How will recently expired US tax provisions affect your financial statements?

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In brief

A number of widely relevant US tax law provisions affecting businesses expired on December 31, 2013. That includes the research and development tax credit, work opportunity tax credit, increased expensing and bonus depreciation allowances, and certain favorable 'subpart F' provisions (i.e., the look-through treatment of payments between related controlled foreign corporations and exceptions for certain active financing income). The financial reporting implications of the expirations should be kept in mind both for calendar year-end and interim-period financial statements.

In detail

Accounting Standards Codification (ASC) Topic 740, *Income Taxes*, requires companies to measure current and deferred income taxes based upon the tax laws that are enacted as of the balance sheet date of the relevant reporting period. With respect to deferred tax assets and liabilities, that means measurement is based upon the enacted law for the period in which the temporary differences are expected to be realized or settled. Expired tax laws are not considered, nor would they be in statements prepared under International Financial Reporting Standards (IFRS).

Accordingly, some of the more significant impacts that should be considered with respect to these expired tax laws include:

- In calculating the annual estimated tax rate to be used for interim reporting purposes, benefits such as the research tax credit will no longer be included. The effective tax rate could also be increased if there is a significant effect related to the expired 'subpart F' provisions.
- If the effective tax rate for future periods is expected to be substantially different from the current effective tax rate, disclosure in management's discussion & analysis within SEC filings should be considered. Disclosure of significant potential effects on cash flows or liquidity should also be considered. Because many of these expired provisions have previously been retroactively reinstated, it may be appropriate to offer some forward-looking disclosure inclusive, of course, of the uncertainty with respect to the legislative environment.
- The expiration of the favorable subpart F provisions, applicable to foreign corporations with tax years beginning after December 31, 2013, should be considered in evaluating an indefinite reinvestment assertion. The expiration could result in potential subpart F inclusions that would arise from cross-border dividend (or certain other) payments at lower levels of the company's offshore structure. A company that has historically asserted indefinite reinvestment with respect to

a foreign subsidiary may not be able to maintain the assertion to the extent the difference in the company's book and tax bases in the foreign subsidiary will be taxable under subpart F. For example, without the look-through rule, distributions paid from a lower-tier foreign subsidiary to its foreign parent may result in a deemed dividend (i.e., subpart F income) to the US parent. Accordingly, the US parent may be unable to assert indefinite reinvestment on the book/tax basis difference related to the unremitted earnings in the lower-tier foreign subsidiary if dividends are expected to be paid after the expiration date of the subpart F look-though exception.

Where the active financing exception applies, it may be necessary to record US deferred taxes for a foreign subsidiary's inside basis temporary differences if their reversals will result in subpart F consequences.

See Example 11-17 in PwC's *Guide to Accounting for Income Taxes* for an illustration of the interaction of subpart F income and the indefinite reinvestment assertion.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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