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Income Tax Accounting

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Grant Thornton's Year End taxGuide Event

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Learning Objectives

Identify technical income tax accounting issues that could affect income tax provision calculations and financial statement disclosures

Recognize potential financial statement risks associated with income tax provisions

Impact of Tax Reform on Financial Statements

Tax reform overview

- Both House and Senate call for a flat 20% corporate rate
  - House Reduced Rate after 2017
  - Senate Reduced Rate after 2018
- Significant expensing and cost recovery provisions
- General interest limitations
- AMT is repealed, but net operating loss limitations now apply

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Tax reform overview cont'd

- Significant international provisions, including:
  - Territorial system and one-time tax on unrepatriated earnings
  - Global minimum tax on certain foreign income
  - Limit U.S. interest deductions based on global interest expense
  - Significant base erosion provisions

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Timing: When to report the effects of legislation

- Impacted filers would be required to report the effects of legislation in the financial statements for the period of enactment

- Date of enactment is the date that legislation is signed into law

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Change in tax rate

- Deferred tax balances would need to be measured at the new tax rate expected to be applicable at the time of reversal

- For interim reporting purposes, the effect of a change in tax rate is recognized in the interim period in which the legislation is enacted, even if the change is retroactive

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Impact of tax attributes and changes to deductions

- Accelerated capital expenditures
- Interest expense deduction limitation
- Tax attributes including, but not limited to, NOL's, tax credits and other carryforwards

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Impact of tax attributes and changes to deductions cont'd

- Repeal of Domestic Production Activities Deduction (DPAD)

- Repeal of Research and Experimental expensing

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New International tax system

- Deemed repatriation of certain foreign earnings
- 100% dividends received deduction
- New anti-deferral provisions as part of the evaluation of the treatment of an entity’s non-U.S. outside basis differences
- Outside basis differences associated with investments in foreign subsidiaries

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New International tax system cont'd

- Foreign Tax Credit
- Several very significant anti-base erosion
- Interest carryforwards

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Indefinite Reinvestment of Foreign Earnings (APB 23)

Indefinite Reinvestment of Foreign Earnings (APB 23): Overview

APB 23 acknowledged:

- Under the U.S. tax rules, foreign earnings are generally not subject to U.S. tax until repatriated or deemed repatriated under the anti-deferral rules

- A parent company may control the events that cause U.S. taxation; if so, it has flexibility in postponing (deferring) the income taxes arising on the repatriation for an extended period

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Indefinite Reinvestment of Foreign Earnings (APB 23): The presumption and the exception

- The Presumption: All unremitted earnings will be repatriated

- The Exception: Management may assert that it has the intent and ability to indefinitely reinvest accumulated foreign earnings in its foreign jurisdictions

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Indefinite Reinvestment of Foreign Earnings (APB 23): Management Considerations

Management should consider the following to support an APB 23 position:

- Management intentions*
- Past experience and past history of dividends
- Working capital forecasts
- Long-term liquidity plans
- Merger and acquisition plans
- Investment plans
- Ability of entity to continue as a going concern
    - If entity is not a going concern, management likely is unable to control the decision of whether or not to permanently reinvest earnings, thus assertion is likely not valid

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Indefinite Reinvestment of Foreign Earnings (APB 23): Exception - Management Considerations

How does management demonstrate and document their intent?

Evidence of **intent** of specific plans for reinvestment should be analyzed and documented including in-country use of foreign cash for:

- Funding of operations
- Foreign acquisitions
- Foreign R&D
- Foreign debt service
- Foreign capital expenditures
- Foreign intercompany charges
- Foreign funding for downstream members of the group

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Indefinite Reinvestment of Foreign Earnings (APB 23): Exception - Management Considerations

How does management demonstrate and document their ability?

Evidence of **ability** to meet anticipated cash flow obligations should be analyzed and documented including sources of cash for:

- Forecasts, including working capital, and budgets for both long and short term
- Acquisitions
- R&D
- Debt service requirements
- Capital expenditures
- Payments to shareholders

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New Centralized Partnership Audit Regime

Partnership Audit Regime

- Potential income tax accounting impacts

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Details of New International Tax System

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Questions?