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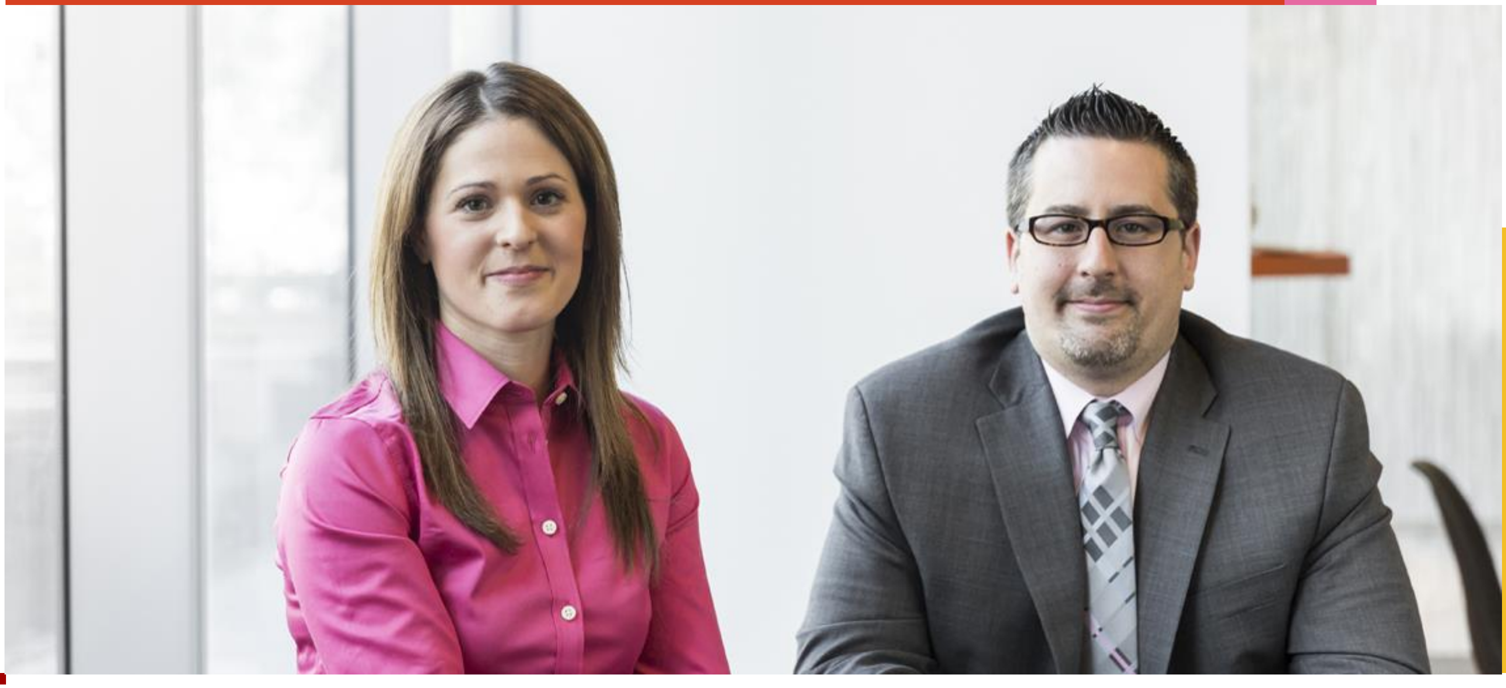
Global tax accounting services newsletter

Focusing on tax accounting issues affecting businesses today

October-December 2017



Introduction

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Senior tax buyers name PwC as their first choice provider for tax accounting services globally*

**These results are based on an independent survey of 2,649 primary buyers of tax accounting services globally, conducted by research agency Jigsaw Research (Q1–Q4 2016).*

The *Global tax accounting services newsletter* is a quarterly publication from PwC's Global Tax Accounting Services (TAS) group. In the newsletter we highlight issues that may be of interest to tax executives, finance directors, and financial controllers.

In this issue, we discuss the tax accounting implications of the recently enacted reform to US tax law. We also provide an update on some of the FASB's recent activity, set out some of the implications of the new auditor reporting model, discuss the new EU tax blacklist and note the IFRIC's recent tax related activity.

In addition we draw your attention to some other significant tax law and tax rate changes that occurred around the globe during the quarter ended December 2017. We continue to see a number of territories proposing or introducing legislation in response to the OECD's BEPS initiative and the European Union's Anti-Tax Avoidance Directives.

Finally, we summarise some key tax accounting areas that could be relevant to the preparation of 2017 year-end financial statements.

This newsletter, tax accounting guides, and other tax accounting publications are also available online. You can also register and access quarterly TAS webcasts for periodic updates on the latest developments.

If you would like to discuss any of the items in this newsletter, tax accounting issues affecting businesses today, or general tax accounting matters, please contact your local PwC team or the relevant Tax Accounting Services network member listed at the end of this document.

You should not rely on the information contained within this newsletter without seeking professional advice. For a thorough summary of developments, please consult with your local PwC team.

In this issue

Accounting and reporting updates

This section offers insight into the most recent developments in accounting standards and financial reporting, along with the tax accounting implications.

The FASB update

FASB weighs in on tax reform

The FASB met on 10 January 2018 to discuss several income tax accounting issues arising from the recent passage of US tax reform. See the 'Recent and upcoming major tax law changes' section below for a discussion of the topics discussed and decisions taken at the meeting.

Leasing standard simplification issued

On 29 November 2017, the FASB voted to propose amendments to the new leases guidance. The proposed guidance would simplify the transition to the new leasing standard (ASC842), allowing companies to apply the new standard at the effective date (1 January 2019) without adjusting the comparative periods presented. This has some similarities with the modified retrospective approach allowed under IFRS 16.

The proposed guidance would also simplify lessor reporting and disclosure for certain leases in which related services are also provided. This would provide an option for lessors which is already available under the existing guidance to lessees.

The proposals have been set out in an Exposure Draft of an Accounting Standard Update issued by the FASB on 4 January 2018, which is available for comment until 5 February 2018. The FASB is aware of the efforts that entities are undertaking to prepare for the adoption of the new leasing standard and is therefore aiming to finalise this issue quickly.

The proposed guidance will mean that entities will not need to restate their tax comparatives and tax departments will therefore be able to focus on the tax implications of the new standard going forward.

The SEC update

SAB 118

Following the enactment of US tax reform, the SEC released Staff Accounting Bulletin 118 (SAB 118) outlining the approaches that the SEC staff believes companies may take when they do not have the necessary information available or analysis completed to report the effects of the new law in their financial statements. The Bulletin is discussed further below in the 'Recent and upcoming major tax law changes' section.

Continued

Accounting and reporting updates

Changes to the auditor's report

The SEC on 23 October 2017 approved the new PCAOB standard changing the auditor reporting model. This will mean that additional information will be required to be included in the auditor's report.

The additional information includes disclosure of audit firm tenure and clarification of the auditor's role and responsibilities (effective for audits of fiscal years ending on or after 15 December 2017). From 2019, some auditors will need to communicate critical audit matters ("CAMs") in their reports.

The new standard has some similarities to the auditor requirements adopted by the UK, the EU and the IAASB in recent years. In particular the CAMs are similar, but not identical, to the key audit matters that are required to be reported in other jurisdictions. In many cases (but by no means all), tax, as an area requiring the application of significant judgment, has been one of the key audit matters identified in audit reports.

The ECOFIN update

EU tax blacklist published

On 5 December 2017 the Economic and Financial Affairs Council ("ECOFIN"), made up of the economics and finance ministers of the EU member states, issued a tax "blacklist". The "blacklist" includes 17 jurisdictions, among them South Korea, the UAE and Barbados. An additional 47 jurisdictions are included in a "greylist" of jurisdictions currently not compliant with EU tax standards but who have committed to amend their rules. The EU has not yet agreed any sanctions on the named jurisdictions. However, potential implications include requirements for detailed country-by-country reporting by multinationals doing business in blacklist countries and sanctions linked to the use of EU funds. In addition, Member States may pursue defensive measures against the listed jurisdictions. Tax departments should keep developments in this area under review if they have operations in or dealings with any of the territories in question. They should note that the list will be reviewed and communications have been issued to the relevant jurisdictions outlining measures they may take in order to be removed from the list.

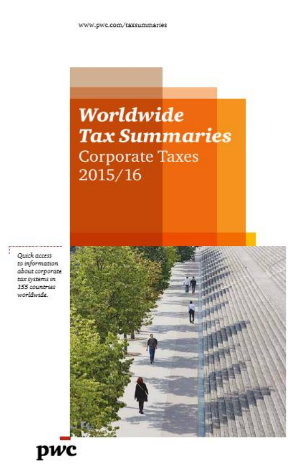
The IFRIC update

The IFRS Interpretations Committee ("IFRIC") has taken a number of important decisions impacting tax accounting and reporting over the past year. The key tax items on the IFRIC's agenda over the past few years, most notably accounting for uncertain tax treatments, have now been dealt with and at the Committee's meetings this quarter there was limited discussion of tax issues.

Continued

Recent and upcoming major tax law changes

This section focuses on major changes in the tax law that may be of interest to multinational companies and can be helpful in accounting for income taxes. It is intended to increase readers' awareness of the main global tax law changes during the quarter, but does not offer a comprehensive list of tax law changes that should be considered for financial statements.



Worldwide tax summaries

We have commented briefly on some of the tax accounting implications of the law changes set out below, particularly where these go beyond the requirement to adjust the current tax provision calculation or adjust deferred tax balances for rate changes. However, companies should not treat the tax accounting analysis in these summaries as exhaustive and should consider the implications for their particular circumstances.

Argentina

On October 31, 2017, the Argentine Executive presented its proposal for comprehensive tax reform. This proposal was enacted in December. The measures include a reduction in the corporate income tax rate from 35% (to remain in effect in 2018) to 30% in 2019 and 2020 and to 25% for subsequent periods. This will be offset by a WHT on dividend distributions of 7% for 2019 and 2020 and 13% for periods after that, leaving the tax on distributed profits broadly unchanged. Other changes include:

- Introduction of a permanent establishment definition for foreign parties undertaking activities in Argentina;
- The existing thin capitalization 2:1 debt-to-equity ratio will be replaced by a BEPS-based rule capping the deduction on interest expense and foreign exchange losses with local and foreign related parties to 30% of the taxpayer's taxable income before interest, foreign exchange losses and depreciation. Nevertheless, taxpayers will be entitled to carry forward (i) excess non-deductible interest for five years and (ii) unutilized deduction capacity for three years;
- Changes to the taxation of indirect transfers of Argentine assets, rendering them taxable subject to certain conditions; and
- Various other changes to capital gains rules.

Companies will need to consider the impact on uncertain tax positions, particularly with regard to changes to permanent establishment rules, and on deferred tax accounting for interest carry-forwards.

Continued

Recent and upcoming major tax law changes

A separate proposal before Parliament includes an optional rebasing provision, permitting taxpayers with a variety of tangible and intangible assets to revalue their assets for tax purposes, in exchange for a payment of 8% - 15% of the amount of the adjustment (depending on the nature of the asset). The basis adjustment can be depreciated for tax purposes over the remaining life of the asset (subject to a minimum life of length to be determined depending on the nature of the asset). To take advantage of this, taxpayers are to be required to withdraw any judicial or administrative proceedings claiming inflation adjustments.

Companies planning to take advantage of this should consider the nature of the payment that is made and the impact of the basis adjustment on their deferred tax balances.

Belgium

The Belgian government enacted in Q4 a significant tax reform law. The law entails a number of changes, most prominently a reduction in the combined corporate income tax rate from the current 33.99% to 29.58% in 2018 and 2019 and 25% from 2020. Other changes include:

- An increase in the dividends received deduction from 95% to 100%;
- Full exemption from tax of capital gains on qualifying shares; and
- The introduction of tax consolidation (a kind of tax grouping or fiscal unity).

To mitigate the cost of these benefits, a number of new restrictions will be put in place. Various deductions will be limited to 70% of taxable income, so that companies will find themselves paying at least some tax more often. The deductions that will be so limited include the incremental notional interest deduction, carried forward dividend received deductions, carried forward losses, carried forward notional interest deductions and carried forward innovation income deductions.

This is a significant change to the existing system, reducing rates and broadening the tax base. It will have extensive tax accounting implications, including the need to remeasure deferred taxes at the new rate, and the need to consider the recoverability of deferred taxes related to carried forward deductions whose offset is now limited.

Separately, on 3 November 2017, a Law on Belgian REITs (the so-called Regulated Real Estate Companies or B-REITs) was enacted. The Law amends the existing regime for public and institutional B-REITs and introduces a new category of B-REITs with social purpose.

Cyprus

The Cypriot government has enacted a change to the tax depreciation rules. Plant and machinery acquired in 2012-2016 benefited from 20% per annum tax depreciation (excluding such assets already eligible for a higher rate of annual tax depreciation). Industrial buildings and hotels acquired in 2012-2016 benefited from 7% per annum tax depreciation. An amendment to the income tax law published on 24 November 2017 extends the eligibility for accelerated tax depreciation to acquisitions made in 2017-2018. The amendment to the income tax law also introduced a 7% per annum tax depreciation on buildings for agricultural and livestock production acquired in 2017 and 2018. Companies acquiring relevant assets will need to account for the impact on their current and deferred tax calculations.

Continued

Recent and upcoming major tax law changes

Canada

The Canadian government has enacted a law (Bill C-63) which implements a number of key March 22, 2017 federal budget proposals. These include provisions dealing with derivatives which allow taxpayers to elect to mark to market all eligible derivatives held on income account, for taxation years beginning after March 21, 2017 and prevent the avoidance or deferral of income tax through the use of offsetting derivative positions in straddle transactions, for any loss realized on a position entered into after March 21, 2017.

The law enhances tax incentives for clean energy generation equipment using geothermal energy, for property acquired generally for use after March 21, 2017.

Other changes relate to oil and gas drillers and the classification of certain expenses as a Canadian development expense (CDE), instead of Canadian exploration expense (CEE). There are also changes to financial sector rules affecting mutual funds and insurance groups.

The law also includes technical amendments to existing laws, affecting reverse takeovers and Canada's international tax rules.

France

The French Constitutional Council on October 6, 2017, ruled that the 3% distribution tax is unconstitutional, following the European Court of Justice (ECJ) decision dated May 17, 2017. The Council specifically found unconstitutional the difference in treatment of distributions by a French parent company. Such distributions are taxable when composed of redistributed dividends of a French or a non-EU subsidiary, but are exempt when composed of redistributed dividends of an EU affiliate. This discriminatory treatment is sufficient to rule that the entire 3% tax is unconstitutional.

The Council noted that there is no reason to postpone the effect of its decision, which was published in the official gazette of the French Republic on October, 8, 2017, and therefore will apply to all pending cases even if no claim has been filed.

In order to finance the refund of the 3 % tax on distributions, the Amended Finance Act for 2017 introduced two surtaxes applying to major French resident companies in the periods ending from 31 December 2017 to 30 December 2018. It is expected to impact the largest 320 companies in France.

The Amended Finance Act provides for:

- A 15 % exceptional surtax, assessed on corporate income tax paid, applicable to companies with turnover/revenue exceeding EUR 1 bn; and
- A 15 % additional surtax, assessed on corporate income tax paid, applicable to companies with turnover/revenue amounting to at least to EUR 3 bn.

The surtaxes are calculated in the same way as the normal French corporate income tax computed at the standard or reduced rate, but before offset of any tax credits or other tax receivables. The turnover taken into account is the turnover in the period of the tax (i.e. a company's accounting period ending between 31 December 2017 and 30 December 2018), adjusted if necessary to correspond to a period of twelve months.

The surtax will temporarily increase the rate of CIT, for affected companies, to 39.43 % (for those companies with turnover/revenue exceeding EUR 1 bn) and 44.43 % (for those with turnover/revenue of at least EUR 3 bn).

Continued

Recent and upcoming major tax law changes

The surtax was published in the Official Gazette on 2 December 2017 and is therefore considered enacted. An advance payment of 95% of the surtax will have to be made together with the payment of the 4th corporate income tax instalment ("CIT"). Companies closing their financial year on 31 December 2017 will have five additional days to make the advance payment which will fall due on 20 December 2017. The balance will be paid at the same time as the balance of CIT.

Companies affected by the surcharge will need to include its effect in their financial statements for the period in question.

We discussed in last quarter's newsletter that a tax action plan had been published in France. Many of its key provisions have now been incorporated into legislation which was enacted in December. In particular, the tax rate reduction to 25% from the current $33^1/_3$% (before the surcharge discussed above) will need to be considered by groups with operations in France.

Germany

The German Federal Tax Court ruled, in a recently published verdict, that capital gains realized by a foreign corporation upon the disposal of shares in a German corporation are fully exempt from German corporate income tax, and not effectively only 95% exempt. This exemption is available to taxpayers provided the capital gains are not realized through a German business, such as a permanent establishment (PE).

The decision is relevant for foreign corporate taxpayers for whom a tax treaty does not provide a German tax exemption for capital gains. While the decision provides relief from the effective 5% tax burden, it remains to be seen how the German tax authorities and legislature will react to the decision.

Groups who have made disposals of shares in German corporations through non-German companies, and accrued or paid German tax on those disposals, should consider the implications for their tax accounting and whether they should recognise an asset or have an uncertain tax position.

Ireland

Following the publication of an independent report into Ireland's tax system, Ireland's government released its budget on 10 October 2017, which was enacted in late December. The budget adopts a number of recommendations from the report, discussed in last quarter's newsletter.

The key changes include a reintroduction of the 80% cap on relief for amortization of IP. This applies with respect to expenditures incurred by a company on qualifying intangible assets effective at midnight on October 10, 2017. Companies will need to be able to track those assets acquired before that date separately.

Excess amortization on assets acquired after the relevant date will be able to be carried forward; this is likely to lead to temporary differences being created which companies will need to account for.

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Recent and upcoming major tax law changes

A second major announcement in the budget was a consultation period on other recommendations from the independent report and on the implementation of the EU Anti-tax avoidance Directive (ATAD), which will require the introduction of CFC provisions, thin capitalization rules, exit taxation, and hybrid taxation provisions over the coming years.

The Finance Act 2017 also provides for an extension of the Accelerated Capital Allowances Scheme (i.e. accelerated tax depreciation) (currently due to expire on 31 December 2017) to the end of 2020.

Latvia

The Latvian government has enacted changes to local tax law to move to a new corporate income tax model, along the lines of the Estonian model, whereby tax is charged only on distributed profits at a rate of 20%. The tax will also apply to a number of deemed distributions, including non-business adjustments and TP adjustments required to bring book profits in line with the arm's length principle. The distribution of profits from share sales will not be subject to the tax, unless the shares were held for less than three years. The use of brought forward losses will continue to be possible for a limited time, with restrictions.

Netherlands

The Dutch government has proposed a number of potential changes to its fiscal unity rules in response to a series of cases at the European Court of Justice which are expected to be decided in the next few months. Should the verdict go against the government (and follow the Advocate General's opinion), the changes would be introduced with effect from the date of the proposal. They would eliminate certain favourable treatments available in the context of the fiscal unity regime.

There would be amendments to the anti-base erosion rules, the participation exemption, the participation debt rules, loss utilisation rules following a change of beneficial ownership, and rules regarding the reduction of the dividend tax. Certain transactions within a fiscal unity could become regarded. The changes to the rules would become effective only if the ECJ rules against the Dutch government, but would be retroactive to the date of the proposal.

The government has also made a number of other proposals for tax changes.

The first is a plan to lower tax rates. The standard corporate income tax rate, it is proposed, will be reduced in steps from 25 per cent to 21 per cent (2019: 24 per cent, 2020: 22.5 per cent and 2021: 21 per cent). The lower basic rate (in 2017 for taxable profit up to EUR 200,000) will decrease in a similar fashion from 20 per cent to 16 per cent (2019: 19 per cent, 2020: 17.5 per cent and 2021: 16 per cent).

Profits from research and development (R&D) are taxed at a favourable rate of 5 per cent in the Netherlands under the innovation box regime. In the future it is proposed that the effective tax rate will rise to 7 per cent.

For all buildings, tax depreciation is proposed to be limited so that it can only reduce the tax basis to 100 per cent of the actual value of the building (according to the Valuation of Immovable Property Act). Currently buildings that are used for a company's own activities may be depreciated for tax purposes to 50 per cent of the actual value.

Continued

Recent and upcoming major tax law changes

The Netherlands currently does not levy a withholding tax on interest and royalty payments, but the new government has proposed a withholding tax on interest and royalty payments in artificial structures. For example, the new tax would apply if an artificial structure makes interest or royalty payments to low-tax jurisdictions. These rules, which are connected to the EU initiative to introduce a blacklist for non-cooperative tax jurisdictions, likely would not be implemented before 2023.

Other changes are proposed to the loss relief rules. The carry back period would remain at one year, but companies would only be able to carry forward losses for six years, down from the current nine.

Companies should monitor developments to ensure that they are aware as and when these proposals are enacted and become effective.

The changes to the innovation box rules and the previously announced changes to the dividend withholding rules were enacted before the end of 2017; the remaining proposals are expected to be enacted in years to come.

New Zealand

The New Zealand government has introduced wide ranging proposals to implement various BEPS Actions into law in New Zealand. The law is going through a consultation process but is expected to be enacted in mid-2018; the consultation responses are unlikely to change the thrust of the policy, although some changes to the details of the draft law may be anticipated.

The draft law would tighten the thin capitalisation regime, by making changes to the way that thin capitalisations ratios are calculated and restricting the ability of taxpayers to enter into transactions near a thin cap measurement date which are intended to impact the thin cap ratio. There are other changes that relax the rules, such as a *de minimis* interest threshold of NZ$1m for taxpayers with only third part debt, and a public benefit exemption.

Transfer pricing ("TP") of debt will also be changed, requiring borrowings above NZ$10m to be priced at a notch below the ultimate parent's credit rating or at BBB- in the absence of an ultimate parent. Exotic debt features such as subordination, long (over five year) terms, or convertibility will in general be ignored.

Transfer pricing in general will change, shifting the burden of proof so that taxpayers will need to demonstrate that pricing is on arm's length terms. The time limit for TP enquiries will also be extended from four years to seven years.

Permanent establishment ("PE") rules will be tightened. A deemed PE anti-avoidance rule is to be introduced, targeted at large multinationals (with consolidated global turnover of more than EUR 750 million), where a related or commercially dependent entity carries out activities for the purpose of bringing about a supply by the non-resident and there is a tax avoidance purpose that is more than incidental. An exception will apply if the activities are preparatory or auxiliary in nature (e.g. general marketing and advertising of a non-resident's products). Various other PE changes are proposed which will have similar effects. There is little guidance yet on the allocation of profits to PEs in these circumstances.

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Recent and upcoming major tax law changes

Anti-hybrid rules will also be introduced that will counteract tax benefits associated with hybrid entities or arrangements. As we have seen elsewhere (e.g. the UK), these rules are complex. They are broadly in line with the OECD recommendations on hybrid mismatches. Various elections will be available to simplify the application of the rules.

Groups with New Zealand operations should consider the tax accounting implications of these proposals. They are likely, at least initially, to increase uncertainty for taxpayers.

Poland

The Polish government has enacted (on 27 November 2017) a number of changes to tax law that were previously proposed, to take effect from 1 January 2018.

These include interest restrictions, with a *de minimis* of PLN 3m, based on a fixed ratio of 30% of EBITDA. Other restrictions on intra-group base eroding payments will be introduced.

The new law introduces a distinction between capital sourced income/losses and other income/losses, and restricts the ability to offset losses from one source against income from the other.

There are changes to CFC rules, which will increase the shareholding required for a foreign company to be a CFC and require taxpayers to assess CFC status based on effective tax rate rather than nominal tax rate. The classification of passive income for the purposes of the CFC rules will be broadened.

There are a number of other changes, making this a very significant law for Polish taxpayers.

Portugal

In addition to the regular corporate income tax rate, companies in Portugal with taxable profits above €1,500,000 are required to pay a state surcharge with the rate changing depending on their level of profits (3% from €1.5m to €7.5m; 5% from €7.5m to €35m; 7% from €35m onwards). The 2018 State Budget Law raises the rate applicable to amounts above €35m to 9% for 2018 and future periods. This change has been approved by the Parliament (and is thus substantively enacted) and was enacted when signed by the President in late December.

Romania

Romania's government has transposed a number of the EU's Anti-Tax Avoidance Directive provisions into the Romanian Fiscal Code. This brings a new set of interest deductibility limitation, exit taxation, anti-abuse and controlled foreign company rules. The interest deductibility rules currently in force (i.e. interest limitation cap and debt-to-equity ratio) are being replaced by new rules. As of 1 January 2018, excessive borrowing costs (calculated as the difference between any debt-related costs – including foreign exchange expenses and capitalised interest - and income from interest and other economically equivalent income) incurred in a fiscal period which exceed the deductible threshold of EUR 200,000 will be deductible for corporate income tax purposes to the extent that they are less than or equal to 10% of profits. The non-deductible excess borrowing costs can be carried forward indefinitely. The limitation also applies to any debt-related costs in connection with loans granted by financial institutions.

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Recent and upcoming major tax law changes

Singapore

Various proposals from Singapore's 2017 budget were enacted on 26 October 2017. These included changes to the requirements for TP documentation, making it mandatory to have TP documentation from 2019. Other changes with more sector specific impacts were made to the country's aircraft leasing scheme and to tax incentives for the financial sector.

United Kingdom

Finance No.2 Act 2017 was enacted on 16 November 2017 (and substantively enacted on 31 October 2017). Its provisions were discussed in previous newsletters.

Key measures include changes to loss relief rules, the introduction of interest restriction rules in line with BEPS Action 4, changes to the Substantial Shareholding Exemption ("SSE") for institutional investors, and changes to the anti-hybrid rules. The interest restriction rules, the loss relief rules, and the SSE changes take effect from 1 April 2017. Anti-hybrid rules were enacted last year and apply from 1 January 2017; some of the changes apply from 1 January 2017 and some from 13 July 2017.

United States of America

There have been major developments in the US tax reform process. The President signed the Tax Cuts and Jobs Act on 22 December thereby resulting in the law being considered enacted and substantially enacted. The changes to US tax law are extensive and will have a pervasive effect on accounting for income taxes for US groups and multinationals with US operations. PwC has published a wealth of information on this topic and this article will provide a brief summary of the key provisions.

The federal corporate income tax rate is reduced from 35% to 21% from 1 January 2018. Companies will need to consider the implications for the rate at which they measure their deferred tax balances.

Under US GAAP, deferred taxes should be remeasured with the effect recorded discretely as a component of income from continuing operations. This is true even if the deferred taxes being remeasured were established through a financial statement component other than continuing operations. This can result in disproportionate tax effects becoming "stranded" in AOCI. During the FASB's 10 January 2018 board meeting, the board members voted to add a narrow-scope project to its agenda to address the accounting related to the tax effects that have become "stranded" in AOCI as a result of tax reform. It plans to release an exposure draft that proposes to require reclassification from AOCI to retained earnings of stranded tax effects solely related to the newly-enacted reduction in the corporate tax rate.

Under IFRS, by contrast, backwards tracing applies so that deferred tax remeasurements should be backwards traced to the component of income to which they relate. This can be complex, but should mean tax effects do not become "stranded" in AOCI.

The corporate Alternative Minimum Tax ("AMT") is eliminated from 1 January 2018 and a mechanism has been provided to refund corporate AMT credits by the end of 2021 to the extent they remain unutilized. Companies will need to consider the implications on realizability for any existing deferred tax assets relating to AMT credit carryforwards. At the recent FASB meeting, certain accounting implications of the new law were considered. During this meeting, the FASB staff indicated that AMT credit carryforwards that are classified as receivables should not be discounted. The board members agreed.

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Recent and upcoming major tax law changes

The law allows for full expensing for many tangible depreciable business assets acquired and placed in service after September 27, 2017 and before January 1, 2023 (January 1, 2024 for longer production period property and aircraft).This could result in additional deferred tax liabilities for fixed assets and potentially additional deferred tax assets for operating loss carryforwards if the full expensing results in a taxable loss. Companies will need to consider the implications of full expensing when assessing the ability to realize deferred tax assets, including those related to net operating loss ("NOL") carryforwards.

For years beginning after 1 January 2018, limitations on interest deductions are expanded such that interest expense (due to both related parties and to third parties) will only be deductible to the extent of interest income plus 30% of adjusted taxable income.

However, the definition of adjusted taxable income changes; from 2018 to 2021, the definition is roughly equivalent to tax basis EBITDA; thereafter it changes to EBIT which will make the restriction more severe. Given the more severe limitation, as well as the applicability to both related party and third party debt, this provisions will likely apply to a broader base than the previous interest restriction rules and will likely give rise to temporary differences for many groups. This is broadly in line with the BEPS proposals that we have seen introduced in many other countries in recent months. Non-deductible interest may be carried forward indefinitely. This will likely give rise to temporary differences for many groups.

For losses arising in years from 2018, NOL deductibility will be restricted by the new law to 80% of taxable income. Such NOLs will not be available to be carried back but may be carried forward indefinitely. This will affect how companies assess their expected NOL realization and may result in changes to valuation allowances/deferred tax asset recognition. Existing NOLs are not affected.

On the domestic front, the research credit is maintained but the section 199 domestic manufacturing deduction is eliminated.

There are also extensive changes affecting international businesses.

The most significant change is the introduction of a 100% dividends received deduction, so that repatriation of foreign profits to the US will be not be subject to US tax at the corporate level. As part of the transition to a territorial system, the law imposes a 'toll-charge' on the undistributed earnings and profits (E&P) of US-owned foreign corporations at 15.5% for cash or cash equivalents and 8% for illiquid assets. Taxpayers may elect for this to be payable over eight years. During the FASB meeting to discuss the new law, the board agreed with the staff's recommendation that the toll charge amount should not be discounted. Under IFRS current tax liabilities may be discounted.

Companies should not think that this relieves them of the need to consider outside basis differences in accounting for subsidiaries. They will still need to determine whether or not they intend to repatriate profits and what the tax implications will be, although the new rules should simplify the calculation of those tax implications in many ways. Companies will still need to consider, for example, the tax effects of foreign withholding taxes,

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Recent and upcoming major tax law changes

applicable state taxes, foreign currency gains or losses, and realizable foreign tax credits (FTCs), if applicable, in measuring the deferred tax effects of the outside basis difference.

The new law introduces some complex anti-base erosion provisions, namely a tax on certain 'global intangible low-taxed income' (GILTI) and a 'base erosion and anti-abuse tax' (BEAT). The GILTI regime effectively taxes 50% of GILTI (which broadly includes foreign subsidiaries' earnings above a routine 10% return on their tangible assets) at the US rate subject to reduced FTCs. At the FASB meeting, the board assented to the staff's proposal that companies have a policy choice as to whether or not to take into account the future impact of the GILTI in measuring deferred taxes.

The BEAT imposes a new minimum tax which will require taxpayers to compute their taxes two ways. Companies subject to the tax (broadly those with annual gross receipts over US$500m and with a base erosion percentage higher than 3%) will need to compare a tax computed at a 10% rate on an expanded definition of taxable income that adds back the certain base eroding payments (i.e. interest, royalties, service fees and similar payments, or payments for asset acquisitions, made to related parties) to regular taxable income with their regular tax liability, reduced by certain credits, and pay the higher of the two.

At the FASB meeting on 10 January 2018, the board agreed that for US GAAP reporters the BEAT should be considered a period cost and companies impacted by the BEAT should not determine their deferreds according to the BEAT regime.

The law also includes a new provision that appears to be designed to encourage the development of intangibles for use outside the United States. It is known as the foreign-derived intangible income ("FDII") regime and is akin to a patent box for US-held intangibles. It allows a deduction for 37.5% of a company's FDII, effectively reducing the rate on FDII to 13.125%.

A further provision of the bill with potential effects on international groups is the denial of a deduction for interest and royalty payments to a related foreign party which involve hybrid transactions or hybrid entities, where the recipient is not taxed on the income or receives a deduction for the payment.

Overall the changes represent the most significant revisions to the US tax code since 1986. Companies should review the impact of the law on their specific circumstances.

For IFRS filers, views are continuing to evolve on the appropriate accounting for a number of the provisions of the new law. We will return to this issue in a later newsletter when more guidance is available.

The SEC has issued guidance on accounting for tax reform under US GAAP in the form of Staff Accounting Bulletin No 118 (SAB 118 or the Bulletin). The guidance recognises that, in some cases, it might be difficult to complete the accounting for the impact of the new law before the financial statements are issued, and it describes an accounting model that could be applied in these circumstances. It envisages three scenarios:

- Measurement of certain income tax effects is complete. In this case companies must reflect the accounting for the new law for the areas where it is complete.

Recent and upcoming major tax law changes

- Measurement of certain income tax effect can be reasonably estimated. In this circumstance companies must report provisional amounts for those specific income tax effects of the new law for which the accounting is incomplete but a reasonable estimate can be made. Provisional amounts or adjustments to provisional amounts identified in the measurement period (the period of one year up to 22 December 2018, or when the accounting is complete, whichever is the earlier), should be included as an adjustment to tax expense or benefit from continuing operations in the period in which the amounts are determined.
- Measurement of certain income tax effects cannot be reasonably estimated. In this scenario companies are not required to report provisional amounts for any specific income tax effects of the new law for which a reasonable estimate cannot be determined, and should continue to apply ASC 740 based on the tax laws that were in effect immediately prior to the enactment of the new law. Companies would report the provisional amounts of the tax effects of the new law in the first reporting period in which a reasonable estimate can be determined.

Appropriate disclosures should be made, as set out in the Bulletin. SAB 118 also states that the staff would not object to a 'foreign private issuer' (reporting under IFRS) applying the same approach solely for the purposes of completing the accounting requirements for the income tax effects of the 2017 Act under IAS 12, 'Income Taxes'.

During the 10 January 2018 board meeting, the FASB staff indicated that private companies and not-for-profit entities reporting under US GAAP should also have the option to apply SAB 118. The board members agreed, and the FASB released a Staff Q&A on 12 January 2018 confirming the decision.

It is not clear whether other securities regulators will issue similar guidance. However, a model in which management uses all of the information and analyses available to estimate the accounting impact of the 2017 Act, and then revises that estimate as more information and analyses become available, is consistent with IFRS. Very careful consideration is required before concluding that it is not possible to make a reasonable estimate. Clear disclosure of the estimates and judgements made is essential.

Tax accounting refresher

In this section we summarise key tax accounting areas that could be relevant to the preparation of 2017 year-end financial statements

Key tax accounting areas

2017 has been a very busy year, with major developments in accounting standard setting, regulators and regulations affecting tax reporting, and legislation in many countries. With many people's focus at year-end on recent legislative changes, particularly those expected in the United States, we considered it would be useful to set out some reminders of key tax accounting issues that have come up during the year.

Accounting standard developments

A number of accounting standards were issued in 2017 or came into effect in 2017; we remind you of some of the key ones below.

ASU 2016-16

Last year the FASB issued Accounting Standard Update (ASU) 2016-16 on intra-entity asset transfers, which will be effective for accounting periods starting after 15 December 2017. Calendar year-end companies therefore don't need to incorporate it into their year-end accounting but should be considering its future impact for disclosure purposes.

ASU 2017-01

Standards issued this year include ASU 2017-01 which clarifies the definition of a business. It is it is likely that more acquisitions will be accounted as asset acquisitions across most industries.

The accounting for asset acquisitions is significantly different from accounting for business combinations. Companies will need to look at acquisitions in the light of the new guidance and may find some unexpected results. Significant differences in pre-tax accounting will impact income tax accounting as well.

ASU 2017-04

The FASB also issued new guidance simplifying goodwill impairment standard earlier this year (ASU 2017-04) which many companies may early adopt. Under the current standard, when impairment testing is carried out, the fair value of a reporting unit is compared to its book value as a first step. If the fair value is greater than book value, there is no impairment. But, if fair value is less than book value, a second step of analysis needs to be performed.

Continued

Tax accounting refresher

In step 2, a hypothetical purchase price allocation is done based on fair value and the fair value of goodwill in step 2 is compared to the book value of goodwill. An impairment of goodwill is recorded to the extent that the book value is higher than the fair value.

The new standard effectively eliminates step 2. Under the new standard, if the fair value of a reporting unit is less than its book value, a goodwill impairment is recorded for the difference.

If a reporting unit has tax deductible goodwill that is subject to impairment, a simultaneous equation method should be used to determine the goodwill impairment amount and associated income tax benefits.

This is because the goodwill impairment would change the deferred tax recorded for book and tax basis difference in tax deductible goodwill, which would then change the carrying value of the reporting unit and therefore the impairment of goodwill. This is an iterative computation and therefore simultaneous equation method should be used to determine the appropriate amount of impairment.

The simultaneous equation method is the same as that used today to determine the final goodwill and related deferred income tax amount in a nontaxable business combination. However, this iterative formula was not something that has had to be considered to date when recording goodwill impairments.

ASC 606 and 842/IFRS 15 and 16

The new revenue recognition standard, effective for accounting periods starting after 15 December 2017 for US GAAP reporters (or on or after 1 January 2018 for IFRS reporters) will have extensive impacts on financial reporting, including on tax. Some groups may have made the decision to early adopt the new standard and tax departments in those groups should have begun to get to grips with the implications through their interim reporting this year.

Assessing the tax implications for multi-national groups in particular will be a complex task, requiring an understanding of the interplay between local tax rules, local accounting standards, IFRS/US GAAP and the specific circumstances of the business.

The leasing standard, which comes into effect the following year, has similarly wide implications.

IFRIC 23

Other changes to IFRS accounting will have a more direct impact on tax reporting. The key change is the introduction of the new Interpretation on Uncertain Tax Treatments, IFRIC 23.

This is the IFRS equivalent of FIN48, and sets out for the first time under IFRS a formal framework for assessing uncertain tax positions (UTPs). We discussed this in some detail in our Q2 newsletter. It is mandatorily effective for periods starting on or after 1 January 2019.

Companies should be thinking now about the implications of the new Interpretation for their UTP accounting.

Transitional rules are set out in the Interpretation, allowing the effect of adoption to be booked in full through retained earnings without a restatement of comparatives. Alternatively the normal rules in IAS 8 may be applied, so long as this can be done without the use of hindsight. To avoid the risk of applying hindsight to their positions when reporting in 2019 companies may wish to calculate their comparative opening position in Q1 2018.

Continued

Tax accounting refresher

In a linked decision, the IFRIC issued an agenda decision which clarified the accounting for interest and penalties on income tax amounts. The agenda decision, discussed in detail in our Q3 newsletter, and which became effective when issued, set out that companies do not have an accounting policy choice as to how to account for interest and penalties on income taxes but should account for such amounts under IAS 12, if the interest and penalties should be considered income taxes, or IAS 37 if not.

Regulatory focus

Securities and Exchange Commission

In the US, the staff of the Securities and Exchange Commission ("SEC") issue comment letters to individual filers of financial statements based on the staff's review of the filings made. Comments addressing income taxes focus on areas of judgment. Key issues include valuation allowances, rate reconciliations, indefinite reinvestment assertions, and UTPs.

When looking at rate reconciliations, the staff have often asked for disaggregation of components of "foreign rate differential" in the ETR reconciliation (e.g., differences in statutory tax rates, impact of permanent differences, changes in valuation allowance assessments in foreign jurisdictions, tax holidays). They have also asked for qualitative and quantitative disclosures in management discussion and analysis ("MD&A") about significant items affecting the ETR, including details of the expectations for the impact of these items in future periods.

Valuation allowance comments focus on the need for additional details regarding the preparer's assessment of the positive and negative evidence for the realizability of deferred tax assets. The staff are particularly interested in understanding the thinking of preparers in the following scenarios:

- There is clear negative evidence, such as cumulative three-year net loss or recent NOL expiration but no valuation allowance was recorded;
- Full or partial release of a valuation allowance;
- A valuation allowance is recorded despite cumulative profitability.

Comments on the indefinite reinvestment assertion focused on changes in the assertion (i.e. ceasing to assert indefinite reinvestment for all or part of a group's unremitted earnings). There were also a number of questions for groups who continued to make an indefinite reinvestment assertion despite the repatriation of some profits in the period.

The staff also sought additional discussion in the MD&A about liquidity, particularly in circumstances where the indefinite reinvestment assertion was made, and about the tax implications of a hypothetical repatriation of the unremitted earnings.

The final area of focus for the SEC staff was UTPs. The comments in general focus on understanding how changes in UTPs impact the effective tax rate reconciliation; reconciling significant prior year changes to UTPs within the required rollforward table, and soliciting additional information to enable users to better understand future changes that may have a material effect on a company's financial condition or operating performance.

Continued

Tax accounting refresher

ESMA

The European Securities and Markets Authority (ESMA) is an independent European Union Authority, which serves as the European Union's securities market regulator, fulfilling in that respect a similar role to the SEC in the US. One of ESMA's areas of responsibility is to promote the effective and consistent application of the European Securities and Markets legislation with respect to financial reporting.

Our Q2 newsletter discussed ESMA's 2016 report on regulatory and enforcement activities.

Although income tax issues were not amongst the enforcement priorities for 2015, income tax did come up in the annual report. The topic specifically elaborated on was unused tax losses, which was identified as an issue that had been discussed at a number of meetings of European enforcers.

Takeaway

In summary, tax reporting continues to be an area subject to intense regulator and investor scrutiny in major financial markets. Organisations should continue their efforts to improve the quality of their disclosures for significant assertions and estimates in their 2017 financial statements, bearing in mind that these should be accurate, transparent, and in plain language.

State aid

2017 has seen some significant developments in the field of State Aid, which followed a busy 2016.

The Amazon decision was announced on 4 October 2017. The European Commission concluded that Luxembourg granted State Aid to Amazon in what seems to be another application of the 'EU arm's length principle' (ALP) that was first articulated in the Apple decision in 2016.

The Commission's decision requires that Luxembourg recover around EUR 250m of tax from Amazon and is likely to be appealed.

The Commission has also recently announced an investigation into the UK's CFC rules, focusing on the Finance Company Partial Exemption regime.

The UK introduced a new CFC regime in 2013 in response to decisions by the European court that held that the previous regime was too restrictive.

The Commission's investigation may help determine how EU member states should balance the freedom of establishment requirements set out in the *Cadbury Schweppes* case with the requirement to put in place a CFC regime that is effective for the purposes of the EU's Anti-Tax Avoidance Directive.

Towards the end of the year, on 18 December, the European Commission announced a new investigation into the Netherlands' tax treatment of Inter IKEA. This appears to focus on the price paid by Inter IKEA for related party assets.

Decisions in other State Aid cases may be issued by the European Commission in the coming months.

Companies should consider whether any of their tax circumstances may have put them at risk of being deemed a recipient of State Aid; they should bear in mind the recent judgments in considering how widely the state aid concept may be applied to tax issues.

They should assess this using the UTP framework (IFRS reporters may also need to give some thought to the contingent liabilities standard, IAS 37).

Continued

Tax accounting refresher

Tax law changes

This newsletter contains tax law updates from over 15 countries around the world, and there have been many more in our Q1, Q2 and Q3 newsletters.

Companies should make sure they have appropriate systems and processes in place to monitor these changes in countries in which they operate, and even in those with which they transact.

They should bear in mind that changes to tax laws should not be accounted for until the laws are enacted (for US GAAP reporters) or substantively enacted (for IFRS reporters). See our publication on what this means in different countries for more details on the differences.

This is the case even when laws are expected to be effective at an earlier date than enactment (e.g. the date that the change was announced). This can mean that financial statements for a period do not reflect laws that are later reflected in tax returns for that period. Where this is a significant issue, companies should make sure adequate disclosure is provided.

Companies should also bear in mind that where effective dates are delayed, income tax accounting should still reflect the law once enacted or substantively enacted. We have seen a number of examples of this in recent years where countries have enacted tax rate reductions that take effect over a period of years, or that reduce in steps.

Companies in these circumstances should consider the need to schedule the reversal of their temporary differences in order to ensure that they are measured at the most appropriate rate.

Continued

Tax accounting refresher

Over the years we have covered a number of technical topics in the tax accounting refresher section of this newsletter. Here we present a summary of the most recent topics and links to the relevant newsletters. We would love your input on what topics you would like us to cover in future newsletters. If you have any feedback, please feel free to reach out to any of the primary authors listed below.

Tax accounting refresher topics

Topic	Newsletter
Tax provisions for carve-out financial statements	Q1 2016
Foreign currency tax accounting	Q2 2016
Outside basis difference	Q3 2016
Key tax accounting areas for preparation of 2016 year-end financial statements	Q4 2016
Interim reporting	Q1 2017
Tax accounting and BEPS	Q2 2017
Technology and the tax function	Q3 2017

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