



# Tax reform in the United States

**Q&As for IFRS preparers**

February 13, 2018

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# Tax reform brings fundamental changes

H.R. 1, originally known as the Tax Cuts and Jobs Act, was enacted on December 22, 2017 and is expected to significantly impact companies' accounting for and reporting of income taxes, and the related processes and controls.

Because IAS 12, *Income Taxes*, requires companies to recognize the effect of tax law changes in the period that they are enacted or substantively enacted, the effects must be recognized in companies' December 2017 financial statements, even though the effective date of the law for most provisions is January 1, 2018.

The legislation includes substantial changes to the taxation of individuals, businesses in all industries, multinational enterprises and others.

Highlights for businesses include the following.

- A permanent reduction in the statutory C corporation tax rate to 21%, repeal of the corporate alternative minimum tax (AMT), expensing of capital investment, limitation of the deduction for interest expense, and a multitude of other changes to the corporate tax rules.
- Fundamental changes to the taxation of multinationals, including a shift from the current system of worldwide taxation with deferral to a hybrid territorial system, featuring a participation exemption regime with current taxation of certain foreign income, a minimum tax on low-taxed foreign earnings, and new measures to deter base erosion and promote US production.
- Significant changes relevant to the taxation of tax-exempt organizations, insurance businesses, financial institutions, regulated investment companies (RICs), and real estate investment trusts (REITs).

# About this publication

This publication considers the financial reporting implications under IFRS of H.R. 1, originally known as the Tax Cuts and Jobs Act ('the Act' or 'tax reform'). The Act was enacted on December 22, 2017 and is expected to significantly impact companies' accounting for and reporting of income taxes, and the related processes and controls.

## This is preliminary guidance

**This guidance reflects our preliminary thinking, based on our current understanding of the indicated tax law provisions and our analysis to date. Certain of the tax law provisions require interpretation, which may be clarified through issuances of guidance by Treasury, regulations, or future technical corrections. In addition, we will continue to evaluate how the authoritative accounting guidance applies to some of the provisions. We will update our preliminary thinking as further information becomes available and further research and analysis is completed.**

## Organization of the text

This publication considers how the requirements of IFRS and in particular IAS 12, *Income Taxes*, apply to the provisions of the Act. Our commentary is referenced to current IFRS literature – e.g. IAS 12.46 is paragraph 46 of IAS 12.

The [Comparison of IFRS to US GAAP](#) includes significant differences that we believe are relevant to the issues considered in this publication.

## February 13, 2018 update

New Q&As added to this edition of the publication from the January 17 edition are identified with \*\*.

## Terminology: Fiscal year-end and fiscal tax year

We use the term 'fiscal year-end' to describe a company whose year-end is other than December 31. So, for example, a company might have a fiscal year-end of March 31 or June 30, whereas a calendar year-end company has a year-end of December 31.

We use the term 'fiscal tax year' to describe the tax year that ends in the specified year. So, for example, the fiscal 2018 tax year for a company with June 30 year-end runs from July 1, 2017 to June 30, 2018.

This terminology is particularly important in considering interim reporting.

## Related resources

KPMG has a website dedicated to the US tax reform: [kpmg.com/us/tax-reform](http://kpmg.com/us/tax-reform)

As part of those resources, the following are particularly relevant to this publication:

- [KPMG Report on New Tax Law – Analysis and observations.](#)
- [KPMG’s Q&As on the financial reporting implications of US GAAP, Tax reform – Supplement to KPMG’s Handbook, Accounting for Income Taxes](#)

## Abbreviations and definitions

The following abbreviations are commonly used for the concepts discussed in this supplement.

<b>AMT</b>	<b>Alternative minimum tax</b>	AMT is designed to ensure that all corporations pay a minimum amount of tax. Tentative minimum tax (TMT) is the minimum amount of tax a corporation is required to pay. The total federal tax liability for each year is the greater of regular taxes payable and the calculated TMT. If TMT exceeds the regular taxes payable, the amount by which TMT exceeds regular tax is the AMT.
<b>BEAT</b>	<b>Base erosion anti-abuse tax</b>	<b>New:</b> The BEAT generally imposes a minimum tax on certain deductible payments made to a foreign affiliate, including payments such as royalties and management fees, but excluding cost of goods sold. It generally applies to payments paid or accrued in tax years beginning after December 31, 2017. Read more in <a href="#">KPMG Report on New Tax Law – Analysis and observations.</a>
<b>CFC</b>	<b>Controlled foreign corporation</b>	A foreign corporation where more than 50% of the total combined voting power or value is owned directly, indirectly, or constructively by US shareholders.
<b>E&amp;P</b>	<b>Earnings and profits</b>	Accumulated earnings and profits for US tax purposes.
<b>FDII</b>	<b>Foreign-derived intangible income</b>	<b>New:</b> A deduction for a proportion of ‘foreign-derived intangible income’ to provide a lower effective tax rate on excess returns earned directly by a US corporation from foreign sales (including licenses and leases) or services. Read more in <a href="#">KPMG Report on New Tax Law – Analysis and observations.</a>

<b>GILTI</b>	<b>Global intangible low-taxed income</b>	<b>New:</b> In general, GILTI is the excess of a shareholder's CFCs' net income over a routine or ordinary return. Read more in <a href="#">KPMG Report on New Tax Law – Analysis and observations</a> .
<b>NOL</b>	<b>Net operating loss</b>	Net operating loss carryforwards for US tax purposes.
<b>Subpart F</b>	<b>Subpart F income</b>	Generally, income of foreign subsidiary operations is not taxable to its US 10% or greater shareholders (US shareholders) until distributed. However, certain income described under the Subpart F rules is deemed to be distributed for US tax purposes to the US shareholders when included in a CFC's earnings (limited to the foreign subsidiary's E&P), regardless of whether the income is actually distributed.

# 1. Executive summary

## Corporate rate

Enacted and substantively enacted on December 22, 2017, the Act reduces the corporate tax rate to 21%, effective January 1, 2018.

This change requires calendar year-end companies to remeasure their deferred tax balances at December 31, 2017. The effects will be recognized consistently with the underlying items to which they relate – in profit or loss, other comprehensive income or directly in equity (backwards-tracing).

Fiscal year-end companies will need to determine the effect of the change in rate on their interim financial reporting, including the effect of the phase-in of the new rate over their 2018 fiscal year.

## Tax on deemed mandatory repatriation

Under the Act, a company's foreign earnings accumulated under legacy tax laws are deemed repatriated. The tax on those deemed repatriated earnings is no longer indefinitely deferred but may be paid over eight years.

The resulting liability for current tax should be recognized as current or noncurrent in the usual way.

Companies will still need to analyze temporary differences in relation to investments in the usual way.

## Other international provisions

The law introduces a new tax on global intangible low-taxed income (GILTI). GILTI is based on a US shareholder's CFCs' net income in excess of a return on tangible business property.

For temporary differences expected to reverse as GILTI, it appears that it may be appropriate to either record deferred tax (e.g. if a company expects to be subject to GILTI on a continuous basis) or to account for the new tax on GILTI as a current period charge.

The Act provides a lower effective tax rate on excess returns earned directly by a US corporation from foreign sales or services. This is achieved by allowing a deduction for a proportion of 'foreign-derived intangible income' (FDII).

It appears that it may be appropriate to account for FDII deductions in the periods when the foreign sales occur and these deductions reduce taxable profit. However, in some circumstances a company may also consider the FDII deduction in measuring the deferred taxes on related temporary differences – e.g. if the company is able to make reliable projections of taxable profits, including foreign sales and the FDII deductions.

The Act creates a base erosion anti-abuse tax (BEAT), which would partially disallow deductions for certain related party transactions. BEAT will function like a minimum tax.

It appears that a company should account for the BEAT similar to the alternative minimum tax (AMT) under previous tax law. This means that deferred taxes

should be measured based on the regular statutory rate, and a company should account for the incremental tax owed under the BEAT system as it is incurred. In addition, it appears that a company does not need to consider whether it will be subject to the BEAT when assessing to what extent operating losses brought forward will be realized in the future. However, if a company is able to make reliable projections of future taxable profits and those projections indicate that a certain amount of operating losses brought forward will not be realized because the company expects to be subject to the BEAT, it may take that into account.

## Other matters

The AMT tax regime is repealed under the Act. Existing AMT credit carryforwards will be fully refundable by 2021. It appears that a company should determine whether minimum tax credit carryforwards related to the repeal of AMT represent current or deferred tax based on its expectation of how these carryforwards will be realized.

Some share-based payment arrangements may allow the employer to net-settle the award for the number of shares required to settle the tax obligation. The change in the top individual tax rate to 37% may therefore be relevant. Whether a company is acting as an agent for the employee or is applying the amendment to the share-based payment standard (effective annual periods beginning on or after January 1, 2018), it should reduce its maximum tax withholding from 39.6% to 37% for 2018, to avoid the excess 2.6% being a cash-settled share-based payment.

## Deferred tax assets

Several new provisions are likely to affect companies' assessment of the realizability of deferred tax assets. These provisions include:

- E&P subject to tax under the mandatory deemed repatriation provisions is a source of foreign source income to support deferred tax assets that may not have been recognized previously;
- the 100% dividends received deduction that may affect the realizability of foreign tax credits;
- cost recovery provisions that accelerate depreciation on depreciable and real property;
- interest expense provisions that limit annual interest deductions and the use of disallowed interest carryforwards;
- annual limitation on the use of net operating loss (NOL) carryforwards (and the extension of their carryforward periods);
- elimination of the corporate AMT; and
- expansion of the executive compensation that is subject to the excessive executive compensation limit.

## Estimation uncertainty

As highlighted throughout this publication, the changes in tax law include various provisions that affect the calculation of current and/or deferred tax that, given the enactment of the legislation prior to year-end, must be considered in preparing financial statements under IFRS. The impact of each change in tax

law will depend on a company's specific facts and circumstances, and will need to be analyzed individually.

In some cases, the impact will be easy to calculate. In other cases, in applying the new tax law, we fully expect that a company will make its best estimate, and may revise that estimate in future periods as a result of new or better information, clarifications of the application of tax laws and/or more experience. In all cases, the financial statements should include appropriate disclosures, including relevant information about major sources of estimation uncertainty in applying the new tax law.

## Internal control considerations

In addition to assessing the accounting implications, management should evaluate the impact that the implementation of tax reform will have on business and financial reporting processes, IT systems and the internal control environment.

This may include considering what changes are necessary to record and process relevant transactions and make estimates, as well as consideration of whether additional controls or changes to existing controls are necessary.

Potential impacts on the internal control environment may include new or changes to existing controls related to risk assessment and the interpretation and application of IAS 12, process and monitoring controls related to the technical tax implications, making estimates and note disclosure.

## 2. Corporate rate

### Questions & Answers

- 2.10** Does the rate reduction have an effect on deferred tax balances for companies with December 2017 year-ends?
- 2.20** Where is the effect of the rate reduction recognized?
- 2.30** How should a fiscal year-end company account for the impact of the change in tax rate?
- 2.40** To which tax rate should a company reconcile in its annual financial statements?

## What the Act says

The centerpiece of the new law is the permanent reduction in the corporate income tax rate from 35% to 21%. The rate reduction generally takes effect on January 1, 2018.

The tax code already included special rules for determining how certain rate changes apply to taxpayers whose tax years straddle relevant effective dates – e.g. fiscal year filers in the case of law changes that are effective as of the beginning of the calendar year (as in this case). The Act does not repeal these special rules, but the application of the new law is not completely clear in all cases and future administrative guidance may be needed.

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).



### Question 2.10

#### Does the rate reduction have an effect on deferred tax balances for companies with December 2017 year ends?

**Interpretive response:** Yes. The law reduces the corporate tax rate to 21% effective January 1, 2018. A company measures its deferred tax assets and liabilities based on tax laws and tax rates that are enacted or substantively enacted at the end of the reporting period. [\[IAS 12.47\]](#)

In the United States, legislation is simultaneously enacted and substantively enacted upon the signing of legislation by the President or upon a successful override vote by both houses of Congress. Both the FASB and the IASB reached this conclusion in February 2005, in their joint deliberations about the income taxes short-term convergence project. Therefore, the tax reform was both enacted and substantively enacted on December 22, 2017.



### Question 2.20

#### Where is the effect of the rate reduction recognized?

**Interpretive response:** The remeasurement of deferred tax assets and liabilities may relate to items recognized outside profit or loss. If this is the case, the effect of the remeasurement is also recorded outside profit or loss – i.e. in other comprehensive income or directly in equity. [\[IAS 12.61A\]](#)

In exceptional circumstances, it may be difficult to determine the amount that should be recorded outside profit or loss – e.g. when a change in tax rate affects an item that was only partly recognized outside profit or loss. In such circumstances, a company may use a reasonable pro rata allocation method to determine the amount of tax consequence to be recognized outside profit or loss. [\[IAS 12.63\]](#)



### Question 2.30

#### How should a fiscal year end company account for the impact of the change in tax rate?

**Background:** The income tax expense recognized in each interim period is based on the best estimate of the weighted-average annual income tax rate expected for the full year ('estimated annual effective income tax rate') applied to the pre-tax income of the interim period. [IAS 34.30(c), IE.B12–IE.B16]

The legislation requires a company to use a blended rate for its fiscal 2018 tax year by applying a pro-rated percentage of the number of days before and after the January 1, 2018 effective date. For example, the fiscal 2018 tax year blended rate for a June 30, 2018 year-end taxpayer is approximately 28%:  $(50\% \times 35\%) + (50\% \times 21\%)$ .

**Interpretive response:** If a change in tax rate is enacted or substantively enacted in an interim period, a company may recognize the effect of the change immediately in the interim period in which the change occurs (Approach 1). However, another acceptable approach is to spread the effect of a change in the tax rate over the remainder of the annual reporting period via an adjustment to the estimated annual effective income tax rate (Approach 2). [IAS 34.30(c), IE.B19]

Under Approach 1, a June 30, 2018 year-end taxpayer will recognize the effects of the Act in its interim reporting period ended December 31, 2017. Under Approach 2, effects would be spread over the current and remaining interim periods.

When adjusting its estimated annual effective income tax rate for the effect of the tax reform, a June 30, 2018 year-end taxpayer should, for example, be mindful that temporary differences created or reversing in the fiscal 2018 tax year will do so at the blended rate of 28%, while other temporary differences reversing in later years will likely reverse at the statutory rate of 21%.



### Question 2.40

#### To which tax rate should a company reconcile in its annual financial statements?

**Interpretive response:** Companies are required to present a numerical reconciliation between either of the following: [IAS 12.81(c)]

- tax expense (income) and the product of accounting profit multiplied by the applicable tax rate; or
- the average effective tax rate and the applicable tax rate.

The applicable tax rate is one that provides the most meaningful information to the users of its financial statements, which is often the domestic rate of tax in the country of domicile (aggregating the tax rate for national taxes and applicable local taxes). However, for a company operating in several jurisdictions, aggregation of separate reconciliations using the domestic rate in each individual jurisdiction may be meaningful. [IAS 12.85]

For a calendar year-end company, the underlying US federal tax rate to consider when preparing a 2017 reconciliation is 35%.

For a fiscal year-end company, the underlying US federal tax rate to consider when preparing a 2018 fiscal year reconciliation is the blended rate that the Act requires the company to use to compute its fiscal 2018 tax liability. As discussed in [Question 2.30](#), a fiscal year-end company computes the blended rate by applying a pro-rated percentage of the number of days before and after the January 1, 2018 effective date.

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# 3. Tax on deemed mandatory repatriation

## Questions & Answers

- 3.10** Should a US taxpayer classify the liability for taxes due on deemed repatriated earnings for a CFC with the same year-end as a deferred tax liability?
- 3.20** Should a company classify the liability for taxes due on deemed repatriated earnings as current or noncurrent?
- 3.30** Should a company discount the liability for taxes due on deemed repatriated earnings?
- 3.40** Does mandatory deemed repatriation eliminate the need for a company to consider the probability of reversal of the related temporary differences?
- 3.50** How should a fiscal year taxpayer recognize the liability for taxes due on deemed repatriated earnings for interim reporting?

## What the Act says

Under the Act, a company's foreign earnings and profits (E&P) accumulated in specified foreign corporations (SFCs) under legacy tax laws are deemed repatriated for the last taxable year of an SFC that begins before January 1, 2018. E&P are determined as the higher of the balance at November 2 or December 31, 2017. This is a one-time transition tax.

The tax on those deemed repatriated earnings may be paid over eight years with no interest charged; the following proportions of the tax on deemed repatriated earnings are payable in each of the eight years:

- 8% in each of Years 1 to 5;
- 15% in Year 6;
- 20% in Year 7; and
- 25% in Year 8.

Payments would be accelerated upon the occurrence of certain triggering events.

This section focuses on the accounting for SFCs that are controlled foreign corporations (CFCs).

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).



### Question 3.10

**Should a US taxpayer classify the liability for taxes due on deemed repatriated earnings for a CFC with the same year end as a deferred tax liability?**

**Interpretive response:** No. A US taxpayer should characterize those obligations as taxes payable; this is because the liability no longer represents the tax effect of a temporary difference. Instead, the liability is determined based on a company's accumulated foreign E&P for tax purposes.

That amount may not approximate either the existing temporary differences related to the company's investments in CFCs (see [Question 3.40](#)) or the existing retained earnings of those CFCs. Differences may arise for many reasons, including accounting versus tax principles related to the recognition, timing and measurement of earnings; currency gains and losses; business combinations and restructurings.



### Question 3.20

**Should a company classify the liability for taxes due on deemed repatriated earnings as current or noncurrent?**

**Interpretive response:** US taxpayers have the unconditional right at the reporting date to defer settlement of the liability for at least 12 months after the

reporting date. Therefore, a company should classify the liability as current or noncurrent based on its expectation of when it will settle the liability. [IAS 1.69]

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### Question 3.30

#### Should a company discount the liability for taxes due on deemed repatriated earnings?

**Interpretive response:** A company may expect to settle its liability for deemed repatriated earnings on a deferred basis, as permitted under the Act. In this case, it appears that a company may choose an accounting policy, to be applied consistently, whether to discount the long-term transition tax payable on the deemed repatriated earnings.

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### Question 3.40

#### Does mandatory deemed repatriation eliminate the need for a company to consider the probability of reversal of the related temporary differences?

**Background:** Tax effects on *taxable* temporary differences with respect to investments in CFCs (subsidiaries) are not recognized if: [IAS 12.39]

- the parent is able to control the timing of the reversal of the temporary difference; and
- it is probable that the temporary difference will not reverse in the foreseeable future.

Tax effects on *deductible* temporary differences with respect to investments in CFCs (subsidiaries) are recognized only to the extent that it is probable that: [IAS 12.44]

- the temporary difference will reverse in the foreseeable future; and
- taxable profit will be available, against which the temporary difference can be utilized.

**Interpretive response:** No. A company that does not plan to repatriate its undistributed foreign earnings should continue to evaluate the probability that the related temporary differences will not reverse in the foreseeable future. This is to avoid, for example, recognizing a deferred tax liability for other items that trigger a tax effect on repatriation – e.g. Section 986(c) currency gain/loss, foreign withholding taxes and state taxes.

The introduction of the new provision may in itself trigger a different intention on the part of the company – making it probable that the related temporary differences will reverse.

A company that does not meet the recognition exception determines the liability based on the expected manner of recovery – e.g. remission of dividends, liquidation or sale.

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### Question 3.50

#### How should a fiscal year taxpayer recognize the liability for taxes due on deemed repatriated earnings for interim reporting?

**Interpretive response:** The transition tax on deemed mandatory repatriation that arises from a change in tax law substantively enacted in an interim period is analogous to a tax credit granted in relation to a one-off event.

Consistent with the treatment of tax on a one-off event, a company may recognize the effect of the transition tax immediately in the interim period in which the change occurs. However, another acceptable approach would be to spread the effect of the change in the tax law over the remainder of the annual reporting period via an adjustment to the estimated annual effective income tax rate. [IAS 34.30(c), IE.B19]

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# 4. Other international provisions

## Questions & Answers

### New Q&A added in this edition: \*\*

- 4.10** How should a company account for the tax impact of GILTI?
- 4.15** How should a company account for the FDII deduction? \*\*
- 4.20** Does the 100% dividends received deduction eliminate the need for a company to consider the reversal of the related temporary differences?
- 4.30** Is the accounting for the BEAT different from the accounting for AMT?
- 4.40** Can a company consider whether it will be subject to the BEAT when assessing to what extent operating losses brought forward will be realized in the future? \*\*

## What the Act says

For tax years of foreign corporations beginning after December 31, 2017, the Act provides that a US shareholder of any CFC must include in taxable income its pro rata share of global intangible low-taxed income (GILTI).

GILTI is considered the excess of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. Additionally, a deduction is permitted for 50% of its GILTI for tax years beginning after December 31, 2017 and before January 1, 2026, with a reduction to 37.5% after December 31, 2025.

The Act also provides a lower effective tax rate on excess returns earned directly by a US corporation from foreign sales (including licenses and leases) or services. This is achieved by allowing a deduction equal to 37.5% of 'foreign-derived intangible income' (FDII). The deduction percentage will be reduced to 21.875% starting in 2026. The total deduction for FDII, GILTI, and the gross-up for foreign taxes attributable to GILTI, cannot exceed a corporation's taxable income.

In addition, the Act creates a base erosion anti-abuse tax (BEAT), which would partially disallow deductions for certain related-party transactions. BEAT only applies to taxpayers with annual domestic gross receipts in excess of \$500 million. BEAT will function like a minimum tax, but unlike the alternative minimum tax (AMT) in the old law, there is no interaction through a credit mechanism with the regular tax system.

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).



### Question 4.10

#### How should a company account for the tax impact of GILTI?

**Interpretive response:** It appears that different approaches may be acceptable in analyzing the tax impacts of the GILTI provisions.

- **Deferred tax.** Account for the tax on GILTI similarly to the tax imposed on existing Subpart F income. Under this approach, deferred taxes are generally recognized for temporary differences in a foreign subsidiary that are expected to result in taxable US income upon reversal. This approach may be appropriate if a company expects to be subject to GILTI on a continuous basis.
- **Current period charge.** Account for the tax on GILTI as a current period tax charge. This approach may be appropriate when a company does not expect to be subject to GILTI on continuous basis.



### Question 4.15\*\*

#### How should a company account for the FDII deduction?

**Interpretive response:** The accounting for this type of deduction is not specifically addressed by IAS 12 and general guidance applies. Because FDII deductions depend on foreign sales in specific periods, among other factors, it appears that it may be appropriate to account for them in the periods when the foreign sales occur and these deductions reduce taxable profit.

However, in some circumstances a company may also consider the FDII deduction in measuring the deferred taxes on related temporary differences – e.g. if the company is able to make reliable projections of taxable profits, including foreign sales and the FDII deductions.



### Question 4.20

#### Does the 100% dividends received deduction eliminate the need for a company to consider the reversal of the related temporary differences?

**Background:** Future dividends received from CFCs will be 100% deductible for US federal income tax purposes.

**Interpretive response:** No. As discussed in [Question 3.40](#), a company that does not plan to repatriate its undistributed foreign earnings should continue to evaluate the probability that the related temporary differences will not reverse in the foreseeable future. This is to avoid, for example, recognizing a deferred tax liability for other items triggering a tax effect on repatriation – e.g. foreign withholding taxes and state taxes.

The introduction of the new provision may in itself trigger a different intention on the part of the company – making it probable that the related temporary differences will reverse.

A company that does not meet the recognition exception determines the liability based on the expected manner of recovery – e.g. remission of dividends, liquidation or sale.



### Question 4.30

#### Is the accounting for the BEAT different from the accounting for AMT?

**Background:** Deferred tax assets and liabilities are measured based on: [IAS 12.47, 51]

- the expected manner of recovery (asset) or settlement (liability); and
- the tax rate expected to apply when the underlying asset (liability) is recovered (settled), based on rates that are enacted or substantively enacted at the reporting date.

**Interpretive response:** For operations subject to the legacy AMT system, in our experience, companies generally measured deferred taxes for temporary differences using regular tax rates regardless of whether the company expected to be a perpetual AMT taxpayer.

Although not identical, the BEAT operates much like AMT and a company can never pay less than it would under the regular tax system. Therefore, it appears that a company should account for the BEAT similar to the AMT under previous tax law. This means that deferred taxes should be measured based on the regular statutory rate, and a company should account for the incremental tax owed under the BEAT system as it is incurred.

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#### Question 4.40\*\*

**Can a company consider whether it will be subject to the BEAT when assessing to what extent operating losses brought forward will be realized in the future?**

**Interpretive response:** It appears that a company does not need to consider whether it will be subject to the BEAT when assessing to what extent operating losses brought forward will be realized in the future – i.e. the company may recognize the deferred tax asset at the amount expected to be realized under the regular tax regime, applying the regular statutory rate.

However, if a company is able to make reliable projections of future taxable profits and those projections indicate that a certain amount of operating losses brought forward will not be realized because the company expects to be subject to the BEAT, it may take that into account. This does not imply applying the BEAT rate.

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# 5. Other matters

## Questions & Answers

- 5.10** Do balances of AMT carryforwards represent current or deferred tax?
- 5.20** If a current tax asset is recognized for a refundable AMT credit carryforward, should it be classified as current or noncurrent? Should it be discounted?
- 5.30** What effect do the changes related to executive compensation have on existing deferred tax assets?
- 5.40** What effect could the reduction in the top individual tax rate have on the accounting for share-based payment awards?

## What the Act says

### Alternative Minimum Tax

The AMT tax regime is repealed under the Act. Existing AMT credit carryforwards will be fully refundable by 2021. For 2018, 2019, and 2020, the AMT credit carryforward can be used to reduce the regular tax obligation. Therefore, an existing AMT credit carryforward would be fully used if the regular tax obligation exceeds the AMT credit carryforward.

Any existing AMT credit carryforwards that do not reduce regular taxes are eligible for a 50% refund in 2018–2020 and a 100% refund in 2021. Specifically, 50% of the AMT credit carryforward that is unused in 2018 will be refunded and then 50% of the remaining amount that is unused in 2019 will be refunded, and so on. This results in full realization of an existing AMT credit carryforward irrespective of future taxable income.

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).

### Executive compensation

The Act will no longer allow deductions for compensation in excess of \$1 million for covered employees, even if paid as commissions or performance-based compensation. It also subjects the principal executive officer, principal financial officer and three other highest paid officers to the limitation and once an individual becomes a covered person, the individual will remain covered for all future years.

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).



#### Question 5.10

#### Do balances of AMT carryforwards represent current or deferred tax?

**Interpretive response:** It appears that a company should determine whether minimum tax credit carryforwards related to the repeal of AMT represent current or deferred tax based on its expectation of how these carryforwards will be realized.

- **Current tax asset.** If a company expects that the carryforward or portion thereof will be refunded in cash, the respective balance represents a current tax asset.
- **Deferred tax asset.** If a company expects that a carryforward or a portion thereof will reduce its taxable income, it would be acceptable to classify the respective balance as a deferred tax asset.



### Question 5.20

**If a current tax asset is recognized for a refundable AMT credit carryforward, should it be classified as current or noncurrent? Should it be discounted?**

**Interpretive response:** If a current tax asset is recognized for a refundable AMT credit carryforward, the company should classify it as noncurrent to the extent that it expects to realize the asset more than 12 months after the reporting date. [IAS 1.66]

It appears that a company may choose an accounting policy, to be applied consistently, whether to discount the current tax asset associated with a refundable AMT credit carryforward (see also [Question 3.30](#)).



### Question 5.30

**What effect do the changes related to executive compensation have on existing deferred tax assets?**

**Interpretive response:** Eliminating the exceptions for commissions and performance-based compensation means that less compensation will be deductible. That may further result in reducing existing deferred tax assets for compensation arrangements that do not qualify for transition relief. There are complex transition rules that may grandfather the deductibility of some previously existing compensation arrangements. Companies should carefully consider the transition requirements when evaluating the effect of the legislation on their existing compensation plans.



### Question 5.40

**What effect could the reduction in the top individual tax rate have on the accounting for share based payment awards?**

**Background:** The Act reduces the top individual tax rate to 37%.

**Interpretive response:** Some share-based payment arrangements may allow the employer to net-settle the award for the number of shares required to settle the tax obligation. The change in the top individual tax rate to 37% may therefore be relevant.

We believe that if the company is acting simply as an agent for the employee and therefore bears no risk associated with the shares, the settlement of the tax obligation via a sale by the employer of a portion of the shares does not mean that the tax portion is a cash-settled share-based payment. If in contrast the company is not acting simply as an agent (i.e. it bears risk associated with the shares), we believe that the tax portion should be classified as a cash-settled share-based payment and the remainder should be classified as equity-settled.

An amendment to IFRS 2, *Share-based Payment*, is effective for annual periods beginning on or after January 1, 2018 (early adoption is permitted). A share-based payment transaction that the company settles net by withholding a specified portion of the equity instruments to meet its statutory tax withholding requirements is classified as equity-settled in its entirety if the entire share-based payment would otherwise be classified as equity-settled without the net settlement feature. Any shares held in excess of the employee's tax obligation associated with share-based payment are accounted for as cash-settled share-based payment. [\[IFRS 2.33E–33H\]](#)

Whether a company is acting as an agent for the employee or is applying the IFRS 2 amendment, it should reduce its maximum tax withholding from 39.6% to 37% for 2018, to avoid the excess 2.6% being a cash-settled share-based payment.

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# 6. Deferred tax assets

## Questions & Answers

- 6.10** What provisions of the Act are likely to affect the recognition of deferred tax assets?

## Deferred tax asset recognition criteria

A deferred tax asset is recognized with respect to deductible temporary differences (subject to certain exceptions), unused tax losses and unused tax credits only to the extent that it is *probable* that taxable profit will be available against which the deductible temporary differences, unused tax losses and unused tax credits can be used.

'Probable' is not defined in IAS 12. In our experience, companies often use a working definition of 'more likely than not' – i.e. a likelihood of more than 50%, which is consistent with the definition of 'probable' in other standards. [IAS 12.24, IFRIC 23.9, BC14–BC15]

In determining whether taxable profit will be available in the future, a company considers: [IAS 12.28]

- taxable temporary differences that will reverse (i.e. will become taxable) in the same period that deductible temporary differences reverse (i.e. will become deductible); and
- the periods into which a tax loss or tax credit, including one arising from a deductible temporary difference, can be carried back or forward.

If the amount of taxable temporary differences is insufficient to recognize a deferred tax asset in full, a company also considers: [IAS 12.29]

- the probability of generating future taxable profits in the periods that the deductible temporary differences reverse; and
- tax-planning opportunities.

All deductible temporary differences are assessed together unless, under tax law, their use is restricted to deductions against income of a specific type. [IAS 12.27A]



### Question 6.10

**What provisions of the Act are likely to affect the recognition of deferred tax assets?**

**Interpretive response:** There are several provisions that are likely to affect the recognition of deferred tax assets.

#### Mandatory deemed repatriation

The amount of E&P subject to tax under the mandatory deemed repatriation provisions is a source of foreign source income to support existing foreign tax credits or other deferred tax assets that may not have been recognized previously.

#### Interest expense limitations

A company should consider the annual limitations on the deductibility of interest expense and the ability to use disallowed interest carryforwards, including the ordering rules. The ordering rules require a company to take future net interest expense into account first, before an incremental deferred tax benefit is recognized at the reporting date for net interest expense carryforwards. Accordingly, this may result in an inability to realize the benefit of the disallowed

interest expense carryforwards even though the carryforwards have an unlimited carryforward period.

### **100% dividends received deduction**

Dividend income will no longer be a source of foreign income to support the realizability of deferred tax assets for foreign tax credits.

### **100% expensing for investments in depreciable property other than real property**

The 100% expensing provision creates new taxable temporary differences in 2017 for assets purchased after September 27, 2017 and may affect deferred tax asset assessments at the enactment date. Immediate expensing may also put some companies in a taxable loss position that generates NOL carryforwards that should be analyzed for realizability.

### **Limitation to 80% of taxable income for NOLs incurred in tax years beginning after December 31, 2017; unlimited carryforward period**

The annual limitation on the use of NOL carryforwards may result in changes to the assessment of deferred tax assets because the NOL may offset only 80% of the reversal of taxable temporary differences in an annual period. Other future taxable income would have to exist to support realization of NOL carryforwards that remain after applying the limitation and must continue to be carried forward. In addition, if a company's deductible temporary differences are expected to reverse in a loss year, the annual benefits of those deferred tax assets will similarly be limited. This will require some companies to perform more detailed scheduling to evaluate the realizability of their deferred tax assets.

The unlimited NOL carryforward period may also result in changes to the assessment of deferred tax assets, including the ability to consider the deferred tax liability associated with indefinite-lived intangible assets as a source of future taxable income, subject to the limitation previously discussed.

Companies should also continue to evaluate the availability of tax-planning opportunities to generate future taxable income sufficient to realize the deferred tax assets associated with indefinite NOL carryforwards. We believe it should be at least more likely than not that management will take advantage of those opportunities.

In addition, when a tax-planning opportunity is intended to generate incremental taxable income, that income is not considered in isolation – it is just one additional component of the company's overall estimate of future taxable income. If the income from the tax-planning opportunity is expected to be offset by future operating losses, that potential income would not provide sufficient evidence to support the realization of deferred tax assets.

### **Refundable AMT credit carryforwards**

Companies should recognize a current tax asset or a deferred tax asset for existing AMT credit carryforwards that are expected to be realized through receipt of cash or a reduction in tax for the period (see [Question 5.10](#)).

**Expansion of executive compensation that is subject to the excessive executive compensation limit**

This provision of the Act may affect deferred tax asset judgments resulting from the reduction of deferred tax assets for compensation arrangements and increases in future taxable income.

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# IFRS compared to US GAAP

The following high-level differences between IFRS and US GAAP are relevant to the income tax accounting issues discussed in this publication; they are not intended to be exhaustive. For further discussion, see our publication, [IFRS compared to US GAAP](#).

IFRS	US GAAP
<b>Asset recognition</b>	
<p>Unlike deferred tax liabilities, a deferred tax asset is recognized only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences or the unused tax losses and tax credits can be used. <a href="#">[IAS 12.24, 34]</a></p>	<p>Unlike IFRS, all deferred tax assets are recognized and a valuation allowance is recognized to the extent that it is more likely than not that the deferred tax assets will not be realized – i.e. deferred tax assets are recognized on a gross basis with a corresponding valuation allowance. <a href="#">[740-10-30-5]</a></p>
<b>Measurement</b>	
<p>Deferred tax assets and liabilities are measured based on:</p> <ul style="list-style-type: none"> <li>— the expected manner of recovery (asset) or settlement (liability); and</li> <li>— the tax rates expected to apply when the underlying asset (liability) is recovered (settled), based on rates that are enacted or substantively enacted at the reporting date. <a href="#">[IAS 12.47, 51]</a></li> </ul>	<p>Deferred tax assets and liabilities are measured based on: <a href="#">[740-10-25-2 – 25-23, 25-47]</a></p> <ul style="list-style-type: none"> <li>— an assumption that the underlying asset (liability) will be recovered (settled) in a manner consistent with its current use in the business; although the precise wording differs in certain respects, we would not generally expect significant differences in practice from IFRS; and</li> <li>— the rate of tax expected to apply when the underlying asset (liability) is realized (settled), like IFRS; but based on rates that are enacted at the reporting date, unlike IFRS.</li> </ul>
<b>Where to recognize income tax</b>	
<p>Income tax is recognized in profit or loss except that: <a href="#">[IAS 12.57–58, 61A, 66]</a></p> <ul style="list-style-type: none"> <li>— deferred tax recognized as part of the acquisition accounting in a business combination is recognized as an adjustment to goodwill (see below); and</li> <li>— income tax related to items recognized, in the current or a previous period, outside profit or loss is recognized consistently with that item – i.e. in other comprehensive income (OCI) or directly in equity.</li> </ul>	<p>Income tax is recognized in profit or loss except that: <a href="#">[740-20-45-2, 805-740-25-8 – 25-9]</a></p> <ul style="list-style-type: none"> <li>— deferred tax recognized as part of the acquisition accounting in a business combination is recognized as an adjustment to goodwill (see below), like IFRS; and</li> <li>— income tax related to items recognized, in the current period, either in other comprehensive income (OCI) or directly in equity, is recognized consistently with that item, like IFRS. However, subsequent changes in the deferred</li> </ul>

IFRS	US GAAP
	tax on those items are generally recognized in profit or loss (see below), unlike IFRS.
A change in deferred tax caused by a change in tax rate is recognized in profit or loss in the period in which the change is substantively enacted, except to the extent that it relates to an item recognized outside profit or loss in the current or in a previous period. [IAS 12.60]	Unlike IFRS, the recognition of a change in deferred tax caused by a change in tax rate is always recognized in profit or loss (income from continuing operations) in the period in which the change is enacted. [740-10-35-4, 740-20-45-8]
The requirement to recognize in OCI or directly in equity the tax effect of items recognized in OCI or directly in equity extends beyond the initial recognition of a deferred tax liability (or asset) to certain subsequent revisions to the tax balance – e.g. subsequent changes due to changes in tax rates or from the assessment of the recoverability of a deferred tax asset. [IAS 12.61A]	Like IFRS, the tax effect of items charged or credited to OCI or directly to equity during the current reporting period is itself charged or credited to OCI or directly to equity. However, unlike IFRS, subsequent changes to deferred tax from changes in tax rates or from the assessment of the recoverability of a deferred tax asset are recognized in profit or loss. [740-20-45-2, 45-11]
There are no forthcoming requirements in this area under IFRS.	<p><b>Forthcoming requirements:</b></p> <p>On February 7, 2018, the FASB voted to provide companies the option to reclassify from accumulated OCI to retained earnings the stranded tax effects directly arising from the change in the federal corporate tax rate. Companies electing to reclassify those effects will also have the option to reclassify other stranded tax effects arising from the Act.</p> <p>The guidance will be effective for all entities for annual and interim periods in fiscal years beginning after December 15, 2018. Early adoption will be permitted for financial statements that have not yet been issued or made available for issuance.</p> <p>The FASB expects to issue the Accounting Standards Update no later than February 16, 2018.</p>
<b>Investments in subsidiaries</b>	
<p>Taxable temporary differences with respect to investments in subsidiaries are not recognized if: [IAS 12.39]</p> <ul style="list-style-type: none"> <li>— the investor is able to control the timing of the reversal of the temporary difference; and</li> <li>— it is probable that the temporary difference will not reverse in the foreseeable future.</li> </ul>	<p>Unlike IFRS, taxable temporary differences with respect to investments in certain foreign subsidiaries are recognized unless (indefinite reversal criteria): [740-30-25-17]</p> <ul style="list-style-type: none"> <li>— the investor is able to control the timing of the reversal of the temporary difference, like IFRS; and</li> <li>— undistributed earnings will be reinvested indefinitely or can be</li> </ul>

IFRS	US GAAP
	distributed on a tax-free basis, unlike IFRS.
Because an entity controls an investment in a subsidiary or branch, there is generally no need to consider whether the entity can control the timing of the reversal of a taxable temporary difference.	Unlike IFRS, a deferred tax liability for outside basis differences is always recognized with respect to domestic subsidiaries that are greater than 50% owned, unless the tax law permits a tax-free recovery of the investment and the parent entity expects that it will ultimately use that means of recovery. [740-30-25-5 – 25-7, 25-17 – 25-18]
<b>Interim financial reporting</b>	
The income tax expense recognized in each interim period is based on the best estimate of the weighted-average annual rate expected for the full year applied to the pre-tax income of the interim period. [IAS 34.30(c), IE.B12–B16]	Like IFRS, income tax expense recognized in each interim period is based on the best estimate of the effective tax rate expected to be applicable for the full year applied to the pre-tax income of the interim period. [740-270-25]
If a change in tax rate is enacted or substantively enacted in an interim period, then an entity may recognize the effect of the change immediately in the interim period in which the change occurs. However, another acceptable approach is to spread the effect of a change in the tax rate over the remainder of the annual reporting period via an adjustment to the estimated annual effective income tax rate. [IAS 34.30(c), IE.B19]	Unlike IFRS, if a change in a tax rate is enacted in an interim period, then the effect of the change is required to be recognized in income from continuing operations immediately in the interim period of enactment. The entity would then evaluate and adjust the estimated annual effective tax rate for the change and apply any resultant change prospectively. [740-270-25]
<b>Share-based payments: statutory tax withholding</b>	
The following is effective for annual periods beginning on or after January 1, 2018; early adoption is permitted.	The following is currently effective for public companies.
A share-based payment transaction that the entity settles net by withholding a specified portion of the equity instruments to meet its statutory tax withholding requirements is classified as equity-settled in its entirety if the entire share-based payment would otherwise be classified as equity-settled without the net settlement feature. Any shares held in excess of the employee's tax obligation associated with share-based payment are accounted for as a cash-settled share-based payment. [IFRS 2.33E–33H]	If an award can be net-settled for up to the maximum statutory tax withholding amount, then the award is equity-classified in its entirety if it otherwise qualifies for equity classification, like IFRS. Unlike IFRS, if the award can be net-settled for an amount in excess of the maximum statutory tax withholding, then the entire award is liability-classified. [718-10-25-18]

IFRS	US GAAP
<b>Specific areas of US tax reform</b>	
<p>The following comparisons refer to the views of the FASB staff. The FASB staff published a series of Q&amp;As on January 22, 2018. These issues are discussed in more depth in KPMG’s Q&amp;As, <a href="#">Tax reform (US GAAP)</a>.</p>	
<b>Discounting long-term balances of current taxes</b>	
<p>It appears that a company may choose an accounting policy, to be applied consistently, whether to discount:</p> <ul style="list-style-type: none"> <li>— the long-term transition tax payable on the deemed repatriated earnings (see <a href="#">Question 3.30</a>); and</li> <li>— the current tax asset associated with a refundable AMT credit carryforward (see <a href="#">Question 5.20</a>).</li> </ul>	<p>The FASB staff believes that companies should not discount the liability related to mandatory deemed repatriation or the current tax asset associated with a refundable AMT credit carryforward. Unlike IFRS, this is not a policy election.</p>
<b>Global intangible low-taxed income</b>	
<p>It appears that different approaches may be acceptable in analyzing the tax impacts of the GILTI provisions (see <a href="#">Question 4.10</a>).</p> <ul style="list-style-type: none"> <li>— <b>Deferred tax.</b> Account for the tax on GILTI similar to the tax imposed on existing Subpart F income. Under this approach, deferred taxes are generally recognized for temporary differences in a foreign subsidiary that are expected to result in taxable US income upon reversal. This approach may be appropriate if a company expects to be subject to GILTI on a continuous basis.</li> <li>— <b>Current period charge.</b> Account for the tax on GILTI as a current period tax charge. This approach may be appropriate when a company does not expect to be subject to GILTI on continuous basis.</li> </ul>	<p>The FASB staff believes that companies can make a policy election to either account for taxes on GILTI as incurred or, like Subpart F, recognize deferred taxes when basis differences exist that are expected to affect the amount of the GILTI inclusion upon reversal. Unlike IFRS, this is a policy election that requires no analysis.</p>
<b>Deductions for foreign-derived intangible income</b>	
<p>It appears that it may be appropriate to account for FDII deductions in the periods when the foreign sales occur and these deductions reduce taxable profit. However, in some circumstances a company may also consider the FDII deduction in measuring the deferred taxes on related temporary differences – e.g. if the company is able to make reliable projections of taxable profits, including foreign sales and the FDII deductions. See <a href="#">Question 4.15</a>.</p>	<p>Unlike IFRS, we believe an FDII deduction is akin to ‘special deduction’ under US GAAP. As a result, FDII deductions will be recognized as a current period deduction in all cases, and will not be considered in the tax rate when measuring deferred taxes.</p>

IFRS	US GAAP
<b>Base erosion anti-abuse tax</b>	
<p>It appears that a company should account for the BEAT similar to AMT under previous tax law. This means that deferred taxes should be measured based on the regular statutory rate, and a company should account for the incremental tax owed under the BEAT system as it is incurred. See <a href="#">Question 4.30</a>.</p>	<p>The FASB staff believes that companies should measure their deferred taxes based on the regular tax rate as they have historically for AMT and account for the incremental tax owed under the BEAT system as it is incurred.</p>
<p>It appears that a company does not need to consider whether it will be subject to the BEAT when assessing to what extent operating losses brought forward will be realized in the future. However, if a company is able to make reliable projections of future taxable profits and those projections indicate that a certain amount of operating losses brought forward will not be realized because the company expects to be subject to the BEAT, it may take that into account. See <a href="#">Question 4.40</a>.</p>	<p>Like IFRS, a company does not need to but may elect to take into account its BEAT status in assessing its valuation allowance related to deferred tax assets.</p>
<b>Classification of AMT carryforwards</b>	
<p>It appears that a company should determine whether minimum tax credit carryforwards related to the repeal of AMT represent current or deferred tax based on its expectation of how these carryforwards will be realized (see <a href="#">Question 5.10</a>).</p> <ul style="list-style-type: none"> <li>— <b>Current tax asset.</b> If a company expects that the carryforward or portion thereof will be refunded in cash, the respective balance represents a current tax asset.</li> <li>— <b>Deferred tax asset.</b> If a company expects that a carryforward or a portion thereof will reduce its taxable income, it would be acceptable to classify the respective balance as a deferred tax asset.</li> </ul>	<p>Like IFRS, while we generally believe that receivable presentation is appropriate based on the nature of the AMT carryforward after the tax law change, we believe it would be acceptable for a company to classify some or all of the carryforward as a deferred tax asset if it expects to use it to offset its income tax liability.</p>

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