In depth
A look at current financial reporting issues

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What's inside:

IFRS tax accounting effects of the US tax reform

At a glance

President Trump signed into law on 22 December 2017 extensive changes to the US tax system. These changes are substantively enacted for accounting purposes in 2017 and should be reflected in the financial statements at 31 December 2017.

The tax law changes could have a significant impact on the current and deferred taxes of entities with a US tax presence. This In depth summarises the key changes and the IFRS tax accounting impact. Additional detailed information about the changes is included in the US In depth publication - Accounting considerations of US tax reform.

Key changes to the US tax system and the IFRS tax accounting impact

Tax law changes	IFRS tax accounting impact
Tax rate The US federal corporate income tax rate is reduced from the existing rate of 35% to 21% with effect from 1 January 2018, regardless of the entity's tax year. Entities that do not have a 31 December reporting date will be subject initially to a pro-rated US federal corporate income tax rate that will apply to the first income tax year that ends after 31 December 2017. For example, a 30 June 2018 reporting date entity would apply a pro-rated US corporate tax rate of approximately 28%.	Deferred tax assets and deferred tax liabilities should be remeasured using the new tax rate, which will apply when the existing temporary differences reverse. Entities with non-calendar reporting dates may recognise the impact of the tax law changes in the interim period in which they were enacted. It is also acceptable to spread the effect over the remainder of the reporting period through the estimate of the annual effective tax rate for interim reporting periods. Entities with non-calendar reporting dates should also consider whether temporary differences reverse during a period when a pro-rated tax rate applies.

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Repeal of alternative minimum tax (AMT) AMT is repealed. AMT carry-forwards at 1 January 2018 can now be offset against regular tax, and any remaining balances will be refundable over the next four years.	Unrecognised deferred tax assets should be reassessed now that the carry-forwards are generally expected to be fully refundable. Entities should decide whether to reclassify AMT carry-forwards as a receivable. An entity might classify AMT carry-forwards as deferred tax assets if they will be recovered against future tax obligations, or as a receivable if they will be repaid in cash. There is an accounting policy choice of whether to discount current tax balances. The FASB staff have concluded that AMT carry-forwards should not be discounted under US GAAP, regardless of the expected manner of recovery.
Changes in the way that net operating losses (NOLs) are recovered NOLs generated after 2017 can be carried forward for an indefinite period, but generally cannot be carried back. Utilisation will be limited to 80% of taxable income in each year. There is no change to the rules applied to NOLs generated before the end of 2017.	These changes might alter the assessment of the recoverability of deferred tax assets arising from NOLs. The changes will largely affect the recoverability of NOLs arising after 1 January 2018, but there could also be an impact on existing temporary differences that are expected to reverse into NOLs after that date.
Interest expense limitation The existing interest deduction limitations will be expanded. Interest deductions will be limited to 30% of adjusted taxable income. Interest not recovered in the year in which it is incurred can be carried forward indefinitely.	This will potentially create additional deferred tax assets that will need to be assessed for recoverability. Current-period interest will be deducted first, which might restrict an entity's ability to recognise deferred tax assets for interest deductions carried forward from previous periods in some cases.
Cost recovery (full expensing) Certain capital expenditure placed in service after 27 September 2017 and before 1 January 2023 may be written off immediately for tax purposes. Companies can also elect not to immediately write off qualifying assets.	This election might affect the current tax charge in 2017. It might create new taxable temporary differences in 2017 and additional deferred tax assets for tax loss carry-forwards (if a taxable loss is determined) that should be assessed for recoverability. Deferred tax liabilities and assets would be measured at the new lower tax rate that will apply when they reverse.

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Territorial tax regime International tax provisions change the US approach to the taxation of foreign earnings, including the transition to a *'territorial regime'* providing a 100% dividend received deduction (DRD) on certain qualifying dividends from foreign subsidiaries.	The new rules might cause entities to reassess whether an existing outside basis difference will reverse in the foreseeable future and could affect the measurement of any deferred tax liability arising on investments in subsidiaries. Future dividends paid by foreign subsidiaries will not be taxed, but there could be withholding and other tax consequences imposed by the foreign jurisdiction on such dividends.
Repatriation – toll charge There will be a deemed mandatory repatriation of previously undistributed earnings and profits (E&P) of foreign corporations owned by U.S. parents. The rate applied depends on the subsidiaries' liquid and non-liquid assets. NOLs can be used to reduce the taxable income arising from the deemed repatriation and foreign tax credits (FTCs) can be used to settle the toll charge. The net charge can be paid in instalments over eight years.	There will be a current income tax liability in 2017 for the toll charge. There is an accounting policy choice of whether to discount current tax balances. The current tax liability might affect the recoverability of existing unrecognised deferred tax assets. The FASB staff have concluded that this liability should not be discounted under US GAAP.
Taxation of foreign earnings Certain global intangible low-taxed income (GILTI) of subsidiaries of US parents will be taxable income for the parent each year, based on the excess of foreign income over a specified return (deemed return on tangible assets of foreign corporations). This will result in a US tax on foreign earnings where: (i) there is not a large aggregate foreign fixed asset base; and (ii) foreign earnings are taxed at a low rate.	It would be acceptable, under IFRS, to recognise the charge for GILTI in the year in which it is included on the tax return on the basis that it is triggered by the existence, on an aggregate basis, of 'excess' low-taxed foreign income in that year. It might also be acceptable to include the impact of the GILTI charge in the tax rate used to measure deferred taxes for temporary differences expected to reverse as GILTI. Judgement will be required to determine whether this is appropriate, and management should consider, for example, whether the entity is likely to be subject to the GILTI charge consistently, and whether it is possible to make a reliable estimate of its impact. Clear disclosure of the accounting model applied, the judgements made and the accounting impact should be given. The FASB staff have concluded that there is an accounting policy choice under US GAAP to either recognise GILTI as a period cost or include it in the measurement of deferred taxes.

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Incentive for US production and selling abroad An additional deduction for US companies that produce domestically and sell abroad has been introduced, referred to as Foreign Derived Intangible Income (FDII). The deduction is 37.5% (reduced to 21.875% for taxable years starting after 31 December 2025) for the portion of foreign-derived income in excess of a fixed return on qualifying business asset investment.	This type of deduction is not addressed specifically by IAS 12. Recognition in the year in which the deductions are included in the tax return would be an acceptable approach under IFRS, on the basis that it is foreign sales in each year that trigger the deduction. It might also be acceptable to include the impact in the tax rate used to measure deferred taxes on temporary differences that will be subject to FDII on reversal. Judgement is used to determine whether this is acceptable, and the decision will depend on an entity's specific facts and circumstances. Clear disclosure of the accounting model applied, the judgements made and the accounting impact should be given. In our view, FDII should be accounted for as a special deduction under US GAAP and recognised in the year in which the deduction is claimed.
Foreign tax credits (FTCs) There are significant modifications to the FTC provisions, and certain indirect FTCs are repealed.	This might affect the assessment of recoverability of deferred tax assets related to FTCs.
Anti-base erosion – minimum tax on certain related party payments A minimum tax, known as BEAT, will be paid when the tax calculation under BEAT exceeds the corporation's regular tax liability (after the application of certain credits). BEAT is a modified taxable income after adding back base erosion payments, such as payments to related foreign persons (generally excluding payments for cost of goods sold).	The FASB staff have concluded that temporary differences should be measured at regular tax rates and the effects of BEAT should therefore be accounted for in the year in which it is incurred. This approach would be acceptable under IFRS.

Recognition of the remeasurement of deferred taxes

IFRS requires the remeasurement of deferred taxes to be recorded outside profit or loss if the deferred tax relates to items previously recognised in other comprehensive income or equity, which is commonly referred to as 'backwards tracing'. It might sometimes be difficult to determine how to allocate the remeasurement. For example, a change in tax rate might affect a deferred tax balance that was previously recognised partly outside profit or loss (for example, in connection with an employee benefit liability). A reasonable pro rata allocation, or other suitable method that achieves a more appropriate allocation, can be used to reflect an entity's circumstances.

Judgements and estimates

The calculations and assessments required by the changes in US tax law are complex, and some entities might find it difficult to complete the analysis before the 2017 financial statements are issued. Challenges will include the time needed to complete and collate the data for the calculations, the actual application of the new law and understanding some of the accounting implications.

Management should do its best to make a reliable estimate of the accounting impact of each aspect of the tax law changes, taking into account 'reliable information that could reasonably be expected to have been obtained and taken into account' (IAS 8 para 5), together with the entity's existing approach to uncertain tax positions. Subsequent adjustments would typically be accounted for as a change in estimate. In almost all cases, management should be able to make a reliable estimate.

Entities should also present all of the required relevant disclosures, including those required by IAS 12 and also disclosures on judgements and estimation uncertainties required by paragraphs 125–133 of IAS 1.

Other accounting considerations

The tax law changes might have other accounting consequences. These might affect, for example, hedge accounting, impairment testing and liquidity disclosures. The extent of the impact and the areas affected will depend on a company's particular circumstances.

Questions?

PwC clients who have questions about this *In depth* should contact their engagement partner.

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