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Impact of US Tax Reform 2017 on Financial statements of corporates and Economy

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1. INTRODUCTION

On December 22, 2017, the President of the United States of America, signed into law TCJA (commonly known as "tax reform"). The Act amended the Internal revenue code of 1986 which was advocated by congressional Republicans and Trump Administration. TCJA or Tax cuts and jobs act of 2017 is a revenue act which introduces a host of changes across the tax code of the US, including but not limited to:

a. The corporate tax rate reduction from 35% to 21%;
b. The "transition tax" associated with the deemed repatriation of foreign earnings;
c. Repeal of the corporate AMT provision etc.

Other aspects of the act include Tax reduction for individuals, increase in standard deduction and family tax credits, elimination of personal exemptions, Reduction of Alternative Minimum Tax.

2. PURPOSE

A significant impact of the Act can be noted on the financial statements of the entities. The reason being ASC 740 requires recognition of tax effects of new tax legislation. This event is expected to have a material impact on the financial statements of most entities, as ASC 740 requires preparers to recognize the tax effects of new tax legislation in the reporting period in which the legislation is enacted, and therefore entities will be required to reflect the tax law changes in their current period financial statements.

3. HOW IS IT IMPACTING THE FINANCIAL STATEMENTS?

Per ASC Topic 740, changes to applicable tax law and rates should be accounted for in the period in which the changes are enacted. Since the bill was signed on December 22, 2017, the impact of the changes are recorded in 2017 financial statements of the calendar year entity. Below is the Accounting impact of changes under RCJA, 2017.

- Impact on income statement-Deferred tax assets and liabilities which were currently valued at 35% need to be revalued at 21% on a retrospective basis. The impact would be recorded as a component of current income tax expense

- Impact of taxes on undistributed foreign earnings- Undistributed foreign earning are taxed at federal level only when repatriated to the US. If a company anticipates repatriation of such earning, it would record deferred tax on such amount.

However, prior to the tax reform, instead of recording DTL, companies assertedthat the foreign earnings will never be repatriated to the US. With the reduction of US taxes and increased incentives on repatriation of foreign earning, companies might reconsider repatriation plans which would further consider recording of DTLs.

Additionally, A minimum tax (5 percent in 2018 and 10 percent in 2019) on large corporations ($500 million or more of average gross receipts) based in part on deductible payments made to related foreign persons is enacted to curtail base erosion

- The threshold for accrual method of accounting has been increased. This means that the criteria for use of cash method and requirement to keep inventory has been relaxed.

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- Corporate dividends deduction- The 80 percent corporate dividends received deduction is reduced to 65 percent and the 70 percent dividends received deduction is reduced to 50 percent for tax years beginning after Dec. 31, 2017. This would have a negative impact on the earnings as it would cause an increase the tax payable amount.

4. IMPACT ON ECONOMY

GDP: The TCJA is estimated to increase the level of GDP, on average, by 1.2% over the first five years (2018–22), 0.8% over the second five years (2023–27) and 0.2% in the long run relative to its level in pre-TCJA baseline projections. When measured relative to the $19.4 trillion US economy in 2017, these estimates imply that the TCJA will increase the size of the US economy by an average of $235 billion over the first five years (2018–22) and by an average of $155 billion over the second five years (2023–27).

Investment: The level of investment is estimated to increase, on average, 7.3% over the first five years (2018–22) relative to pre-TCJA baseline projections but decrease 6.9% relative to pre-TCJA baseline projections over the second five years (2023–27).

Labour Supply and wages: The labour supply is estimated to increase, on average, 1.5% over the first five years (2018–22) and 0.8% over the second five years (2023–27) relative to pre-TCJA baseline projections. This is in large part driven by the lower individual income tax rates and the corresponding reduction in the average marginal tax rate for wages and salaries for the first eight years after tax reform.

5. CONCLUSION

As per the Tax Policy Center, bottom 80% of taxpayers (income under $149,400)are estimated to receive 35% of the benefit in 2018, 34% in 2025 and none of the benefit in 2027, with some groups incurring costs. TPC also estimated 72% of taxpayers would be adversely impacted in 2019 and beyond, if the tax cuts are paid for by spending cuts separate from the legislation, as most spending cuts would impact lower- to middle-income taxpayers and outweigh the benefits from the tax cuts. Bloomberg reported in March 2018 that an estimated 60% of corporate tax savings were going to shareholders, while 15% was going to employees, based on analysis of 51 S&P 500 companies.

Apart from the reduction of tax rate to 21%, there are plenty of other reforms which could significantly impact the effective tax rate of corporates. Examples of such reforms include proposed limitation or disallowance of many deductions, such as the repeal of domestic production activities deduction and elimination of most entertainment related expenses. However, there are such reforms as well which will have a temporary impact and would only impact the value of DTLs and DTAs

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