Taxation of carried interests in partnerships as ordinary income
- Insurance industry reforms
- Marking financial derivatives to market
- Modification of the like-kind exchange rules
- Modification of the depreciation rules for corporate aircraft
- Denying a deduction for punitive damages
- Make permanent and reform the credit for research and experimentation
- Make permanent the Subpart F exception for active financing income
- Make permanent look-through treatment of payments between related CFCs

Some previous proposals have been modified significantly.

The rate of tax on the liabilities of financial institutions with assets in excess of $50 billion would be reduced from 17 basis points to 7 basis points, but the application of the tax would be broadened to include insurance companies, savings and loan holding companies, exchanges, asset managers, broker-dealers, specialty finance corporations, and financial captives. These changes have roughly doubled the revenue relative to the proposal in the FY 2015 budget.

The FY 2016 budget also includes a number of new and significant proposals. Chief among these is a fundamental reform of the system of taxation of the foreign earnings of U.S. companies, which would raise $474 billion over 10 years. In place of the current system of deferral, the budget proposal would impose a minimum tax on foreign earnings above a risk-free return on equity invested in active assets. The minimum tax, imposed on a country-by-country basis, would be set at 19% less 85% of the per-country foreign effective tax rate. The new minimum tax would be imposed on a current basis, and foreign earnings could then be repatriated without further U.S. tax liability.

As part of the transition to the new system of taxation of foreign earnings, the budget would also impose a one-time 14% tax on earnings accumulated in CFCs that have not previously been subject to U.S. tax. A foreign

tax credit would be allowed for foreign taxes associated with those earnings, reduced in proportion to the one-time tax rate relative to the maximum corporate rate. The transition tax would be payable ratably over five years.

Individual tax revisions:
As in the case of businesses, many of the individual (personal) tax proposals in the budget are familiar, including:

- Limit the tax value of certain deductions and exclusions to 28%
- Impose a new minimum tax (the "Fair Share Tax") of 30% of AGI
- Limit the total accrual of tax-advantaged retirement benefits
- Conform SECA taxes for professional service businesses
- Restore the estate, gift, and GST parameters to those in effect in 2009

One of the key sets of revisions proposed by the president involves reforms to the taxation of capital gains for upper-income taxpayers, which would offset the cost of extension and expansion of tax preferences for middle and lower-income taxpayers. The highest tax on capital gains would be increased from 23.8% (including the 3.8% net investment income tax) to 28%. In addition, a transfer of appreciated property would generally be treated as a sale of the property. Thus, the donor or deceased owner of an appreciated asset would be subject to capital gains tax on the excess of the asset's fair market value on the date of the transfer over the transferor's basis. The proposal provides a $100,000 per-person exclusion for gains realized by reason of death, and it would continue the current law exclusion for principal residences. Relief would also be provided for small businesses. These changes would raise about $208 billion over 10 years.

Revenue from imposition of new taxes on upper-income taxpayers would be used in part to offset tax preferences to middle and lower-income taxpayers, such as:

- Increasing the maximum child and dependent care credit
- Permanently extending increased refundability of the child tax credit
- Expanding and making permanent the earned income tax credit
- Creating a new $500 "second earner" tax credit
- Permanently extending the American Opportunity Tax Credit

Treasury's explanation:
The Treasury Department on February 2 released an accompanying explanation of the tax proposals of the budget—Treasury's Green Book—which describes those proposals in greater detail.

Questions?

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

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