US tax reform impact on 2017 IFRS reporting

Overview

Conferees for the US House of Representatives and the Senate have announced agreement on the final terms of the Tax Cuts and Jobs Act (the Act), which is intended to encourage US companies to, among others, bring back jobs and profits from overseas. The Act would reduce the corporate income tax rate to 21%, create a territorial tax system (with a one-time transition tax on previously deferred foreign earnings) rather than a worldwide tax system, broaden the tax base and allow for immediate capital expensing of certain qualified property.

The Act also includes certain anti-deferral and anti-base erosion rules that would require US corporations to pay minimum taxes on foreign earnings and would subject certain payments from US corporations to foreign related parties to additional taxes. House and Senate leaders have said they hope these changes could become law before the end of 2017.

The proposals could have significant income tax accounting implications for companies, starting in the period when the law is substantively enacted. As a result, companies should start analysing the potential effects of the proposal now and begin developing implementation plans so they are prepared to record and disclose the financial reporting effects in the period of (substantive) enactment.

The next stage in the legislative process is for the final version of the Act to be voted on by both chambers of the US Congress. If the Act is passed by both chambers, it will be sent to the US President for signature. On the date when the US President signs the new legislation it is enacted. The US President has publicly announced his desire to sign the Act into law prior to Christmas. If the date of enactment is after the end of a company's annual reporting period, disclosures may be required. If enacted on or before the annual reporting date, its effect will have to be recognised in the financial statements.

This publication is based on the current proposals, which could change during the legislative process. Companies should monitor developments.
Requirements of IAS 12 Income Taxes

Enacted or ‘substantively’ enacted

Current tax should be measured at the amount expected to be paid to or recovered from the tax authorities by reference to tax rates and laws that have been enacted, or substantively enacted, by the end of the reporting period (IAS 12.46). Deferred tax should be measured by reference to the tax rates and laws, as enacted, or substantively enacted, by the end of the reporting period, that are expected to apply in the periods in which the assets and liabilities to which the deferred tax relates are realised or settled (IAS 12.47). In the United States, (substantive) enactment takes place when the legislation is signed by the President or there is a successful veto override vote by both houses of Congress.

(Substantive) enactment on or before 31 December 2017

If the tax legislation is (substantively) enacted on or before 31 December 2017, then calendar year-end companies must apply the new tax legislation (e.g., new tax rates) in measuring their current and deferred tax assets and liabilities in their 2017 annual financial statements.

There is no relief from this requirement under IAS 12, even to deal with circumstances in which complex legislation is (substantively) enacted shortly before year-end. In the preparation of financial statements, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors requires a company to use reliable information that was available when those financial statements were authorised for issue and could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

(Substantive) enactment after 31 December 2017

If the tax legislation is (substantively) enacted after 31 December 2017, then IAS 10 Events after the Reporting Period identifies the enactment or announcement of a change in tax rates and laws after the end of the reporting period as an example of a non-adjusting event (IAS 10.22(h)). A non-adjusting event is dealt with by disclosure only.

For example, a company with a reporting period ending on 31 December 2017, issuing its financial statements on 20 March 2018, would measure its tax assets and liabilities by reference to tax rates and laws enacted or substantively enacted as at 31 December 2017, even if these had changed significantly before 20 March 2018. However, the company would have to disclose the nature of those changes and provide an estimate of the financial effect of those changes if the impact is expected to be significant (IAS 10.21).

Particular aspects of the proposals to consider

Tax on accumulated earnings and profits of foreign subsidiaries

Paragraph 39 of IAS 12 requires a deferred tax liability to be recognised for all taxable temporary differences associated with investments, both domestic and foreign, in subsidiaries, branches and associates or interests in joint arrangements, unless:

- The parent, investor, joint venturer or joint operator is able to control the timing of the reversal of the temporary difference
- It is probable that the temporary difference will not reverse in the foreseeable future

The Act would subject foreign earnings, on which US income tax is currently deferred, to a one-time transition tax that would be based on certain historical earnings and profits (E&P) that were not previously taxed in the US. A company should provide for the tax consequences from the one-time transition tax as soon as the legislation is (substantively) enacted.
**Backward tracing of changes in deferred taxation**

Paragraph 61A of IAS 12 requires tax relating to items not accounted for in profit or loss, whether in the same period or a different period, to be recognised:

- In other comprehensive income, if it relates to an item accounted for in other comprehensive income
- Directly in equity, if it relates to an item accounted for directly in equity

This requirement to have regard to the previous history of a transaction in accounting for its tax effects is commonly referred to as ‘backward tracing’. If current and deferred taxes change as a result of new tax legislation, IAS 12 requires the impact to be attributed to the items in profit or loss, other comprehensive income and equity that gave rise to the tax in the first place. This will apply, for example, to the effects of any changes in tax rates in the measurement of deferred tax assets and liabilities recognised in earlier periods.

**Uncertain tax positions**

In June 2017, the IASB issued IFRIC 23 Uncertainty over Income Tax Treatments, which is applicable for annual reporting periods beginning on or after 1 January 2019 (although earlier application is permitted).

IFRIC 23 deals with situations in which it may be unclear how tax law applies to a particular transaction or circumstance. The acceptability of a particular tax treatment under tax law may not be known until the relevant taxation authority or a court takes a decision in the future. Consequently, a dispute or an examination of a particular tax treatment by the taxation authority may affect a company’s accounting for a current or deferred tax asset or liability.

Although IFRIC 23 is not yet mandatory and was not specifically developed to deal with tax law changes, it provides helpful guidance that companies may wish to consider in accounting for the uncertainties that exist with respect to their tax positions in light of any changes in legislation.

**Disclosure**

In addition to the IAS 10 disclosure requirements noted above, a company should also disclose the following information:

- The amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes (IAS 12.80(d))
- An explanation of changes in the applicable tax rate(s) compared to the previous accounting period (IAS 12.81(d))
- Judgements, information about the assumptions made and other estimates, as per paragraphs 122 and 125-129 of IAS 1 Presentation of Financial Statements
- When it is probable that the taxation authority will accept an uncertain tax treatment, paragraph 88 of IAS 12 should be applied to determine the disclosure of a tax-related contingency

**What companies need to do now**

**Planning**

Because a new tax law could be (substantively) enacted by the end of the year, companies may have limited time to determine its effects. Companies therefore need to start planning for the potential effects on financial reporting, even though the details and the timing of any final legislation are unclear.

Companies need to begin developing a formal plan across their finance and tax departments to respond to items such as a new corporate tax rate, a one-time transition tax, an immediate write-off of certain assets, any changes to existing tax attributes and any changes to internal controls that might be required.
The effects of the new tax law may be complex because of the significant changes, the need to collect long-time historical data, the potential impact on the way business is organised and also because companies will have limited time to perform this assessment if the legislation is signed before 31 December 2017.

**Changes to processes and internal controls**

Companies must also consider making changes to their systems, processes and internal control over financial reporting. This includes making sure the systems and processes are appropriately designed to collect the information necessary to transition to the new tax law and to calculate the company’s income tax provision under the new tax law.

Internal controls also need to be designed to make sure that the accounting implications of the transition and tax provision calculations made after (substantive) enactment are accurately recorded in the financial statements. Key areas to consider are calculating the one-time transition tax, tracking outside basis differences after enactment, determining the timing of the reversal of temporary differences, assessing the realisability of deferred tax assets and carry forwards and calculating any minimum or excise taxes.

**How we see it**

Companies must continue to monitor and model the proposals and be prepared to record and disclose the financial reporting effects if the new tax law is (substantively) enacted.

In addition to understanding the effects of the proposals and assessing any needed changes to systems, processes and internal control over financial reporting, companies should be prepared to make the necessary disclosures about risks and uncertainties arising from the change in tax law.

Finally, listed companies must continue to monitor developments from regulatory bodies.