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BDO KNOWS:
ASC 740 AND U.S. TAX REFORM

The enactment of the tax reform[1] on December 22, 2017, introduces the most significant legislative change to the tax system since the Reagan administration. It also includes the most substantial international tax reform in decades, and is a major overhaul of the Internal Revenue Code (IRC) that will impact every taxpayer in the U.S.

Tax reform will have a considerable financial reporting impact, and particularly as it relates to ASC Topic 740 Income Taxes (ASC 740). Reporting entities are required to record the impact of tax reform in the period that includes the enactment date. This publication addresses the accounting for income tax implications and financial statement disclosures associated with key tax law changes.

Additional BDO resources on Tax Reform are available **here**.

CONTENTS

1 Legislation H.R. 1, formerly known as "Tax Cuts and Jobs Act."

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SEC STAFF ACCOUNTING BULLETIN (SAB) 118

Concurrent with the enactment of the tax reform legislation, the SEC staff issued, on December 22, 2017, SAB 118 which lays out an approach registrants may follow to comply with the enactment period accounting requirements.

According to SAB 118, registrants can have up to 12 months from the enactment date to complete the accounting for some or all of the income tax effects triggered by the enactment of the new law. However, they need to determine and use "reasonable estimates" for some or all of the expected effects beginning with the enactment period. Reasonable estimates then need to be revised to reflect additional information, evaluation, and calculation until the accounting is considered complete. The accounting must be finalized no later than 12 months from the enactment date. If reasonable estimate(s) cannot be determined, the accounting should continue to be based on the old law until reasonable estimate(s) can be determined in a subsequent period.

If the accounting is considered complete with respect to one or more effects, it must be reported in that period. That is an entity cannot delay recognition of income tax effects for which the accounting is considered complete.

There are numerous disclosures that should be provided when the SAB 118 approach is applied for one or more income tax effects. For additional information on SAB 118, including illustrative examples, refer to **SEC and Tax Reform, SAB 118**.

Various stakeholders have expressed concerns to the Financial Accounting Standards Board (FASB) about whether private companies and not-for-profit (NFP) entities could apply SAB 118. The FASB staff issued, on January 11, 2018, a **FASB Q&A** that outlines their view allowing private companies and non-for-profit entities to choose an accounting policy to apply SAB 118.

Private companies that elect to apply SAB 118 should apply the guidance in its entirety including the required disclosures. Any private companies applying SAB 118 should disclose their accounting policy in accordance with ASC 235-10-50-1 through 50-3.

The following interpretations should be read, keeping in mind the guidance of SAB 118 and how it might affect the timing of completing and disclosing the accounting for one or more income tax effects.

BDO Observation: The Department of the Treasury and the Internal Revenue Service will likely issue technical clarifications, corrections, and interpretive regulations in the coming weeks and months, which entities should continue to monitor in order to refine their initial estimates under SAB 118.

TAX REFORM SIGNIFICANT BUSINESS TAX CHANGES

CORPORATE TAX RATE REDUCTION

Old Law

Corporate taxpayers were taxed based on a system of graduated marginal tax rates applied to the taxpayer's taxable income. The graduated marginal tax rates ranged from a 15 percent tax rate (on taxable income that did not exceed $50,000) to a 35 percent tax rate (on taxable income that exceeded $10,000,000).

Corporate taxpayers that met the criteria to be a qualified personal service corporation defined in IRC §481(d)(2) were taxed at a flat rate of 35 percent.

New Law

Corporate taxpayers will be taxed at a flat rate of 21 percent.

Effective Date of New Law

The new flat tax rate is effective on January 1, 2018 for calendar year reporting entities. For entities with other fiscal year-ends, the new flat tax rate applies on a pro-rata basis to the portion of the year that falls after December 31, 2017.

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ASC 740 Implications

All U.S. deferred income tax assets and liabilities from deductible and taxable temporary differences will be adjusted (i.e., remeasured) from the previous corporate rate to the new corporate rate.[2] The cumulative adjustment will be recognized in income tax expense from continuing operations as a discrete item in the period that includes the enactment date.[3]

Refer to the SAB 118 discussion above for additional guidance on the timing of recognition.

The cumulative deferred tax adjustment should reflect the impact to deductible and taxable temporary differences expected to reverse on or after the effective date of the new rate (i.e., deductible and taxable temporary differences expected to reverse on or after January 1, 2018).[4]

This tax rate change is considered enacted in the period which includes the day the President signed the bill into law. Therefore, for calendar year corporations the period of enactment is the fourth quarter.

The current tax rate will not change until the period that includes the effective date. For calendar year reporting entities (for book and tax purposes) the tax rate change impact on current tax will be recognized beginning with the taxable year which begins on the effective date of January 1, 2018.

When the effective date does not fall on the first day of the reporting entity's tax period, the current tax for the year which includes the effective date will be determined using the previous and the new rates applied to proportionate amounts of taxable income which bear the same ratio as days under the prior rate versus days under new rate to total days in the entire taxable year (i.e., a blended rate).[5]

For interim period reporting, the federal statutory rate in fiscal year 2018 is a blended rate, as defined in the legislation, applied as of the start of the fiscal year. Therefore, the blended rate is considered effective in the enactment period.[6]

BDO Observations: The change in corporate tax rate will have a vast impact on financial reporting of income taxes including the following:

- Both calendar year and fiscal year reporting entities (e.g., March 31 or June 30) will need to determine the gross deductible and taxable temporary differences expected to reverse on and after the effective date of January 1, 2018, to quantify the cumulative impact of remeasuring deferred income taxes.
- Fiscal year reporting entities' remeasurement work might be more challenging due to the blended rate application in fiscal 2018 tax years. They will need to estimate the reversal of temporary differences that occur in the period after the effective date but before the end of their fiscal year and technically apply the blended rate to the gross temporary differences expected to reverse in that fiscal period. The use of a blended rate is likely to result in some adjustment in the final quarter, which is when the annual results are finalized and the annual change in gross temporary differences are determined. The full year impact will be reported and included in the annual report (Form 10-K). Temporary differences that are expected to reverse in a subsequent fiscal year will be remeasured at the enacted 21 percent rate.
- If a net operating loss (NOL) is expected in the fiscal year which includes the enactment date, the NOL is considered a "new NOL" subject to an indefinite carryforward period but cannot be carried back for a refund of taxes paid in the two prior years.[7] Therefore, the deferred tax asset (DTA) for these NOL carryforwards should be measured at the new rate of 21 percent.

2 ASC 740-10-35-4.

3 ASC 740-10-45-15.

4 ASC 740-10-55-23.

5 IRC §15(a).

6 Generally, the impact on the current tax provision should not be accounted for in the annual effective rate (ETR) estimate sooner than the interim period which includes the effective date (Example Case A in ASC 740-270-55-45 to 55-49).

7 The Act provides a different treatment of NOL generated in the fiscal year which includes the enactment date. Accordingly, the new 80 percent limitation on NOL utilization does not apply to the year of enactment NOL (Act section 13302(e)(1) states the 80 percent limitation provision applies to tax years beginning after December 31, 2017. Act section 13302(e)(2) states the Carryforward/Carryback provision applies to losses generated in tax years ending after December 31, 2017).

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- Some reporting entities may not maintain a roll forward of gross temporary differences at the end of each interim period and instead used a "placeholder" tax account to book interim period income tax provisions and then adjust the balance sheet tax accounts (current and deferred) at the end of the year. These entities will still need to determine a reasonable estimate of gross temporary differences as of the enactment period quarter so they can remeasure to the new rate and recognize the rate change impact in the enactment period accounting.
- Reporting entities should remeasure the individual components of their deferred income taxes inventory rather than make an adjustment to a net deferred tax balance. For example, entities with a full valuation allowance as of the enactment date still need to determine the impact to the individual components of the temporary differences inventory since the reversing pattern and period of a temporary difference depends on the manner and timing of the recovery/settlement of the related asset or liability.
- While state tax laws are not changing (at least presently), the measurement of state deferred income taxes could be affected by the change in federal tax rate. State income taxes are generally deductible expenses in the federal taxable income calculation. Therefore, under ASC 740, state deferred income taxes are a temporary difference in the federal deferred tax calculation.[8] However, in practice, certain reporting entities measure state deferred income taxes net of the federal benefit of the state taxes (e.g., state blended rate of 6 percent before the federal effect of 35 percent or a rate of 3.9 percent to measure state deferred income taxes). These reporting entities would need to adjust their accounting system to reflect the change in federal tax rate.
- Income tax credit carryforwards, including those for research and development, foreign taxes, and alternative minimum taxes, will need to be considered separately from the deferred tax assets for deductible temporary differences and NOL carryforwards (see foreign tax credit section for further details). Simply put, income tax credits as of the enactment date do not have to be remeasured to a new rate (i.e., income tax credits are not deductions).
- The remeasurement of deferred tax assets and liabilities at the new corporate tax rate may also require a corresponding reassessment of valuation allowances.[9]
- The tax rate change on deferred income taxes recorded in other comprehensive income (OCI) will be recognized in income tax expense from continuing operations. This pertains to deferred taxes recognized through OCI as of the enactment date, taking into account the year-to-date OCI gain (loss).
- The requirement to recognize the cumulative effect on deferred taxes due to a tax rate adjustment in income tax expense from continuing operations will cause the tax-related entries previously recognized in OCI at the rate of 35 percent to remain in OCI. When the related pretax income (loss) is recycled to net income, the related deferred tax entries will also reverse but at the new rate of 21 percent. The delta between the tax-related entries previously recognized at 35 percent and the reversing tax-related entries (based at 21 percent) will be left in OCI. In practice, these effects have historically been referred to as "disproportionate" OCI effects. The timing of "clearing" these effects into net income is not prescribed in U.S. GAAP.

At the FASB meeting on January 10, 2018, the Board decided to proceed with developing a proposed Accounting Standards Update (ASU) that would provide for a one-time reclassification from other comprehensive income to retained earnings for the OCI stranded impact caused by the requirement to remeasure deferred taxes from 35 percent to 21 percent. The one-time reclassification would be mandatory but only apply to this federal tax rate change. The equity reclassification would have to be reflected in the period of enactment including all periods in which SAB 118 accounting is being followed. The proposed ASU was issued on January 18, 2018, with a 15-day comment period. It proposes an effective date for fiscal periods beginning after December 15, 2018, with retrospective adoption to the enactment period(s). Early adoption would be permitted when the financial statements have not been filed yet (e.g., the calendar 2017 annual reporting period).[10]

8 ASC 740-10-55-20.

9 ASC 740-10-35-4.

10 The FASB decided at its January 10 meeting to add a long-term agenda project on "backward tracing" to OCI and also consider the topic as part of its ongoing tax disclosures project.

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- A similar effect could arise with deferred income taxes recognized through goodwill. Reporting entities that have made acquisition(s) in the early part of the year will not be able to remeasure acquired deferred income taxes through an adjustment to goodwill. The rate change effect is not considered a "measurement period" adjustment under ASC 805. They must follow the general principle which requires recognition of all effects (from tax law/rate changes) through income tax expense.
- For interim reporting purposes, the cumulative effect of the tax rate change should be shown as a discrete item and not included as part of the annual effective tax rate (ETR) estimate.[11] For example, a June 30 fiscal year entity's second quarter annual ETR estimate (the interim period which includes the enactment date) is not going to be affected by the cumulative effect. Instead, the cumulative effect is recognized as a second quarter (enactment period) discrete period effect.
- While deferred taxes are required to be adjusted in the enactment period, current tax is not affected by the rate change until the period the rate change is effective. That is, the tax rate change is not reflected in the ETR estimate until the interim period in which the tax rate change is effective. The rate change is considered effective in the enactment period for fiscal year entities due to the blended rate requirements.
- Examples 1 and 2 below illustrate the application of these rules to a calendar year and fiscal year reporting entity, respectively.

11 ASC 740-270-25-5.

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EXAMPLE 1 – CHANGE IN TAX RATES – CALENDAR YEAR REPORTING ENTITY

Entity A, a public company, has the following information for the 2017 calendar period:

- Pre-tax book income from continuing operations of $15,000
- Beginning year cumulative gross deductible temporary differences of $5,000
- Temporary differences net reduction (reversing and originating) during the year of $2,000
- End of year cumulative gross deductible temporary differences of $3,000
- Unfavorable permanent item of $1,000
- Current and recent profit and no valuation allowance
- Federal taxable income of $14,000 ($15,000 plus $1,000 less $2,000) before state tax deduction
- All temporary differences originate from income (loss) in continuing operations
- Applicable state income tax rate of six percent (assume state taxable income is the same as federal taxable income before the state tax deduction)

Tax Accounting Analysis & Entries:

The temporary differences at the end of the fourth quarter interim period have a gross balance of $3,000 and a federal DTA of $1,050 based on the 35 percent rate and a state DTA of $180. The federal DTL effect from state deferred tax is $63 (35 percent times $180).[12]

Since the temporary differences are expected to reverse in period(s) starting on or after the effective date of the new tax rate, the entire gross balance of $3,000 should be remeasured at a new rate of 21 percent, resulting in adjusted DTA of $630 and adjusted DTL related to deferred state taxes of $38.

The cumulative effect of remeasuring the federal deferred tax balances from 35 percent to 21 percent is $395 (i.e., the DTA balance of $1,050 less the remeasured balance of $630 or an expense of $420, plus the DTL balance of $63 less the remeasured balance of $38 or a benefit of $25 for a net expense effect of $395).

The enactment period of the corporate tax rate change with respect to Entity A is the fourth quarter of 2017. Therefore, the adjustment entry for the remeasurement of the deferred tax balance is recognized in the fourth quarter of 2017:

Debit: Deferred Tax Expense	$395	
Credit: Deferred Tax Asset		$395

(federal deferred tax remeasurement)

Entity A's full year current and deferred provision would include the following entries:

Debit: Current State Tax Expense	$840	
Credit: State Income Tax Payable		$840

(state taxable income of $14,000 x 6 percent)

Debit: Current Federal Tax Expense	$4,606	
Credit: Federal Income Tax Payable		$4,606

(federal taxable income of $14,000 less state tax deduction of $840 or $13,160 x 35 percent[13])

Debit: State Deferred Tax Expense	$120	
Credit: State Deferred Tax Asset		$120

(current year change in gross deductible temporary differences of $2,000 x 6 percent)

12 As explained above, some entities measure state deferred income taxes net of the federal tax rate effect and for them there is no federal temporary difference for state taxes.

13 The federal statutory tax rate of 35 percent has been used to simplify the example. Note that the actual current federal payable would be different in practice, as the old law requires using graduated rates when taxable income does not exceed $18,333.

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Debit: Federal Deferred Tax Expense $1,053
Credit: Federal Deferred Tax Asset (Liability) $1,053
(current year change in gross deductible temporary differences $2,000 x 35 percent or $700 expense, less federal deferred effect of state deferred tax of $42 benefit ($120 x 35 percent), plus the cumulative deferred tax remeasurement impact of $395 expense)

Entity A's total provisions for the 2017 financial period of $6,619 (current tax of $5,446 plus deferred tax of $1,173) reflects an effective tax rate of 44.13 percent:

Tax at Statutory rate	$5,250	(pretax income of $15,000 x 35 percent)
Permanent item	$350	(unfavorable permanent item of $1,000 x 35 percent)
State Income Tax[14]	$624[15]	(current tax of $840 plus deferred tax of $120 less federal effect of $336)
Tax Rate Change	$395	(remeasurement of deferred taxes)
Effective Tax	**$6,619**	

The following table summarizes the federal and state income tax provisions:

	FEDERAL	STATE	TOTAL
CURRENT	$4,606	$840	$5,446
DEFERRED	$1,053	$120	$1,173
TOTAL	$5,659	$960	$6,619

Note – This is a basic illustration of the impact on the effective tax rate due to tax rate change. Most reporting entities that provide a reconciliation of statutory rate to effective rate have several reconciling items. Also, this tax legislation will cause additional tax rate impacts which are discussed later (e.g., the transition tax on accumulated foreign income and corollary effects on valuation allowance accounting to name two potential effects).

EXAMPLE 2 – CHANGE IN TAX RATES – FISCAL YEAR REPORTING ENTITY

Entity A, a public company, has a fiscal year ending June 30. As of the end of the current interim period ending December 31, 2017, Entity A has the following forecasted information for the taxable year ending June 30, 2018:

- Pre-tax book income from continuing operations of $15,000
- Beginning year cumulative gross deductible temporary differences of $5,000
- Temporary differences net reduction during the year of $2,000
- End of year cumulative gross deductible temporary differences of $3,000
- Unfavorable permanent item of $1,000
- Current and recent profit and no valuation allowance
- Federal taxable income of $14,000 ($15,000 plus $1,000 less $2,000) before state tax deduction
- All temporary differences originate from income (loss) in continuing operations
- Applicable state income tax rate of six percent (assume state taxable income is the same as federal taxable income before the state tax deduction)

14 State income tax is shown net of Federal benefit.

15 State tax effect can be summarized as following: current state tax expense of $840 plus deferred tax effect of $120 for a total of state tax expense of $960 less federal effects of $294 (current benefit) plus $42 (deferred benefit) for a total of federal tax benefit of $336.

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Tax Accounting Analysis & Entries:

The tax reform enactment date (December 22, 2017) falls within Entity A's second interim period ended December 31, 2017. Therefore, the interim period ended December 31, 2017 is the enactment period for accounting (i.e., Q2-2018).

Blended Federal Tax Rate:

Entity A's tax year includes the effective date (January 1, 2018) of the corporate tax rate change. Therefore A's income tax liability for the year is determined using the previous and new rates applied to proportionate amount of taxable income which bears the same ratio as days under the previous rate versus days under new rate to total days in the entire year.[16] The annual ETR estimate is also updated for the effect of the blended rate in the interim period which includes the enactment date (the blended rate is considered effective). The application of a blended rate is illustrated in this Example.

Interim Period Tax Provisions Methodology (ASC Subtopic 740-270):

There are two parts to a quarterly income tax provision: (1) income tax on year-to-date ordinary income (loss) (i.e., income (loss) from continuing operations excluding significant, unusual, or infrequently occurring items), and (2) income tax on year-to-date significant, unusual, or infrequent income (loss) items (i.e., discrete period effects when the items occur).[17]

- Income tax on ordinary income begins with a first-quarter calculation of an annual effective tax rate (Q1 ETR) estimate. The estimate is updated in the second and third interim periods to reflect revised expectations of annual income (loss) and permanent items. The annual tax rate estimate comprises **of forecasted current and deferred income taxes.**
- Income tax from year-to-date discrete period items includes specified items such as the impact on **deferred income taxes** from tax law and tax rate changes.[18] These income tax effects cannot be spread throughout the annual period and must be recognized in a single interim period. [19]

Below is an illustration of the year-to-date quarterly computations of the annual ETR estimate for Entity A, assuming the only year-to-date discrete period item is the remeasurement of deferred income taxes occurring in Q2-2018 due to the federal tax rate change.

Entity A's Income Tax from Year-to-date Continuing Operations:

Entity A's Q1-2018 ETR Estimate was calculated as follows:

Forecasted pretax income	$13,000 (a)
Forecasted permanent difference	$800
Book taxable income	$13,800
Applicable federal + state tax rates	38.9% *
Forecast income tax	$5,368 (b)
Q1 Estimated annual effective tax rate	41.29% (b)/(a)
Year-to-date income (loss)	$3,000 (c)
Year-to-date income tax	$1,239 (Q1-ETR x (c))

*federal tax rate of 35 percent plus state tax rate adjusted for federal effect (6 percent x 65 percent)

Entity A's Q2-2018 ETR is calculated as follows taking into account revised forecast of income and permanent items:

Forecasted pretax income	$15,000 (a)
Forecasted permanent difference	$1,000
Book taxable income	$16,000
Applicable federal blended rate + state tax rate	32.38%*
Forecast income tax	$5,180 (b)
Q2 Estimated annual effective tax rate	34.53% (b)/(a)
Year-to-date income (loss)	$7,000 (c)
Year-to-date income tax	$2,417 (Q2-ETR x (c))

*blended federal rate of 28.06% plus state tax rate adjusted for federal effect (6 percent x 71.94 percent)

16 IRC §15(a).

17 ASC 740-270-25-1 and 25-2.

18 ASC 740-270-30-11.

19 ASC 740-270-25-5.

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For purposes of updating the Q2-ETR, the new tax rate is considered administratively effective as of the beginning of Entity A's current fiscal year. Therefore, the Q2-ETR would be updated for the effect the fiscal year blended tax rate would have on the forecasted current and deferred income taxes. The blended rate is determined as follows:

[(Tax rate in effect until December 31, 2017 of 35 percent times (184 days/365 days)) + (Tax rate in effect on January 1, 2018 of 21 percent times (181 days/365 days))] = 28.06 percent. **The federal blended rate is rounded to 28 percent for purposes of illustrating the discrete period tax effect below.**

The state applicable rate adjusted for the federal effect would be 6 percent times 72 percent (which is 1 less 28 percent) or a state rate of 4.32 percent.

Entity A's Q2-2018 Discrete Period Tax Effect:

Entity A will need to determine the gross deductible and taxable temporary differences expected at the end of its fiscal year to make the deferred tax remeasurement adjustment.

The temporary difference at the beginning of the year was a gross balance of $5,000 and a DTA of $1,750 at 35 percent rate.

Entity A is able to make a reasonable estimate (as contemplated in SAB 118) for federal and state taxes that a net reduction of $2,000 of the temporary differences are expected during the current fiscal year, resulting in a gross balance of $3,000 at end of the fiscal year (refer to Appendix A for consideration of SAB 118).

Therefore, gross temporary differences expected to reverse after the effective date of the new tax rate are $5,000 and should be remeasured as following:

- $2,000 gross deductible temporary differences expected to reverse at a blended rate of 28 percent.[20]
- $3,000 gross deductible temporary difference expected to reverse at a new rate of 21 percent.

The resulting adjusted federal DTA as of December 31, 2017 is $1,190 (gross temporary difference of $2,000 times 28 percent or $560) plus ($3,000 times 21 percent or $630).

The cumulative effect of remeasuring the net DTA from 35 percent is a $560 expense (i.e., DTA balance of $1,750 on $5,000 gross temporary differences times 35 percent less a remeasured DTA balance of $1,190).

The cumulative effect of remeasuring the federal effect of state deferred income tax is $33 benefit (i.e., a federal DTL balance of $105 on $5,000 gross state deductible temporary difference times 6 percent times 35 percent less a remeasured balance of a federal DTL of $72).[21]

The total discrete period federal deferred income tax effect is a $527 expense ($560 less $33).

20 The blended rate of 28.06 percent is derived by dividing the number of days in 2017 by 365 and the number of days in 2018 by 365 as required by IRC Section 15. For a June 30 entity, the rate can be approximated by adding 35 percent plus 21 percent and dividing the sum by 2, assuming there are equal days in the first part of the year as in the latter part of the year (so an approximated rate of 28 percent).

21 The remeasured federal DTL of $72 is computed as following: ($2,000 x 6 percent x 28 percent) plus ($3,000 x 6 percent x 21 percent).

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The following table summarizes the December 31, 2017 year-to-date income tax provisions from continuing operations and the discrete period effect:

	Ordinary Income			Tax				
Reporting Period	Reporting Period	Year-to-Date	Estimated Annual Effective Tax Rate	Year-to-Date	Less Previously Provided	Reporting Period	Discrete Effect	Total Quarterly Tax Expense
First quarter	$3,000	$3,000	41.29%	$1,239		$1,239		$1,239
Second quarter	$4,000	$7,000	34.53%	$2,417	$1,239	$1,178	$527	$1,705
Fiscal year Forecast		$15,000*						
Year to Date	$7,000					$2,417	$527	$2,944

*Based on Q2 annual forecast

Entity A would make the following second quarter journal entries to recognize quarterly income tax provisions (refer to Appendix A for details of the quarterly federal and state calculations):

Debit: State Current Income Tax Expense	$227	
Credit: State Income Tax Payable		$227
(Q2-2018 current state tax)		
Debit: State Deferred Tax Expense	$30	
Credit: State Deferred Tax Asset		$30
(Q2-2018 deferred state tax)		
Debit: Federal Current Income Tax Expense	$823	
Credit: Federal Income Tax Payable		$823
(Q2-2018 current federal tax)		
Debit: Federal Deferred Tax Expense	$98	
Credit: Federal Deferred Tax Asset		$98
(Q2-2018 deferred federal tax)		
Debit: Federal Deferred Tax Expense	$527	
Credit: Federal Deferred Tax Asset		$527

(cumulative effect of federal deferred tax remeasurement including a $560 expense less a $33 benefit)

Total income tax provision recognized in the interim period ending December 31, 2017 (Q2-2018) is $1,705.

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TAXATION OF FOREIGN INCOME & FOREIGN PERSONS

TREATMENT OF DEFERRED FOREIGN INCOME

Old Law:

U.S. corporations owning foreign subsidiaries generally were allowed to defer, with some exceptions, recognition of foreign earnings as U.S. taxable income until the earnings were repatriated. Once repatriation occurs, a foreign tax credit (FTC) is allowed to offset a portion of the U.S. taxes to prevent double taxation.

New Law:

U.S. shareholders owning at least 10 percent of a foreign corporation will include in current year taxable income[22] the shareholder's pro rata share of the net post-1986 historical earnings and profits (E&P) of the foreign subsidiary to the extent such E&P has not been previously subject to U.S. tax. The net E&P would be determined by taking into account the U.S. shareholder's proportionate share of any E&P deficits of other foreign subsidiaries of the U.S. shareholder or members of the U.S. shareholder's affiliated group.

Net E&P must be based on the greater of the aggregated post-1986 accumulated E&P as of November 2, 2017, or December 31, 2017. Such E&P amounts are not reduced by distributions during the taxable year.

The transition tax would apply to all U.S. shareholders of a specified foreign corporation. The E&P will be classified as either E&P that has been retained in the form of cash or cash equivalents, or E&P that has been reinvested in the foreign subsidiary's business (e.g., property, plant and equipment). The portion of the E&P comprised of cash or cash equivalents will be taxed at a reduced rate of 15.5 percent, while any remaining E&P will be taxed at a reduced rate of 8 percent.

FTC carryforwards will be available to offset the transition tax on a proportionate basis (i.e., utilization of FTC carryforwards will be partially limited). No deduction will be permitted for any foreign taxes that will not be allowed as a FTC under this limitation. That is, if foreign taxes are not creditable against the transition tax, they are not deductible either.

NOL carryforwards will be available to offset the transition tax liability. The U.S. shareholder will also be allowed to make an election to forego usage of the NOL carryforward and instead utilize existing FTCs.

At the election of the U.S. shareholder, the tax liability will be payable over a period of up to eight years, using specified percentages (eight percent per year for the first five years, 15 percent in year six, 20 percent in year seven, and 25 percent in year eight). There is no interest charge for electing installment payments.

Effective Date of New Law

The provision is effective for the U.S. shareholder's taxable year which includes the last taxable year of a foreign corporation that begins before January 1, 2018 (e.g., calendar 2017 tax period for a calendar year U.S. corporation and foreign subsidiary).

ASC 740 Implications

All U.S. reporting entities with foreign subsidiaries will need to determine their transition tax irrespective of their prior accounting assertion for accumulated foreign earnings and irrespective of whether they intend to repatriate cash back to the U.S.[23] The foreign earnings transition tax will be recognized as a discrete item in the financial statements of the enactment period. However, refer to SAB 118 discussion for additional guidance on recognition timing.

The transition tax will be presented as long and short-term income tax payable, depending on the reporting entity's particular payment schedule election.

Reporting entities that previously asserted an "indefinite reinvestment" of accumulated foreign earnings and did not recognize a DTL for undistributed foreign earnings will now have to recognize a tax liability. If they have already recognized a DTL based on the law in effect prior to the December 22, 2017, they will have to adjust the liability to reflect the new transition tax provisions.

Going forward, foreign earnings of U.S.-owned foreign subsidiaries will be exempt from U.S. taxation through a 100 percent Dividend Received Deduction (DRD), except for certain foreign income that will still be subject to U.S. anti-deferral rules (i.e., subpart F of the Internal Revenue Code and a new minimum tax on certain global intangible foreign income, covered below).

22 The tax year which includes the foreign corporation's last tax year beginning before January 1, 2018.

23 That is, irrespective of whether they maintained an "indefinite reinvestment assertion" of foreign earnings under ASC 740-30-25-17.

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BDO Observations:

- The calculation of the transition tax is expected to be complex and time consuming. There are multiple variables including E&P determined on two different measurement dates, foreign tax paid or incurred, foreign withholding tax, and potential foreign currency translation effects. Having to segregate cash and cash equivalents from other foreign assets and on two different measurement dates adds additional complexity.
- The calculation of the transition tax will involve many tax return positions that should be evaluated for uncertain tax benefits (i.e., FIN 48). The measurement of the transition tax should reflect the effect of tax return positions that are considered more likely than not sustainable based on the transition tax law. An uncertain tax benefits liability arising from the determination of the transition tax liability will also be recognized in income tax expense in the enactment period. However, refer to SAB 118 discussion for additional guidance on recognition timing.
- Foreign withholding tax will need to be considered if foreign earnings are expected to be repatriated to the U.S. Therefore, management will need to represent whether foreign earnings are or are not needed in the U.S. and whether a foreign withholding tax on the repatriation would be incurred or can be avoided (e.g., through tax restructuring to minimize or avoid withholding taxes). The transition tax liability should include the effect of a withholding tax expected to be incurred on repatriation.[24]
- The determination of FTCs available to offset the transition tax will be complex and include FTCs that are already recognized as carryforwards, FTCs for the foreign taxes incurred or paid on post-1986 accumulated and undistributed foreign income, and FTCs related to previously taxed subpart F income. FTC carryforwards attributable to pre- tax reform periods that cannot be fully utilized to offset the transition tax might have to be written off to the income statement. Additional guidance on the ability to utilize FTCs is expected.
- The transition tax is considered a source of income to support the realization of NOL and FTC carryforwards.[25] When both NOL and FTC carryforwards are available to offset the transition tax liability but the combined utilization is limited, entities will need to determine whether it is more beneficial to elect to use FTCs instead of NOL carryforwards. For example, FTCs with remaining two year carryforward period might be used before an NOL carryforward with a remaining 15 year carryforward period. These decisions could have valuation allowance consequences. Valuation allowance changes triggered by the transition tax should also be recognized as an adjustment to income tax expense in the enactment period.
- The impact on state income tax liabilities should also be considered. Many states do not conform to the IRC, or choose to “decouple” from certain IRC provisions, in the calculation of state taxable income. Therefore, state tax filings should be evaluated to determine the impact (if any) on state income tax from the federal taxable income recognition of deemed foreign income. State income tax expected to be incurred on accumulated foreign earnings should also be recorded to income tax expense in the period of enactment.
- The transition tax liability must be recognized entirely in current year taxable income, although an election can be made to pay the tax in eight annual installments based on specified percentages. In that context, a question arose as to whether the transition tax liability should be discounted. Under Topic 740, discounting of deferred income taxes has been prohibited for various reasons, including complexity. At the FASB meeting on January 10, 2018, the Board decided that the transition tax liability itself should not be discounted. On January 22, 2018, the FASB issued a Q&A on “**Whether to Discount the Tax Liability on the Deemed Repatriation**.”

24 ASC 740-10-55-24.

25 Utilization of NOL and FTC carryforwards is still subject to regular limitation rules under IRC Section 382.

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TAXATION OF FOREIGN EARNINGS & ADDITIONAL TAX ON INTERNATIONAL PAYMENTS

Old Law

U.S. shareholders of a Controlled Foreign Corporation (CFC) were required to currently include in their U.S. taxable income their allocable share of net subpart F income earned by the CFC even when no cash or property was actually distributed.

New Law

Many of the provisions under the old law still apply; however, there are new additions that have been included in the tax reform legislation to prevent base erosion. The first addition is a new tax on global intangible low-taxed income (GILTI).

Foreign intangible income has been described as "mobile" income that can be shielded from U.S. tax through foreign corporations located in low-tax jurisdictions. This new tax targets high-yield foreign intangible income and imposes a "global minimum" effective tax of about 10 percent on such income. However, the calculation is complex because it involves applying an annual benchmark return on assets to the aggregate book value of tangible property from all foreign jurisdictions and comparing it to foreign income (pretax less foreign tax) from all jurisdictions. Any excess is then subject to this new tax. The effective rate of this new tax is not 21 percent because a deduction - initially 50 percent of the GILTI tax – is also allowed. The mechanics of the GILTI provision is discussed in detail below.

Another addition is a tax on certain payments that are deducted in the U.S. and are made to a foreign affiliated entity.

The eroding of the U.S. income-base and federal income tax revenue has been referred to as "base erosion" tax payments. The solution introduced by the Act is a new tax called BEAT. This new tax targets certain payments from U.S. corporations to affiliated foreign entities which cause a reduction of U.S. taxable income and tax liability. BEAT is triggered by certain U.S. corporations (at least $500 million in gross receipts) when base-erosion U.S. payments (e.g., deductible royalty, interest, depreciation and amortization from certain property acquisitions) is at least 3 percent of total deductions allowed for the year. The BEAT rate is initially 10 percent, increasing to 12.5 percent in 2026. The BEAT calculation is discussed in detail below.

Global Intangible Low-Taxed Income (GILTI):
Under the provision, a U.S. shareholder of a CFC must include in gross income for its taxable year its GILTI in a manner generally similar to inclusions of Subpart F income. GILTI is calculated as gross income of the CFC[26] in excess of extraordinary returns from tangible assets. The extraordinary return base equals 10 percent of the CFC's aggregate adjusted basis in depreciable tangible property. Only 80 percent of the foreign taxes paid on the income would be allowed as a FTC. A deduction of GILTI is provided for domestic corporations, discussed below.

Deduction for Foreign-Derived Intangible Income (FDII) and GILTI:
The provision provides domestic corporations, defined as a U.S. based C-corporation that is not a Regulated Investment Company (RIC) or Real Estate Investment Trust (REIT), with deductions related to FDII and GILTI (discussed above).

FDII is defined as foreign-derived intangible income earned by a domestic corporation in connection with the sale of goods or services to any person who is not a U.S. person and is for foreign use only (i.e., U.S. export sales). There are limitations on the deduction if the sale of goods or services are provided to a foreign related party.

For taxable years beginning after December 31, 2017, and before January 1, 2026, the provision generally allows a deduction equal to the sum of 37.5 percent of its FDII plus 50 percent of GILTI tax (if any). For taxable years beginning after December 31, 2025, the deduction for FDII is reduced to 21.875 percent and the deduction for GILTI tax is lowered to 37.5 percent. The deduction for FDII and GILTI tax is not allowed to reduce taxable income below zero.

Base Erosion and Anti-abuse Tax (BEAT):
For tax periods beginning after December 31, 2017, there will be a new additional tax on certain payments made by a domestic corporation to a foreign related party, if the domestic corporate group (including the foreign affiliates) meets both of the following criteria:

1. Aggregate average gross receipts of at least $500 million from a U.S. trade or business over a three-year period.
2. Base erosion percentage for the taxable year is 3 percent or higher. The base erosion percentage is the aggregate amount of base erosion tax benefits divided by the aggregate amount of the total deductions allowable for the taxable year (including the base erosion tax benefits).

26 CFC's gross income excludes effectively connected income (ECI), subpart F income, high-taxed income, dividends from related parties, and foreign oil and gas extraction income.

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Companies that meet the criteria will be subject to BEAT and potentially required to pay an additional tax. That is, these companies will determine regular taxable income and tax liability at 21 percent and then determine modified taxable income and tax liability at the BEAT rate of 10 percent (a 5 percent rate applies for only one year). Their U.S. tax liability will be the higher of the two.

For tax periods beginning after December 31, 2025, the tax rate is increased from 10 percent to 12.5 percent.

Modified taxable income is calculated by adding back the base eroding payments to regular taxable income, and would not include NOLs. Base erosion payments generally are amounts paid or incurred by the domestic corporation to a foreign related party for which a deduction is allowable (e.g., interest)[27], and also include deductions allowed for depreciation and amortization for amounts paid in connection with the acquisition of depreciable or real property from the foreign related party.

Base erosion payments generally do not include any deductions related to costs of goods sold, or otherwise allowable costs which reduce gross receipts and any base erosion payments on which tax has been deducted and withheld (e.g. withholding on interest and royalty payments).

ASC 740 Implications

Global Intangible Low-taxed Income (GILTI) Tax: This provision is effectively designed to tax foreign source intangible income and ultimately favors U.S. holding of intangibles over foreign holding structures.

The potential inclusion (in U.S. taxable income) of GILTI could increase the effective tax rate of U.S. corporations powered by global intangible assets (e.g., life science, pharmaceutical, technology). This tax provision has unique features such as an annual benchmark return on investments in foreign tangible assets and a requirement to include (in U.S. taxable income) the "excess" (if any) of foreign net income over an annual benchmark return on investments in tangible assets.

Under ASC 740, deferred income taxes are recognized for book-to-tax basis differences in assets and liabilities if recovery of the assets and settlement of the liabilities would result in taxable (deductible) amounts different than the financial reporting income (expense). For U.S. corporations with very small or insignificant foreign tangible property, recognition of U.S. deferred income tax liabilities for the excess of book-over-tax basis in foreign intangibles might provide a reasonable estimate of the U.S. tax consequence from GILTI. However, most U.S. corporations will have some investments in foreign tangible properties and thus will have a sizable benchmark return on investment (albeit a different one every year) that can be excluded from GILTI. Additional measurement complexity is caused by the GILTI deduction provision (up to 50 percent of GILTI incurred in tax years 2018 to 2025).

At the FASB meeting on January 10, 2018, the Board voted to recommend an accounting policy option, with clear disclosure, to either treat GILTI tax as a period cost when incurred (i.e., permanent item in the effective tax rate) or recognize deferred taxes for temporary differences that are expected to result in GILTI tax. The policy choice should be consistently applied and appropriately disclosed.[28]

On January 22, 2018, the FASB issued a Q&A on **"Accounting for Global Intangible Low-Taxed Income."**

Deduction for Foreign-Derived Intangible Income (FDII): Similar to GILTI tax, a question arises as to whether the FDII benefit should be treated as a permanent effect on the annual effective tax rate (i.e., a period benefit) or be provided for in measuring deferred income taxes.

The calculation of the tax benefit is based on a measure of export sale intangible-derived income which could vary every year, depending on numerous factors including gross margins on intangible-derived income. That is, it is contingent on future performance of specific sales activities. In some respects, this new benefit resembles prior export-related tax benefits (e.g., foreign sales corporation or FSC and its successor Extra Territorial Income Exclusion of EIE, both of which have been repealed). These prior benefits were treated as permanent items in the annual effective tax rate.

Under ASC 740, a tax benefit from statutory depletion and other types of "special deductions" such as the benefit for domestic production activities (i.e., IRC Sec. 199) shall not be anticipated for purposes of offsetting deferred tax liabilities for taxable temporary differences. Instead, the tax benefit of special deductions ordinarily is recognized no earlier than the year in which those special deductions are deductible on the tax return.[29] While ASC 740 does not define "special deduction," this new export benefit is analogous to other benefits treated as "special deductions" under ASC 740.

27 Companies required to reduce interest expense deduction due to IRC Section 163(j) will apportion the reduction first to unrelated party interest before related party interest when determining modified taxable income (i.e., the reduction in interest expense is not applied pro rata between related and unrelated party interest).

28 The FASB noted that ASC 740 is not clear as to the appropriate accounting but that accounting for GILTI tax as a period cost provides the most useful information to readers of financial statements.

29 ASC 740-10-25-37.

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Therefore, it is appropriate to recognize the new export tax benefit under GAAP when it becomes deductible on the tax return.

However, similar to the impact other special deductions may have on future taxable income, entities would have to consider the need for a valuation allowance.[30]

Base Erosion and Anti-abuse Tax (BEAT):
The BEAT law creates a modified taxable income to be determined annually in addition to regular taxable income. The annual tax liability is the higher of the two. However, the tax incurred under BEAT law is incremental (i.e., an excess tax over regular tax based on 21 percent rate). That is, it will cause the effective tax rate to exceed the statutory 21 percent rate (absent items that would lower the effective rate such as R&D credits). Unlike alternative minimum tax (AMT), the incremental tax incurred by BEAT law is not creditable against future regular tax liabilities (the two calculations are not integrated).

The accounting issue is whether companies that expect to incur BEAT every year such as certain global entities with significantly large U.S. operations and intercompany transactions would have to account for this incremental tax in measuring deferred income taxes.

At the FASB meeting on January 10, 2018, the Board noted that BEAT can be analogized to the corporate AMT.[31] However, it also noted that the tax is designed to be incremental tax such that a taxpayer can never pay less than statutory tax rate.

The FASB decided that an entity subject to BEAT should recognize deferred tax assets and deferred tax liabilities at the regular tax rate rather than the reduced BEAT rate. Additionally, BEAT is not required to be forecasted for purpose of deferred tax asset realization assessment. On January 22, 2018, the FASB issued a Q&A on **"Accounting for the Base Erosion Anti-Abuse Tax."**

It is possible that certain assets and liabilities would drive the BEAT calculation such as an intercompany acquisition of depreciable/amortizable property and intercompany loans. However, it remains to be determined whether it might be appropriate to maintain two sets of temporary differences related to these assets or liabilities: i) a temporary difference for regular taxable income, and ii) another one for the modified taxable income to account for the disallowance of basis recovery under BEAT. However, it would not entirely eliminate the impact on the effective rates in the asset-recovery periods because BEAT is incremental to the regular rate.

Therefore, BEAT incurred is considered incremental to the statutory rate of 21 percent and would have the same impact on the annual effective tax rate as other unfavorable permanent items.

30 ASC 740-10-55-30.

31 ASC 740-10-30-11 addresses the accounting for AMT.

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DEDUCTION FOR FOREIGN-SOURCE PORTION OF DIVIDENDS

Old Law

Foreign earnings of U.S. corporations were subject to a U.S. tax on dividends repatriation, subject to a foreign tax credit. U.S. taxation was deferred if foreign earnings were kept outside the U.S. and invested in an active trade or business. Under the Act, foreign earnings that have been accumulated outside the U.S. are now subject to a final tax or "transition tax" as explained above.

New Law

Under a new modified "territorial" system of U.S. international taxation, 100 percent of foreign source portion of dividends distributed by a foreign corporation to a U.S. corporate shareholder that owns 10 percent or more of the voting stock of the foreign corporation is exempt from U.S. taxation.[32]

No foreign tax credit or deduction is permitted for any foreign taxes (including withholding taxes) paid or accrued with respect to any exempt dividend, and no deduction is allowed for expenses properly allocable to an exempt dividend (or stock that gives rise to exempt dividends).

The exemption does not apply to dividends received from a passive foreign investment company (PFIC).

An indirect foreign tax credit is still allowed for any subpart F income that is included in the income of the U.S. shareholder on a current year basis.

Effective Date of New Law

The new law is effective for distributions made after December 31, 2017.

ASC 740 Implications

The largest component of a U.S. corporation's investment in a foreign subsidiary (i.e., the underlying foreign earnings) is now tax-free income in the U.S. Going forward, the cost of repatriating foreign U.S. exempt income will be foreign withholding tax, potential U.S. tax on foreign currency translation gains, and potential state taxes.

Under ASC 740, the undistributed earnings of a subsidiary included in consolidated income shall be presumed to be transferred to the parent entity.[33] Therefore, a consolidated subsidiary's undistributed earnings are considered a temporary difference, unless the earnings can be recovered tax free. For that reason, the undistributed earnings of a domestic subsidiary have generally been excluded from deferred income tax due to the U.S. parent's ability to transfer the earnings and not incur a tax at the parent level because of a 100 percent dividend-received deduction. The new law now extends the long-standing exclusion of domestic subsidiary earnings to foreign subsidiary earnings with the new 100 percent dividend-received deduction provision.

32 Dividends that were received (and deducted) by one CFC from another CFC (i.e., "hybrid dividends") are excluded from the 100-percent DRD treatment when distributed to the U.S. shareholder.

33 ASC 740-30-25-3.

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BDO Observations:

- This U.S. policy change is arguably the most significant change in decades. It should significantly ease financial reporting related to reinvestment assertions for foreign earnings.
- However, U.S. corporations will still need to consider their intentions and plans with respect to foreign income and determine whether they need to accrue foreign withholding taxes which are no longer creditable under the new law.[34] That is, they need to declare their intention and ability to avoid or incur the withholding tax cost. This determination also affects the need to recognize (through OCI) deferred taxes on foreign currency translation gains (losses), as discussed further below.
- If a U.S. corporation decides to dispose of a foreign subsidiary, it might also have to accrue a U.S. deferred tax liability if disposal would result in a gain that is U.S. taxable income (i.e., not exempt foreign income). Under the new tax law, foreign exempt income that is repatriated to a U.S. corporation will reduce the tax basis in the stock of the foreign subsidiary for purposes of determining loss but not gain on disposal. A deferred tax asset for excess tax-over-book basis can only be recognized if and when it becomes apparent that disposal would occur in the near term (within 12 months).[35]
- Under current U.S. tax law, foreign currency translation gains (losses) are taxable upon remittance of foreign income from a controlled foreign corporation. Therefore, deferred income tax related to foreign currency translation adjustments (gain or loss) recognized in OCI would still need to be considered. Deferred income tax for current year foreign currency translation gain (loss) in OCI should be also be recognized in OCI.[36]
- More guidance on this new tax policy and its impact on financial accounting is likely to emerge after the U.S. Treasury has provided regulations and stakeholders have had a chance to consider the impact.

34 ASC 740-10-55-24.

35 ASC 740-30-25-9.

36 ASC 740-20-45-11(b).

NET OPERATING LOSS DEDUCTION

Old Law

Corporate taxpayers could take a deduction for the total NOL available (aggregate of NOL carryovers plus NOL carrybacks to that year) for a taxable year to the extent they had taxable income.[37]

Corporate taxpayers that generated a loss in a taxable year could carryback the NOL to each of the two preceding tax years, and forward to the twenty tax years following the loss year.[38]

New Law

Corporate taxpayers that generate a loss in a taxable year beginning after December 31, 2017, will be able to carry forward the NOL indefinitely but utilization will be subject to an annual deduction limitation of 80 percent of taxable income. The losses will not be allowed to be carried back.

Effective Date of New Law

The provision allowing unused NOL to be carryforward indefinitely and disallowed carryback applies to net operating losses arising in taxable years ending after December 31, 2017.

The provision establishing an annual limitation on NOL deduction of 80 percent of taxable income applies to losses arising in taxable years beginning after December 31, 2017.

ASC 740 Implications

Corporate taxpayers with a valuation allowance and a "naked credit" deferred tax liability may have to reassess the amount and/or need for a valuation allowance as a result of the carryforward period change to net operating losses.

A "naked credit" is a deferred tax liability for an indefinite-lived asset such as land, goodwill, and indefinite-lived intangibles because the asset is not amortizable or depreciable for book accounting purposes.

The recovery of the book values of indefinite-lived intangible assets and land generally do not occur through depreciation or amortization but through impairment or disposal. Therefore, the reversal of DTLs related to indefinite-lived intangible assets (or land) cannot (in most cases) be considered a source of income for a valuation allowance in a jurisdiction where there is a finite loss carryforward period. This can result in an increase to the valuation allowance for the same amount, i.e., a "gross-up" effect or "naked credit."

37 IRC §172(a).

38 IRC §172(b).

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The new law results in U.S. federal NOL DTA (generated in tax years ending after December 31, 2017) being indefinite-lived as the loss carryforward period is indefinite. This change would allow "naked credit" DTLs to be considered a source of income to support a new U.S. federal NOL DTA.

BDO Observations:

- Companies will need to remeasure their NOL carryforward deferred tax assets existing as of the enactment period at the new 21 percent tax rate, except for NOL that can be and is expected to be carried back to prior year(s) for a refund of tax paid at the previous rate of 35 percent.
- Companies will need to track NOLs subject to a 20-year carryforward period separately from NOLs that will have an indefinite carryforward period. Deductible temporary differences that will reverse after the enactment period may become part of an NOL that can be carried forward indefinitely.
- Valuation allowance changes resulting from a "naked credit" effect will also be recognized as part of the enactment period accounting.
- NOLs for fiscal year taxpayers could be challenging to track for the tax year that includes the effective date. For example, losses generated in fiscal years that start before December 31, 2017, and end after December 31, 2017, would not be subject to the 80 percent of taxable income annual limitation. Generally, they cannot be carried back, but can be carried forward indefinitely.
- The new annual limitation on utilization of indefinite-lived NOLs (except for an NOL generated in fiscal year 2018 as noted in the previous bullet) will present a new complexity and potential uncertainty related to valuation allowance accounting. The issue is whether a portion of all U.S. federal taxable temporary differences are no longer considered a source of income due to the 80 percent annual limitation. Stated differently, because an NOL deduction is limited to the 80 percent of taxable income, it is necessary to consider the effect on reversing taxable temporary differences and determine whether some portion (i.e., 20 percent) is no longer considered a source of income to support the realization of a U.S. federal NOL DTA.
- Some believe that "grossing up" a valuation allowance (i.e., recognition of a valuation allowance in excess of net deferred tax assets) by loss-making entities due to the new annual limitation would not provide useful information. A loss-making entity would generally require a valuation allowance, absent sufficient positive evidence of potential source of income (e.g., a tax planning strategy). Grossing up a valuation allowance is not representative of the expected taxable income of loss-making entities. Under ASC 740, a loss-making entity is not expected to have taxable income and pay income tax in the future periods that the DTLs are expected to reverse.
- Tax Reform may prompt entities to consider the impact of "tax planning strategies" (as defined in ASC 740) as a source of income. Under Tax Reform, a U.S. NOL will now be considered an indefinite-lived tax asset. Under ASC 740, tax planning strategies encompass hypothetical actions that management is able to implement should it be needed to avoid expiring attributes. The issue is whether tax planning strategies that meet the prudent & feasible requirements in ASC 740 can no longer be considered a viable source of income to avoid U.S. federal valuation allowance because of the tax law change making new U.S. NOLs indefinite-lived. Some believe consideration of tax planning strategies should be allowed, although we are aware of a different view and would expect more discussions on the topic.
- Some believe that excluding tax planning strategies as a source of income would be an unintended accounting consequence of the Act that would create more practice challenges in an area that is already too complex and a frequent source of financial statement errors. Barring consideration of "prudent & feasible" tax planning strategies in the U.S. jurisdiction simply because a U.S. NOL does not have expiration date is not reflective of how organizations manage their income tax and maximize benefits from tax loss carryforwards.

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ALTERNATIVE MINIMUM TAX (AMT)

Old Law

Corporate taxpayers were taxed on the excess (if any) of their tentative minimum tax over their regular tax for the taxable year.[39] The tentative minimum tax was computed at 20 percent of their alternative minimum taxable income (AMTI) for the taxable year that exceeds the $40,000 exemption amount. The alternative minimum taxable income was determined by starting with regular taxable income and adjusting for tax preference items

AMT tax paid by corporate taxpayers was a future credit against regular tax and the credit could be carried forward indefinitely.

New Law

Corporate taxpayers will no longer be subject to the AMT starting with tax year 2018 for calendar year taxpayers.

Taxpayers that have existing AMT credits from previously paid AMT will be allowed to offset their regular tax liability for any taxable year. Additionally, the AMT credit will be refundable for any taxable year beginning after December 31, 2017 and before January 1, 2022 in an amount equal to 50 percent of the excess of the AMT credit for the taxable year over the amount of the credit allowable for the year against regular tax liability. In tax year 2021, 100 percent of any remaining excess AMT credit will be refunded thus, the full amount of the AMT credit will either be used or refunded.

Effective Date of New Law

The new law is effective for taxable years beginning after December 31, 2017.

ASC 740 Implications

The tax law change making AMT credits annually refundable through 2021 ensures realization of these credits. Therefore, if a DTA for AMT credit carryforwards is offset either completely or partially by a valuation allowance, the valuation allowance should be released as part of the enactment period accounting. The release should be recognized discretely as part of income tax expense (benefit) of the enactment period.

DTAs for AMT credit carryforwards continue to remain a component of the inventory of deferred income taxes classified as noncurrent assets/liabilities in a classified balance sheet. However, some reporting entities might choose to reclassify the AMT credits expected to be utilized and refunded in the current year into current tax receivable. Yet, some reporting entities might choose to present AMT credits as noncurrent receivable.

At a FASB meeting on January 10, 2018, the Board considered whether an AMT credit carryforwards presented as noncurrent receivable should be discounted. The FASB decided against discounting of an AMT credit accounted for as a receivable. This decision is consistent with the FASB's other decision to prohibit discounting of the transition tax liability. On January 22, 2018, the FASB issued a Q&A on **"Whether to Discount Alternative Minimum Tax Credits That Become Refundable."**

BDO Observations:

- We expect some diversity in how reporting entities may choose to present and classify AMT credits. Continued presentation as a noncurrent DTA is appropriate but some might determine that noncurrent receivable is more appropriate due to the tax law making these credits refundable.
- The elimination of AMT for periods after 2017 is going to reduce accounting complexity that has been experienced by loss-making entities with full valuation allowances. Also, certain reporting entities (e.g., those in the mining and extraction industries) that have been historically subject to AMT will no longer be required to measure temporary differences at the AMT rate. These entities will begin measuring temporary differences at the regular rate of 21 percent.

39 IRC §55.

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BUSINESS INTEREST DEDUCTION LIMITATION

Old Law

Corporate taxpayers were generally limited on the amount of interest expense they were able to deduct on loans from foreign related persons when the corporate taxpayer's debt-to-equity ratio exceeded the safe harbor ratio of 1.5 to 1.0, and the corporate taxpayer's net interest expense exceeded 50 percent of its adjusted taxable income.[40]

Interest expense disallowed could be carried forward indefinitely to subsequent tax periods.

New Law

The deduction for net interest expense incurred by a corporate taxpayer will be limited to 30 percent of the taxpayer's adjusted taxable income, no matter whether the loan is from a foreign related person, foreign unrelated person, or domestic person. The limitation is determined at the tax filing level (i.e. at the consolidated level for a group of affiliated entities that file a consolidated tax return).

However, taxpayers with average gross receipts for the three prior taxable years of $25 million or less are exempt from the limitation.

Adjusted taxable income includes addbacks for net interest expense and NOL deductions. For taxable years beginning after December 31, 2017, and before January 1, 2022, taxpayers are allowed to add back depreciation, amortization and depletion expenses in the calculation of adjusted taxable income.

However, after January 1, 2022, taxpayers will no longer be allowed the favorable adjustment for depreciation, amortization and depletion.

The portion of disallowed interest is allowed to be carried forward indefinitely after the year in which the interest expense was paid or accrued. The carryforward is used on a first in, first out basis, which is relevant to potential change in ownership limitations under Section 382.

This new limitation will impact both related and unrelated-party debt arrangements including domestic borrowings. Companies with significant interest expense deductions may see an increase to their taxable income due to new limitation.

ASC 740 Implications

The potential increase in taxable income due to disallowed interest would be considered in taxable income forecasts for valuation allowance accounting. However, disallowed interest would result in a DTA with an indefinite carryforward period. Therefore, a reporting entity ultimately needs to have sufficient positive evidence and prospects of generating book taxable income to recover its deferred tax assets.

BDO Observations:

- The limitation in early years is based on a measure of taxable income similar to book EBITA. However, starting in 2022, the limitation will be significantly increased, causing greater disallowance of interest and more DTAs due to disallowed interest. A reporting entity ultimately needs to have sufficient taxable income in all future years in which the DTA is expected to be carried into in order to avoid the need for a valuation allowance (essentially the foreseeable future).
- Disallowed interest carryforwards will also be subject to the limitation under IRC Section 382 upon certain corporate acquisitions. Acquirers may need to consider this impact in acquisition accounting.

40 Taxable income adjusted by net interest expense, NOL deductions, domestic production activities deduction, depreciation, and amortization (among others).

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MODIFIED ACCELERATED COST RECOVERY SYSTEM

INCREASED BONUS DEPRECIATION

Old Law

Corporate taxpayers received (unless the taxpayer elected out) an additional first-year depreciation deduction equal to 50 percent of the cost of qualifying property in the taxable year in which the property was placed in service before January 1, 2020.[41] The 50 percent additional first-year depreciation deduction was phased down for property placed in service after December 31, 2017 (40 percent in 2018 and 30 percent in 2019).

New Law

Corporate taxpayers will receive (unless the taxpayer elects out) an additional first-year depreciation deduction equal to 100 percent of the cost of qualifying property in the taxable year in which the property is placed in service after September 27, 2017, and before January 1, 2023. The full expensing will begin to phase out for property placed in service after January 1, 2023 (refer to Appendix B for the phased-out schedule).

The Act makes another significant change by allowing this benefit for acquisitions of "old" and "new" qualified property (refer to Appendix B for the definition of qualified property).

There is a new phase-down of bonus depreciation for property that was acquired before September 28, 2017, and placed in service after September 27, 2017 (refer to Appendix B for more details).

Effective Date of New Law

The new law is effective for property which is acquired and placed in service after September 27, 2017.

ASC 740 Implications

The additional first-year depreciation deduction equal to 100 percent of the cost of qualifying property will result in a taxable temporary difference. For book purposes, the property will be depreciated over the useful life, and for tax purposes the entire depreciation deduction will be accelerated to the taxable year the property was placed in service.

BDO Observations:

- The 100 percent bonus depreciation is available for property acquired after September 27 which is prior to the enactment date of December 22, 2017. For example, calendar year reporting entities that acquired property after September 27 will now be able to accelerate recovery of property basis to reduce current taxes payable at a rate of 35 percent. This will have an impact on the current income tax provision. However, the deferred tax liability would be measured at 21 percent which is the new rate. This tax rate differential will come through the annual effective rate of the enactment period. Fiscal year reporting entities could have a similar impact because the current provision "blended rate" would be different than the 21 percent new rate that would be used to measure the deferred tax liability arising from bonus depreciation.
- Companies will also need to monitor which states decide not to adopt the federal bonus depreciation rules. In these situations separate state depreciation calculations will be needed with the consequent different temporary differences and deferred taxes.
- The new law allows "used" property to qualify for additional-first year depreciation deduction, which is a significant change that will allow taxpayers to expense all the costs of their property additions in the tax year placed in service (except for the property that meets one or more of the exceptions outlined in the Appendix). The deferred tax accounting followed for "new" property acquisitions would also apply for "used" property acquisitions.

41 IRC §168(k).

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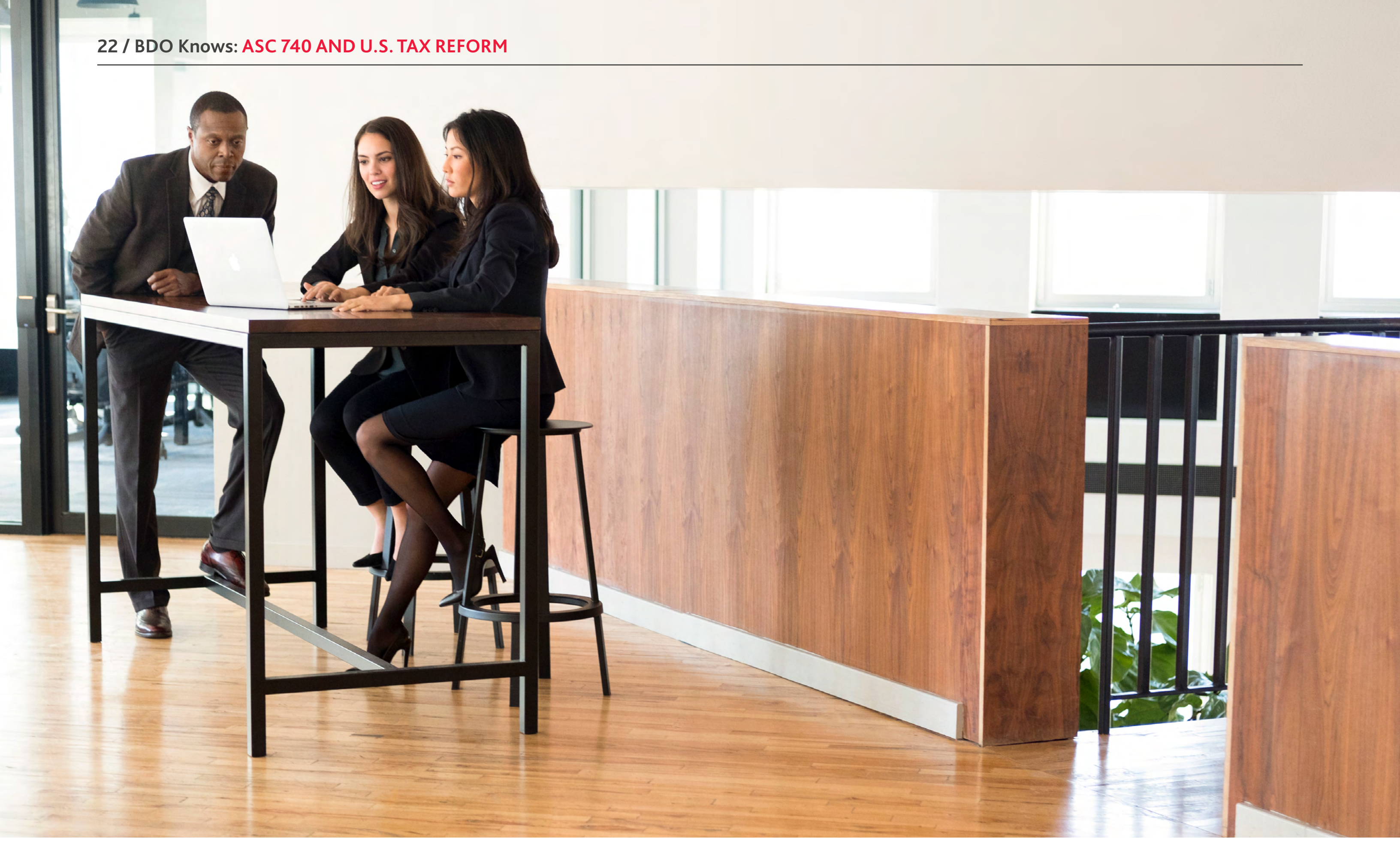

SECTION 179 EXPENSING

Old Law

Corporate taxpayers could elect to expense the cost of qualifying property up to $500,000 (annual limit) in the taxable year in which the property was placed in service. The $500,000 annual limitation was reduced by the amount by which the cost of such property placed in service during the taxable year exceeded $2,000,000.[42]

New Law

Corporate taxpayers may elect to expense the cost of qualifying property up to $1,000,000 (annual limit) in the taxable year in which the property is placed in service. The $1,000,000 annual limitation is reduced by the amount by which the cost of such property placed in service during the taxable year exceeds $2,500,000.

Effective Date of New Law

The new law is effective for taxable years beginning after December 31, 2017.

ASC 740 Implications

The Section 179 expensing will result in a current tax benefit and an offsetting taxable temporary difference and a deferred tax liability. For book purposes the property will be depreciated over the useful life, causing the reversal of the taxable temporary difference. Unlike the retroactive effective date of the bonus deprecation provision, this change is not effective until after the enactment date. Therefore, it will not affect enactment period accounting for calendar year entities.

However, fiscal year entities that acquired property in the current fiscal year and elect to expense the cost under the Section 179 limitation existing prior to the Act will have a current income tax benefit at a blended rate for the current fiscal year. The deferred tax liability would be measured at 21 percent which is the applicable rate when the taxable temporary difference is expected to reverse. This tax rate differential will come through the annual effective rate of the enactment period (i.e. the current fiscal year).

42 IRC §179.

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UNICAP IRC §263A

Old Law

Corporate taxpayers were required to capitalize certain costs as part of inventory for tax purposes that are normally expensed for book purposes.[43] The capitalization rules apply to real or tangible property either produced or acquired for resale. However, taxpayers who were eligible to utilize the cash method of accounting, or are a reseller whose average gross receipts for the past three tax years do not exceed $10,000,000 were exempt from complying with the capitalization rules.

New Law

Corporate taxpayers are required to capitalize certain costs as part of inventory for tax purposes that are normally expensed for book purposes. The capitalization rules apply to real or tangible property either produced or acquired for resale. However, taxpayers who are eligible to utilize the cash method of accounting, or are a reseller whose average gross receipts for the past three tax years do not exceed $25,000,000 are exempt from complying with the capitalization rules.

Effective Date of New Law

The new law is effective for taxable years beginning after December 31, 2017.

ASC 740 Implications

Section 263A/UNICAP results in a temporary difference between book inventory basis and tax inventory basis. Costs required to be capitalized into inventory for tax purposes are deductible once the product is sold; however, for book purposes those costs are expensed as incurred, creating a temporary difference related to inventory.

Corporate taxpayers will need to reassess whether they meet the UNICAP exemptions in order to properly calculate deferred income tax balances related to inventory. Reporting entities that are no longer required to apply UNICAP due to the new gross receipts test will reverse into taxable income the cumulative UNICAP temporary difference in their 2018 taxable year. This will impact current and deferred income taxes.

BDO Observations:

- Form 3115, Application for Change in Accounting Method may have to be filed to stop computing the UNICAP adjustments due to the new gross receipts threshold. The current automatic UNICAP method change under Rev. Proc. 2017-30 provides for a Section 481(a) adjustment, which the taxpayer will need consider and compute.
- A decision that UNICAP no longer applies is a "tax return position" that needs to be considered under FIN 48 accounting if the position is considered uncertain.

43 IRC §263A.

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DEDUCTION FOR EXCESSIVE EMPLOYEE REMUNERATION

Old Law

The law prohibited publicly held companies from deducting more than $1 million per year in compensation paid to each of certain covered employees.[44] Covered employees generally include the chief executive officer (CEO) (or employee acting in that capacity) of the corporation, as well as the four highest compensated officers (excluding the CEO).

There were certain exclusions from the calculation of the covered employee's compensation for purposes of determining the $1 million limitation, most common of which are commission based compensation and qualified performance-based compensation.

New Law

Publicly held companies are still prohibited from deducting more than $1 million per year in compensation to each of certain covered employees. The new law changes the definition of covered employee to include the CEO, chief financial officer (CFO) and three highest paid employees. Under the modified definition, once an employee qualifies as a covered person, the deduction limitation would apply to that person for federal tax purposes so long as the corporation pays compensation to such person (or to any beneficiaries).

The law also expands the application of Section 162(m) beyond all domestic publicly traded corporations. Now all foreign companies publicly traded through American Depository Receipts (ADRs) and certain corporations that are not publicly traded are subject to Section 162(m).

Also, the new law removes the commission and performance-based compensation exceptions from the calculation of the covered employee's compensation for purposes of determining the $1 million limitation.

Effective Date of New Law

The new law is effective for taxable years beginning after December 31, 2017. However, the new law does not apply to remuneration which is pursuant to a written binding contract that was in effect on November 2, 2017, and has not been modified in any material respect on or after such date.

ASC 740 Implications

The new law could cause more executive compensation to be nondeductible, resulting in higher effective tax rates due to permanent disallowance of certain executive compensation. Reporting entities need to determine the potential impact from all compensation arrangements, including cash salary, bonus payments, share-based payments, and deferred compensation payments. Deferred income tax related to compensation arrangements (e.g., nonqualified stock options) should reflect the expectation whether the $1 million deduction limitation is or is not expected to apply.

BDO Observations:

- Compensation arrangements entered into after November 2, 2017, but before year end will have to be reassessed to determine whether they are expected to be affected by the annual limitation. If they are not expected to result in deductible amounts in the future (e.g., upon vesting, exercise, or payment), the impact should be accounted for as part of the current year tax provision and the enactment period accounting.
- The increase to taxable income (without offsetting deferred tax assets) caused by permanent disallowance of material compensation costs should be considered in the forecast of income for valuation allowance accounting.

44 IRC §162(m).

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ENTERTAINMENT EXPENSES

Old Law

Corporate taxpayers could not deduct expenses related to (1) an activity generally considered to be entertainment, amusement, or recreation (entertainment), unless the taxpayer establishes that the expense was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or (2) a facility used in connection with such activity.

If the taxpayer established that entertainment expenses were directly related to (or associated with) the active conduct of its trade or business, the deduction generally was limited to 50 percent of the amount otherwise deductible. Similarly, a deduction for any expense for food or beverages generally was limited to 50 percent of the amount otherwise deductible.

New Law

Corporate taxpayers will not be able to deduct expenses related to entertainment, amusement, or recreation even if it is directly related to (or, in certain cases associated with) the active conduct of the taxpayer's trade or business.

Effective Date of New Law

The new law is effective for amounts incurred or paid after December 31, 2017.

ASC 740 Implications

The disallowance of 100 percent of entertainment expenses will increase the income tax provision and the effective tax rate of the year in which the costs are incurred (i.e., permanent item).

BDO Observations:

- Companies will have to track their "meals" expenses separately from their "entertainment" expenses, and can no longer track them in the same general ledger account as entertainment expenses are not deductible, but meals are 50 percent deductible.
- The increase to taxable income caused by the permanent disallowance (i.e., no offsetting deferred tax asset) of material entertainment costs should be considered in the forecast of income for valuation allowance accounting.

SECTION 199 – DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

Old Law

Corporate taxpayers were generally permitted a deduction equal to 9 percent of the lesser of qualified production activities income (QPAI) or taxable income.[45] The QPAI for any taxable year means an amount equal to the excess (if any) of the taxpayer's domestic production income over the sum of the domestic production cost of goods sold and other applicable domestic production deductions.

New Law

Corporate taxpayers will no longer be permitted a domestic production activities deduction (DPAD) starting with tax year 2018 for calendar year taxpayers.

Effective Date of New Law

The new law is effective for taxable years beginning after December 31, 2017.

BDO Observations:

- Fiscal year entities will be able to claim the DPAD in the fiscal year that includes the enactment date.

45 IRC §199.

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VOLUNTARY ENTITY CLASSIFICATION CHANGES

Old Law

Taxable income from pass-through entities (S-Corporations and Partnerships) would flow through directly to investors based on ownership percentage, and be taxed at the investor's tax rate (i.e. individual, corporate, etc.).

New Law

Investors/owners are allowed a deduction equal to 20 percent of the qualified business income with respect to such trade or business income from pass-through entities (S-Corporations and Partnerships), but certain limitations apply.

Effective Date of New Law

The new law is effective for taxable years beginning after December 31, 2017.

ASC 740 Implications

The reduction in the corporate tax rate as well as the new exemption of certain amounts of pass through income may lead some entities to elect to change their tax status to take advantage of the new laws. The current and deferred tax effects from a change in tax status are generally recognized in income tax expense from continuing operations at the date the change in tax status occurs.[46]

The effect of an election for a voluntary change in tax status is recognized on the approval date or on the filing date if approval is not necessary and a change in tax status that results from a change in tax law is recognized on the enactment date.[47]

FINANCIAL STATEMENT DISCLOSURE IMPLICATIONS

Tax reform will have a significant impact on the financial statements that include the enactment period. The tax footnote disclosures included in annual financial statements of the enactment period will have to provide sufficient information on the cumulative effect of the tax reform enactment. There is a requirement to disclose significant components of income tax expense from continuing operations including the effect of a tax law and tax rate changes. This disclosure will also include the effect on a valuation allowance changes due to tax reform enactment. For many public companies, the income tax footnote's effective tax rate disclosure which reconciles statutory rate to effective rate will have a reconciling item or items for the cumulative effect of the tax reform enactment. The various balance-sheet related disclosures of the inventory of deferred taxes, NOL and credit carryforwards, and uncertain tax benefit liabilities could also be affected.

46 ASC 740-10-45-19.

47 ASC 740-10-25-33.

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SECURITIES AND EXCHANGE COMMISSION (SEC) IMPLICATIONS

Registrants will need to consider the impact of the Tax Cuts and Jobs Act on the disclosures within Management's Discussion and Analysis (MD&A),[48] specifically as it relates to liquidity, the results of operations, and critical accounting estimates.

A discussion is required of known trends, commitments, events, or uncertainties associated with the Tax Reform Act that are reasonably likely to result in liquidity increasing or decreasing in any material way, on both a short-term and a long-term basis.[49] A registrant with significant foreign earnings must consider the impact of the one-time transition tax, including any changes to its contractual obligations table if the liability is to be paid in annual installments.[50] Furthermore, the ongoing effects of other changes (e.g., the reduced corporate tax rate, among others) should be discussed.

A discussion of the impact of the Tax Reform Act on the results of operations should include (i) a one-time impact of the change in the corporate tax rate on DTAs and DTLs, (ii) the one-time transition tax if the registrant has material foreign operations,[51] and (iii) the ongoing impact of the reduced corporate tax rate. The first two items above should be consistent with amounts reflected in the effective rate reconciliation in the footnotes to the financial statements.

A registrant's critical accounting policies and estimates[52] discussion will need to be updated to address the material uncertainties associated with the estimates made within the tax provision, including a discussion surrounding the estimate of the one-time transition tax if the registrant has material foreign operations and there are significant uncertainties around the amount reflected in the financial statements.

In addition to the disclosure requirements of SAB 118 discussed above, registrants will need to consider the income tax disclosures required under Regulation S-X, Rule 4-08(h), including disclosure of the amounts of income tax expense (benefit) applicable to United States Federal income taxes, foreign income taxes, and each other major component of income taxes as well as a reconciliation between the amount of reported income tax expense (benefit) and the amount computed by multiplying the income (loss) before tax by the applicable statutory Federal income tax rate including detail of the underlying causes for the difference in the two amounts.

If the Tax Reform was signed into law after the balance sheet but prior to the issuance of interim or/and annual financial statements, the passage would be a known event that (presumably) is reasonably likely to materially affect operating results and liquidity. Therefore, a registrant should discuss the expected effects on future operating results and liquidity. A registrant should also consider disclosing (via a footnote to the contractual obligations table) the material change in other long term liabilities that occurred after the balance sheet date.

48 Item 303 of Regulation S-K addresses the required disclosures within MD&A.

49 Item 303(a)(1) of Regulation S-K addresses liquidity. The Instructions to Item 303 address the need to discuss liquidity on both a short-term and long-term basis.

50 The tax liability is payable over a period of up to eight years, 8.0 percent of the net tax liability in the first five years, 15 percent in the sixth year, 20 percent in the seventh year and 25 percent in the eighth year. Item 303(a)(5) of Regulation S-K addresses the requirements within the contractual obligations table.

51 Item 303(a)(3) of Regulation S-K requires a discussion of unusual or infrequent events or transaction that materially affected reporting income from continuing operations, and the extent to which the event or transaction impacted income.

52 The SEC's **December 2001 Release** emphasized the required discussion of critical accounting estimates within MD&A.

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INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

The enactment date for IFRS is also December 22, 2017.

The income tax accounting effects of tax reform under IFRS are generally similar to the U.S. GAAP effects discussed in the sections above; however there are a few differences. The International Accounting Standards Board (IASB) might decide to deliberate certain new provisions such as GILTI and BEAT and issue its interpretive guidance under IFRS.

Under U.S. GAAP, the cumulative adjustment will be recognized in income tax expense from continuing operations as a discrete item in the period that includes the enactment date.[53] However, under IFRS deferred tax adjustments due to tax law/rate change must follow "backwards tracing" to the financial statements component (continuing operations, discontinued operations, OCI, and equity) in which the deferred tax item originated.

For more information on accounting under IFRS, refer to BDO's **IFRS at a glance**.

SUMMARY

The enactment of the "Tax Cuts and Jobs Act" is one of the most significant and impactful pieces of legislation that influences the tax system due to the wide-ranging overhaul of the Internal Revenue Code. The implications for financial reporting, and specifically income tax accounting are complex and far-reaching. We believe this publication provides sufficient introductory background and technical analysis into many of the tax law changes. This publication will be updated in the future to reflect significant additional new information and interpretative guidance, if any.

HOW BDO CAN HELP

Companies will have numerous operational challenges and risks from having to determine, within a short period, all of the effects stemming from the Tax Reform and account for them in their financial statements.

BDO is well-equipped to help preparers navigate the myriad of complex tax, accounting, SEC reporting, and audit considerations needed to be addressed by the enactment of the Tax Reform.

BDO professionals have a wealth of experience working with "best in class" U.S. GAAP, income tax accounting and international tax functions within domestic and international organizations. By leveraging our extensive experience with companies of all sizes across a wide range of industries, we have the ability to offer a comprehensive range of services to assist and complement the internal accounting and tax functions through a collaborative and tailored approach.

53 ASC 740-10-45-15.

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APPENDICES

APPENDIX A – EXAMPLE 2 FISCAL-YEAR QUARTERLY CALCULATION OF CURRENT AND DEFERRED TAX

Entity A's federal and state income tax provisions for the interim period ended December 31, 2017 (Q2-2018) is estimated as follows:

Forecasted Taxable Income and Current Tax Expense

	3 MONTHS YEAR-TO-DATE	6 MONTHS YEAR-TO-DATE	Q2-2018 PROVISIONS
Pretax income	$3,000	$7,000	
Permanent item	$185*	$467*	
Temporary Difference	($500)**	($1,000)	
Taxable Income	$2,685	$6,467	
State tax rate	6%	6%	
Current state tax expense	$161 (a)	$388 (a)	$227
Federal taxable income	$2,524	$6,079	
Federal tax rate	35%	28.06%	
Current federal tax expense	$883 (b)	$1,706 (b)	$823
Total current tax expense	$1,044 (a) + (b)	$2,094 (a) + (b)	$1,050

*allocated based on the ratio of YTD income to forecasted income ** forecasted annual change of $2,000/4

Forecasted Deferred Tax Provisions on Ordinary/Recurring Income

	3 MONTHS YEAR-TO-DATE	6 MONTHS YEAR-TO-DATE	Q2-2018 PROVISIONS
Change in gross deductible temporary difference	($500)	($1,000)	
State tax rate	6%	6%	
State Deferred Tax Expense	$30 (a)	$60 (a)	$30
Federal change after state tax effect	($470)	($940)	
Federal tax rate	35%	28.06%	
Federal deferred tax expense	$165 (b)	$263 (b)	$98
Total deferred tax expense	$195 (a) + (b)	$323 (a) + (b)	$128

SAB 118 Consideration: The degree to which an entity is able to estimate its mid-year gross temporary differences is expected to vary depending on the reporting entity's size, income tax accounting system, and historical practices. Fiscal year reporting entities that cannot determine reasonable estimate(s) of gross temporary differences at the end of the interim period which includes the enactment date and/or the temporary differences expected to reverse within the fiscal period (and thus be subject to a blended tax rate) from the temporary differences expected to reverse after the fiscal period will have to disclose the reasons. The remeasurement accounting for such entities may not be completed prior to their interim period and must be completed within the 12-month measurement period provided by SAB 118.

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APPENDIX B – ADDITIONAL FIRST-YEAR DEPRECIATION DEDUCTION NEW LAW

The full expensing of property acquisition will begin to phase out for property placed in service after January 1, 2023, as follows:

- For property placed in service after September 27, 2017, and before January 1, 2023, 100 percent expensing
- For property placed in service after December 31, 2022, and before January 1, 2024, 80 percent expensing
- For property placed in service after December 31, 2023, and before January 1, 2025, 60 percent expensing
- For property placed in service after December 31, 2024, and before January 1, 2026, 40 percent expensing
- For property placed in service after December 31, 2025, and before January 1, 2027, 20 percent expensing

There is a present-law phase-down of bonus depreciation for property that was acquired before September 28, 2017, and placed in service after September 27, 2017. Property that meets that criteria will be phased-down, as follows:

- For property acquired before September 28, 2017 and placed in service from September 28, 2017 – December 31, 2017, 50 percent expensing
- For property acquired before September 28, 2017 and placed in service during calendar year 2018, 40 percent expensing
- For property acquired before September 28, 2017 and placed in service during calendar year 2019, 30 percent expensing
- For property acquired before September 28, 2017 and placed in service during calendar year 2020 and thereafter, 0 percent expensing

The definition of qualified property under the new law is the same as the previous law except that the original use of qualified property must commence with the taxpayer is no longer a requirement. Thus, under the new law, the additional-first year depreciation deduction applies to purchases of used and new property. The additional first-year depreciation deduction only applies to property purchased in an arm's length transaction, and does not apply in the following situations:

- Property received as a gift or from a decedent
- Property acquired in a nontaxable exchange (i.e. reorganization)
- Property acquired from a member of the taxpayer's family, or another related entity as defined in IRC Section 267
- Property acquired from a person who controls, is controlled by, or is under common control with, the taxpayer

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