



Tax Reform ASC 740 Considerations: House Bill and Senate Finance Committee Proposal



ASC 740 Ready for Tax Reform?

The corporate tax provisions of the Tax Cuts and Jobs Act – latest developments

The Tax Cuts and Jobs Act (“TCJA”) continues to evolve. On Thursday, November 16, the House of Representatives passed the Tax Cuts and Jobs Act, H.R. 1 (the “House bill”), which was originally released on November 2 and subsequently amended. On November 9, Senator Orrin Hatch (R-UT), Chairman of the Senate Finance Committee, had the staff of the Joint Committee on Taxation release its “Description of the Chairman’s Mark” (the “Finance Committee proposal”) of the Tax Cuts and Jobs Act, a proposal to be marked up by the Senate Finance Committee the week of November 13. On November 16, the Senate Finance Committee voted to approve the Finance Committee proposal, including amendments. The Finance Committee proposal will now advance to the Senate floor for consideration by the full Senate.

Table of Contents

ASC 740 Overview	3
Highlights	3
House bill and Finance Committee proposal comparison	4
Corporate Rate Reduction	4
Deemed Repatriation	4
“Foreign ‘High Returns’” and	5
“Global Intangible Low-Taxed Income”	5
Payments to a Related Foreign Entity	6
Interest Expense Limitations	6
Interest Expense Limitations - continued	7
Modification of Net Operating Loss Deduction	8
Loss of Business Deductions and Credits	8
ASC 740 Considerations	9
Contacts	10

ASC 740 Overview

Pursuant to U.S. Generally Accepted Accounting Principles the tax effects of new tax legislation is not accounted for prior to the reporting period in which a tax law is enacted. In the U.S. jurisdiction, the enactment date generally is the day the president signs the legislation into law. Because the provisions in the House Bill and Finance Committee proposal have not been enacted they should not directly impact financial statements. If enacted, the provisions may have a material impact on a companies' financial statements. As any tax effects would need to be accounted for in the reporting period of enactment, it may be prudent for companies to start to analyze the impact the provisions would have on tax accounts and disclosures if enacted.

Pursuant to ASC 740-10-45-15, when deferred tax accounts are adjusted for the effect of a change in tax laws or rates, the effect shall be included in income from continuing operations for the period that includes the enactment date.

If the change in tax law is enacted subsequent to the balance sheet date but prior to issuance of the financial statements, it would be considered a nonrecognized subsequent event and companies will need to determine whether they need to disclose the change in tax law and an estimate of its effect in order to keep their financial statements from being misleading.

For state income tax purposes, many states explicitly adopt the Internal Revenue Code ("IRC") as of a fixed date and require legislation to enact the IRC as of a new date. States that explicitly conform to or adopt the Internal Revenue Code "as in effect", however, will incorporate changes adopted by federal tax reform without needing to enact specific legislation. In those states, such conformity may impact a company's state deferred tax assets/liabilities in the period of enactment.

To the extent potential income tax reform could materially affect the company or its business, SEC registrants should also consider possible disclosure requirements under Risk Factors and Management's discussion and analysis of financial condition and results of operations.

Highlights

This summary highlights a comparison of notable provisions in the House bill and the Finance Committee proposal impacting corporations. Unless otherwise noted, these provisions, if enacted, would be effective for taxable years beginning after December 31, 2017. Following the comparison of the notable provisions, we have provided ASC 740 considerations.

For additional information and insights regarding tax reform and the provisions highlighted herein, visit Deloitte's [Tax News & Views](#).

House bill and Finance Committee proposal comparison

Corporate Rate Reduction

House bill:

Reduce the general corporate tax rate to 20 percent effective for taxable years beginning after December 31, 2017.

Finance Committee proposal:

Reduce the general corporate tax rate to 20 percent for taxable years beginning after December 31, 2018.

Deemed Repatriation

House bill:

A U.S. shareholder owning at least 10 percent of the vote of a controlled foreign corporation and certain other U.S. shareholders with related domestic subsidiaries owning at least 10 percent of the vote of a foreign subsidiary would generally include in income, in its year in which the subsidiary's last tax year beginning before 2018 ends, the shareholder's pro rata share of the accumulated post-1986 deferred foreign income of the foreign subsidiary, net of the shareholder's share of deficits of other foreign subsidiaries allocated to the first foreign subsidiary. The amount of such deferred income generally takes into account earnings and profits ("E&P") as of November 2, 2017, or December 31, 2017 (whichever is higher), without diminution by reason of dividends distributed in the year that includes such date. The netting of earnings and deficits takes into account the U.S. shareholder's earnings and profits deficits of foreign subsidiaries of the U.S. shareholder or members of the U.S. shareholder's affiliated group.

The U.S. shareholder can claim a deduction against this inclusion, sufficient to reduce the resulting U.S. tax to 14 percent of the inclusion (to the extent of the shareholder's shares of its subsidiaries' "cash positions") and to 7 percent for the remainder of the inclusion.

The transition tax can potentially be offset by a proportionate share of the foreign taxes deemed paid upon the inclusions, and by the full amount of the U.S. shareholder's pre-existing foreign tax credit carryforwards (if any). The inclusion would not trigger overall foreign loss recapture. At the election of the U.S. shareholder, the tax liability would be payable over a period of up to eight years, in equal annual installments of 12.5 percent of the total tax liability due.

Finance Committee proposal:

A U.S. shareholder (potentially limited to corporate shareholder) of a foreign corporation must include in income for the subsidiary's last tax year beginning before January 1, 2018, the shareholder's pro rata share undistributed, nonpreviously taxed post-1986 foreign earnings. E&P is only taken into account to the extent it was accumulated during periods when the foreign corporation had at least one U.S. shareholder.

The amount of such E&P is determined as of November 9, 2017, or other applicable measurement date as appropriate (and as of yet unspecified), unreduced by distributions during the taxable year to which the provision applies.

The mandatory inclusion generally may be reduced by foreign earnings and profits deficits that are properly allocable to that person.

For purposes of this provision, the E&P is 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 (for example, property, plant, and equipment). The portion of the E&P comprising cash or cash equivalents is taxed at a reduced rate of 10 percent, while any remaining E&P is taxed at a reduced rate of 5 percent. Rules will be provided to avoid the double counting of cash assets.

The Finance Committee proposal provides that (1) foreign tax credit carryforwards are fully available, and foreign tax credits triggered by the deemed repatriation are partially available, to offset the U.S. tax; and (2) at the election of the U.S. shareholder, the tax liability would be payable over a period of up to eight years (payments for each of the first five years equals 8 percent of the net tax liability, sixth year equals 15 percent, increasing to 20 percent for the seventh year, and the remaining balance of 25 percent in the eighth year).

“Foreign ‘High Returns’” and “Global Intangible Low-Taxed Income”

House bill:

A U.S. parent of one or more controlled foreign corporations is subject to current U.S. tax on 50 percent of the U.S. parent’s foreign “high returns.” Foreign high returns are generally based on the excess of the U.S. parent’s foreign subsidiaries’ aggregate net income (net of the items listed below) over a routine return (7 percent plus the federal short-term rate) on the relevant portions of the foreign subsidiaries’ aggregate adjusted bases in their depreciable tangible property, adjusted downward for interest expense. For this purpose, income excludes income effectively connected with a U.S. trade or business, subpart F income, insurance and financing income that meets the requirements for the active finance exception (“AFE”) or high-tax exception from subpart F income, income from the disposition of commodities produced or extracted by the taxpayer, and certain related-party payments. As in the case of subpart F income, the U.S. parent is taxed on foreign high returns each year, regardless of whether those earnings are repatriated to the United States.

Inclusions of foreign high returns trigger deemed payments, by the U.S. parent, of the subsidiaries’ foreign income taxes. However, the taxes will be deemed paid only to the extent of 80 percent of the relevant portion of the controlled foreign corporation’s foreign income taxes. Credits for these deemed-paid taxes would not be allowed against U.S. tax imposed on other foreign-source income (that is, such foreign tax credits would only be allowed to offset U.S. tax on foreign high return inclusions), and are not be allowed to be carried back or forward to other tax years.

Finance Committee proposal:

Tax on global intangible low-taxed income (“GILTI”). GILTI is the excess of the shareholder’s net tested income over the deemed tangible income return, which is defined as 10 percent of the shareholder’s basis in tangible property used to produce tested income.

Tested income for this purpose is the gross income of the corporation determined without regard to the following exceptions: (1) the corporation’s effectively connected income under section 952(b); (2) any gross income taken into account in determining the corporation’s subpart F income; (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4); (4) any dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income and foreign oil related income, over deductions (including taxes) properly allocable to such gross income under rules similar to the rules of section 954(b)(5).

The proposal requires that the amount of GILTI included by a U.S. shareholder be allocated across all of such shareholder’s CFCs, based on the CFC’s proportionate share of tested income. In addition, the shareholder can claim a foreign tax credit for 80 percent of the taxes paid or accrued with respect to the tested income of each CFC from which the shareholder has an inclusion.

If the U.S. shareholder is a domestic corporation, the GILTI amount would generally be offset by a 50% deduction (reduced to 37.5% for taxable years beginning after December 31, 2025), resulting in an effective corporate tax rate of 10% on this amount.

Payments to a Related Foreign Entity

House bill:

Payments (other than interest) made by a U.S. corporation to a related foreign corporation that are deductible, includible in costs of goods sold, or includible in the basis of a depreciable or amortizable asset are subject to a 20 percent excise tax, unless the related foreign corporation elects to treat the payments as income effectively connected with the conduct of a U.S. trade or business. Exceptions would apply for intercompany services which a U.S. company elects to pay for at cost (that is, no markup) and certain commodities transactions. In addition, a foreign tax credit of up to 80% of actual taxes paid is available. Further, in the event no election is made, no deduction would be allowed for the U.S. corporation's excise tax liability.

Finance Committee proposal:

An applicable taxpayer with excess base erosion payments for the taxable year must pay a tax equal to the excess of 10 percent of its taxable income (determined without regard to deductions attributable to base erosion payments) over its regular tax liability reduced by the general business credit and the research credit.

For purposes of this provision, a base erosion payment generally means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable, including any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortization in lieu of depreciation). A base erosion payment also includes any amount that constitutes reductions in gross receipts of the taxpayer that is paid to or accrued by the taxpayer with respect to: (1) a surrogate foreign corporation which is a related party of the taxpayer, and (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation. A surrogate foreign corporation has the meaning given in section 7874(a)(2).

Interest Expense Limitations

House bill:

Generally limit the interest deduction on business interest to (1) business interest income plus (2) 30 percent of the taxpayer's adjusted taxable income. Business interest is defined as interest paid or accrued on indebtedness which is properly allocable to a trade or business, with business interest income defined similarly. Business interest and business interest income do not include investment interest and investment income, respectively, within the meaning of section 163(d)(3). Adjusted taxable income is computed without regard to any (1) item of

Finance Committee proposal:

Generally limit the interest deduction on business interest to business interest income plus 30 percent of the taxpayer's adjusted taxable income. Business interest and business interest income appear to be defined as allocable to a trade or business and not investment interest and income, within the meaning of section 163(d). Adjusted taxable income is computed without regard to any (1) item of income, gain, deduction, or loss, which is not allocable to the trade or business; (2) business interest income or expense; (3) the 17.4 percent

Interest Expense Limitations - continued

House bill - continued:

Income, gain, deduction, or loss, which is not allocable to the trade or business; (2) business interest income or expense; (3) net operating losses; and (4) depreciation, amortization, and depletion.

The provision would generally apply to all taxpayers, with an exception for certain small businesses and for interest allocable to certain enumerated businesses (generally, performing services as an employee, a real property trade or business (defined in section 469(c)(7)(C)), and businesses of certain regulated public utilities).

Business interest that is not otherwise allowed as a deduction by reason of this provision would be treated as paid or accrued in the succeeding taxable year, and could be carried forward to the fifth year following the year in which paid or accrued. Further, disallowed business interest would be treated as an allowed deduction on a first-in, first-out basis. Section 381(c) would be amended to include disallowed business interest as a tax attribute thereunder, and conforming amendments would be made under section 382 to treat disallowed business interest as a pre-change loss under subsection (d).

The provision appears to apply to interest on debt existing prior to a taxable year beginning after December 31, 2017, to the extent such interest is paid or accrued on or after such a taxable year.

In addition, under the House bill, interest deductions of a U.S. corporation that is a member of an international financial reporting group are generally limited to 110 percent of the U.S. corporation's proportionate share of the group's reported net interest expense, where the proportion is based on the ratio of U.S. corporation's earnings before interest, taxes, depreciation, and amortization ("EBITDA") to the group's EBITDA. This limitation applies in addition to the general rules for disallowance of interest expense elsewhere in the code and taxpayers would be disallowed interest deductions pursuant to whichever provision denies a greater amount of interest deductions.

An international financial reporting group is a group of entities that includes at least one foreign corporation engaged in a trade or business in the United States, or at least one domestic corporation and one foreign corporation; prepares consolidated financial statements; and has annual global gross receipts of more than \$100 million.

Finance Committee proposal - continued:

Deduction for certain passthrough income; and (4) the net operating loss deduction.

In the case of a group of affiliated corporations that file a consolidated return, the Finance Committee proposal appears to clarify that the limitation applies at the consolidated tax return filing level.

An exception applies for certain small businesses and businesses of certain regulated public utilities. The Finance Committee proposal allows, at the taxpayer's election, a taxpayer not to apply the limitation to certain real property-related businesses.

Business interest that is not otherwise allowed as a deduction by reason of this provision would be treated as paid or accrued in the succeeding taxable year, and could be carried forward indefinitely. It appears that section 381(c) would be amended under the Finance Committee proposal to include disallowed business interest as a tax attribute thereunder, and section 382 would be amended to treat disallowed business interest as a pre-change loss under subsection (d).

In addition, the Finance Committee proposal would limit interest deductions to the extent attributable to excess borrowing in the United States. Under the Finance Committee proposal, interest paid by a domestic corporation that is a member of a worldwide affiliated group is reduced by the product of the domestic corporation's net interest expense multiplied by the "debt-to-equity differential percentage" of the "worldwide" affiliated group (which would include foreign corporations, and for which the ownership threshold would only be 50%).

The debt-to-equity differential percentage means, with respect to any worldwide affiliated group, the excess domestic indebtedness of the group divided by the total indebtedness of the domestic corporations that are members of the group. All U.S. members of the worldwide affiliated group are treated as one member for these purposes.

Excess domestic indebtedness is the amount by which the total indebtedness of the U.S. members exceeds 110% of the total indebtedness those members would hold if their total indebtedness to total equity ratio were proportionate to the ratio of total indebtedness to total equity in the worldwide group.

Modification of Net Operating Loss Deduction

House bill:

Would modify aspects of current law regarding net operating losses ("NOLs") including, the amount of NOLs that may be deducted and the carryback and carryforward periods for NOLs.

Under the House bill, the carryback period would generally be eliminated. There is a limited exception for certain "eligible disaster losses" and a transition rule for taxable years that include any portion of the period beginning on September 28, 2017 and ending on December 31, 2017 (and, for this transition period for NOLs and related items, the increased expensing under bill section 3101 would not be taken into account). In addition, the NOL carryforward period would be indefinite.

The amount of the NOL deduction allowed would be limited to 90 percent of taxable income computed without regard to the NOL deduction. The amount of NOLs, or so-called indefinite NOLs, carried to a succeeding year would be increased, however, by an annual interest factor (that is, the annual short-term rate (determined under section 1274(d)) for the last month ending before the beginning of the taxable year, plus 4 percentage points).

In general, the effective date is December 31, 2017.

Finance Committee proposal:

The NOL carryback period would generally be eliminated and the carryforward period would become indefinite. Similarly, the amount of the NOL deduction allowed would be limited to 90 percent of taxable income (80% of taxable income for tax years beginning after December 31, 2023) computed without regard to the NOL deduction.

In general, the effective date is December 31, 2017.

Loss of Business Deductions and Credits

House bill:

Would repeal or otherwise limit a number of other business deductions and exclusions available under current law, including lobbying expenses, Section 199, entertainment expenses, and certain fringe benefits.

Would repeal, modify or otherwise limit a number of business and energy credits available under current law, including clinical testing expenses, employer-provided child care, historic building rehabilitation credit, work opportunity tax credit, unused business credits, new market tax credit, production tax credit, solar investment tax credit, credit for residential energy-efficient property, oil recovery credit, credit for oil and gas production from marginal wells, and production from advanced nuclear power facilities.

Finance Committee proposal:

Would repeal or otherwise limit a number of other business deductions and exclusions available under current law including, Section 199, entertainment expenses, and certain fringe benefits.

Would modify the orphan drug credit and rehabilitation credit available under current law and repeal the deduction for unused business credits.

ASC 740 Considerations

Because ASC 740 requires the tax effects of a change in tax laws or rates to be recorded in the period of enactment, no financial statement adjustments are required prior to the President signing the final bill into law. If enacted, however, many provisions will significantly impact financial statements including, but not limited to, the following:

1. Deferred tax assets and liabilities, including those related to items initially recorded through OCI and shareholders' equity, will need to be remeasured for the impact of a corporate rate reduction and any adjustments would be included in income from continuing operations for the period that includes the enactment date. When remeasuring deferred tax assets and liabilities, to the extent the tax law is enacted prior to the period that includes the effective date of a corporate rate reduction, companies would be required to schedule the reversal of temporary differences and tax attributes to determine amounts that will reverse after the effective date as opposed to those that will reverse prior to the effective date.
2. An entity may no longer be able to assert that it is indefinitely reinvested in a foreign subsidiary or foreign corporate joint venture that is permanent in duration if the deemed repatriation of foreign earnings and profits provision is enacted, and a current liability may be required to be recognized. In addition, existing deferred tax liabilities recognized for investments in foreign corporations may need to be remeasured. If an election is made to pay the related tax liability over an 8-year period, a portion of the liability may be classified as non-current.
3. A U.S. entity may be required to include in taxable income some portion of the earnings of foreign related parties and may be taxed on or effectively lose the benefit of deductions for related party payments if the provisions related to foreign high returns, GILTI, and/or payments to related foreign entity are enacted. These provisions could impact a company's effective tax rate. Companies should also consider the need to record U.S. deferred taxes related to such foreign entities.
4. Several provisions in the House Bill and Senate proposal eliminate or limit deductions and tax credits (e.g. interest expense limitation, modifications to net operating losses, loss of business deductions and credits) which could unfavorably impact a company's effective tax rate and negatively impact earnings. A deferred tax asset should be recorded for any interest amounts disallowed but carried forward as an attribute. Companies should consider whether the proposed changes impact the availability of their existing interest Section 163(j) carryforwards.

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