

On December 22, 2017, H.R. 1, originally called the Tax Cuts and Jobs Act (the Act), was signed into law by President Donald Trump. The landmark tax reform legislation includes sweeping changes to corporate tax rates, business deductions and the international tax regime. Pursuant to Accounting Standards Codification Topic 740, *Accounting for Income Taxes (ASC 740)*, under U.S. Generally Accepted Accounting Principles (U.S. GAAP), the impact of the legislative changes must be assessed and recorded for financial reporting purposes in the period of enactment (regardless of the effective date), which means companies need to reflect the impact of the new law in the financial statements that include December 22, 2017. For calendar year companies, this is the reporting period ending December 31, 2017.

Below is a discussion of some of the accounting for income tax considerations related to key provisions in the final tax reform legislation. For a more detailed discussion on these provisions, and others that may impact your company's tax or financial reporting obligations, please see [H.R. 1 Tax Reform – Highlights of the Key Items](#).

Corporate Tax Rate and Alternative Minimum Tax (AMT)

The corporate tax rate is set for a reduction with a new rate of 21%, effective January 1, 2018 (down from current rate of 35%). ASC 740 requires that deferred tax assets and liabilities be measured at the enacted tax rate expected to apply when temporary differences are to be realized or settled. As a result, companies are required to recognize the effect of the change in tax rate on deferred tax assets and liabilities in the period in which tax legislation is enacted, regardless of the effective date of the change.

In addition to a lower corporate tax rate, the corporate AMT is repealed under the new tax law for tax years beginning after December 31, 2017. Although the corporate AMT regime is repealed, for tax years beginning after 2017 and before 2021, corporations can continue to offset their regular tax liability with existing AMT credit carryforwards and claim a refund equal to 50% of the excess of the credit for the tax year over the amount of the AMT credit allowable for the year to offset regular tax. The refundable credit is increased to 100% for tax years beginning in 2021. This change impacts business taxpayers with deferred tax assets related to AMT credit carryforwards and how these carryforwards and any valuation allowance that had been recorded should be reflected in the corporation's financial statements.

Expensing of Capital Investments

The final tax reform legislation includes a provision for full expensing of short-lived capital investments, such as machinery and equipment, for five years (those qualified depreciable assets acquired and placed in service after September 27, 2017 and before January 1, 2023). The expensing will then phase out in 20% increments over the following four years. An additional year will be allowed for certain aircraft and qualified property with longer production periods. If companies are planning to take advantage of the opportunity to fully expense qualified property, they should consider the retroactive application of this change in the measurement of current and deferred taxes, upon enactment of the new rule (2017). Full expensing could create additional temporary differences for fixed assets and additional net operating loss carryforward deferred tax assets if the full expensing leads to a taxable loss. States may not conform to these federal full expensing rules and companies should be prepared for potentially significant challenges in measuring state current and deferred taxes as a result.

Interest Expense Limitation

Current law limitations on the ability of a corporation to deduct interest expense will be more restricted under the new tax law. An entity's deduction will be limited to the sum of 30% of adjusted taxable income (ATI), business interest income and floor plan finance interest. ATI is computed without regard to deductions allowable for depreciation, amortization, or depletion for taxable years beginning after December 31, 2017 and before January 1, 2022. After January 1, 2022, ATI will be computed without an addback for depreciation, amortization or depletion. Disallowed interest expense may be carried forward indefinitely; however, Sec. 382 limitations will apply to the carryforward of disallowed business interest in a corporate acquisition. Companies with interest limitations need to evaluate the impact of the new law on their ability to deduct interest expenses as well as the realizability of any carryforwards related to disallowed interest expense as the carryforward period is increased from five years to indefinite.

Separate interest limitation rules will apply for interest expense incurred by partnerships.

Net Operating Loss (NOL) Deduction

Under the new tax law, a company's ability to utilize its NOL deduction is limited to 80% of taxable income for tax years beginning after December 31, 2017. Generally all carrybacks are eliminated, while carryforward of the NOL is allowed indefinitely (rather than for 20 years as under present law) for losses arising in tax years ending after December 31, 2017. Companies need to reset the applicable tax rates for NOLs to reflect the new tax rates and consider the effect of changes to NOL limitations and carryforward periods on the ability to realize existing deferred tax assets associated with NOLs. Indefinite carryforwards may result in indefinite-lived intangibles being available in connection with the realization of the NOL carryforward. This may also affect a company's valuation allowance assessment. ASC 740 provides that tax law provisions that limit the utilization of an operating loss or tax credit carryforward should be applied to determine the likelihood that deferred tax assets will not be realized by reduction of taxes payable on taxable income during the carryforward period.

International Taxation

The final tax reform legislation imposes a territorial system of international taxation with an exemption system for the foreign-source portion of dividends received from certain foreign corporations by U.S. shareholders that are domestic corporations that meet certain conditions. In order to transition to the exemption system, a mandatory deemed repatriation tax will be imposed on any undistributed earnings and profits (E&P) of U.S.-owned foreign corporations. The mandatory deemed repatriation would apply to any U.S. shareholder of a foreign corporation satisfying certain conditions. The effective tax rate on the mandatory deemed repatriation will differ depending upon whether the earnings are invested in liquid or illiquid assets. Companies need to carefully evaluate the impact of the international tax changes on their existing financial statements in the period of enactment, including a declaration in terms of their intentions with respect to outside basis. Companies also need to record a tax liability for the deemed repatriation tax to be levied on unremitted E&P and consider the impact of the charge and enactment of a territorial system on their valuation allowance assessment.

State Taxation

There may also be significant state and local income tax effects on a company's taxable income computation as a result of the new tax legislation, but this is largely dependent upon how each state conforms to the federal tax system. Companies need to assess conformity rules for each state to determine the state and local tax effects and then consider relevant tax accounting requirements.

The Takeaway

Due to the short time frame between the enactment of the Act and the calendar year-end, companies face a significant task in addressing the implications of the Act on their financial reporting obligations. In an effort to address this and to help ensure timely public disclosures of the accounting impacts of the Act, the U.S. Securities and Exchange Commission (SEC) issued a staff accounting bulletin (SAB-118) on December 22, 2017.

SAB-118 provides an opportunity for companies to use a **measurement period** approach on their financial statements to the extent that the accounting for certain income tax effects of the Act is incomplete. SAB-118 states that in no circumstances should the measurement period extend beyond one year from the enactment date. The approach offered by the SEC is similar to purchase accounting under ASC 805, *Business Combinations*. Under the measurement period approach, companies would include a **reasonable estimate** of the impact of the tax reform legislation on their financial statements to the extent that the accounting for certain income tax effects of the Act is incomplete. The reasonable estimate would be reported as a provisional amount in the company's financial statements and require various additional disclosures to the financials that are outlined in SAB-118. In the event that a reasonable estimate cannot be determined for the current reporting period, companies should continue to utilize prior law until a reasonable estimate is available. Companies are expected to account for the Act for U.S. GAAP purposes on a good-faith basis.

Even with the allowance of a measurement period approach, calendar year companies still face significant challenges in implementing and accounting for the various legislative changes that must be reflected in the financial statements for the period ending December 31, 2017.

Please contact us for a more detailed discussion of the impact of tax reform legislation and for a tailored approach to your company's specific reporting obligations.

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