Tax in transition

Five areas of focus as companies work to implement the TCJA

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Companies continue to work through challenges stemming from the 2017 tax reform law known as the Tax Cuts and Jobs Act (TCJA), which ushered in new rules, new compliance and reporting obligations, and new risks. The Internal Revenue Service and U.S. Department of the Treasury continue to issue and finalize guidance in key areas, but the rules are complex, and many companies are finding they still have unanswered questions.

The TCJA's rules affect various business functions and require greater communication among them. They also have implications for current, future and, in some cases, past tax years. Companies need to be mindful of effective dates, transitions and phase-in rules for different TCJA provisions as outlined in the statute and any Treasury or IRS implementing guidance. They also need to consider potential interactions among different provisions in the law that may have implications for tax planning and compliance.

To help with this process, the following highlights five areas that may continue to pose TCJA implementation challenges for companies.

1

Tax compliance and planning

The volume of TCJA changes means companies are facing increased compliance challenges. These include new and expanded federal, state and international tax computations; new disclosure statements; and new forms and schedules. Many of the TCJA's computations require new data feeds — which may necessitate increased investment in tools and resources to collect, analyze, store and submit the required information.

As the Treasury and IRS issue additional interpretive guidance, companies may need to revisit and adjust their return positions — new guidance may result in businesses needing to report uncertain tax positions (UTPs), change accounting methods or file amended returns. In addition, absent guidance on the level of authority for return positions, businesses must decide how to make reasonable estimates and document support for those decisions and computations.

Forward-thinking companies understand that compliance is an ongoing exercise. When evaluating TCJA compliance readiness, some questions to consider include:

1. Has the company sufficiently planned for the increased filing obligations and computations stemming from the TCJA? Has the company considered the ability to offset unfavorable compliance changes with new planning opportunities?
2. Has the company considered how it will manage the accounting method implications, including methods implication for controlled foreign corporations (CFCs), of the TCJA's changes both for tax year 2018 and prospectively? Does the company have a plan to address and/or mitigate controversy as the rules continue to change?
3. Are the updates made by the company to existing processes and systems proving sufficient to manage the TCJA's increased data and reporting requirements?
4. How is the company assessing whether its investments in people, process and technology to implement and operationalize tax reform can scale to meet emerging needs?

2

Tax controversy

Regulatory guidance related to the TCJA is still being finalized, and some of the key rules implementing the law remain in flux. For businesses, this means continuing uncertainty, increased compliance burdens and the potential for unintentional errors in the interpretation of complex and evolving laws.

For many taxpayers, the eventual finalization of TCJA guidance may lead to changes to financial statement tax reserves, UTP disclosures on tax return filings and potential amended returns. It could also lead to protracted tax controversies related to post-TCJA tax return years. Now, more than ever, it is important for companies to thoroughly document tax return positions, particularly in areas where interpretation of the law is still evolving. Once involved in a tax controversy, it is also important to understand the available IRS procedures and options to effectively resolve disputes and manage audits. As companies prepare for anticipated controversy, some implementation questions include:

1. What steps can the company take to properly document its return positions, especially in areas in which regulatory guidance is unclear or not yet finalized, or where information may be limited and estimates must be used?
2. What should the company consider proactively disclosing to the IRS regarding its tax return positions?
3. What systems does the company have in place to manage and coordinate its existing tax controversies?

3

International tax

The TCJA's changes to the US international tax system have required businesses to revisit their structures, supply chains and overall tax planning. While Treasury has issued "final" regulatory guidance on several key international tax provisions, guidance as to others remains merely proposed. And businesses must wrestle with how the new rules interact with each other and with long-standing Internal Revenue Code (IRC) rules.

Companies are also preparing for a potential uptick in tax controversy related to the TCJA's international provisions as the IRS begins to examine how they have applied the new rules, particularly around the transition tax.

Treasury is expected to issue more international tax guidance, but, in the meantime, some implementation questions include:

1. What transactions, internal or external, could potentially accelerate the remaining "installments" of the transition tax liability of a US multinational enterprise (US MNE)?
2. How do the earnings stripping rules apply to CFCs?
3. What operational changes, if any, might a US MNE make in view of the proposed "high-taxed" global intangible low-taxed income (GILTI) exception — should Treasury confirm the availability of that exception?
4. How might a US MNE address US and non-US taxes on its GILTI?
5. What operational changes (if any) should a US MNE make to ensure that it will satisfy the documentation requirements needed for the foreign-derived intangible income (FDII) deduction?

4

Executive compensation

Companies continue to face complexities related to the tax treatment of executive compensation and fringe benefits that came along with tax reform. The TCJA expanded the Section 162(m) $1m deduction limit that applies to compensation paid to top executives of publicly held companies for tax years beginning after December 31, 2017. Private companies that issue public debt, as well as foreign private issuers, are subject to the limitation if they are required to file certain reports with the SEC. Changes in the definitions may also pull in other issuers that do not have publicly traded common stock but are subject to other SEC reporting requirements. Chief financial officers (CFOs) had previously been excluded from the category of "covered employees" under Section 162(m) but are now explicitly included, as are other executive officers who meet the definition of a named executive officer for any period, even if they terminate employment or are no longer in a "proxy officer" position. Thus, the category of covered employees will grow over time.

The law included transition relief that allows employers to rely on prior law for compensation arrangements governed by a written binding contract in effect on November 2, 2017, if it was not materially modified subsequently. As they analyze the applicability of this transition relief, companies need to have proper documentation and record-keeping processes in place. If they have arrangements under a binding contract, they need to make sure any changes are not "material modifications." Applying the compensation deduction limitation may also be particularly challenging for some corporate structures in which compensation payments are made among related entities, as well as for companies pursuing mergers and acquisitions. Proposed regulations have been issued that eliminate exceptions from the $1 million deduction limit for compensation paid by certain partnerships (in a so-called Up-C structure). The proposed regulations also eliminate any transition rules for companies that become publicly held through an initial public offering or otherwise. These regulatory changes include written binding contract exceptions.

The TCJA also eliminated employer deductions for a variety of employee fringe benefits and work-related expenses, such as membership dues, commuting expenses (including some employer-provided parking) and employer-provided moving expenses.

These changes to the tax treatment of executive compensation paid by companies and to fringe benefits raise the following questions:

1. What companies are pulled into the new definition of "publicly held" for purposes of the $1m deduction limit?
2. For companies with existing compensation awards that continue to be deductible under the binding contract exception, is there proper documentation to support this position?
3. Given the growing number of employees who will be added over time to the "covered employee" group as a result of attrition or corporate transactions, is the company taking steps to track the members of this group of employees?
4. How are the company's compensation programs being structured to account for the TCJA's changes?
5. What changes should be made to the company's existing policies and benefit programs to account for the law's changes to the deductibility of fringe benefits?

See "*From the C-suite to the parking lot — what employers should keep in mind when implementing the TCJA's compensation and benefits changes*," July 2019.

5

State taxation

Every state that has an income tax relies in some way on the IRC to determine the state tax base. Some use the taxpayer's determination of federal gross income, adjusted gross income or taxable income as their starting point with specific subtractions or adjustments, while others incorporate specific IRC provisions.

The 50 states differ on their approaches to TCJA conformity. In most cases, states have conformed to provisions that increase revenues. Few states have provided rate reductions consistent with the TCJA's base expansion trade-off, resulting in a relative increase in the state tax burden for most businesses. Adding to the complexity, some states have reversed their positions on TCJA conformity, creating great uncertainty in state tax forecasting.

Businesses should continue to monitor state legislative and administrative responses to federal tax conformity, understand the impact on their multistate tax liabilities and consider the steps they should take to respond.

Among the key questions to ask:

1. Should a company join in the state legislative IRC conformity discussions that are continuing to unfold? Which of the company's legal entities own the foreign subsidiaries that are subject to the federal transition tax, GILTI, FDII, and base erosion and anti-abuse tax, and in which states might they be subject to those taxes?
2. Do the states in which the company operates administer these international tax provisions in the same way as the federal government? Do these provisions conflict with the states' existing base erosion provisions (such as their related-party add-back and tax haven rules), and are the states prohibited by other laws (including the US and state constitutions, as well as statutory limitations), from taking the federal government's approach?
3. How have the states in which the business operates conformed to the TCJA's 30% business interest expense limitation rule? Is it determined on a consolidated basis and the same way as the federal limitation, or does the state require a different, separate computation? What is the state tax impact on the business's existing debt structure, including on existing intracompany debt, and what other limitations do those states impose on interest deductibility?

Conclusion

These questions provide a glimpse into some of the complexity companies face implementing the TCJA. Issues will continue to emerge as the rules are finalized and companies try to make planning decisions while applying guidance that continues to evolve. Companies need to monitor and evaluate guidance as it is issued, as well as consider educating and engaging with policymakers on implementation challenges affecting their business operations.

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