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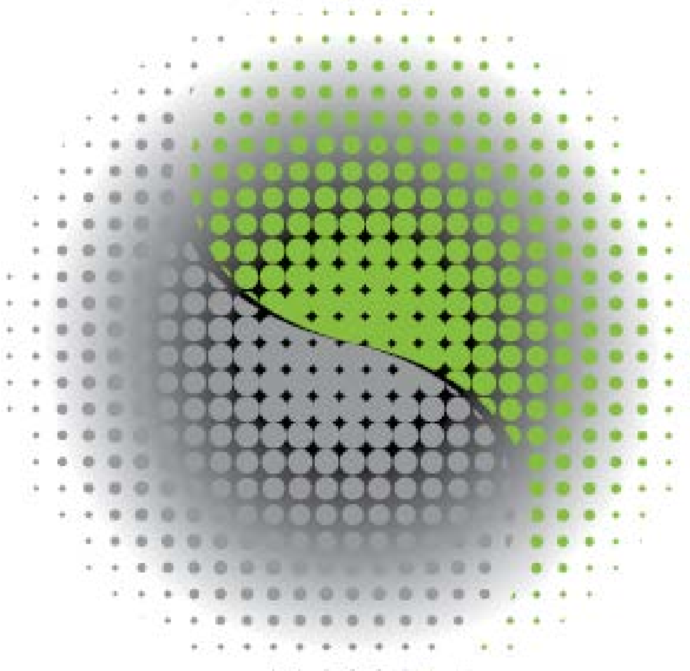

Canadian Tax Alert

US tax reform – financial reporting considerations

February 15, 2018

On December 22, 2017, the US tax legislation known as the Tax Cuts and Jobs Act (the Act) was signed into law by the President. As a result, recognition of the tax effects of the Act is required in the periods that include December 22, 2017.

There are many Canadian entities that do business in the United States and these new US tax legislative changes will impact the financial reporting for those Canadian entities. These entities should make their best estimate of all effects of the Act in their financial statements and provide disclosures regarding significant judgements and estimation uncertainties as necessary. As new information becomes available, or understanding of the Act is refined in subsequent periods, those estimates should be revised.

Contacts:

Jim McDonald
National Service Line Leader US Tax
Tel: 416-874-3139

Arthur Driedger
Tel: 416-643-8226

Roman Vorsin
Tel: 403-4267-0507

Terri Scott
Tel: 204-926-7660

Change in corporate tax rate

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The corporate tax rate is reduced to 21%, effective January 1, 2018. International Accounting Standard (IAS) 12.47 requires that deferred tax assets (DTAs) and deferred tax liabilities (DTLs) be measured at the enacted or substantively enacted tax rates that are expected to apply to the period when the asset is realized or the liability is settled. Entities must adjust the DTAs and DTLs in their financial statements for reporting periods ending on or after December 22, 2017.

DTAs and DTLs that exist as of the enactment date (December 22, 2017) and are expected to reverse after the Act's effective date (January 1, 2018) should be adjusted to the new statutory tax rate of 21%. Any DTAs and DTLs expected to reverse before the effective date would not be affected by the new statutory tax rate.

Deferred tax balances attributable to items previously recognized outside profit or loss are required by IAS 12.58 and 12.60(a) to be recognized either in other comprehensive income or directly in equity. It is recognized consistent with the recognition of the original amount. This can be referred to as "backwards tracing".

If the entity has a reporting and fiscal year end other than December 31, the tax change will administratively be effective at the beginning of the entity's next fiscal year. The tax rate applicable for that year will be the blended tax rate.

The blended rate is based on the applicable rates before and after the change and the number of days in the period within the taxable year before and after the effective date of the change in the tax rate.

Modification of net operating losses (NOL)

Under previous tax law, NOLs generally had a carryback period of two years and a carryforward period of 20 years. The Act eliminates, with certain exceptions, the NOL carryback period and permits an indefinite carryforward period. The amount of the NOL deduction is limited to 80% of taxable income, which is computed without regard to the NOL deduction.

In general, the amendments to carryback and carryforward periods and the limitation on NOL utilization apply to losses arising in taxation years beginning after December 31, 2017.

When considering future taxable income for the recognition of DTAs, an entity should look to the future reversals of existing taxable temporary differences in periods prior to expiry of the NOL. Because losses arising in taxable years beginning after December 31, 2017 will not expire, the pool of taxable temporary differences that may be available to justify recognition of the resulting DTAs may be expanded.

Transition tax

The Act moves the United States from a worldwide tax system to a participation exemption system by giving corporations a 100% dividend received deduction for dividends distributed by a controlled foreign corporation (CFC).

As a transition to this new system, any US shareholder of a specified foreign corporation (SFC) must include the US shareholder's net pro rata share of certain undistributed and previously untaxed post-1986 foreign earnings and profits (E&P) of the SFC in gross income at the end of the SFC's last tax year beginning before January 1, 2018. A foreign corporation's E&P is taken into account only to the extent that they were accumulated during periods in which the corporation was a SFC, calculated as the greater of the E&P accumulated as of November 2, 2017 or December 31, 2017.

The liability can be paid interest free over a period of up to 8 years.

In the period of enactment, the entity should recognize a current/non-current payable for the transition tax due.

As current tax is not subject to IAS 12.53, if the payment extends beyond the current period, the liability should be recognized at a discounted amount if the effect is material.

Also, any DTAs related to foreign tax credits will need to be analyzed as to their on-going value.

Outside basis differences and global intangible low-taxed income (GILTI)

Effective January 1, 2018, the Act has a new requirement that certain GILTI earned by CFCs must be included in the gross income of the CFCs' US shareholder in the period it arises.

DTLs in respect of taxable outside basis differences are not recognized if the entity is able to control the timing of the reversal of the temporary difference and it is probable that this reversal will not arise in the foreseeable future.

DTAs in respect of deductible outside basis differences are recognized only if it is probably that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

The deemed repatriation tax on the GILTI inclusion may result in an entity having to recognize a liability associated with outside basis differences that was previously not recognized under IAS 12.39.

A question arises as to whether the reduction of the outside basis difference that may arise as a result of a GILTI inclusion should be considered as a probable reversal of the outside basis difference for which a DTL needs to be recognized.

An entity may still be subject to income tax on its foreign investments in the future (foreign exchange gains, capital gains on sale of investment, foreign income taxes, and withholding taxes) and if so, it will need to consider whether it needs to recognize any deferred taxes as a result.

IAS 12 does not provide clear guidance on whether (and how) certain aspects of the GILTI may affect the recognition of DTLs related to the outside basis differences from foreign investees. For example, under IAS 12, the recognition of a DTL with respect to a taxable outside basis from investees is assessed investee by investee, whereas for tax purposes, GILTI is established by aggregating income from foreign investees.

There may also be significant practical difficulties in applying the principles of IAS 12 to the GILTI. In particular, the computation of GILTI is subject to future and contingent events that may render the estimation of whether, and to what extent, an entity will have a GILTI inclusion in a specific future year is subject to a high level of uncertainty for certain entities.

Base erosion anti-abuse tax (BEAT)

For fiscal years beginning after December 31, 2017, a corporation is potentially subject to tax under the BEAT provision if the controlled group of which it is a part of has sufficient gross receipts and has a certain level of "base erosion payments" (foreign related party payments). Under the BEAT, a corporation must pay a base erosion minimum tax amount in addition to its regular tax liability after credits.

Because the amounts that may be payable under the BEAT provisions are based on a notion of taxable profit, it is an income tax within the scope of IAS 12 and accordingly, it may affect the tax rate used in the measurement of DTAs and DTLs.

The following should be considered:

- The BEAT provisions are designed to be an incremental tax, and accordingly, an entity can never pay less than its statutory tax rate of 21%.
- The entity may not know whether it will be subject to the BEAT tax.
- It is expected that most taxpayers will ultimately take measures to reduce their exposure and therefore, will ultimately pay taxes at or as close to the regular rate as possible.

Accordingly, in many circumstances, entities may conclude that deferred taxes should be measured at the 21% statutory tax rate, with any payment of BEAT reflected as a period income tax expense.

Alternative minimum tax (AMT)

The corporate AMT has been repealed for fiscal years beginning after December 31, 2017. Entities with AMT credit carryforwards that have not yet been used may claim a refund in future years for those credits even though no income tax liability exists.

Entities can continue using AMT credits to offset any regular income tax liability in years 2018 through 2020, with 50 percent of remaining AMT credits refunded in each of the 2018, 2019, and 2010 fiscal years and all remaining credits refunded in fiscal year 2021.

Since the AMT credit will now be fully refundable regardless of whether there is a future income tax liability before AMT credits, the benefit of the AMT credit will be realized. Entities will need to recognize an asset with respect to AMT credit carryforwards that have not been previously recognized.

If you have any questions about these issues, please speak to your Deloitte contact or get in touch anyone listed in this Alert.

Deloitte LLP
Bay Adelaide Centre, East Tower
8 Adelaide Street West, Suite 200
Toronto ON M5H 0A9
Canada