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Life Sciences Industry Accounting Guide
Income Taxes

March 2026

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Preface

The life sciences ecosystem encompasses a wide array of entities that discover, develop, and manufacture health care products. Such entities include pharmaceutical manufacturers; biotechnology companies; medical device, diagnostic, and equipment manufacturers; and service companies such as drug distributors, contract research organizations (CROs), contract manufacturing organizations (CMOs), and health technology companies.

Finance and accounting professionals in the life sciences industry face complex issues and must exercise significant judgment in applying existing rules to matters such as research and development (R&D) costs, acquisitions and divestitures, consolidation, contingencies, revenue recognition, income taxes, financial instruments, and financial statement presentation and disclosure. The 2026 edition of Deloitte's *Life Sciences Industry Accounting Guide* (the "Guide") addresses these and other relevant topics affecting the industry this year. It includes interpretive guidance; illustrative examples; recent standard-setting, legislative, and rulemaking developments (through March 6, 2026); and key differences between U.S. GAAP and IFRS® Accounting Standards. Appendix B lists the titles of standards and other literature we cited, and Appendix C defines the abbreviations we used. Key changes made to this Guide since publication of the 2025 edition are summarized in Appendix D.

We hope the Guide is helpful in navigating the various accounting and reporting challenges that life sciences entities face. We encourage clients to contact their Deloitte team for additional information and assistance.

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Chapter 7 — Income Taxes

7.1 Introduction

The accounting for income taxes under ASC 740 is sometimes very specific and can be complex. The overall objective of accounting for income taxes is to reflect (1) the amount an entity currently owes to tax authorities (current tax payable) and (2) deferred tax assets (DTAs) and deferred tax liabilities (DTLs) for the tax effects of transactions or events that have occurred but that have not yet been reflected in a tax return or vice versa (also referred to as "basis differences" or "temporary differences"). A DTA will be recorded for items that will result in future tax deductions (sometimes referred to as a benefit or a deductible temporary difference), and DTLs are recorded for items that will result in the inclusion of future taxable income in an entity's tax return (taxable temporary difference). This balance sheet approach is used to calculate temporary differences and, in effect, takes into account the total tax that would be payable (or receivable) if all of an entity's assets and liabilities were realized at their carrying value at a specific time (the reporting date).

In accordance with ASC 740, the critical event for recognition of a DTA is the event that gives rise to the deductible temporary difference, tax credit, or net operating loss (NOL) carryforward. Once that event occurs, those tax benefits should be recognized, subject to a realizability assessment. In effect, earning taxable income in future years is treated as a confirmation of realizability and not as a prerequisite to asset recognition. At the same time, management should consider future events to record valuation allowances against those DTAs to reflect amounts that are more likely than not to be realized in future tax returns. In the case of DTLs, ASC 740 requires an entity to include in its balance sheet an obligation for the tax consequences of taxable temporary differences, even when losses are expected in future years.

The following is a brief, general summary of deferred tax accounting under ASC 740:

- DTLs are recognized for future taxable amounts.
- DTAs are recognized for future deductions, operating losses, and tax credit carryforwards.
- The enacted tax rate expected to apply is used to measure DTAs and DTLs.
- A valuation allowance is recognized to reduce DTAs to the amounts that are more likely than not to be realized.
- The amount of the valuation allowance is based on all available positive and negative evidence about the future. The more objective the positive or negative evidence, the more weight the evidence carries in supporting the determination of whether DTAs will or will not be realized.
- Deferred tax expense or benefit is computed as the difference between the beginning and ending balance of the net DTA or DTL for the period.
- Entities present DTAs and DTLs as noncurrent in a classified balance sheet.
- The effects of changes in rates or laws are recognized in the period of enactment.

7.2 Industry Issues

The discussions and examples below contain guidance on income tax matters that frequently affect life sciences entities. The guidance cited is not intended to be all-inclusive or comprehensive; rather, it provides targeted considerations related to the application of ASC 740 that are most relevant to the industry.

For more information about the topics summarized below, see Deloitte's Roadmap *Income Taxes*.

7.2.1 Scope Considerations

The scope of ASC 740 is limited to "taxes based on income" when income is determined after revenues and gains are reduced by some amount of expenses and losses allowed by the jurisdiction. Therefore, a tax based solely on revenues would not be within the scope of ASC 740 because the taxable base amount is not reduced by any expenses. A tax based on gross receipts, revenue, or capital should be accounted for under other applicable literature (e.g., ASC 405, ASC 450). In contrast, a tax whose base takes into account both income and expense is within the scope of ASC 740. A common question for life sciences entities to consider is whether certain R&D credits are within the scope of ASC 740.

Certain tax jurisdictions provide refundable credits (e.g., qualifying R&D credits in certain countries and state jurisdictions and alternative fuel tax credits for U.S. federal income tax) that do not depend on the entity's ongoing tax status or tax position (e.g., an entity may receive a refund despite being in a taxable loss position). Tax credits (e.g., refundable credits) whose realization does not depend on the entity's generation of taxable income or the entity's ongoing tax status or tax position are not considered an element of income tax accounting under ASC 740. Thus, even if the credit claims are filed in connection with a tax return, the refunds are not considered to be part of income taxes and therefore are not within the scope of ASC 740. In such cases, an entity would not record the credit as a reduction of income tax expense; rather, the entity should determine the credit's classification on the basis of its nature.

When determining the classification of these credits, an entity may consider them to be a form of government grant or assistance. An entity may look to paragraphs 24 and 29 of IAS 20 for guidance on government grants. See Section 12.1.1.2 for more information.

Changing Lanes

In December 2025, the FASB issued ASU 2025-10, which adds guidance to ASC 832 on the recognition, measurement, and presentation of government grants. See Section 12.1.1.3 for more information.

In rare circumstances, a tax law may change the way a tax credit is realized. For example, a jurisdiction may have historically required that a credit be realized on the tax return as a reduction in taxes payable but subsequently changes the law so that the credit can be realized even though an entity has not first incurred a tax liability (i.e., the credit amount becomes refundable but was not when it arose). In this situation, an entity would generally continue to apply ASC 740 to the credits recognized at the time of the law change. Any new refundable credits earned after the tax law change would be accounted for as refundable credits in accordance with the guidance in this section.

Credits whose realization ultimately depends on taxable income (e.g., nonrefundable R&D credits) are generally recognized as a reduction of income tax expense. See Section 12.2 of Deloitte's Roadmap *Income Taxes* for additional guidance on the presentation and recognition of investment tax credits.

7.2.2 Intra-Entity Transfers of IP

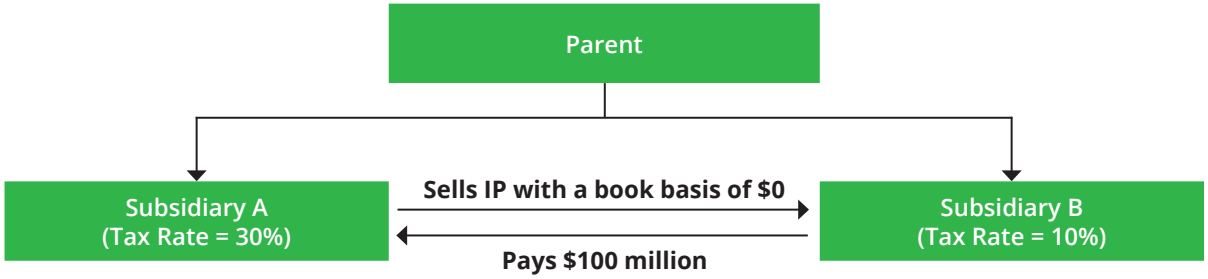
Life sciences entities often develop IP such as drug formulas, trade secrets, know-how, and other proprietary information. This IP may be developed in one jurisdiction but subsequently transferred to a subsidiary in another jurisdiction. Such transfers are often tax-motivated, and both the initial and subsequent accounting for them has historically been complex. An entity should record the current and deferred tax effects of intra-entity transfers of assets other than inventory, including the tax consequences of intra-entity asset transfers involving IP.

ASC 740-10-25-3(e) prohibits recognition of the deferred tax consequences of intra-entity transfers of inventory. However, this prohibition does not apply to noninventory assets. Under ASC 740-10-25-20(i), the selling (transferring) entity in an intra-entity transfer of an asset other than inventory is required to recognize any current tax expense or benefit upon transfer of the asset. Similarly, the purchasing (receiving) entity is required to recognize a DTA or DTL, as well as the related deferred tax benefit or expense, upon receipt of the asset.

The example below illustrates the income tax accounting for intra-entity transfers of assets other than inventory.

Example 7-1

Consider the following:



In accordance with ASC 740-10-25-20(i), since the transferred asset is an asset other than inventory (IP in this case), A is required to recognize the current tax expense associated with the taxable gain on the sale of the IP by recording the following journal entry:

Current tax expense	30,000,000	
Current taxes payable		30,000,000

In addition, B is required to recognize the deferred tax effects associated with its purchase of the IP by recording the following journal entry:

DTA	10,000,000	
Deferred tax benefit		10,000,000

7.2.2.1 Interim Reporting Considerations

There is no explicit guidance in ASC 740-270 on whether the tax effects of intra-entity transfers of assets other than inventory should be recognized as discrete items or included in the estimated annual effective tax rate (AETR) for interim reporting purposes. Paragraph BC13 of ASU 2016-16 states, in part:

> Because of the variety of intra-entity asset transfers, the Board did not want to preclude an entity from making its own assessment about how to treat an intra-entity asset transfer for purposes of the estimate. The Board also agreed with stakeholders who indicated that if the Board had decided that all intra-entity asset transfers should be treated similarly for purposes of the estimate, it would have created an exception to the model in Topic 740. The Board's view is that it would not be unusual for entities following the guidance to conclude that many intra-entity transfers of assets other than inventory would be treated as discrete items for purposes of the computation. However, the Board understands from stakeholders' input that because the nature of, frequency of, and ability to estimate these transfers vary among entities, there are circumstances in which an entity could conclude that the transaction should be included in the computation of the estimated annual effective tax rate. The Board understands that an entity will need to apply judgment on the basis of the facts and circumstances to conclude whether the tax consequences of an intra-entity asset transfer other than inventory should be included in the computation of the estimated annual effective tax rate or treated as a discrete item in the interim period in which the transfer occurs.

Connecting the Dots

Entities should carefully consider all of the provisions and exceptions in ASC 740-270 to determine whether the tax effects of intra-entity asset transfers should be treated as discrete or included in the estimated AETR for interim reporting purposes.

7.2.3 Transfer Pricing

Many life sciences entities are global and operate legal entities in multiple countries. This may simply be owing to the size and scale of the business or may be the result of regulatory requirements. For example, life sciences entities are frequently required to have regulatory approval to manufacture or distribute products in each country in which their products are manufactured or sold. Similarly, CROs are often required to perform R&D services on different patient populations in multiple geographic locations. Because of the global nature of many life sciences entities, income tax accounting issues regarding the use of transfer pricing for intra-entity and related-party transactions arise. Generally, transfer pricing is the pricing used for transfers of tangible property, intangible property, services, or financing between affiliated entities in different tax jurisdictions. These transactions include transfers between domestic or international entities, such as (1) U.S. to foreign, (2) foreign to foreign, (3) U.S. to U.S., and (4) U.S. state to state.

The general transfer pricing principle is that the pricing of a related-party transaction should be consistent with the pricing of similar transactions between independent entities under similar circumstances (i.e., an arm's-length transaction). Transfer pricing tax regulations are intended to prevent entities from using intra-entity charges to evade taxes by inflating or deflating the profits of a particular jurisdiction in which the larger consolidated group does business. Even if a parent corporation or its subsidiaries are in tax jurisdictions with similar tax rates, an entity may have tax positions that are subject to the recognition and measurement principles in ASC 740-10-25-6 and ASC 740-10-30-7.

An entity's exposure to transfer pricing primarily occurs when the entity includes in its tax return the benefit received from a related-party transaction that was determined to have not been conducted as though it was at arm's length. An unrecognized tax benefit (UTB) results when one of the related parties reports either lower revenue or higher costs than it can sustain under examination with the taxing authority (depending on the type of transaction). While it is likely that a portion of the revenue or costs will be allowed in these situations, the amount of benefit is often uncertain because of the subjectivity of valuing the related-party transaction. The UTB is recorded to reflect this uncertainty.

An entity must perform two steps in applying ASC 740 to all uncertain tax positions within its scope: (1) recognition and (2) measurement. The requirements of ASC 740 in the context of transfer pricing arrangements, including related considerations, are outlined below.

7.2.3.1 Determining the Unit of Account

Before applying the recognition and measurement criteria, an entity must identify all material uncertain tax positions and determine the appropriate unit of account for assessment. As noted in ASC 740-10-20, a tax position encompasses an "allocation or a shift of income between jurisdictions" (i.e., a transfer pricing arrangement). Therefore, intra-entity and related-party transactions under transfer pricing arrangements are within the scope of ASC 740.

Further, tax positions related to transfer pricing generally should be evaluated individually, since two entities and two tax jurisdictions are involved in each transaction. Such an evaluation should be performed even when the transaction is supported by a transfer pricing study prepared by one of the entities. Typically, there would be at least two units of account. For example, the price at which one entity will sell goods to another entity will ultimately be the basis the second entity will use to determine its cost of goods sold. In addition, some transfer pricing arrangements could be made up of multiple components that could be challenged individually or in aggregate by a tax authority. Therefore, there could be multiple units of account associated with a particular transfer pricing arrangement.

7.2.3.2 Recognition

ASC 740-10-25-6 indicates that the threshold for recognition has been met "when it is more likely than not, based on the technical merits, that the position will be sustained upon examination." An entity should apply the recognition threshold and guidance in ASC 740 to each unit of account in a transfer pricing arrangement. In some cases, a tax position will be determined to have met the recognition threshold if a transaction has taken place to generate the tax positions and some level of benefit will therefore be sustained. For example, assume that a U.S. parent entity receives a royalty for the use of intangibles by a foreign subsidiary that results in taxable income for the parent and a tax deduction for the foreign subsidiary. The initial tax filing (income in the receiving jurisdiction and expense/deduction in the paying jurisdiction) may typically meet the more-likely-than-not recognition threshold on the basis of its technical merits, since a transaction between two parties has occurred. However, because there are two entities and two tax jurisdictions involved, the tax jurisdictions could question whether the income is sufficient, whether the deduction is excessive, or both. Such factors should generally be considered during the recognition phase as part of the determination of what the tax jurisdictions are more likely than not to accept on the basis of the technical merits.

7.2.3.3 Measurement

After an entity has assessed the recognition criteria in ASC 740 and has concluded that it is more likely than not that the tax position taken will be sustained upon examination, the entity should measure the associated tax benefit. This measurement should take into account all relevant information, including tax treaties and arrangements between tax authorities. As discussed above, each tax position should be assessed individually and a minimum of two tax positions should be assessed for recognition and measurement in each transfer pricing transaction.

For measurement purposes, ASC 740-10-30-7 requires that the tax benefit be based on the amount that is more than 50 percent likely to be realized upon settlement with a tax jurisdiction "that has full knowledge of all relevant information." Intra-entity or transfer pricing assessments present some unique measurement-related challenges that are based on the existence of tax treaties or other arrangements (or the lack of such arrangements) between two tax jurisdictions.

Measurement of uncertain tax positions is typically based on facts and circumstances. The following are some general considerations (not all-inclusive):

- *Transfer pricing studies* — An entity will often conduct a transfer pricing study with the objective of documenting the appropriate arm's-length pricing for the transactions. The entity should consider the following when using a transfer pricing study to support the tax positions taken:
  - The qualifications and independence of third-party specialists involved (if any).
  - The type of study performed (e.g., benchmarking analysis, limited or specified-method analysis, U.S. documentation report, Organisation for Economic Co-operation and Development [OECD] report) and, to avoid incurring penalties, whether the study satisfies the particular jurisdiction's requirements.
  - The specific transactions and tax jurisdictions covered in the study.
  - The period covered by the study.
  - The reasonableness of the model(s) and the underlying assumptions used in the study (i.e., comparability of companies or transactions used, risks borne, any adjustments made to input data).
  - Any changes in the current environment, including new tax laws in effect.
- *Historical experience* — An entity should consider previous settlement outcomes of similar tax positions in the same tax jurisdictions. Information about similar tax positions, in the same tax jurisdictions, that the entity has settled in previous years may serve as a good indicator of the expected settlement of current positions.
- *Applicability of tax treaties or other arrangements* — An entity should consider whether a tax treaty applies to a particular tax position and, if so, how the treaty would affect the negotiation and settlement with the tax authorities involved.
- *Symmetry of positions* — Even though each tax position should be evaluated individually for appropriate measurement, if there is a high likelihood of settlement through "competent-authority" procedures under the tax treaty or other agreement, an entity should generally use the same assumptions about such a settlement to measure both positions (i.e., the measurement assumptions are similar, but the positions are not offset). Under the terms of certain tax treaties entered into by the United States and foreign jurisdictions, countries mutually agree to competent-authority procedures to relieve companies of double taxation created by transfer pricing adjustments to previously filed returns. If competent-authority procedures are available, entities should carefully consider whether to pursue relief through them and whether the particular jurisdictions involved are highly likely to reach an agreement with respect to the particular disputed transactions.

An entity should carefully consider whether the tax jurisdictions involved strictly apply the arm's-length principle. Some jurisdictions may have a mandated statutory margin that may or may not equate to what is considered arm's length by another reciprocal taxing jurisdiction. In these situations, when an entity measures positions, it may be inappropriate for the entity to assume that they are symmetrical.

7.2.3.4 Presentation

In some cases, if two governments follow the OECD's transfer pricing guidelines to resolve substantive issues related to transfer pricing transactions between units of the same entity, an asset could be recognized in one jurisdiction because of the application of competent-authority procedures, and a liability could be recognized for UTBs from another tax jurisdiction that arose because of transactions between the entity's affiliates that are not considered at arm's length.

In this case, an entity should present the liability for UTBs and the tax benefit on a gross basis in its balance sheet. In addition, a public entity would include only the gross liability for UTBs in the tabular reconciliation disclosure. However, in the disclosure required by ASC 740-10-50-15A(b), the public entity would include the liability for UTBs and the tax benefit on a net basis in the amount of UTBs that, if recognized, would affect the effective tax rate.

7.2.4 Research and Development

For many life sciences entities, R&D activities represent a significant focus and expenditure. Beyond the above-mentioned scope considerations related to refundable R&D tax credits, these activities may result in various income tax accounting impacts that should be accounted for in accordance with ASC 740. For example, R&D cost-sharing agreements may affect an entity's accounting for the income tax effects of share-based payments. In addition, an entity may acquire R&D assets in a business combination that result in the creation of temporary differences. These issues are summarized below.

7.2.4.1 R&D Cost-Sharing Arrangements

A reporting entity may enter into an arrangement with a related entity (typically a foreign subsidiary) to share the cost of developing certain intangible assets. Under such an arrangement, which is often referred to as a cost-sharing arrangement, one company bears expenses on behalf of another company and is subsequently reimbursed for those costs. The shared costs may include the cost of share-based payments issued to employees of the reporting entity. Regarding the tax impact of the sharing of share-based payment costs, the discussion document for the FASB Statement 123(R) Resource Group's July 21, 2005, meeting states, in part:

> Related companies that plan to share the cost of developing intangible property may choose to enter into what is called a cost-sharing agreement whereby one company bears certain expenses on behalf of another company and is reimbursed for those expenses. U.S. tax regulations specify the expenses that must be included in a pool of shared costs; such expenses include costs related to stock-based compensation awards granted in tax years beginning after August 26, 2003.
>
> The tax regulations provide two methods for determining the amount and timing of share-based compensation that is to be included in the pool of shared costs: the "exercise method" and the "grant method." Under the exercise method, the timing and amount of the allocated expense is based on the intrinsic value that the award has on the exercise date. Companies that elect to follow the grant method use grant-date fair values that are determined based on the amount of U.S. GAAP compensation costs that are to be included in a pool of shared costs. Companies must include such costs in U.S. taxable income regardless of whether the options are ultimately exercised by the holder and result in an actual U.S. tax deduction.

Cost-sharing agreements affect the U.S. company's accounting for the income tax effects of share-based compensation. Companies should consider the impact of cost-sharing arrangements when measuring, on the basis of the tax election they have made or plan to make, the initial and subsequent deferred tax effects.

Example 7-2

Company A, which is located in the United States, enters into a cost-sharing arrangement with its subsidiary, Company B, which is located in Switzerland. Under the arrangement, the two companies share costs associated with the R&D of certain technology. Company B reimburses A for 30 percent of the R&D costs incurred by A. The U.S. tax rate is 25 percent. Cumulative book compensation for a fully vested option issued to a U.S. employee is $100 for the year ending on December 31, 20X6. The award is exercised during 20X7, when the intrinsic value of the option is $150.

The tax accounting impact discussed below.

Exercise Method

On December 31, 20X6, A records $18 as the DTA related to the option (rounded for $100 book compensation expense × 70% not subject to reimbursement × 25% tax rate). When, in 20X7, the option is exercised, any net tax benefit that exceeds the DTA is an excess tax benefit and is recorded in the income statement. The company is entitled to a U.S. tax deduction resulting in a benefit (net of the inclusion) of $26 (rounded for $150 intrinsic value when the option is exercised × 70% not reimbursed × 25%). Accordingly, $8 ($26 – $18) would be recorded in the income statement as an excess tax benefit.

Grant Method

The cost-sharing impact is an increase of currently payable U.S. taxes each period; however, in contrast to the exercise method, the cost-sharing method should have no direct impact on the carrying amount of the U.S. DTA related to share-based compensation. If there was $100 of stock-based compensation during 20X6, the impact on the December 31, 20X6, current tax provision would be $8 (rounded for $100 book compensation expense × 30% reimbursed × 25%). If the stock-based charge under ASC 718 is considered a deductible temporary difference, a DTA also should be recorded in 20X6 for the financial statement expense, in the amount of $25 ($100 book compensation expense × 25%). The net impact on the 20X6 income statement is a tax benefit of $17 ($25 – $8). At settlement, the excess tax deduction of $13 (rounded for excess of intrinsic value over $50 book compensation expense × 25%) would be recorded in the income statement.

7.2.4.2 R&D Assets Acquired in a Business Combination

Acquired R&D assets will be separately recognized and measured at their acquisition-date fair values. ASC 350-30-35-17A states that an R&D asset acquired in a business combination must be considered an indefinite-lived intangible asset until completion or abandonment of the associated R&D efforts. Once the R&D efforts are complete or abandoned, an entity should apply the guidance in ASC 350 to determine the useful life of the R&D assets and should amortize these assets accordingly in the financial statements. If the project is abandoned, the asset would be written off if it has no alternative use.

In accordance with ASC 740, deferred taxes should be recorded for temporary differences related to acquired R&D assets as of the business combination's acquisition date. As with all acquired assets and assumed liabilities, an entity must compare the amount recorded for an R&D intangible asset with its tax basis to determine whether a temporary difference exists. If the tax basis of the R&D intangible asset is zero, as it will be in a typical nontaxable business combination, a DTL will be recorded for that basis difference. If an IPR&D asset with no alternative future use is acquired in an asset acquisition and is expensed (see Section 6.2.2.4), a DTA should be recorded for any excess tax basis over the zero book basis.

7.2.5 Valuation Allowances and Tax-Planning Strategies

A life sciences entity that has recurring losses or other negative evidence must consider all available evidence, both positive and negative, to determine whether a valuation allowance against its DTAs is needed. In assessing positive and negative evidence, an entity must consider the following four possible sources of taxable income discussed in ASC 740-10-30-18:

1. "Future reversals of existing taxable temporary differences."
2. "Future taxable income exclusive of reversing temporary differences and carryforwards."
3. "Taxable income in prior carryback year(s) if carryback is permitted under the tax law."
4. "Tax-planning strategies."

This analysis can be quite complex depending on the entity's facts and circumstances. Significant judgment is often required, particularly in the evaluation of items (2) and (4) above. It is difficult to assert that the entity will have future taxable income exclusive of reversing taxable temporary differences when it has cumulative losses in recent years. Further, tax-planning strategies must meet certain criteria to be treated as a source of taxable income, and evaluation of those criteria is often not straightforward.

7.2.6 Prescription Drug Fees

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act, imposed an annual fee, payable to the U.S. Treasury, on the pharmaceutical manufacturing industry for each calendar year beginning on or after January 1, 2011. The amount of the fee to be paid by a given entity is based on the entity's branded prescription drug (BPD) sales for the preceding year as a percentage of the industry's BPD sales for the same period. Under current U.S. tax law, the fee is not tax deductible and will therefore result in a permanent difference between an entity's income for financial reporting purposes and its taxable income. This permanent difference will result in an increase in the entity's overall effective tax rate.

7.2.7 Section 382 Limitations on NOL Carryforwards

Because of the significant up-front costs required for companies to bring a new drug through regulatory approval and ultimately to market, it is common for companies in the life sciences industry to generate losses in the early stage of their life cycle. Companies can generally benefit from these losses in the form of NOL carryforwards that offset future taxable income.

However, Internal Revenue Code (IRC) Section 382 provides that loss corporations may be subject to a limitation on the amount of the NOL carryforward that can be realized in periods after a change in ownership (the "Section 382 limitation"). While ownership changes can result from a business combination or an IPO transaction, they can also be driven by a new round of equity financing that affects the company's ownership structure when certain thresholds are met. Companies should assess all changes to their ownership structure to determine whether any Section 382 limitation is required.

The determination of a Section 382 limitation involves a high degree of complexity and requires careful evaluation. An assessment of potential limitations on NOL carryforwards should be included as part of a company's ongoing tax-planning and tax-forecasting strategies, and the impacts of such limitations on potential funding, exit plans, or acquisition portfolio strategies should also be considered. Companies that may be subject to Section 382 limitations are encouraged to consult with their tax advisers.

In September 2019, the U.S. Treasury and the IRS issued proposed Treasury regulations on the items of income and deduction that are treated as built-in gains and losses under IRC Section 382. The proposed regulations would have significantly modified existing guidance on the determination of built-in gains and losses. While the proposed regulations were formally withdrawn in July 2025, the U.S. Treasury and the IRS expect to repropose the guidance in this area. We expect that any future guidance would be less favorable than existing guidance. Accordingly, companies should continue monitoring the status of IRC Section 382 guidance and consult with their tax advisers to understand how future proposals could affect their income tax profile.

7.2.8 Tax Deductibility of Patent Infringement Litigation Costs

Patent infringement litigation costs incurred after the actual sale of a product, which are expensed for book purposes, are generally tax deductible as "ordinary and necessary" business expenses under IRC Section 162(a). However, for generic drug companies filing ANDAs under the Hatch-Waxman Act, the treatment of these costs (i.e., expensed vs. capitalized) can result in a temporary difference. This is because the IRS has challenged the tax deductibility of costs incurred by generic drug companies to navigate the "paragraph IV" process (i.e., the process in which a generic drug company seeks FDA approval of an ANDA by certifying, in accordance with 21 U.S.C. Section 355(j)(2)(A)(vii)(IV), that it believes that a third party's patent is invalid or will not be infringed by the generic drug company's new product).

7.2.8.1 Background

On March 8, 2013, the IRS Office of Chief Counsel issued a memorandum clarifying the capitalization of incurred legal fees related to NDAs and ANDAs, including patent litigation costs arising from paragraph IV patent certification. The memorandum states that legal costs associated with the paragraph IV process should be capitalized.

In a manner consistent with the memorandum, the IRS confirmed that FDA-approved ANDAs are amortizable intangibles under IRC Section 197 and should be amortized ratably over a 15-year period. Further, the IRS argued that patent litigation costs are part of the ANDA approval process (the intangible asset). Accordingly, the IRS issued notices of proposed adjustments (NOPAs) to companies that had immediately expensed (deducted) these costs in their annual tax returns.

7.2.8.2 U.S. Tax Court Ruling

Many generic pharmaceutical companies challenged the NOPAs by issuing protest statements to the IRS or bringing lawsuits to the U.S. Tax Court. In April 2021, after years of litigation, the U.S. Tax Court issued a ruling (Mylan Inc. and Subsidiaries vs. Commissioner of Internal Revenue) that was partly favorable to Mylan Inc., a generic pharmaceutical company.

In its ruling, the U.S. Tax Court held, in part, that the generic pharmaceutical company could immediately deduct the legal fees it had incurred to defend patent infringement lawsuits as "ordinary and necessary business expenses," and did not need to capitalize those expenses as the IRS argued, because the patent litigation was separate from the ANDA approval process. The IRS appealed the U.S. Tax Court's ruling to the U.S. Court of Appeals for the Third Circuit, and the Tax Court's ruling was upheld. This matter is closed, establishing a precedent.

7.2.9 Selling Income Tax Credits to Monetize Them

Income tax credits that can be used only to reduce an income tax liability and would never be refundable by the government are within the scope of ASC 740. Some tax jurisdictions might, however, allow an entity that generates certain types of income tax credits to either use a credit to reduce its own income tax liability or effectively "sell" all or a portion of the credit by assigning the right to claim the credit to another qualified entity. One such situation is illustrated in the example below, which is adapted from the summary in the New Jersey Economic Development Authority's (NJEDA's) FAQs on the New Jersey Technology Business Tax Certificate Transfer Program.

Example 7-3

The New Jersey Technology Business Tax Certificate Transfer Program enables approved technology and biotechnology businesses with NOLs to sell their unused NOL carryover and unused R&D tax credits for at least 80 percent of the value of the tax benefits to a profitable corporate taxpayer in New Jersey that is not an affiliated business. This allows technology and biotechnology businesses with NOLs to turn their tax losses and credits into cash to buy equipment or facilities, or for other allowable expenditures. The NJEDA determines eligibility, and the New Jersey Division of Taxation determines the value of the tax benefits (unused NOL carryover and unused R&D tax credits).

In those situations, if an entity does not have sufficient taxable income to use all or a portion of the income tax credit or in which using it might take multiple tax years, the entity might achieve a better economic benefit (i.e., present value benefit) by selling the credit. Regardless of intent, if the credit can be used only to reduce an income tax liability of either the entity that generated it or the entity to which it is transferred and would never be refundable by the government, we believe that the credit should remain within the scope of ASC 740.[1] In such situations, the entity that generated the credit would recognize and measure it in accordance with the recognition and measurement criteria of ASC 740. To the extent that the income tax credit does not reduce income taxes currently payable, the entity would recognize a DTA for the carryforward and assess it for realizability in a manner consistent with the sources of income cited in ASC 740-10-30-18. While we believe that such an assessment would generally be predicated upon the normal course of business (i.e., an entity would not factor in its ability to sell the underlying credit as a basis for realizing the related DTA), we understand on the basis of a technical inquiry with the FASB staff that it would also be acceptable to consider the expected sales proceeds when assessing realizability.

If the entity were to subsequently sell the income tax credit, we understand on the basis of the same FASB staff technical inquiry that it would be most appropriate to reflect any proceeds and resulting gain/loss on the sale as a component of the tax provision. Alternatively, we believe that the sale could be treated no differently than the sale of any other asset, with gain or loss recognized in pretax earnings for any difference between the proceeds received and the recorded carrying value of the DTA for the income tax credit that was recognized in accordance with the guidance in ASC 740 on recognition and measurement.[2]

[1] While we believe that accounting for transferable credits within the scope of ASC 740 is most appropriate, we also believe, in a manner consistent with feedback received from the FASB staff, that it would be acceptable for a company to account for transferable credits in a manner similar to the accounting for refundable credits (described in Section 7.2.1) since the company generating the credits does not need taxable income to monetize the credits.

[2] If an entity's policy is to reflect gain or loss in pretax earnings, it would not be appropriate to consider the expected proceeds when assessing realizability of the related DTA.

7.2.10 Tariffs and Potential Interaction With Income Tax Accounting

Although tariffs are not new to the global economic landscape, their prominence and impact have grown significantly in the past year as a result of rapid increases in tariff rates and shifting trade patterns. The introduction or modification of import taxes can significantly alter existing cost structures, disrupt supply chains, and create new operational and compliance challenges, which can, in turn, lead to significant accounting and financial reporting implications.

Entities should consider how potential profitability, liquidity, and impairment concerns associated with the tariffs might influence income tax accounting under ASC 740 in affected jurisdictions. For example, a reduction in a jurisdiction's current-period income or the actual incurrence of losses, a decrease in forecasted income or a forecast of future losses, or both could lead an entity to reassess whether (1) it is more likely than not that some or all of the jurisdiction's DTAs are realizable and, in some cases, (2) recognition of a valuation allowance is needed in that jurisdiction. Similarly, changes in profitability or liquidity due to rising costs or intercompany transfer pricing might also result in changes in an entity's assessment of whether certain foreign earnings can remain indefinitely reinvested.

Adjustments to forecasted income (like those assumed for other impairment analyses) may also need to be factored into an entity's estimated AETR. Uncertainty regarding an entity's forecasted income, or a forecasted reduction in an entity's income as a result of changing macroeconomic conditions, might hinder management's ability to reliably estimate its AETR, either because the entity cannot reliably estimate its ordinary income or because the entity's AETR is highly sensitive to changes in estimated ordinary income for the year (e.g., in situations in which ordinary income is closer to breakeven and permanent items do not "scale" with ordinary income). In either case, the actual effective tax rate for the year to date may be the best estimate of the AETR.

For further discussion of accounting and financial reporting considerations related to tariffs, see Section 12.5.4 (which includes a discussion of the U.S. Supreme Court's February 20, 2026, ruling that the president lacked the legal authority to impose tariffs by executive order) and Deloitte's August 13, 2025, *Accounting Spotlight*.

7.3 Tax Legislation

Various corporate tax provisions that are relevant to life sciences entities have been added or amended by the Tax Cuts and Jobs Act of 2017 (the "2017 Act"), the CARES Act (enacted in 2020), the IRA (enacted in 2022), and the legislation formally titled "An Act to Provide Reconciliation Pursuant to Title II of H. Con. Res. 14" (the "2025 Act") and commonly referred to as the One Big Beautiful Bill Act. Such provisions are discussed below.

7.3.1 Global Intangible Low-Taxed Income

The 2017 Act created a new requirement that certain income (i.e., global intangible low-taxed income [GILTI]) earned by a controlled foreign corporation (CFC) must be included currently in the gross income of the CFC's U.S. shareholder. GILTI is the excess of the shareholder's "net CFC tested income" (NCTI) over the net deemed tangible income return (the "routine return"), which is defined as the excess of (1) 10 percent of the aggregate of the U.S. shareholder's pro rata share of the qualified business asset investment of each CFC with respect to which it is a U.S. shareholder over (2) the amount of certain interest expense taken into account in the determination of NCTI.

A domestic corporation is permitted a deduction of up to 50 percent of the sum of the GILTI inclusion and the amount treated as a dividend in accordance with IRC Section 78 ("IRC Section 78 gross-up"). If the sum of the GILTI inclusion (and related IRC Section 78 gross-up) and the corporation's foreign-derived intangible income (FDII) exceeds the corporation's taxable income, the deductions for GILTI and

for FDII are reduced by the excess. As a result, the GILTI deduction can be no more than 50 percent of the corporation's taxable income (and will be less if the corporation is also entitled to an FDII deduction).

7.3.2 Deduction for FDII

The 2017 Act added IRC Section 250, which allows a domestic corporation an immediate deduction against U.S. taxable income for a portion of its FDII. The amount of the deduction depends, in part, on the corporation's U.S. taxable income. The percentage of income that can be deducted is reduced in taxable years beginning after December 31, 2025.

7.3.3 Base Erosion Anti-Abuse Tax

For tax years beginning after December 31, 2017, a corporation is potentially subject to tax under the 2017 Act's base erosion anti-abuse tax (BEAT) provision if the controlled group of which it is a part has sufficient gross receipts and derives a sufficient level of "base erosion tax benefits." Under the BEAT, a corporation must pay a base erosion minimum tax amount (BEMTA) in addition to its regular tax liability after credits. The BEMTA is generally equal to the excess of (1) a fixed percentage of a corporation's modified taxable income (taxable income determined without regard to any base erosion tax benefit related to any base erosion payment, and without regard to a portion of its NOL deduction) over (2) its regular tax liability (reduced by certain credits). The fixed percentage is generally 5 percent for taxable years beginning in 2018, 10 percent for years beginning after 2018 and before 2026, and 12.5 percent for years after 2025.

7.3.4 Corporate Alternative Minimum Tax

The 2017 Act repealed the prior corporate alternative minimum tax (AMT) for tax years beginning after December 31, 2017. Subsequently, the IRA established a new corporate AMT that imposes a 15 percent minimum tax on the adjusted financial statement income (AFSI) of applicable corporations for taxable years beginning after December 31, 2022. An applicable corporation is any corporation (other than an S corporation, a regulated investment company, or a real estate investment trust [REIT]) that meets the $1 billion three-year average annual AFSI test, which is applied on the basis of a three-year look-back period ending with the relevant taxable year. The corporate AMT under the IRA is similar in many ways to the since-repealed, pre-2018 U.S. AMT system that applied to corporations. Regarding that system, ASC 740 specifies that "[i]n the U.S. federal tax jurisdiction, the applicable tax rate [for measuring U.S. federal deferred taxes] is the regular tax rate." It further notes that a DTA would be recognized for AMT credit carryforwards available under the system, which would then be assessed for realization. We believe that the corporate AMT under the IRA should be accounted for in a similar manner.

7.3.4.1 Potential Interaction With Valuation Allowance

A corporate AMT was introduced in 2022 as part of the IRA. While deferred taxes will continue to be measured at the regular tax rate, a corporate AMT will have an effect on existing DTAs in the regular tax system if an entity expects to perpetually pay corporate AMT (e.g., while an NOL for an entity that is expected to perpetually pay corporate AMT might result in a reduction in tax under the regular system, the NOL may not be available for corporate AMT purposes and the entity might pay corporate AMT tax on the income sheltered by the NOL in the regular tax system). We believe that there are two acceptable approaches to assessing the realizability of DTAs in the regular system for perpetual corporate AMT taxpayers.[3]

[3] An entity would need to select one approach as a policy choice and apply it consistently.

Under the first approach, the entity would assess the realizability of its DTAs[4] while considering the incremental tax effects of the corporate AMT. If, for example, the expected tax benefit of an NOL is less than the reported amount because the utilization of the NOL will result in incremental corporate AMT, an entity would have to use a valuation allowance to reflect the actual amount of tax benefit that will be realized with respect to the NOL. Alternatively, the entity could assess the realizability of its DTAs solely on the basis of the regular tax system without taking into account amounts due under the corporate AMT system (i.e., any incremental impact of the corporate AMT would be accounted for in the period in which the corporate AMT is incurred).

These approaches are illustrated in the example below.

Example 7-4

Assume that Entity A:

- Had $1,000 of pre-2018 NOL carryforwards and no corporate AMT credit or NOL carryforward.
- Expects sufficient future income to fully utilize its pre-2018 NOL carryforward.
- Expects to be a corporate AMT taxpayer perpetually and, accordingly, will need to record a full valuation allowance against any corporate AMT credit carryforwards that arise in future years.

For simplicity, further assume that there are no other permanent or temporary differences or attributes.

These assumptions are reflected in the table below.

	Regular Tax	Corporate AMT
Future pre-NOL AFSI and taxable income **(A)**	$ 1,000	$ 1,000
NOL deduction	(1,000)	0
Taxable income/AFSI **(B)**	$ 0	$ 1,000
Tax rate **(C)**	21%	15%
Taxes payable with NOL carryforward **(B × C)**	$ 0	$ 150
Taxes payable without NOL carryforward **(A × C)**	$ 210	$ 150

Entity A could select either of the following approaches to assess the realizability of DTAs in the regular system:

- *Approach 1* — The utilization of the NOL reduces the regular tax liability of $210 down to the corporate AMT liability of $150. As a result, the NOL only results in a reduction of future cash outflows of $60, necessitating a $150 valuation allowance against the $210 NOL DTA.
- *Approach 2* — The $150 incremental cost of corporate AMT would be accounted for in the period in which it arises, and no valuation allowance would be recorded against the $210 NOL DTA because there is sufficient regular taxable income expected in future years.

In addition, the IRA allows entities to reduce their corporate AMT tax liability by certain general business credits. Entities applying the first approach that have a valuation allowance because of an inability to use such credits in the regular tax system would need to consider whether such credits may now be realizable as a result of the corporate AMT.

[4] Related to deductible temporary differences or attributes.

7.3.5 Stock Buyback 1 Percent Excise Tax

The IRA added a new IRC section, Section 4501, that imposes a 1 percent excise tax on stock repurchases by publicly traded companies that occur after December 31, 2022. Specifically, under new IRC Section 4501, a covered corporation would be subject to a tax equal to 1 percent of (1) the fair market value of any stock of the corporation that is repurchased by this corporation (or certain affiliates) during any taxable year, with limited exceptions, less (2) the fair market value of any stock issued by the covered corporation (or certain affiliates) during the taxable year (including compensatory stock issuances). The 1 percent excise tax may also be imposed on acquisitions of stock in certain mergers or acquisitions involving covered corporations.

Because the tax is not based on a measure of income, the excise tax is not an income tax and, therefore, is not within the scope of ASC 740. The accounting for taxes paid in connection with the repurchase of stock is not specifically addressed in U.S. GAAP. However, entities may consider the guidance in AICPA Technical Q&As Section 4110.09, which indicates that direct and incremental legal and accounting costs associated with the acquisition of treasury stock may be added to the cost of the treasury stock. Therefore, it is acceptable to account for the IRC Section 4501 excise tax obligation that results from the repurchase of common stock classified within permanent equity as a cost of the treasury stock transaction. Any reductions in the excise tax obligation associated with share issuances would also be recognized as part of the original treasury stock transaction even if the share issuance is a different type of instrument than the share that was repurchased. Additional considerations are necessary when the excise tax obligation that arises is related to redemptions of preferred stock. Such an excise tax obligation would be recognized as a cost of redeeming the preferred stock. The accounting for redemptions of preferred stock differs depending on the classification of the preferred stock as permanent equity, temporary equity, or a liability. An entity would need to use a systematic and rational allocation approach to account for the effect of share issuances on the excise tax obligation when the entity has repurchases of both common stock and preferred stock during a taxable period.

7.3.6 Capital Expensing

The 2017 Act permits 100 percent immediate expensing for qualified property through 2022. This expensing is phased down each subsequent year through 2026 (80 percent in 2023, 60 percent in 2024, 40 percent in 2025, 20 percent in 2026).

7.3.7 Orphan Drug Credit

The 2017 Act halved the credit for research on rare diseases, known as the orphan drug credit.

7.3.8 Research and Experimental Expenses

The 2017 Act requires research and experimental (R&E) expenses to be amortized over 5 years for R&E activities performed in the United States (or 15 years for R&E activities performed outside the United States).

7.3.9 Deductibility of NOLs

The 2017 Act eliminated, with certain exceptions, the NOL carryback period and permits an indefinite carryforward period while limiting the NOL deduction to 80 percent of taxable income (computed without regard to the NOL deduction). The CARES Act repeals the 80 percent limitation for taxable years beginning before January 1, 2021.

7.3.10 Deductibility of Business Interest Expense

The CARES Act amends IRC Section 163(j) as applied to taxable years beginning in 2019 and 2020. IRC Section 163(j) limits the deduction for business interest expense to the sum of (1) the taxpayer's business interest income, (2) 30 percent of the taxpayer's adjusted taxable income,[5] and (3) the taxpayer's floor plan financing interest expense for the taxable year. The CARES Act increases the 30 percent adjusted taxable income threshold to 50 percent for taxable years beginning in 2019 and 2020.

7.3.11 Expensing of Qualified Improvement Property

The 2017 Act inadvertently failed to include qualified improvement property (QIP) in the 15-year property classification. Accordingly, QIP was classified by default as 39-year property and was consequently ineligible for the additional first-year bonus depreciation. To fix these inadvertent oversights, the CARES Act includes technical amendments that are retroactive to the effective date of the 2017 Act. Companies will need to consider (1) how the QIP technical correction affects their assessment of uncertain tax positions, including the impacts of interest and penalties; (2) the possibility of having to file amended tax returns; and (3) the related impact on current taxes payable and DTAs and DTLs.

Changing Lanes

On July 4, 2025, President Trump signed the 2025 Act into law. The centerpiece of the 2025 Act is the extension of expiring — and in some cases expired — provisions of the 2017 Act. The 2025 Act modifies provisions that are relevant to life sciences entities, including:

- *GILTI* — Before the 2025 Act was signed into law, the maximum GILTI deduction was set to be reduced to 37.5 percent for taxable years beginning after December 31, 2025. The 2025 Act made numerous changes to the GILTI regime that apply to foreign corporations for tax years beginning after December 31, 2025. Most notably, these changes include:
  - Reducing from 20 percent to 10 percent the haircut for foreign income taxes deemed paid with respect to a GILTI inclusion.
  - Changing the IRC Section 250 deduction (related to a taxpayer's GILTI inclusion and related IRC Section 78 gross-up) to 40 percent for taxable years beginning after December 31, 2025.
  - Removing the reduction to GILTI related to a taxpayer's routine return.
  - Changing the term GILTI to NCTI (note, however, that for consistency, we use the original term — GILTI — throughout this publication).

  The 2025 Act could affect the measurement of GILTI DTAs or DTLs for companies that provide them (see discussion of policy election in Section 3.4.10.2 of Deloitte's Roadmap *Income Taxes*).
- *FDII* — The 2025 Act modifies the FDII regime to remove the impact of a corporation's qualified business asset investment and generally allows a deduction of 33.34 percent of the corporation's entire foreign-derived deduction-eligible income (FDDEI) (formerly known as FDII). Note, however, that for consistency, we use FDII (the original term) throughout this publication. Certain types of income — such as gains from selling intangible property (as defined in IRC Section 367(d)(4)) or other depreciable, amortizable, or depletable assets — are excluded from being treated as deduction-eligible income (DEI) or from FDDEI. This includes income from transactions covered by IRC Section 367(d). These rules apply to sales or dispositions conducted after June 16, 2025.

[5] The 2025 Act permanently reinstated the calculation of adjusted taxable income to align with EBITDA. This calculation applies to taxable years beginning after December 31, 2024, and included an adjustment under which certain income inclusions would be disregarded as of taxable years beginning after December 31, 2025.

In addition, interest expense and R&E costs can no longer be allocated or apportioned in the calculation of DEI or FDDEI. Except as noted, these changes take effect for tax years starting after December 31, 2025.

- *BEAT* — The 2025 Act increases the BEAT rate to 10.5 percent, up from the current 10 percent rate. If no congressional action had been taken, the rate would have risen to 12.5 percent starting in 2026. In addition, the 2025 Act repeals the scheduled 2026 changes to the treatment of certain tax credits. These changes apply to taxable years beginning after December 31, 2025.
- *Capital expensing* — The 2025 Act permits 100 percent immediate expensing for qualified property acquired and placed in service on or after January 19, 2025.
- *R&E expenses* — The 2025 Act allows taxpayers to deduct R&E expenses immediately in the year in which the costs were paid or incurred for R&E activities performed in the United States. The 2025 Act does not modify the treatment of R&E expenses for R&E activities performed outside the United States. This change applies to taxable years beginning after December 31, 2024. Further, the 2025 Act provides an election to deduct the remaining unamortized balance of capitalized domestic R&E expenses paid or incurred after December 31, 2021, and before January 1, 2025.

For a discussion of other matters related to the income tax accounting consequences of the 2025 Act's provisions, see Deloitte's July 15, 2025, *Heads Up*, and Appendix G of Deloitte's Roadmap *Income Taxes*.

7.4 OECD Pillar Two

In October 2021, more than 135 countries and jurisdictions entered into an agreement (the "Global Tax Deal") to participate in a "two-pillar" international tax approach developed by the OECD, which includes establishing a global minimum corporate tax rate of 15 percent. The OECD published *Tax Challenges Arising From the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)*[6] in December 2021 and subsequently issued additional commentary and administrative guidance[7] clarifying several aspects of the model rules (collectively, the "GloBE rules").

The Pillar Two rules are intended to ensure that large multinational enterprise (MNE) groups pay a minimum level of tax on the income arising in each of the jurisdictions in which they operate. The rules do so by imposing a top-up tax on profits arising in a jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the 15 percent minimum rate. The Pillar Two rules include:[8]

- "[A]n Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity."
- "[A]n Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR."

[6] OECD (2021), *Tax Challenges Arising From Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en.

[7] The OECD periodically publishes commentary, administrative guidance, and information about the GloBE rules on its Web site.

[8] Quoted text in the first two bullet points is from OECD/G20 Base Erosion and Profit Shifting Project, *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, October 2021.

- A Qualified Domestic Minimum Top-up Tax (QDMTT) that applies to local constituent entities of in-scope MNEs and produces outcomes that are consistent with the GloBE rules.
- A Subject to Tax Rule (STTR) that allows source jurisdictions to "tax back" when defined categories of intra-group covered income are subject to nominal corporate income tax rates below the STTR minimum rate and domestic taxing rights over that income have been ceded under a treaty.

At the FASB's February 1, 2023, meeting, the FASB staff announced that the global minimum tax imposed under the Pillar Two rules, as published by the OECD,[9] is an AMT and that deferred taxes would not be recognized or adjusted for the effect of global minimum taxes that conform to such Pillar Two rules. As support for its conclusion, the FASB staff cited the guidance in ASC 740-10-30-10 and ASC 740-10-30-12 as well as in ASC 740-10-55-31 and 55-32. Accordingly, the incremental effects of such taxes would be accounted for as a period cost (i.e., the increase in tax payable would only be reflected in an entity's financial statements after a law is actually effective).

Connecting the Dots

Since MD&A within a company's quarterly and annual filings must include discussion and analysis of significant economic changes that materially affect the amount of reported income from continuing operations, if a registrant's reported income tax is, or is likely to be, materially affected by the Pillar Two rules, the SEC staff expects the registrant's MD&A disclosure to contain a description of the extent of the economic impact on reported income. As registrants have additional time to assess the impacts of Pillar Two on their results of operations or financial condition, they should enhance their disclosures (e.g., by quantifying the reasonably likely impact, if known and material). Such disclosures may need to include a range of reasonably likely outcomes when a registrant's specific facts and circumstances are uncertain.

For more information about Pillar Two generally, see Deloitte's December 22, 2021, U.S. International Tax Alert *Pillar Two: OECD Inclusive Framework Global Minimum Tax Model Rules*. For more information about the accounting and disclosure implications of Pillar Two, see Deloitte's February 1, 2023, and March 5, 2024 (updated November 8, 2024), *Financial Reporting Alert* newsletters and Appendix F of Deloitte's Roadmap *Income Taxes*.

Changing Lanes

On January 20, 2025, President Trump issued an executive order instructing the secretary of the Treasury and the permanent representative of the United States to the OECD to notify the OECD that previous commitments made by the United States with respect to the Global Tax Deal "have no force or effect within the United States absent an act by the Congress adopting the relevant provisions of the Global Tax Deal." The long-term implications of the executive order are presently unclear, but the executive order in and of itself is not expected to have any current-period accounting effects. Entities should continue to monitor U.S. legislation for new developments and consider the need to adjust their disclosures regarding the impacts of Pillar Two accordingly.

[9] As jurisdictions enact laws in response to the Pillar Two rules, each jurisdiction's enacted law will ultimately need to be separately evaluated for consistency with the framework.

7.5 New Accounting Standard — Improvements to Income Tax Disclosures (ASU 2023-09)

In December 2023, the FASB issued ASU 2023-09, which establishes new income tax disclosure requirements in addition to modifying and eliminating certain existing requirements. The new guidance is aimed at addressing what the ASU describes as stakeholder feedback indicating that "the existing income tax disclosures should be enhanced to provide information to better assess how an entity's operations and related tax risks and tax planning and operational opportunities affect its tax rate and prospects for future cash flows."

Under the new guidance, entities must consistently categorize and provide greater disaggregation of information in the rate reconciliation. They must also further disaggregate income taxes paid. The disclosure requirements of ASU 2023-09 apply to all entities subject to ASC 740.

The rate reconciliation requirements for PBEs differ from those for non-PBEs as follows:

- *PBEs* — Under ASC 740 before adoption of ASU 2023-09, public entities[10] are required to reconcile the income tax expense (or benefit) from continuing operations with the amount that would result from applying the domestic federal statutory rate to pretax income (loss) from continuing operations. The ASU provides that in addition to complying with that requirement, PBEs must annually "(1) disclose specific categories in the rate reconciliation and (2) provide additional information for reconciling items that meet a quantitative threshold (if the effect of those reconciling items is equal to or greater than 5 percent of the amount computed by multiplying pretax income [or loss] by the applicable statutory income tax rate)."
- *Non-PBEs* — Under ASC 740 before adoption of ASU 2023-09, nonpublic entities are required to provide disclosure of the nature of significant reconciling items, but a numerical reconciliation of income tax expense is not required. Under the ASU, although a numerical reconciliation is not required, non-PBEs are required to disclose (1) the nature and effect of the specific categories of reconciling items introduced by the new guidance and (2) individual jurisdictions resulting in a significant difference between the effective tax rate and the statutory tax rate.

In addition to requiring compliance with the new rate reconciliation disclosure requirements, ASU 2023-09 requires all entities within the scope of ASC 740 to provide annual disclosure of income taxes paid by disaggregating those amounts by foreign, domestic, and state taxes, with further disaggregation by jurisdiction on the basis of a quantitative threshold of 5 percent "of total income taxes paid (net of refunds received)." However, comparative information for all periods presented is not required for the disclosures related to income taxes paid in an individual jurisdiction under ASC 740-10-50-23.

The amendments in ASU 2023-09 are effective for PBEs for annual periods beginning after December 15, 2024. For entities other than PBEs, the amendments are effective for annual periods beginning after December 15, 2025. The ASU permits entities to early adopt the amendments "for annual financial statements that have not yet been issued or made available for issuance."

For more information about ASU 2023-09, see Deloitte's May 20, 2025, *Heads Up* and Appendix B of Deloitte's Roadmap *Income Taxes*.

[10] ASU 2023-09 replaces the term "public entity" throughout ASC 740 with the term "public business entity" as defined in the ASC master glossary.

7.6 SEC Comment Letter Themes Related to Income Taxes

Overall, the themes of SEC staff comments issued to registrants on financial reporting and disclosures related to income taxes have remained consistent year over year. Such comments continue to focus on (1) valuation allowances, (2) disclosures related to the income tax rate, (3) tax effects of significant or unusual transactions that occurred during the period, and (4) noncompliance with disclosure requirements (e.g., omission of required disclosures).

The SEC staff continues to request early-warning disclosures to help financial statement users understand key estimates and assumptions that registrants made in recording items related to income taxes and how changes to those estimates and assumptions could potentially affect the financial statements in the future. The SEC staff also continues to issue comments on non-GAAP measures with a particular focus on the income tax impact of the adjustments made to the GAAP measures. For additional information about non-GAAP measures, see Deloitte's Roadmap *Non-GAAP Financial Measures and Metrics*.

In 2022, the SEC issued updates to certain C&DIs on non-GAAP financial measures. However, C&DI Question 102.11 as issued on May 17, 2016, remains applicable in providing clarification on the presentation of the income tax effects of certain metrics based on the nature of the measure:

> **Question 102.11**
>
> **Question:** How should income tax effects related to adjustments to arrive at a non-GAAP measure be calculated and presented?
>
> **Answer:** A registrant should provide income tax effects on its non-GAAP measures depending on the nature of the measures. If a measure is a liquidity measure that includes income taxes, it might be acceptable to adjust GAAP taxes to show taxes paid in cash. If a measure is a performance measure, the registrant should include current and deferred income tax expense commensurate with the non-GAAP measure of profitability. In addition, adjustments to arrive at a non-GAAP measure should not be presented "net of tax." Rather, income taxes should be shown as a separate adjustment and clearly explained.

Historically, the SEC staff has stated that boilerplate language should be avoided with respect to income tax disclosures within MD&A and that approaches more conducive to effective disclosure would include:

- Using the income tax rate reconciliation as a starting point and describing the details of the material items.
- Discussing significant foreign jurisdictions, including statutory rates, effective rates, and the current and future impact of reconciling items.
- Providing meaningful disclosures about known trends and uncertainties, including expectations regarding the countries where registrants operate.

For more information about SEC comment letter themes that are relevant to the life sciences industry, see Deloitte's Roadmap *SEC Comment Letter Considerations, Including Industry Insights*.

Appendix B — Titles of Standards and Other Literature

AICPA Literature

Accounting and Valuation Guides

Assets Acquired to Be Used in Research and Development Activities

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Clarified Statements on Auditing Standards

AU-C Section 501, "Audit Evidence — Specific Considerations for Selected Items"

AU-C Section 620, "Using the Work of an Auditor's Specialist"

FASB Literature

ASC Topics

ASC 105, *Generally Accepted Accounting Principles*

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 220, *Income Statement — Reporting Comprehensive Income*

ASC 230, *Statement of Cash Flows*

ASC 235, *Notes to Financial Statements*

ASC 250, *Accounting Changes and Error Corrections*

ASC 260, *Earnings per Share*

ASC 270, *Interim Reporting*

ASC 275, *Risks and Uncertainties*

ASC 280, *Segment Reporting*

ASC 310, *Receivables*

ASC 320, *Investments — Debt Securities*

ASC 321, *Investments — Equity Securities*

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Appendix C — Abbreviations

Abbreviation	Description
AETR	annual effective tax rate
AFSI	adjusted financial statement income
AI	artificial intelligence
AICPA	American Institute of Certified Public Accountants
AIN	AICPA Accounting Interpretation of an APB Opinion
AMT	alternative minimum tax
ANDA	abbreviated new drug application
AOCI	accumulated other comprehensive income
APB	Accounting Principles Board
API	active pharmaceutical ingredient
ARO	asset retirement obligation
ASC	FASB Accounting Standards Codification
ASR	accelerated share repurchase
ASU	FASB Accounting Standards Update
AUD	Australian dollar(s)
BC	Basis for Conclusions
BEAT	base erosion anti-abuse tax
BEMTA	base erosion minimum tax amount
BPD	branded prescription drug
C&DI	Compliance and Disclosure Interpretation
CAM	critical audit matter
CAQ	Center for Audit Quality
CARB	California Air Resources Board
CARES Act	Coronavirus Aid, Relief, and Economic Security Act

Abbreviation	Description
CFC	controlled foreign corporation
CIMA	Chartered Institute of Management Accountants
CMO	contract manufacturing organization
CMS	Centers for Medicare & Medicaid Services
CODM	chief operating decision maker
CPU	central processing unit
CRO	contract research organization
CSRD	Corporate Sustainability Reporting Directive
CYR	choose-your-rate
DD&A	depreciation, depletion, and amortization
DEI	deduction-eligible income
DISE	disaggregation of income statement expenses
DTA	deferred tax asset
DTL	deferred tax liability
EBITDA	earnings before interest, taxes, depreciation, and amortization
EC	European Commission
ED	exposure draft
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EFRAG	European Financial Reporting Advisory Group
EGC	emerging growth company
EITF	Emerging Issues Task Force
ELOC	equity line of credit
EPS	earnings per share

Abbreviation	Description
ESA	energy service agreement
ESPP	employee stock purchase plan
ESRS	European Sustainability Reporting Standards
E.U.	European Union
EUR	euros
EU Taxonomy	EU Taxonomy for Sustainable Activities
Exchange Act	Securities Exchange Act of 1934
FAQ	frequently asked question
FASB	Financial Accounting Standards Board
FAST Act	Fixing America's Surface Transportation Act
FDA	U.S. Food and Drug Administration
FDDEI	foreign-derived deduction-eligible income
FDII	foreign-derived intangible income
FinREC	AICPA Financial Reporting Executive Committee
FOB	free on board
FPI	foreign private issuer
FRM	SEC Division of Corporation Finance Financial Reporting Manual
FVO	fair value option
FVTOCI	fair value through other comprehensive income
GAAP	generally accepted accounting principles
GDP	gross domestic product
GHG	greenhouse gas
GILTI	global intangible low-taxed income
GloBE	Global anti-Base Erosion
GPO	group purchasing organization
GPU	graphics processing unit
GWP	global warming potential
HAFWP	how and for what purpose
HFI	held for investment

Abbreviation	Description
HFS	held for sale
HHS	U.S. Department of Health and Human Services
HVAC	heating, ventilation, and air conditioning
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IEEPA	International Emergency Economic Powers Act
IFRS	International Financial Reporting Standard
IIR	investigator-initiated research
IOSCO	International Organization of Securities Commissions
IP	intellectual property
IPCC	Intergovernmental Panel on Climate Change
IPO	initial public offering
IPR&D	in-process research and development
IRA	Inflation Reduction Act of 2022
IRC	Internal Revenue Code
IRS	Internal Revenue Service
ISO	incentive stock option
ISSB	International Sustainability Standards Board
IT	information technology
ITC	invitation to comment
JOBS Act	Jumpstart Our Business Startups Act
LCD	liquid-crystal display
LIBOR	London Interbank Offered Rate
LIFO	last in, first out
LLM	large language model
M&A	merger and acquisition

Abbreviation	Description
MD&A	Management's Discussion & Analysis
MFN	most-favored-nation
MNE	multinational enterprise
MSL	medical science liaison
NCTI	net CFC tested income
NDA	new drug application
NFP	not-for-profit (entity)
NIH	National Institutes of Health
NLP	natural language processing
NOL	net operating loss
NOPA	notice of proposed adjustment
NQSO or **NSO**	nonqualified stock option
OCA	SEC Office of the Chief Accountant
OCI	other comprehensive income
OECD	Organisation for Economic Co-operation and Development
OEM	original equipment manufacturer
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PCC	Private Company Council
PIE	public interest entity
PIK	paid-in-kind
PIPE	private investment in public equity
PP&E	property, plant, and equipment
PRV	priority review voucher
PTRS	probability of technical and regulatory success
Q&A	question and answer
QIP	qualified improvement property
R&D	research and development
R&E	research and experimental

Abbreviation	Description
RAM	random-access memory
REIT	real estate investment trust
REMS	risk evaluation and mitigation strategy
ROU	right-of-use
S&P 500	Standard & Poor's 500 Index
SaaS	software as a service
SAB	SEC Staff Accounting Bulletin
SAFE	simple agreement for future equity
SASB	Sustainability Accounting Standards Board
SEC	U.S. Securities and Exchange Commission
Securities Act	Securities Act of 1933
SEPA	standby equity purchase agreement
SG&A	selling, general, and administrative
SOX	Sarbanes-Oxley Act of 2002
SPAC	special-purpose acquisition company
SPPI	solely payments of principal and interest
SRC	smaller reporting company
TCFD	Task Force on Climate-Related Financial Disclosures
TD	Treasury Decision
TRG	transition resource group
TSA	transition services agreement
USD	U.S. dollar(s)
UTB	unrecognized tax benefit
VCO	voluntary carbon offset
VIE	variable interest entity
VWAP	volume-weighted average daily market price

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