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Tax Accounting Perspectives

Valuation allowance considerations related to Tax Reform
January 31, 2018

On December 22, 2017, President Trump signed into law P.L. 115-97, commonly referred to as the 2017 Tax Reform Act (the "Act"). Under ASC 740, Income Taxes, the tax effects of the Act are required to be recognized in the interim and annual periods that include the enactment date. This perspective discusses the impact the new legislation may have on the valuation allowance ("VA") analyses performed by entities in the period of enactment.

What's new?

Enacted tax reform includes provisions that may impact valuation allowance conclusions

Corporate tax reform includes provisions that could substantially change the calculations necessary to prepare an entity's year-end or quarterly income tax provision. The Act may also have a significant impact on projected future taxable income that could effect valuation allowance conclusions.

Highlights

Consider all available evidence, both positive and negative, including future sources of income

An entity must consider all available evidence, both positive and negative, when evaluating the realizability of its deferred tax assets ("DTAs"). DTAs are reduced by a VA to an amount that is more likely than not to be realized. Realization ultimately depends on future taxable income. There are four sources of taxable income listed in ASC 740-10-30-18 that may be available under the tax law to realize the DTAs: (a) future reversal of existing taxable temporary differences; (b) future taxable income exclusive of reversing temporary differences and carryforwards; (c) taxable income in prior carryback year(s) if carryback is permitted under the tax law; and (d) tax planning strategies.

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What does this mean for you
A number of the Act provisions may impact valuation allowance analyses

Deloitte perspective
Assess the realizability of all deferred tax assets

An entity must evaluate whether there is a change in judgment about the realizability of its DTAs at each reporting period.

Refer to the [2017 Deloitte Roadmap to Accounting for Income Taxes](), Chapter 4.21 – 4.47 for further discussion on the establishment and analysis.

What does this mean for you

A number of the Act provisions may impact valuation allowance analyses

Reduction of corporate rate to 21%: Adjustments to deferred tax liabilities and assets ("DTLs and "DTAs") for the change in the tax rate generally would result in a corresponding adjustment to any related VA.

Interest Expense Limitation: Consider whether the objective and verifiable estimate of future taxable income based on historical operating results should be adjusted by the effects of any interest limited under modified I.R.C. §163(j) – see Deloitte's Financial Reporting Alert 18-1, FAQ About Tax Reform, Question 2.2 for further discussion.

Adjustments to Deductions: An entity should reflect in projected future taxable income any impact of disallowance or limitation on the deductibility of certain expenditures that are permanent differences. For example, evaluate whether the modifications to officer compensation under I.R.C §162(m) would result in a change in recognition and measurement of tax positions related to compensation agreements with covered employees.

Foreign Tax Credits ("FTCs"): Changes to the international tax provisions related to FTCs place additional limitations on the use of FTCs to reduce U.S. income tax liability. An entity should update its valuation allowance analysis as related to FTCs taking into account the impact the additional limitations may have on the realizability of FTC carryforwards, while considering the potential utilization of credits against any transition tax due.

Alternative Minimum Tax (AMT): Since the AMT credit will now be fully refundable (may be subject to limitations) regardless of whether there is a future income tax liability before AMT credits, the benefit of the AMT credit will be realized. Therefore, a valuation allowance may need to be released and an income tax benefit recognized.

Changes to Net Operating Loss ("NOL") Deduction: Under the new law, the amount of NOL deduction is limited to 80 percent of taxable income. As such, only 80 percent of future reversal of existing taxable temporary differences should be considered as a source of taxable income for realization of DTAs.

Furthermore, NOLs generated in tax years arising after December 31, 2017, may be carried forward indefinitely. Generally, a taxable temporary difference associated with an indefinite-life asset is considered to be a source of taxable income to support realization of an NOL with an unlimited carryforward period. This would also generally be true for a deductible temporary difference that is scheduled to reverse into an NOL with an unlimited carryforward period.

Consider tax planning strategies

Entities are still required to consider the availability of tax planning strategies when evaluating the realizability of its DTAs.

Refer to Deloitte's Financial Reporting Alert 18-1, FAQ About Tax Reform, for additional guidance.

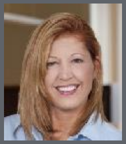
Deloitte perspective

Assess realizability of all DTAs

While many of the Act's provisions will impact the tax years beginning after December 31, 2017, the future impact of these laws needs to be considered when assessing the realizability of all DTAs that exist after the date of enactment (December 22, 2017). Reevaluate existing VAs, as well as the realizability of any new DTAs.

Contacts

National Tax Accounting Group



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