U.S. Tax Reform Raises the Stakes for Data Management at MNCs

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VERTEX

SUMMARY

The Tax Cuts and Jobs Act of 2017 (TCJA) will go down in history as the most sweeping piece of U.S. tax legislation in more than 30 years. Nearly every U.S. taxpayer will be impacted by it for years to come. Multinational businesses are no exception. For some, TCJA has completely altered the tax landscape in which they have operated for decades. And though scholars, practitioners, and politicians might debate for some time whether TCJA is, in fact, real tax reform or just a rate cut, one thing is certain — TCJA is not tax simplification. At a minimum, the new calculations it introduced are complex, data-intensive and extensively intertwined. This truly digital-age reform highlights more than ever the need for tax departments to advance their capabilities around the governance, control and management of tax data.

THE CHANGING TAX ENVIRONMENT PRE-TCJA

Recent years have seen more scrutiny than ever on the global tax posture of multinational businesses. From EU state aid inquiries, to the OECD's Base Erosion and Profit Shifting (BEPS) initiative and stateless income discussions, to social media shaming campaigns driven by non-government entities, pressure has been building on companies to defend their tax reputations. Combine that with the political desire to make the U.S. a more attractive landscape in which to conduct a global business, and the seeds for U.S. tax reform were firmly planted. TCJA, in large part, is the U.S. response to this changing environment.

The impact of TCJA for multinational businesses was as immediate as it was significant. Within weeks of TCJA's introduction in November, 2017, tax departments moved from speculating about tax reform to estimating (as best they could) the immediate impact on their companies' 2017 financial statements. And now, those tax departments' efforts are threefold:

- fine-tuning and adjusting their year-end estimates,
- calculating the ultimate impact of the changes while collating the data needed, and
- developing complex models to inform their future tax planning activity

This changing tax legislative environment means that the tax department's role has been changing as well. The C-suite more than ever sees an elevated role for the tax department. This role is much more than a tax compliance and reporting shop. Now it's all about exploring options -- conducting complex scenario planning as a strategic business advisor and carefully managing tax liability and reputation risks. And all this must be done amid ongoing legislative changes yet to come.

The first step in achieving this expanded role is to understand the changes. The following pages provide an overview of key changes impacting corporations, and the data management challenges they present.

DATA MANAGEMENT CHALLENGES OF TCJA — A SNAPSHOT

KEY TCJA CHANGES IMPACTING CORPORATIONS

PROVISION	TECHNICAL SUMMARY	DATA MANAGEMENT CHALLENGES
Corporate tax rate change	Starting Jan 1, 2018, C Corporations are subject to a flat tax of 21%. Fiscal-year filers will use a blended tax rate based on the number of days pre and post January 1, 2018.	• Future challenge will arise around applying the correct rate when accounting for the true-up calculations related to pre-TCJA periods. • Additional data may be needed to support new disclosures required by the SEC, especially around the true up of the estimates permitted under SAB 118.
Full expensing of business assets	100% deduction ("bonus depreciation") of qualifying new and used property placed in service on or after Sept. 27, 2017 and before Jan 1, 2023. The deduction decreases over the next four years until reaching 20% for property placed in service after 2025.	• The increased deductions could further complicate the book versus tax basis reconciliation needed to support deferred tax assets/liabilities. More granular data may be needed to perform these reconciliations. Lack of state tax conformity will also make the state deferred tax reconciliations more cumbersome.
Limitation on business interest deduction	Business interest expense deduction on both related and unrelated party debt is limited to 30% of EBITDA (switches to EBIT in 2022). Unused expense deduction may be carried forward indefinitely.	• Detailed data will be needed to calculate EBITDA/EBIT. The limitations may also impact other CFC-related calculations (like Subpart F and GILTI) as well as valuation allowance considerations.
Changes to Net Operating Loss (NOL) limitation	The deduction for NOLs arising after Dec 21, 2017 is limited to 80% of taxable income. No carryback is allowed, only carryforward.	• With unlimited carryforward potential, accurate tracking of both pre- and post-TCJA NOLs has become even more important to support utilization and related deferred tax assets. Two different NOL aging schedules will now be needed. It is also likely that the US tax return will now include a new, supporting form. Updates to valuation allowance planning for NOL carryforwards and limitations will also be needed.
Alternative Minimum Tax (AMT) repeal	The Corporate AMT is repealed. Companies with AMT credit carryforwards may be eligible for a partial refundable credit against regular tax liability in 2018 through 2019 with the remaining fully deductible in 2021.	• Make sure you can defend the credit carryovers you have and still be able to do the AMT calculate to be able to get refunds.
Domestic production activities deduction (§199) repeal	The manufacturing deduction is repealed.	
Dividends received deduction changes	Effective Jan 1, 2018, the deduction for domestic dividends decreases from 70% to 50% (for less-than 20%-owned corporations) and from 80% to 65% (for less-than-80%-owned corporations).	
Capitalization and amortization of research and development expenses	Beginning in 2022, certain research or experimental expenditures must be capitalized and amortized.	• For impacted companies, new amortization schedules must be maintained to track basis differences and support the new deferred tax asset.

KEY TCJA CHANGES IMPACTING CORPORATIONS (CONT'D)

PROVISION	TECHNICAL SUMMARY	DATA MANAGEMENT CHALLENGES
Excessive employee compensation	Beginning in 2018, the amount of compensation deductible for certain named executives has changed by: • repealing the exception for performance-based compensation, and • expanding the companies and employees covered by the rule.	• Details about executive-level compensation plans and payments are typically not kept in the core financial systems. Additional detail will be needed to calculate the broadened disallowance.
Disallowance of business entertainment expenses	Starting Jan 1, 2018, the business entertainment expense deduction limitation increases from 50% to 100%.	• Now that entertainment expenses are no longer deductible, data will be needed to segregate them from the meal expenses that are still 50% deductible. Many companies currently account for these items in a single account.
New credit for wages paid to employees while on Family and Medical Leave (FMLA) pay	Starting in 2018, employers who pay at least 50% of an employee's regular wages during family and medical leave can claim a credit of 12.5% of the wages paid for up to 12 weeks.	• New, detailed data will be needed to calculate this credit. It is likely that this data will have to come from outside the core financial systems.

KEY TCJA U.S. INTERNATIONAL TAX CHANGES

PROVISION	SUMMARY	DATA MANAGEMENT CHALLENGES
Switch from modified worldwide system to a partial participation exemption system	Starting in 2018, dividends received from controlled foreign corporations (CFCs) receive a 100% dividends-received deduction (DRD). Accordingly, no foreign tax credit is allowed for dividends that qualify for the DRD. As a result of the switch, a one-time "toll tax" is imposed on the US shareholders' share of their CFCs' accumulated earnings and profits that were not previously taxed in the US. This tax is calculated at the rate of 15.5% for earnings that are in the form of cash and 8% for all other earnings. An election can be made to pay the tax in 8 installments by making the first payment by the original due date of the tax return and including a statement with the return when filed.	• Calculating the one-time "toll tax" to make this switch requires the accumulation of large amounts of data, some dating back to 1986. This data feeds into the calculation of earning and profits, and will also be needed to support the classification of the earnings that are attributable to cash versus other. Calendar-year taxpayers have made initial calculations but may need additional data to refine those before the year is over.
Foreign derived intangible income (FDII) deduction	Designed to encourage the retention of intellectual property in the U.S., the FDII rules provide a deduction for foreign-derived income from those intangibles to result in a favorable effective tax rate of 13.125% for 2018 through 2025, increasing to 16.406% in 2026.	• The FDII calculations are very complex and detailed data will be needed to support them. The existing lack of clarity around some definitions in this area could require taxpayers to perform multiple calculations each needing slightly different data and scenarios.

KEY TCJA U.S. INTERNATIONAL TAX CHANGES (CONT'D)

PROVISION	SUMMARY	DATA MANAGEMENT CHALLENGES
Global intangible low-taxed income (GILTI)	Under the GILTI regime, beginning in 2018 a US shareholder will recognize their share of a CFC's net income derived from intellectual property in a low-tax jurisdiction (with certain exclusions) minus a deemed 10% return on its aggregate tangible property. A deduction against GILTI will mean that the effective tax rate for GILTI is 10.5% from Jan 1, 2018 through 2025, and 13.125% thereafter. Foreign tax credits may be able to offset GILTI, but only up to 80% of the GILTI amount.	• GILTI also requires detailed and complex calculations that will require data that may not be readily available. The income inclusion is calculated using US tax principles, as opposed to the traditional earnings and profits calculation that have historically been used to calculate Subpart F inclusions, which may still need to be calculated. These calculations are data intensive. • To take a foreign tax credit against GILTI, additional complex calculations and detailed data will be needed. This credit calculation will require separate tracking from other foreign tax credits as GILTI is its own basket. • Currently companies have a choice to treat GILTI as a permanent or temporary adjustment for tax provision purposes. Companies will want to use the data gathered to calculate GILTI to model which treatment to use. If choosing to treat it as a deferred tax item, it will need to be carefully tracked. Advisors have recommended that until a treatment is chosen GILTI must be treated as a current expense. Once deferred treatment is chosen, it cannot be changed.
Base erosion anti-abuse tax (BEAT)	Beginning in 2018, corporations who make "base erosion payments" will be subject to a minimum tax (5% for 2018, 10% for 2019 through 2025 and 12.5% thereafter) on their modified taxable income. BEAT is essentially the opposite of the FDII deduction.	• This calculation will require detailed data about base erosion payments. Those related party payments will need to be reconciled to the data reported on Forms 5471/5472 as well as the transfer pricing documentations and Country-by-Country reports.
Expanded definition of CFC for Subpart F purposes	Expanded stock attribution rules mean that some US shareholders of CFCs may now be subject to Subpart F and GILTI inclusion rules. In addition, companies may have more CFCs than in prior years.	• New data will be needed to calculate Subpart F and GILT income for affected taxpayers.
Hybrid transactions	Starting in 2018, disqualified related party payments (e.g. for interest and royalties) pursuant to a hybrid transaction (whereby jurisdictions treat the same transaction differently) will be nondeductible.	• The details of these transactions will need to be gathered in order to properly identify them as relating to hybrid transactions. It is very likely that the data to make the determination will not exist within the core financial systems.

WHAT TO LOOK FOR IN 2018 AND BEYOND

While much of the TCJA tidal wave outlined above is impacting corporations today, there is more change to come in every area of income tax.

Federal

While the IRS has already issued some preliminary notices describing their intention to address specific issues with regulations, formalized guidance for most of the TCJA provisions is still forthcoming. There will also likely be Technical Corrections enacted during 2018 to address any errors and unintended consequences of TCJA. Tax departments should pay special attention to TCJA changes with later effective dates, calculation changes that are triggered by specific dates, and to those provisions that are scheduled to sunset.

State

Responses to TCJA by U.S. states will also add another level of complexity. The most immediate responses will relate to changes states will make based on whether or not they are automatic conformity states. Those that automatically conform are evaluating whether to "de-couple" from certain federal changes. Those that do not automatically conform are evaluating which, if any, provisions to adopt. In addition, if history is any indication, U.S. tax reform will likely kick off a round of separate significant state-tax reform as state legislators adjust to altered tax revenue streams. Some states could experience a perceived "windfall" of revenue from multinational companies who may then lobby for some state corporate tax reform.

Global

Just as U.S. states will, other countries are likely to respond to U.S. tax reform and enact legislation aimed at protecting their own economies, or increase audit pressure should their countries be "base eroded" if the U.S. multinational companies bring back intellectual property and cash to the U.S. There is already talk of a "race to the bottom" to be the country with the lowest corporate income tax. Given that the rest of the world relies predominantly on VAT for tax revenue, taxpayers can anticipate that there will be increases in VAT rates to cover the deficit if corporate tax rates should drop further.

A NEW DAY FOR DATA MANAGEMENT

The changes brought about by TCJA are as diverse as they are abundant (and complex). They will require tax departments to perform numerous new, detailed, and complex calculations – many of which will significantly challenge the department's management of tax data.

The data management challenges put under the spotlight by TCJA include:

- gathering new data, or data at a more granular level,
- harnessing multiple sets of data to adeptly respond to shifts resulting from yet-to-be issued guidance,
- accessing the new data required for new tax forms and financial reporting disclosures, some of which may not be readily available in the company's financial systems,
- leveraging data across numerous new calculations that are interconnected,
- tracking of and accounting for new carryovers or other limitations, and
- utilizing new data and calculations in the tax planning functions.

Yesterday's approach to managing data will likely not suffice in this new era.

In the end, there will be significant impacts to compliance processes, accounting for income tax processes, tax planning processes, as well as new and increased audit scrutiny. Without adequate data management practices and the technology to support them (and the improved governance and control they provide), tax departments will have difficulty keeping pace with TCJA changes.

EMBRACING NEW TECHNOLOGY

Tax departments will not only need to put their data management processes under severe scrutiny, but they must also evaluate their technology and systems. Yesterday's approach to managing data will likely not suffice in this new era. Businesses will require greater speed, transparency, and control over data. Employing tax data management technology will be a crucial step toward arming the tax department for the challenges of TCJA.

While identifying and getting access to the data needed is the first step, it's the effective management of that data that will elevate the capabilities of the tax department, including the governance and control over data and processes. In other words, it won't be enough to just get data. The tax department must be able to leverage new and highly detailed data into the new calculations. The right data management technology will also allow the tax function to retain control over the data, which enables them to efficiently maintain control and governance over any new tax processes, calculations, and reporting required in response to TCJA.

TECHNOLOGY MUST-HAVE'S

To be most impactful, tax departments must look for data management technology that enables them to:

- **Respond in a timely manner** and with confidence, to ongoing legislative changes and guidance from tax authorities around the globe.
- **Help the C-suite** understand the impact of TCJA on the company's current operating model as well as options for future operations or restructuring.
- **Improve visibility** to the new and changing drivers of the company's effective tax rate (ETR) and to easily forecast them.
- **Support a "touch once" approach** to managing the data used across all tax processes globally, providing internal confidence of data validation and accuracy, plus the controls and governance demanded by the C-suite, external audit firms, internal audit teams, and jurisdiction tax auditors.
- **Become an improved steward and strategist,** a true strategic business partner in this dynamic tax and trade environment.
- **Respond to operational requests** to tax sensitize data for what-if scenario planning and forecasting of organizational restructuring in response to legislative changes.

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- **Drive process improvements** allowing the tax team to meet the new compliance demands more efficiently which will allow more time to serve as the strategic business partner and catalyst the C-suite needs today.
- **Provide tax transparency** and reconciliation through global enterprise-level business intelligence tools.
- **Retain the data** and a full record of transformations and calculations for future audits.

NEW DAY. NEW WAY.

The complexities that TCJA introduced into the tax landscape for multinational companies cannot be overstated. The stakes are high. Reputation. Risk. Financial performance. Improved data management, control, and governance have been elevated from ideals to tablestakes in order for the tax function to be the valued business partner the C-suite now needs in the post-TCJA era.

ABOUT THE AUTHOR

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Prior to joining Vertex, Nancy was a Tax Director at 21st Century/Farmers Insurance and MBNA America Bank. She was also a Supervising Tax Analyst in the Philadelphia office of KPMG. Nancy's areas of expertise include federal, state and local corporate income taxation and accounting for income taxes. Her particular focus has been on tax for the financial services industry. Nancy is a licensed CPA, has a B.S. in Business Administration from Drexel University and a M.S. in Taxation from Widener University.

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