



Tax reform – What's next

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Learning objectives

1

Identify the ongoing accounting and reporting implications of the Act

2

Recognize the accounting and reporting implications of certain provisions of the Act for 2018

3

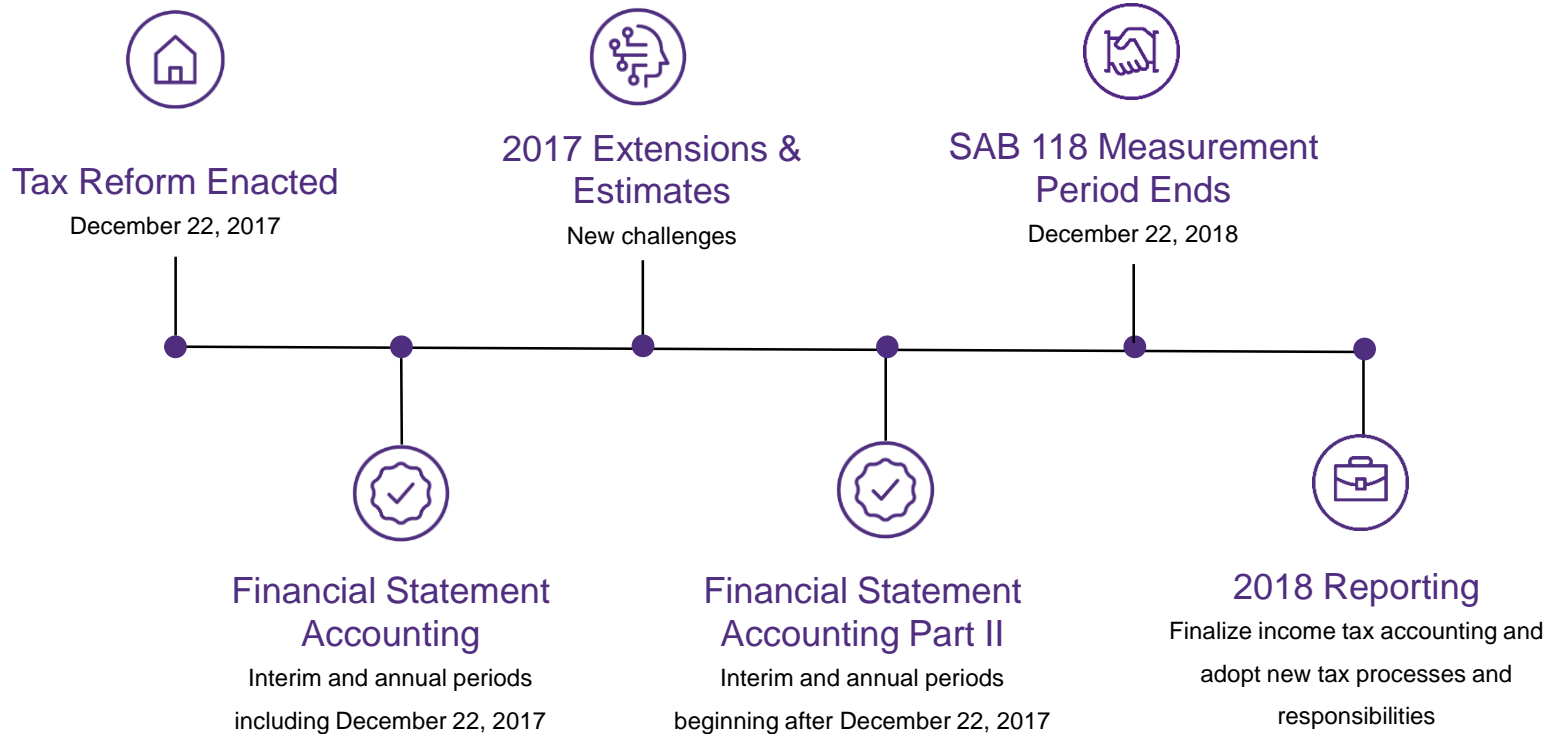
Describe how certain provisions of the Act will impact the effective tax rate in 2018

Agenda

- 1 Introduction
- 2 Tax Reform Recap
- 3 SAB 118 and ASC 740-270
- 4 Significant Items Impacted by Tax Reform
- 5 Indefinite Reinvestment Implications

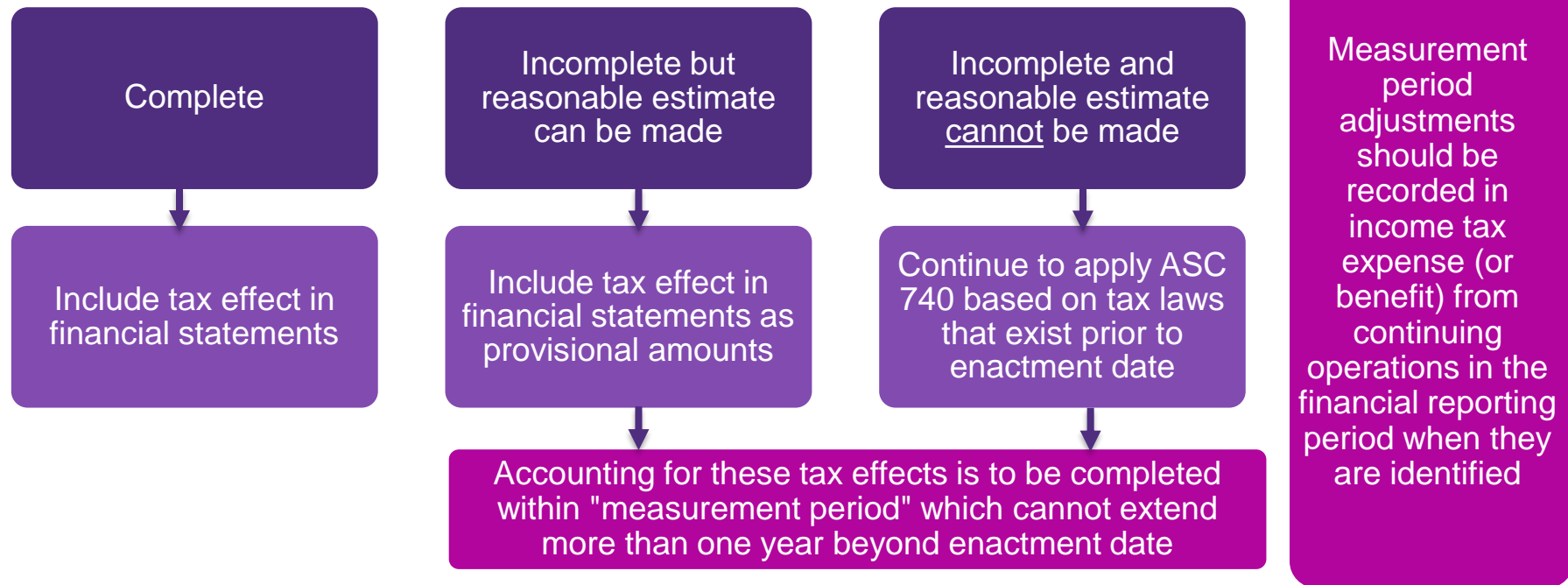
- 6 ASU 2018-02: Stranded Tax Effects
- 7 Ongoing Disclosure Requirements

The Tax Reform Journey Continues



Staff Accounting Bulletin (SAB) 118

Codified into ASC 740 (ASU 2018-05) - tax effects for which accounting is:



Common SAB 118 Estimates

- Re-measurement of deferred tax assets / liabilities
- One-time transition tax
- Impact of new 162(m) rules
- State implications
- Valuation allowance on deferred tax assets
- Change in indefinite reinvestment assertion

Can reasonable estimate be made?



- Record provisional amount in period of enactment
- Record "measurement period adjustments" discretely in period when determined
- Record nothing in period of enactment
- Record amounts in future periods when reasonable estimates can be made

Interim Reporting - General

General rules for calculating tax expense for interim periods

- 1 Calculate ***estimated*** annual effective tax rate ("EAETR")
- 2 Apply EAETR to YTD Ordinary Income / (Loss)
- 3 Consider discrete items
- 4 Apply intraperiod allocation rules
- 5 Consider limitations and exceptions to the general rule
- 6 Potentially revise EAETR in future interim periods, as better information becomes available

Estimated annual effective tax rate

- Make best estimate of the annual effective tax rate for full fiscal year at end of each interim period
- Use EAETR to record tax on current year-to-date basis
 - Project year-end temporary differences and valuation allowances
- Tax Cuts and Jobs Act considerations:

Do

- Adjust EAETR for changes to ongoing effects of the Tax Act
- Disclose what provisions were not considered in EAETR or are based on provisional amounts in EAETR

Don't

- Adjust EAETR for measurement period adjustments to enactment-date effects of the Act
- Compute EAETR with global intangible low tax income (GILTI) in deferred taxes if policy not yet elected

Impact of Tax Act on EAETR



Reduced corporate tax rate

Expansion of executive compensation limitation under Section 162(m)

Modifications to interest expense limitations under 163(j)

Expansion of limitations on M&E expenses

State tax effects

Executive compensation deductions

Limits on executive compensation deductions

- Expands the limit on deduction of covered employees' compensation in excess of \$1 million
- Expands definition of a covered employee to include CFO
- Applies to compensation of a covered employee in all future years
- Expands definition of a public entity to which deduction limitation applies

Accounting implications

- Less deductible employee compensation; could impact projections of future taxable income
- Permanent differences from nondeductability impact entity's effective tax rate

Business interest deduction example

Example 1

Taxable Income <u>before</u> section 163(j)	\$10
Taxable - Business Interest Income	(5)
Tax Deductible – Business Interest Expense	40
Depreciation and Amortization (pre-2022)	55
<hr/>	
Adjusted Taxable Income	\$100
163(j) Limitation%	30%
<hr/>	
Adjusted Taxable Income Limitation	\$30

Interest Deduction under section 163(j) = \$35 (Interest Income of \$5, plus 30% of ATI or \$30).*

*\$5 of disallowed interest is treated as interest incurred in the next succeeding year.

Meals and Entertainment

- The following deductions are repealed after December 31, 2017:
 - 50% deduction for entertainment expense
 - Deduction for certain employee transportation fringes
 - Deduction for employee achievement awards
- Deduction for meals provided for the convenience of the employer
 - Reduced to 50% for 2018 through 2025 and eliminated beginning in 2026

Highlights of ASC 606

Step	Topic	Area of focus
Step 1	Enforceable Rights and Obligations – LTA/MSA vs P.O.	<ul style="list-style-type: none"> Long term agreements with minimum guarantees or substantial cancellation penalties Enforceability of forecast (when forecasts are provided) Customer's option to purchase incremental goods/services and not an obligation when long term agreement exists Impact of safety stock agreements on determining when a contract exists
	Contract Combination Requirements	<ul style="list-style-type: none"> Contract combination due to price concessions Impact of one global agreement with different pricing structure that includes incremental discounts
Step 2	Performance Obligations – material rights	<ul style="list-style-type: none"> Impact of tiered pricing or prospective volume discounts on identification of material right Impact of mandatory price reductions for consideration of material rights Impact of coupons for future product purchases that are only provided along with current sale
	Performance Obligations – selling related goods or service	<ul style="list-style-type: none"> Evaluation of selling related goods (such as displays etc.) on identification of performance obligations vs costs to fulfill a contract (requiring capitalization)
Step 3	Transaction Price – consideration paid/payable to customer	<ul style="list-style-type: none"> Impact of price concessions/discounts/allowances/rebates that are retroactive Impact of slotting fees/Co-op advertising allowance/buy downs or price protections Impact of pay to play arrangements
Step 5	Revenue recognition timing	<ul style="list-style-type: none"> Impact of transfer of control model on sell through transactions today
Other	Principal vs Agent	<ul style="list-style-type: none"> Impact of drop ship transactions and determination of gross vs net reporting
	Licensing Agreements	<ul style="list-style-type: none"> Estimation of royalties required vs lag reporting under legacy practice
Costs	Direct contract costs to obtain and fulfill a contract	<ul style="list-style-type: none"> No direct response advertising cost capitalization Impact of cost capitalization requirements for direct costs such as commissions, costs of selling related goods/services, sales goal tied incentive compensation

Revenue recognition & ASC 606

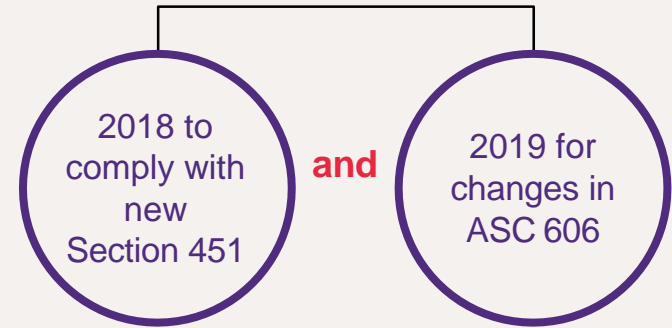
Implementation

- Treasury and IRS will likely require a Form 3115 to comply with the revised Section 451 for 2018
- It will likely be automatic
- Unclear whether procedures will provide audit protection
- Unclear whether there will be a Section 481(a) spread period
 - TCJA seems to require a Section 481(a) adjustment, but unclear whether Treasury and the IRS will provide a cut-off method for certain circumstances

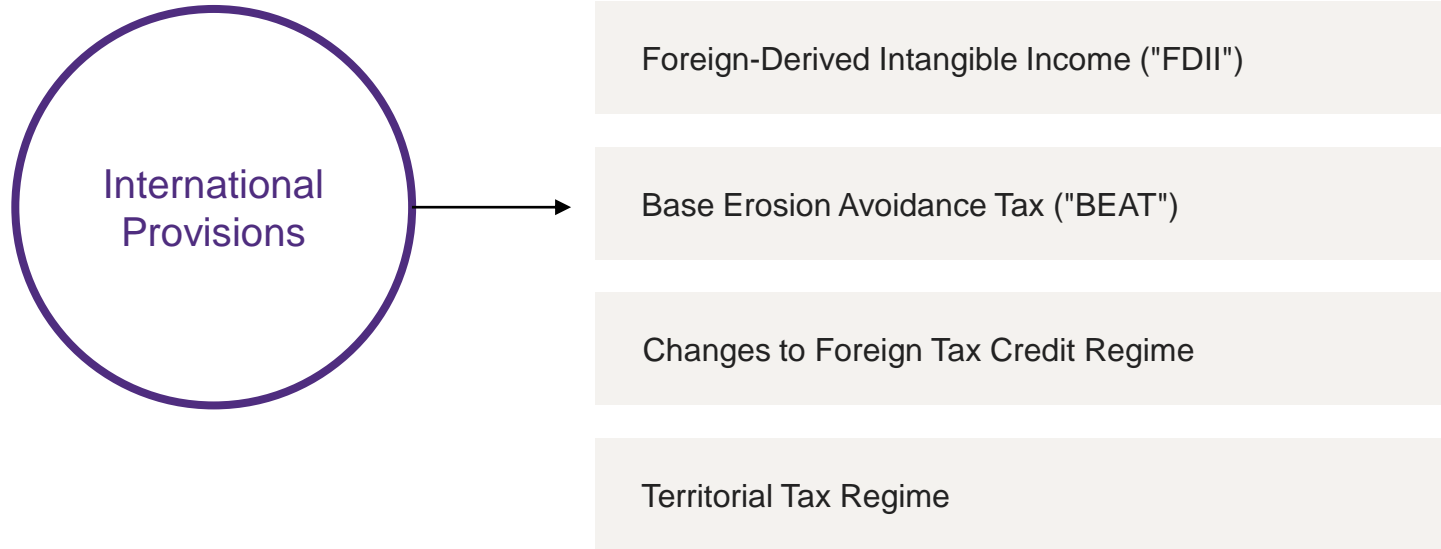
Method changes

Public companies implement once for both ASC 606 and Section 451

But **private** companies may have to implement twice



Impact of Tax Act on EAETR



Minimum tax and incentive for intangible income

- Effective for tax years beginning after 2017, U.S. shareholders of controlled foreign corporations are subject to current U.S. tax on their global intangible low-taxed income (GILTI)

GILTI: Excess of aggregated net "tested income" from controlled foreign corporations over a routine return on certain qualified tangible assets

- Foreign taxes credit limited to 80%
- Separate foreign tax credit basket for GILTI, with no carry-forward or carry-back available for excess credits
- Domestic corporations receive a 50% deduction of GILTI amount

FASB staff view – GILTI tax

Should an entity recognize deferred taxes for basis differences expected to reverse as GILTI in future years or should GILTI be included in current period tax expense in the period incurred?

Treat as an accounting policy election

- Record deferred taxes **or**
- Record as current period tax expense in period incurred

Disclose the policy election. Consistent application of the policy is required

FDII - Foreign-derived deduction eligible income

- FDDI is any income that is derived in connection with
 - property that is sold by the taxpayer to any person who is not a U.S. person and that the taxpayer establishes is for a foreign use, or
 - services provided by the taxpayer that the taxpayer establishes are provided to any person, or with respect to property, not located within the United States.
- Foreign use means any use, consumption, or disposition that is not within the United States.
- Special rules apply to transactions that involve domestic intermediaries or related parties.
 - A deduction for property used by a foreign related party in connection with property sold or services rendered to a foreign unrelated party is generally allowed.
- The terms sold, sells, and sale include any lease, exchange, or other disposition.

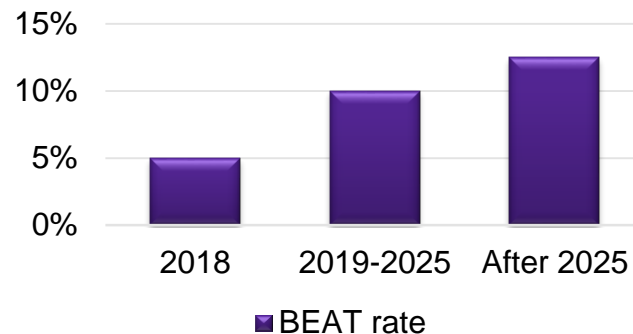
Base erosion and anti-abuse tax

“Base Erosion Anti-Abuse Tax” (BEAT):

- Tax on deductible payments to “related” foreign parties
- Minimum tax on certain domestic corporations’ “modified taxable income”

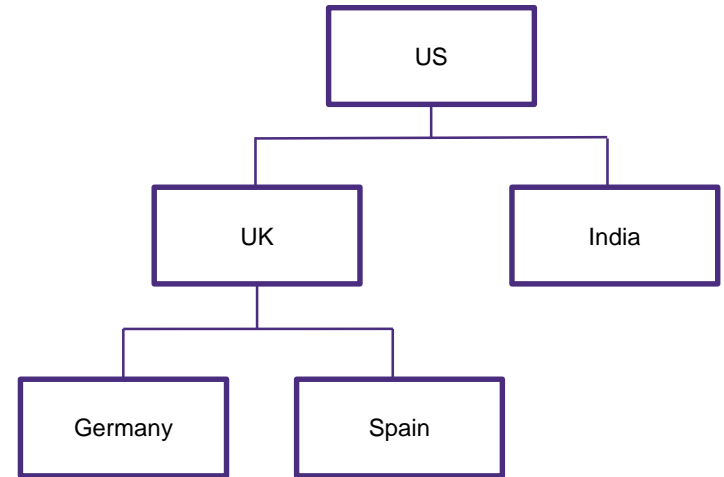
Entities will need to evaluate their liabilities under the minimum tax under BEAT to determine they have captured all of their tax positions and recorded them appropriately

Phased implementation



Indefinite Reinvestment Implications

- No change in U.S. GAAP guidance
- International provisions in Tax Act were created to incentive repatriation of cash to US
- Dividends Received Deduction (DRD) will generally allow dividends made to US to be made tax-free. Still need to consider :
 - Foreign withholding taxes
 - U.S. state and local taxation of dividend income
 - Foreign income taxes on dividend income
- Other outside-basis differences may exist (other than E&P), e.g., resulting from business combinations, cumulative translation adjustments and other items



Indefinite Reinvestment Implications

Interim Reporting Considerations



Discrete items - Change in assertion on beginning of year outside basis difference



EAETR – tax effects of current year foreign earnings



Intraperiod allocation rules



Foreign currency fluctuations



Interaction with one-time transition tax



Financial statement disclosures

Valuation Allowance Assessments



Positive and Negative

- History of losses?
- History of attributes expiring unused?

Subjectivity

- Least subjective – ability to carryback NOLs
- Most subjective – future income

ASC 740-10-30-18

- Future reversals of existing DTLs
- Future taxable income
- Income in carryback years, *if available*
- Tax-planning strategies

MLTN

- Reduce DTA to amount that will MLTN be realized

Valuation Allowance – Naked Credit

Example 1

	Balance at 12/31/17	2018	2019	2020	2021
Deductible temporary differences (DTAs)	1,200	(400)	(400)	(400)	-
Taxable temporary differences (DTLs)	(1,200)	300	300	300	300
Taxable income (loss)		(100)	(100)	(100)	300
NOL subject to 80% limit		-	-	-	240
NOL carryforward generated		(100)	(100)	(100)	-
Cumulative NOL carryforward		(100)	(200)	(300)	(60)

ASU 2018-02: Reclassification of certain tax effects from AOCI

- The effect of new tax laws on deferred taxes initially recorded in OCI is recorded as tax expense related to continuing operations.
 - Prohibition of backward tracing triggers stranded debits/credits in AOCI
- ASU 2018-02 gives the option to reclassify to retained earnings
 - Stranded tax effects related to the change in federal tax rate
 - Other stranded tax effects that relate to the Act
- Requires new disclosure on accounting policies on how a company releases the tax effects from AOCI

ASU 2018-02: Reclassification of certain tax effects from AOCI (cont'd)

- Careful consideration on how ASU 2018-02 interacts with other accounting standards effective in Q1'18

Effective dates of ASU 2018-02 for calendar year-ends

	All entities	Early adoption?
Elected retrospectively or in the period of adoption	2019	Yes

Example: stranded tax effects in AOCI

Entity has an available for sale (AFS) security with an unrealized loss of \$1000, which is recorded as follows:

DR: Other comprehensive income	\$1000	
CR: AFS security		\$1000

The deferred tax impact (at 35%) of the temporary difference related to unrealized loss is recorded as follows:

DR: Deferred tax asset	\$350	
CR: Other comprehensive income		\$350

When deferred taxes are remeasured at enactment date at 21% , the remeasurement is recognized through current period income tax expense (or benefit):

DR: Income tax expense	\$140	
CR: Deferred tax asset		\$140

This results in a DTA of \$210 but the impact of the tax effect recorded in Accumulated OCI (AOCI) still remains \$350

Interim reporting disclosures

Tax reform

- Companies making Q1 disclosures need to consider some of the following tax reform related disclosures:
 - Updates to SAB 118 amounts disclosed/reported in Q4 2017
 - GILTI accounting policy
 - Any changes to a significant accounting policy in the quarter
 - Additional disclosures required by ASU 2018-02

SEC and FASB resources

- SAB Topic 5.EE. Income Tax Accounting Implications of the Tax Cuts and Jobs Act (SAB 118) <https://www.sec.gov/interps/account/staff-accounting-bulletin-118.htm>
- Compliance and Disclosure Interpretations, *Exchange Act Form 8-K* <https://www.sec.gov/divisions/corpfin/guidance/8-kinterp.htm>
- Information Update - Applicability of Staff Accounting Bulletin No. 118 to Investment Companies Impacted by the Tax Cuts and Jobs Act <http://www.sec.gov/divisions/investment/imannouncements/im-info-2017-07.pdf>
- Accounting for the Tax Cuts and Jobs Act http://www.fasb.org/jsp/FASB/Page/BridgePage&cid=1176169774397#section_2
- Revenue Recognition ASC 606 <http://www.fasb.org/jsp/FASB/Page/ImageBridgePage&cid=1176169257359>

Grant Thornton resources

- Grant Thornton's Tax Reform Center www.grantthornton.com/services/tax-services/tax-reform.aspx
- Sign up at <http://about.bna.com/future-ready-business-Grant-Thornton> for Future Ready Business program updates

Questions?



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