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A CFO'S GUIDE

# CORPORATE TAX POST-TCJA

An Armanino White Paper

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One of the most important challenges facing a CFO in the wake of a change like this is to assess the corporate tax function to ensure it provides the greatest value to the company.

The Tax Cuts and Jobs Act of 2017 (TCJA) made some of the most sweeping changes to U.S. taxation of corporations in decades. The law was extraordinary in both the breadth of provisions that it changed and the depth of the changes it made to those provisions. CFOs who lead their organizations through this period of change and complexity position themselves as strategic leaders.

One of the most important challenges facing a CFO in the wake of a change like this is to assess the corporate tax function to ensure it provides the greatest value to the company. This also means finding the right level of support to navigate the many different tax concepts in play.

For any given company, the resources necessary to manage these changes can vary widely from one provision to the next. Some provisions of the law are minor enhancements to existing incentives, which in-house tax professionals likely are equipped to manage with only occasional external support. At the other extreme, some provisions are such dramatic departures from previous tax policy that, even a year after enactment, the IRS is struggling to issue guidance explaining how they will be implemented.

In this guide, we provide context to help CFOs assess their company's readiness to comply with the new law and determine what resources will be needed to enact those changes.

## The TCJA's Impact on Existing Tax Incentives

Much of the coverage of the TCJA has focused on the ways in which it directly changed many provisions of the Internal Revenue Code. But the law's indirect effects on existing parts of the code can, in some cases, be just as significant.

In light of the changes enacted by the TCJA, now is a good time to reassess whether your company is a candidate for any of the major tax credits and incentives. One example of a tax incentive that got an indirect boost from the TCJA was the research and development (R&D) tax credit. The R&D credit is such an important incentive that it is now a permanent part of the law, thanks to the Protecting Americans from Tax Hikes (PATH) Act of 2015. Its importance was underscored by the fact that House and Senate "talking points" about the TCJA specifically noted the preservation of the credit.

The TCJA's reduction in corporate tax rates increases the R&D credit's net benefit. Taxpayers who claim the credit are prohibited from also deducting the expenses attributable to qualified research activities from their taxable income. Now, the additional taxable income arising from the disallowed expenses is taxed at a maximum of 21 percent, as opposed to pre-TCJA rates as high as 35 percent, increasing the value of the credit.

Elimination of the corporate alternative minimum tax (AMT) also enhances the value of the credit. Prior to the TCJA, corporations that were subject to the AMT could not use credits and deductions to offset their minimum tax. Those corporations will now be subject only to regular income tax — opening up the opportunity to claim the R&D credit, as well as other incentives.

Yet another TCJA provision makes the R&D credit a little more appealing starting in 2022. The provision, which requires taxpayers to capitalize and amortize R&D expenditures over a five-year period (15 years if the research is performed outside the U.S.), takes effect for tax years beginning after Dec. 31, 2021.

## Limiting NOL Deductions

The TCJA also made major changes to the tax treatment of net operating losses (NOLs). Pre-TCJA rules generally let a business carry back a loss two years or carry it forward 20 years. In addition, these NOL carryovers and carrybacks were available to fully offset taxable income, unless the taxpayer was subject to AMT or other restrictions, such as section 382 limitations (see below). The TCJA eliminated NOL carrybacks, but it does allow indefinite carryforwards. The law also limits the amount of the deduction to 80 percent of taxable income.

These different treatments will result in two different categories that a business must track. NOLs carried forward from before the TCJA will need to be tracked for a 20-year lifetime, while those incurred after enactment of the new law should be accounted for separately.

For corporations that have undergone ownership changes, the TCJA might also affect the availability of NOLs and other carryforwards in the event of an ownership change. Section 382 limits the amount of income that can be offset by NOLs once the corporation has undergone an ownership change.

## Managing the TCJA's International Tax Provisions

The tax effect of cross-border growth is one of the most significant variables that CFOs must understand and interpret for their leadership teams. Doing business in another country doesn't just add another government's laws into the strategic mix — it also adds complexity and strategic opportunities to the company's U.S. tax planning. Now more than ever, CFOs must lead executives away from the tendency to view U.S. and foreign taxes as two separate issues and move them toward a global view of the company's tax position.

### Deemed Repatriation

For some time now, policy experts have argued that the U.S. misses out on significant revenues from multinationals because the tax impact of transferring profits back to the U.S. is prohibitive. The TCJA imposed a one-time tax on pre-2018 income held in offshore subsidiaries controlled by U.S. businesses. The rates are low by corporate tax standards: Cash and other liquid assets are taxed at 15 percent, while noncash assets are taxed at 8 percent. In addition, some credit is allowed for foreign taxes already paid on these assets, and the law permits the payment of this tax in installments over eight years.

### Global Intangible Low-Taxed Income (GILTI)

The GILTI provision was designed to reduce deferral of income earned outside the U.S. In a way, it's meant to address in the future the same issue as the deemed repatriation provision addressed with past overseas earnings.

The TCJA established a system of exemptions that allowed some earnings of a foreign corporation to be repatriated via dividends paid to a U.S. corporate shareholder without generating U.S. tax. GILTI attempts to limit abuse of the dividend exclusion. In short, the GILTI provision subjects to U.S. tax in the current year all income of a "controlled foreign corporation" (CFC) in excess of 10 percent of the net tax value of its depreciable (i.e., "tangible") assets. The law presumes that any dividends exceeding this percentage must be derived from intangible assets such as goodwill. This results in annual repatriation of foreign income, preventing U.S.-based multinationals from accumulating wealth offshore.

### Foreign-Derived Intangible Income (FDII)

The FDII rules are intended to create an incentive for U.S.-based multinationals to export to other countries. The provision works by calculating a baseline fixed rate of return on business assets — 10 percent on a company's qualified business asset investment (QBAI), or depreciable assets. Income that exceeds the 10-percent-of-QBAI baseline is then analyzed to determine how much is derived from foreign sources. That amount is the taxpayer's FDII for the tax year, and it is taxed at a favorable rate of 13.125 percent in the U.S., as opposed to the regular corporate income tax rate of 21 percent. QBAI and the calculation of the fixed rate of return are defined to some degree in the statutory language, but this will be another area subject to significant interpretation in IRS regulations.

### Base Erosion and Anti-Abuse Tax (BEAT)

The TCJA's BEAT rules attempt to reduce the permanent shifting of U.S. income to low-tax jurisdictions. The provision is intended to keep the U.S. in compliance with international efforts to prevent tax avoidance. If a U.S. multinational has income sufficient to trigger this tax (average annual gross receipts of $500 million or more), the computation starts with a calculation of BEAT-specific "modified taxable income." Basically, this is the corporation's taxable income for the current year plus otherwise deductible payments made to related foreign persons. Once modified taxable income is determined, the BEAT is applied at a rate that changes over the life of the provision. BEAT is calculated at 5 percent in 2018, 10 percent from 2019 to 2024, and 12.5 percent beginning in 2025.

### Transfer Pricing

One of the most significant changes of the TCJA was the reduction of the corporate tax rate to a flat 21 percent. This lower U.S. rate means that multinational companies with U.S. tax obligations may want to review their current choices and available options to see if there are alternatives within the rules that reduce their overall tax bill. Longer term, multinationals that are trying to calculate the most cost-effective location for new operations will need to factor the lower rates into their deliberations.

## M&A: Where It All Comes Into Play

At the big-picture level, the TCJA will affect mergers and acquisitions (M&A) tax due diligence at all levels for the foreseeable future. The law will likely become a dividing line in tax legislative history, much like the Tax Reform Act of 1986 (TRA 86).

Acquirers will now need to review compliance with the law as it existed pre- and post-TCJA. In addition, some provisions of the law may have a more direct impact on transactions in the near term, including:

### Interest Limitations

The new law limits the deductibility of interest expense in a taxable year to 30 percent of a business's taxable income, with certain adjustments. The impact of this change on a debt-financed transaction could affect the valuation of the deal.

These limitations won't hit everyone. Businesses with $25 million or less in gross receipts are not subject to the limitation, but that fact makes them an even greater risk when assessing past compliance at the due diligence phase. If a target company erroneously calculated its gross receipts as less than $25 million, the ramifications could be significant if the error is not discovered in a timely manner and valued appropriately into the deal.

### Tangible Asset Expensing

The TCJA includes several depreciation incentives, including a 100 percent bonus depreciation until 2022 and a permanent increase in the section 179 limitation on deductibility in the year the asset was placed in service. Depending on the type of company targeted, these provisions could make an asset acquisition much more desirable from a tax standpoint.

### Those Pesky NOLs Again ...

As noted above, the TCJA NOL provisions can play havoc with the valuation of an ownership change. What was already a complex part of transactional due diligence became significantly more complicated with the elimination of carrybacks and the change in carryforward lifespan of post-TCJA deals. Businesses will face the bookkeeping challenge of tracking NOL carryforwards with different lifetimes, as well as the tax compliance challenge of calculating section 382 limitations on the value of ownership shares.

## New Complexity for Financial Statement Tax Provision

The number and complexity of tax law changes in the TCJA will also affect financial statement tax provision for years to come. A few of the topics we have discussed above provide good examples of the types of concerns that will need to be addressed:

- **Deemed repatriation:** For multinationals, one key component of the reconciliation between financial statement income and taxable income is the "indefinite reinvestment assertion." This is a statement that management makes when it plans to hold financial statement income from a foreign subsidiary in that subsidiary and reinvest it in that subsidiary for the foreseeable future. Given the TCJA's provision that deems accumulated foreign earnings as automatically repatriated for taxable income purposes, affected businesses need to ask: Should the accounting assertion be modified? If not, how does the assertion change the tax provision?
- **NOL carryforwards:** The bifurcated treatment of pre- and post-TCJA NOLs will need to be reflected in the tax provision of the financial statements. The decrease in future tax rates has decreased the future value of NOLs that have been on the books since before the TCJA. On the other hand, the indefinite carryforward of later NOLs might make them eligible to offset deferred tax liabilities with indefinite lives.
- **GILTI calculation:** On top of the fact that the GILTI provision hasn't been completely fleshed out through final regulations, corporations are scrambling to figure out how GILTI affects financial statement income. The law requires that the full amount of GILTI be included in U.S. taxable income, but then it allows a deduction that reduces the effective tax rate. This process includes a forecast of U.S. taxable income that contains other temporary and permanent differences, such as NOL carryforward and carryback adjustments.

## Don't Go It Alone

The scope of the TCJA's legislative language was intimidating on its own, and the IRS is releasing rules that can run hundreds of pages just to explain one aspect of one provision. It's all but impossible for one person, or even a few knowledgeable professionals, to stay abreast of the implementation without some outside help. Seek advisors with the technical knowledge to understand the impact of each provision on your business, and the relationship skills to help you manage the changes.

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*At Armanino, our experts work closely with CFOs, as well as their legal and tax advisors, to ensure that companies implement an international expansion strategy that benefits the business, creates a streamlined global tax profile, and supports the achievement of short- and long-term growth goals. For more information on global expansion best practices, send us a note at info@armanino.com and we'll connect you with one of our international tax experts.*