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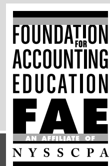

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Private Company Council and FASB: partners in an innovative collaboration

By CHRIS GAETANO
Trusted Professional Staff

Seven years after the formation of the Private Company Council (PCC), the body has found itself transitioning into a new role, with less emphasis on its original purpose of developing private-company alternatives to U.S. generally accepted accounting principles (GAAP), in favor of a more integrated involvement with the overall standards-setting process in support of the Financial Accounting Standards Board (FASB), which oversees it.

Neville Grusd, president of Merchant Financial Corporation and one of the council's founding members, said that this was a natural evolution, as the process of looking through GAAP and finding alternatives suitable for private companies is inherently a backward-looking one, with a finite number of tasks.

"It's natural that you run out of the look-back projects, but there's always going to be new stuff going on and coming up all the time, and getting the input of the PCC helps the FASB [make] a decision," he said.

Beth van Bladel, director of CFO for Hire LLC and a current member of the council, added that, over the years, the FASB has come to better understand the value that a private-company perspective brings to the standards-setting process, strengthening the two bodies' collaborative relationship even further.

"I have found it to be an incredibly rewarding experience, working with the PCC to identify practical expedients and collaborating with the FASB to consider simplification measures or develop new standards," she said.

The origins of the PCC

This change is reflective of an overall cultural shift within the FASB that has been taking place since the formation of the PCC in 2012, which saw an expansion of the board's understanding of its constituents and their particular needs, according to Russell G. Golden, the current chair of the FASB. The council itself formed after the publication of a 2010 joint study by the Financial Accounting Foundation (FAF), the American Institute of CPAs (AICPA) and the National Association of State Boards of Accountancy (NASBA), he said. That study found that there were systemic problems with the standards-setting process as it related to private companies, especially in terms of the relevance of certain rules, such as goodwill impairment. It recommended creating modifications and alternatives to current GAAP rules, as well as a new board to oversee their development.

At the time, the FASB was in the middle of developing several major standards, such as those covering leases and revenue recognition, as part of its convergence project with the International Accounting Standards Board (IASB), which had a heavy focus on public companies. This reflected a larger overall focus on public companies that, Golden said, needed to be overcome.

"We had to first recognize that private companies were different from public companies," he said. "This doesn't mean that every transaction will be accounted for differently, but we should recognize that access to management is a substantial difference between public and private companies, and therefore we should always consider if there should be different disclosures."

Russell G. Golden

FAF President and CEO Teresa S. Polley said that this focus on convergence led certain private company stakeholders to believe that they weren't being considered and that their needs were secondary to those of public companies, a sentiment that she said came out during their community outreach efforts.

"I think there was a bit of a perception that this whole international convergence effort didn't have a lot to do with private companies; it was more to do with public companies, which are more cross-border registrants, so I think at the time, the private companies were feeling disenfranchised," she said.

While the joint report recommended that the new private company board be its own separate body, ultimately, the FAF chose to make it part of the FASB's structure—a decision that Polley said was motivated largely by a desire to avoid bifurcating GAAP between private and public company standards.

"We just really thought that if we go down a path where we create a whole separate body with a whole separate GAAP, it would create additional complexity in the system, so that was our working premise when we went out with the initial proposal of a body that would be created under the purview of the FAF working closely with the FASB," she said.

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PARTNERSHIPS AND LLCs TAXATION CONFERENCE

Final IRS regs on pass-through deduction offer some clarity, says conference speaker

By CHRIS GAETANO
Trusted Professional Staff

The 20 percent deduction for pass-through entities has been one of the most prominent components of the Tax Cuts and Jobs Act (TCJA), but also one of its most misunderstood, according to **Robert Thee**, a tax director at Gettry Marcus CPA, P.C., who spoke at the Foundation for Accounting Education's Partnerships and LLCs Taxation Conference on Jan. 23. Fortunately, he said, the IRS has clarified many issues through the issuance of final guidance in mid-January, although some of these regulations strike him as puzzling. Overall, he said, this guidance carries significant planning implications for tax professionals.

For instance, under proposed regulations issued in August, a pass-through entity could aggregate business income only on the individual level. But, Thee said, under the final IRS regulations, a pass-through entity can now perform aggregation on the entity level, provided that the business qualifies for the deduction in the first place. Generally, the deduction's value is equal to 20 percent of qualified business income (QBI) or the greater of either 50 percent of W-2 wages or 25 percent of W-2 wages plus 2.5 percent of unadjusted basis (in qualified property) immediately before acquisition (UBIA). The final regulations allow aggregation at the entity level in order to enable businesses that do not, on their own, have sufficient W-2 wages or QBI to get the maximum deduction, said Thee.

"So that's a very key benefit," he explained. "If you have a business that has a lot of income passing through but not a lot of wages or not a lot of property, and you have another business that does have a lot of wages and a lot of property, you can combine the two and get the benefit."

Under the final regulations, Thee said that entities need to meet all of the following requirements to aggregate: There must be at least 50 percent common ownership, which, he said, does not have to be strictly common—family attribution rules apply, for instance; the ownership described must exist for the majority of the tax year in which the aggregated items are included in income; all aggregated items must be reported on returns with the same tax year; and none of the trades or businesses involved can be a specified service trade or business (SSTB). (SSTBs are businesses that provide services in the areas of health, law, consulting, athletics, financial or brokerages services, or businesses whose principal asset is the reputation or skill of one or more of its employees or its owner.)

In addition, two out of three of the following requirements must also be met: The trade or business must provide products and services that are the same or that are customarily offered together; share facilities or a significant centralized business element; and operate in coordination with, or reliance upon, one or more of the businesses in the aggregated group.

"To give an example where you don't qualify," he said, "someone owns investments in partnerships [and] has an 80 percent interest in all these partnerships, and so you have met the ownership test. Now, say they have a bunch of restaurant chains across the country, but each one is managed independently and [they] don't rely on each other. You would meet condition one, the ownership, but since you don't meet either two or three, you cannot aggregate them."

Thee said he found it surprising that the final regulations apparently differentiate residential and commercial rental operations, and so they cannot be aggregated together, even though these two types of operations are very similar. He compared this provision to another provision centered around partnership income, which he found just as puzzling—one governing guaranteed payments.

"Even if the economics are the exact same thing, if it's called a 'guaranteed payment,' it doesn't qualify," he said. "If [a partnership pays] each partner a guaranteed payment of $500,000, each would have $500,000 of ordinary income and cash in their pockets. Under the old rules, there would be no difference; they'd be taxed the same way. But on the other hand, if instead of guaranteed payments, [they were called] distributions of $500,000 each from capital, [the partners would] be on the same spot for taxable income, … but now they can qualify for the QBI deduction."

At the same time, the final regulations did ease up a bit on the rules surrounding W-2 income. Presumably to prevent firms from turning every employee into an independent contractor, the earlier proposed regulations said that former employees are still deemed to be employees for the purposes of calculating the deduction, even if they're not employees for the purposes of payroll tax. This is still the case in the final regulations, though he said the IRS has added a three-year lookback period, "meaning that after three years, that doesn't hold, and [it] allows for rebuttal of presumption based on corroborating records."

The final regulations also provided further explanation of what couns as an SSTB, which has been a major area of discussion since the passage of the TCJA. For example, the statute bars those working in the health field from getting the deduction. While the proposed regulations limited this disqualification just to those providing direct services to the patient, in the final version, there is no such distinction. The final regulations also clarified that accounting, another profession considered to be an SSTB, includes CPAs, enrolled agents and return preparers.

"Some people initially thought, 'Oh, accounting—that just means CPAs and financial statements, but the tax prep services we can break out.' But, no, that doesn't qualify," he said.

Thee admitted that some of the definitions in the final regulations don't always make sense to him. For instance, while financial services—defined as managing wealth and advising clients—are considered to be SSTBs, banking or money-lending services are not. Similarly, while securities brokers are considered to be SSTBs, real estate or insurance brokers are not.

However, in the event that the final regulations, as released, put a client in a bad position, he gave his audience some good news: "The final regs say you *can* rely on the proposed regs for the 2018 year. So if there was something in the proposed regs that was favorable [but] changed, you can still take that position, or rely on the final regs, for 2018 returns."

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Private Company Council

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The beginning of the collaboration

Golden said that the first collaboration between the two bodies was in developing the new PCC's decision-making framework, which was the first time that there was an acknowledgment on the FASB's part that there should be different effective dates and disclosure considerations for private companies. Participants in the collaborative effort outlined how the PCC would determine whether there needed to be a private company alternative to current standards, he said, and they talked about the characteristics that differentiate the needs of private company financial statement users from those of public companies. For example, they discussed how investors in private companies are likely to have greater access to management, and, as a result, certain disclosures aren't as necessary as they would be in public companies.

Grusd conceded that he came into the PCC with "a very simplistic view of what I thought we should be changing." He said that on the day of his very first meeting, he was initially worried about the very different approaches that PCC members had versus FASB members—a concern that was borne out of coming to the standards-setting world largely as an outsider.

"To me, the FASB was a mythical entity that was up in the clouds, and those were the people who made the rules for the country's accounting. I was in awe," he said. "[But] there was Russ Golden, and he was really a regular guy, and I got to know the people on the FASB."

Grusd changed his perspective over the course of working on private-company GAAP alternatives, saying that he came away from his experience with a respect for the "depth to which the FASB board members drilled down into an issue."

Changes within the FASB

As the PCC undertook this work, the FASB came to understand that the issues with GAAP were not limited to just private companies, and that it needed to expand its understanding of exactly who its constituents were and how it had fallen short in meeting their needs over the years. In time, this understanding has turned into what Golden said was a cultural change at the FASB, which now talked about "how we need to serve all stakeholders equally," not just public companies but private companies, not-for-profits, employee benefit plans and other entities.

He noted that this process also got the FASB thinking about how even public companies could benefit from the changes made with nonpublic companies in mind, namely in terms of toning down some of the complexity that had built up in GAAP over the years. It was this thinking that led to the FASB's simplification initiative, which made narrow-scope simplifications to accounting standards through a series of short-term projects.

"What the PCC, at the broad level, was talking about was how we can make GAAP simpler without losing the relevance to the user," Golden said. "We made quite a number of improvements there, and a lot of those ideas came from PCC members and stakeholders, as well as public company stakeholders."

The FASB's changes have, in turn, reflected back to the PCC: The current chair, Candace E. Wright, a director with Postlethwaite & Netterville, said that the FASB has enabled collaboration of the sort that she did not believe would have been possible 10 years ago.

Consequently, rather than wait for the PCC to develop a GAAP alternative for a new standard, the FASB is increasingly opting to involve the PCC in the process from the start. Van Bladel noted, for example, that the PCC had a great deal of input in helping to shape ASU 2018-15, which concerned accounting for the implementation costs of cloud-computing contracts. She said that since she already had operational experience in this area, she was able to provide the FASB staff with greater insight into how cloud-computing implementation costs affect private companies and how the FASB might analogize their costs to those associated with internal-use software.

Beth van Bladel

"It can be very challenging to balance the needs of users, auditors and preparers of financial statements," Van Bladel said. "Fortunately, we have the Private Company Decision-Making Framework, which provides an objective guide to facilitate our deliberation process. I am confident the PCC will continue to be a resource to the FASB as it continues its efforts to balance the needs of users and auditors with the cost and complexity for preparers."

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