Tax accounting services

Top tax accounting considerations for 2021

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Introduction

2021 had considerable activity across the global legislative and regulatory landscapes, which has resulted in companies being tasked with understanding the changes from a technical perspective, including the related financial reporting impacts, as well as any process, data and internal control implications. These developments, combined with the continued uncertain worldwide economic conditions, add to the challenges in accounting for income taxes.

To assist companies in navigating these complexities, PwC's National Tax Accounting Services (TAS) team has developed this publication to provide a general overview of the significant financial reporting developments, as well as helpful reminders for year-end. This publication also provides useful links to quickly access additional information.

Unless specifically indicated, the discussion and references throughout this publication pertain to US generally accepted accounting principles (US GAAP) and reporting considerations.

As we start the new year and anticipate continued developments throughout 2022, it is important for companies to remain focused on current events in order to accurately and timely evaluate how these developments will impact financial reporting.

Our TAS team will continue to keep companies informed of the rapidly evolving legislative and regulatory environment, including perspectives on tax accounting impacts. As developments occur, we will provide updates through additional thought leadership.

Happy new year from our team to yours,

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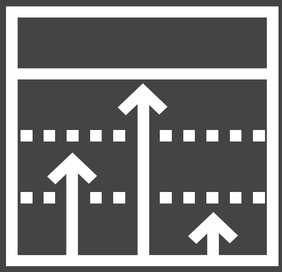
Tax law developments

Under US GAAP, changes in tax law are accounted for in the period of enactment, regardless of the effective date. The total effects of the law changes on current and deferred taxes, including the impact on the realizability of deferred tax assets, are accounted for as a component of continuing operations. This is regardless of the category of income in which the underlying pretax income/expense or asset/liability was or will be reported. If enactment occurs in an interim period, companies would need to consider whether the impacts of the law change are recorded discretely in the period or accounted for as part of the estimated annual effective tax rate.

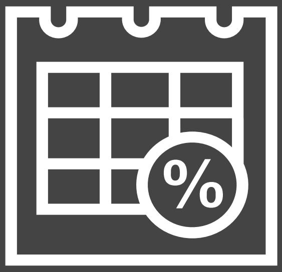
In 2021, various territories implemented and amended legislative rules with respect to the European Union Anti-Tax Avoidance Directives (ATAD I and II) in addition to continued measures to support businesses impacted by COVID-19.

The most significant developments included tax law changes in the UK, Netherlands and Spain, tax reform proposals in Brazil and the US, as well as the progression of the OECD global tax initiatives.

Enactment



Continuing operations



Interim

United Kingdom

The UK Finance Act 2021 was enacted for US GAAP purposes in June of 2021. Key elements of the Act include:

- Increase in the corporate income tax rate from 19% to 25% beginning on April 1, 2023,
- Introduction of a “super deduction” for companies investing in new qualifying plant and machinery from April 1, 2021 until March 31, 2023, and
- Temporary extension of the trading loss carryback period from one year to three years which applies for accounting periods ending between April 1, 2020 and March 31, 2022.

Netherlands

Amendments to the loss carryforward rules were enacted in June of 2021. Key changes to the loss carryforward rules include:

- Changing the loss carryforward period from a six year carryforward period to an indefinite carryforward period, and
- Introducing an annual cap of EUR 1 million plus 50% of the taxable profit above EUR 1 million on the utilization of carried forward losses.

Further, on December 27, 2021 the Dutch Tax Plan 2022 was enacted. Key changes include:

- An increase in the corporate income tax rate to 25.8% as of January 1, 2022, and
- A threshold reduction from 30% to 20% for the EBITDA interest expense limitation for financial years starting on or after January 1, 2022.

Spain

On December 28, 2021, Spain enacted Law 22/2021 for the 2022 General State Budget. A key measure, which is effective for tax periods starting on or after January 1, 2022, includes the introduction of a 15% minimum corporate tax rate. This rate is applicable to taxpayers that meet either of the two following conditions:

- Net turnover equal to or exceeding EUR 20 million in the 12 month period preceding the current tax period, or
- Taxpayers who are taxed under the tax consolidation regime, regardless of turnover.

The minimum tax rate will be adjusted to 10% for newly created entities and 18% for credit institutions and for entities linked to exploration, research and exploitation of hydrocarbon deposits and subway storage facilities.

Brazil

In September of 2021, the Brazil House of Representatives approved a bill on tax reform which contains provisions to reduce the corporate income tax rate from 34% to 26% for most businesses and reintroduce a 15% dividend withholding tax rate, along with other base broadening measures. Upon enactment, these provisions are expected to be effective beginning January 1, 2022. As of the date of this publication, this bill is not final.

United States

While broad US tax reform legislation was not enacted in 2021, it was still a busy year. For example, the $1.9 trillion covid-relief "American Rescue Plan Act" was enacted with tax provisions that included a measure repealing the election for US affiliated groups to allocate interest expense on a worldwide basis, effective for tax years beginning in 2021. A $1.2 trillion Infrastructure Investment and Jobs Act was enacted with revenue offsets that include a new cryptocurrency information reporting requirement and the reinstatement of certain Superfund excise taxes.

As a reminder, there are certain key changes from the 2017 tax reform act (the 2017 Act) taking effect in 2022. Under the 2017 Act, deductions for net interest expense under Section 163(j) are limited to 30% of adjusted taxable income, which has, up until this point, been defined similarly to EBITDA (earnings before interest, taxes, depreciation, and amortization). For tax years beginning after December 31, 2021, the calculation of adjusted taxable income is defined similarly to EBIT (earnings before interest and taxes).

The 2017 Act also amended Section 174 related to the treatment of research and experimental (R&E) expenditures. Taxpayers may no longer deduct R&E expenditures incurred in tax years beginning after December 31, 2021. Instead, taxpayers must capitalize all of their R&D costs and amortize those expenses over five or 15 years, as applicable.

Note: The House-passed "Build Back Better Act" (H.R. 5376) that is pending further action in the Senate contains a provision that would reinstate on a temporary basis the previous Section 174 treatment of R&E expenditures.

Companies should continue to monitor developments in 2022 around broader US tax reform. Enactment of tax law subsequent to a company's period end, but prior to the issuance of financial statements, would represent a nonrecognized subsequent event and should be disclosed.

OECD global tax initiatives

The OECD Inclusive Framework on Base Erosion and Profit Shifting (IF) has 137 out of 140 countries politically committed to the fundamental changes proposed for the international corporate tax system, which is often referred to as Pillar One and Pillar Two.

Pillar One introduces rules with respect to profit reallocation between territories and will initially apply to multinational enterprises with a profitability above 10% (calculated as profits before tax over revenue) and global turnover above EUR 20 billion. It is the OECD's aim to further define and publish model rules for domestic legislation by early 2022.

Pillar Two introduces a global minimum tax of 15%. The OECD released model rules for implementation in domestic legislation on December 20, 2021. This was followed by the European Commission publishing a draft Directive on December 22, 2021 which closely follows the OECD Pillar Two rules with some adjustments to conform to EU law on implementing a 15% minimum effective tax rate in EU Member States. The Pillar Two rules have a much wider application and would include multinational enterprises with global revenue above EUR 750 million. It is expected that the OECD will release commentary relating to these model rules in early 2022. This commentary is expected to provide further background, examples and clarifications of the model rules.

While the overall intent of the OECD is to achieve implementation of both Pillars to be effective in 2023, there are significant technical considerations to be finalized before each tax jurisdiction can implement these rules. Enactment can only be achieved through each individual tax jurisdiction's domestic legislative process.

As tax jurisdictions move closer to implementation of the OECD proposals, companies will need to monitor the progress of both Pillar One and Pillar Two in order to account for the financial statement impact upon each tax jurisdiction's enactment.

Valuation allowances

Assessing the need for a valuation allowance against deferred tax assets (DTAs) is a complex area and often requires significant judgment. The potential impacts of enacted legislative changes, as well as the continuation of the economic impacts as a result of COVID-19, can further complicate the analysis. To assist companies in performing the assessment, the following considerations and reminders should be evaluated:

All available evidence: The accounting standard requires that all available evidence, both positive and negative, be considered in determining whether a valuation allowance is needed as of each reporting period date. The weight given to each piece of evidence is directly related to the extent that evidence can be objectively verified, with recent financial results generally carrying more weight than forecasted earnings. However, forecasts are a key piece of evidence that need to be considered, including how enacted tax law changes may impact expected future results.

Cumulative income: The cumulative income/(loss) position of a company is one of the factors that should be weighted in the assessment. While ASC 740 indicates that cumulative losses are a significant piece of negative evidence that is often difficult to overcome, the cumulative loss alone is not a single determinative factor. Likewise, a cumulative income position should not be considered a single determinative factor.

Determining the weight of the cumulative income/(loss) position requires judgment, which has been particularly challenging for many companies as a result of the economic impacts of the pandemic. As companies assess the weight of recent results, the following questions may be considered useful:

- How do the two years of operations since the pandemic began compare to each other?
- What are the trends in earnings in those years? Are there new factors regarding the entity's business or products that would suggest there is a new trend in earnings that is expected for the foreseeable future?
- If an entity reported losses in 2020 as a result of the pandemic, has the entity seen a level of recovery in 2021 relative to 2020? How do the actual results compare to forecasts?
- For entities that historically reported losses and as a result of the pandemic are reporting positive results, are the positive results sustainable?
- Have any changes been made to the business as a result of the pandemic and what are the sustainable effects on earnings as a result of these changes?

Impact of tax law changes: The valuation allowance assessment must consider the impact of changes in tax law in the period of enactment, including the effects of law changes that take effect in future periods.

Each jurisdiction's tax law changes will present unique considerations for how the respective changes may impact the valuation allowance assessment. Considerations that companies should evaluate include:

- **Carryforward periods**: A change in carryforward period may impact realizability of deferred tax assets, including available sources of taxable income. For example, for a jurisdiction with a change to an indefinite carryforward period, a source of income that supports realizability may now include deferred tax liabilities related to indefinite-lived assets.
- **Limitations**: New limitations on the usage of a net operating loss or a tax attribute should be considered in determining the amount realizable and may require scheduling.
- **Interaction of attributes**: In many instances, the utilization of attributes interact and may further be impacted by the interaction with other deductible temporary differences. Scheduling may be necessary to analyze all factors in the valuation allowance assessment.

PwC Income taxes guide Chapter 5 provides additional details, including a discussion on the four sources of taxable income that companies should consider as part of the valuation allowance assessment.

Income tax disclosures

With the continued focus globally on transparency, including around taxes, and in consideration of the significant legislative developments, financial statement disclosures are key to providing decision-useful information to regulators, investors and other stakeholders. As companies prepare their year-end financial statements, the following key reminders should be considered to determine if the disclosure provides a reader insight into the tax positions of the company:

Early warning disclosures: Areas that require significant estimates and judgments, such as valuation allowances and uncertain tax positions, may require an early warning disclosure if a company expects a change in a material estimate to occur within 12 months.

Valuation allowances: Requirements for disclosures related to a change in a valuation allowance position include a discussion of the positive and negative evidence considered, how the evidence was weighted and the basis for the conclusion as to whether a valuation allowance is or is not required.

Uncertain tax positions: If it is reasonably possible that the positions and events could change the associated recognized tax benefits within the next 12 months, companies are required to disclose the nature of the uncertain tax position and the related events. This includes previously unrecognized tax benefits that are expected to be recognized upon the expiration of a statute of limitations within the next year.

Outside basis differences: For companies asserting indefinite reinvestment, there are several required disclosures, including the amount of the outside basis difference, a discussion of what would cause the difference to become taxable, and an estimate of the related unrecognized deferred tax liability or a statement it is impracticable to estimate the unrecognized liability.

Effective tax rate: For public companies, SEC Rule 4-08(h) of Regulation S-X requires that individual reconciling items be broken out separately within the effective tax rate reconciliation if it is more than 5 percent of the amount computed by multiplying pre-tax income by the statutory tax rate. For US based companies, the threshold is 1.05%. Additionally, discussion should provide users with an understanding of the underlying factors of the rate, items that are considered unusual and infrequent as well as a discussion of significant changes that may occur in the future.

Tax related disclosures should be consistent with other financial statement disclosures, including MD&A.

Standard setting updates

While the FASB's focus on standard setting in 2021 related to accounting considerations outside the area of taxes, companies should keep in mind the following Accounting Standard Updates (ASU):

ASU 2019-12 Simplifying the Accounting for Income Taxes

Beginning in 2021, public entities were required to adopt ASU 2019-12 for annual and interim periods. For all other entities, the ASU is effective for annual periods beginning in 2022, and interim periods beginning in 2023.

The standard eliminates certain exceptions to the general principles in ASC 740 and makes amendments to other areas with a focus on simplification and consistent application of US GAAP. For a detailed discussion of the various provisions in the ASU, refer to the PwC InDepth linked within the resource section below.

ASU 2021-10 Government Assistance Disclosures (Topic 832)

In November 2021, the FASB issued ASU 2021-10 on Government Assistance. This standard, which is codified as ASC 832, introduces new disclosure requirements for government assistance and applies to entities that have accounted for transactions with a government by analogizing to a grant or contribution accounting model.

As government assistance can take many forms including that of tax credits, cash grants, financial assistance for certain eligible expenditures or grants of other assets, the determination of whether the assistance is within the scope of ASC 832 is dependent on an analysis of the nature of the assistance and the conditions on which it is predicated.

ASC 832 is relevant to consider for any tax credits or incentives that do not fall within the scope of ASC 740 or another specific standard under US GAAP. For credits or incentives where there is no dependency upon income taxes payable or taxable income and where the credit is refundable, the benefit would generally not be subject to the principles of the income tax accounting standard. If a credit or incentive is determined to be outside the scope of ASC 740 or another specific standard under US GAAP, the credit or incentive item generally falls within the scope of ASC 832.

For items within the scope of ASC 832, there are specific disclosure requirements to keep in mind. ASC 832-10-50-3 requires business entities to provide disclosures for annual periods that provide information about government assistance that will enable a user to better assess the overall nature of the transaction and its impact on the financial statements.

The effective date is for fiscal years beginning after December 15, 2021 with early adoption permitted.

ASU 2021-08: Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers

In October 2021, the FASB issued guidance that requires contract assets and contract liabilities (i.e., deferred revenue) acquired in a business combination to be recognized and measured by the acquirer on the acquisition date in accordance with ASC 606, Revenue from Contracts with Customers.

Generally, this new guidance will result in the acquirer recognizing contract assets and contract liabilities at the same amounts recorded by the acquiree. Under current US GAAP, contract assets and contract liabilities acquired in a business combination are recorded by the acquirer at fair value. The new guidance creates an exception to the general recognition and measurement principles of ASC 805, Business Combinations.

The new guidance should be applied prospectively and is effective for calendar year public business entities beginning in 2023 and all other calendar year entities in 2024, including interim periods within those respective years. Early adoption is permitted, including in interim periods, for any financial statements that have not yet been issued.

Companies should consider whether early adoption of this standard in 2021 impacts the deferred tax accounting consequences of the business combination.

Useful resources

Publications

Tax Accounting Services Publications

In depth: FASB simplifies accounting for income taxes

In depth: Accounting for acquired contract assets and contract liabilities

Accounting guides

Financial statement presentation

Income taxes

Other resources

Tax Readiness: Q4 financial reporting considerations (webcast replay)

PwC's Viewpoint - Income tax accounting

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