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Global Tax Alert

US Administration releases Joint Statement on Reform: Income Tax accounting considerations related to potential future US tax legislation and steps companies can take now to prepare

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Overview of Joint Statement on Reform

On 27 July 2017, the "Big Six" group of Administration and congressional negotiators issued a "Joint Statement on Reform" (the statement) that largely affirms previously stated goals for the effort and further provides that the group will not be considering the House border adjustability proposal. The statement said the goal is a plan that reduces tax rates as much as possible, allows "unprecedented" capital expensing, places a priority on permanence and encourages United States (US) companies to bring back jobs and profits from overseas.

With border adjustability no longer being considered as a potential revenue raiser, consensus on reform is drawing Congress one step closer to the possibility of new legislation. If enacted, the legislation could have significant income tax accounting implications for companies in the United States in the financial reporting period of enactment. As companies evaluate the potential future effects of the recently released statement on reform, evaluating the potential future income tax accounting effects will require careful consideration and preparation. Following is an overview of areas for consideration.

Building a better working world

Financial statement income tax accounting for enacted tax law changes

For financial reporting purposes, under Accounting Standards Codification 740 (ASC 740), a change in enacted tax law and/or tax rates is recognized in the period in which the new legislation is enacted. In the case of US federal income taxes, the enactment date is the date the bill becomes law (i.e., upon presidential signature). For interim reporting purposes, the effect of new legislation must be recognized in the interim period in which the legislation is enacted even if the change in the tax rates is retroactive.

The enactment date of legislation often differs from the effective dates of certain provisions within a bill. As a reminder, the effects on income taxes currently payable or refundable for the current year are recorded after the effective dates prescribed in the statutes and are reflected in the computation of the annual effective tax rate beginning no earlier than the first interim period that includes the enactment date of the new legislation. The total effect of income tax law changes on deferred tax balances is recorded as a component of tax expense related to continuing operations for the period in which the law is enacted, even if the assets and liabilities relate to discontinued operations, a prior business combination or items of accumulated other comprehensive income.

Steps a company can take now to prepare for future legislation

Depending on the timing of when a reform bill may be signed by the President, many companies may have very limited time between the date of enactment and the end of their financial reporting period. Therefore, planning in advance to evaluate readiness and prepare for the possible financial statement effects of tax reform may be helpful. Although there is no draft legislation at this time, key themes around reform are a lower corporate income tax rate with "unprecedented capital expensing," a broader tax base, a mandatory one-time tax on previously deferred foreign earnings and a potential shift to a territorial tax regime. It is possible that a reduction in the corporate income tax rate could be phased in over a number of years. A phase-in of a rate reduction would require additional steps to accurately calculate the impact of a tax rate reduction on a company's deferred tax assets and liabilities.

Below is a summary of some of the steps that companies can consider taking now to prepare for a possible tax law change:

- Understand the timing of ASC 740 accounting requirements for changes in tax legislation for financial reporting purposes
- Develop procedures and a timeline to prepare for any steps required and evaluate resource needs
- Review existing Sarbanes-Oxley controls on changes in legislation and ensure controls are adequate
- Validate cumulative federal temporary differences before possible re-measurement at a lower corporate income tax rate
- Evaluate the reversal periods for temporary differences and identify stakeholders that will be needed to provide this information if necessary
- Model the impact of proposals such as immediate capital expensing, and assess the potential impact on the realizability of existing tax attributes, such as net operating losses, foreign tax credits and excess interest expense carryforwards
- Prepare for computations of a one-time tax on previously deferred foreign earnings by validating outside basis differences in foreign subsidiaries as well as US tax attributes, such as earnings and profits and foreign tax credit pools, which can affect the measurement of outside basis differences
- Evaluate and document potential changes to indefinite reinvestment assertions related to any pre-reform activities the company may be undertaking
- Prepare to reassess indefinite reinvestment assertions and associated deferred tax liabilities for unremitted foreign earnings
- Assess the state tax effects of federal tax reform for states that automatically conform to federal tax law
- Evaluate the company's disclosures and internal and external reporting needs

Looking ahead

Although there are still hurdles to overcome, the statement is an important development toward the enactment of tax reform. The "Big 6" negotiators have indicated "the time has arrived for the two tax-writing committees to develop and draft legislation that will result in the first comprehensive tax reform in a generation." As lawmakers further formulate the details around the framework put forth, we will continue to keep our eyes on the draft legislation for further insights on the potential financial reporting implications.

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