Tax reform: Key areas for audit committee focus

Board perspectives

While the new federal tax law has generally been well received by the business community, tax professionals have concerns about the significant uncertainty regarding key provisions of the new law and are seeking guidance and/or technical corrections from the U.S. Department of the Treasury and Congress. In the absence of timely guidance from the government, tax and finance departments will face a number of challenges in preparing the company's remaining interim and year-end financial statements and tax return filings. Below, we have identified some of the key challenges that warrant the attention of the audit committee.

International tax provisions. The new law contains five new international tax provisions aimed at curbing the erosion of the U.S. tax base. These new provisions are highly complex, sometimes ambiguous, and interrelated—and will require the company to develop new data to perform the required calculations. Uncertainty regarding how to implement these provisions has placed many tax departments under tremendous pressure to provide insights regarding their impact over the near and longer term so that companies can plan accordingly. At the same time, tax departments need to calculate tax obligations for upcoming quarterly filings. Pending the issuance of technical corrections or formal guidance, the consensus seems to be that if a provision of the tax law seems broken, but clear, tax departments should follow the law as written. However, where the law is ambiguous or unclear, tax departments should do their best to determine the law's meaning, take a reasonable position, use best estimates, and be consistent.

Effective tax rates. Given the uncertainty around the new law and the new data requirements, many tax and finance departments are also struggling to determine their company's effective tax rate (ETR). Developing ETR projection models has proven extremely difficult. The key is to understand the baseline—i.e., "if we did nothing, what would our ETR be?" and then determine what options might be available to adjust the company's ETR. Obviously, these are business decisions for the company—not just the tax department. To give themselves some leeway, some chief financial officers are presenting their company's ETR as a range spanning several percentage points and making their best estimate of ETR each quarter based on the facts and circumstances.

Staff Accounting Bulletin 118 adjustments. Pursuant to Staff Accounting Bulletin 118, many companies provided provisional estimates of the new law's tax effects in their year-end financial statements. Because of this, balances provisionally recorded as of year-end must be adjusted each quarter in 2018 as companies obtain actual data or detailed forecasts.

Strategic implications. Clearly, the new tax law has important strategic considerations for companies and their boards, and audit committee members may be in a unique position to add value in these discussions. For example, changes in the deductibility of interest and changes in cash flow may cause a company to reassess its capital structure and mix of debt and equity; capital allocation decisions, including decisions about investment in the business versus returning cash to shareholders, might need to be revisited in light of the increased liquidity resulting from lower tax rates and/or repatriation of foreign earnings; and reassessment of the corporate footprint and intra-group pricing arrangements might be appropriate in light of the new international provisions.

It's important to keep in mind that U.S. tax reform is not happening in a vacuum; it's part of a global story about base erosion and profit shifting and country-by-country tax reporting—and that means more transparency. Reputation risk and good corporate citizenship are now part of company and audit committee discussions about tax strategy and planning.

Finally, a critical consideration for every audit committee is whether management, including the tax and finance departments, have the resources and talent required to meet the demands of implementing the new tax law while also implementing important new accounting standards on revenue recognition, leases, and financial instruments.

For more on U.S. tax reform, visit kpmg.com.

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Contact us

kpmg.com/blc
T: 1-800-808-5764
E: us-kpmgmktblc@kpmg.com

kpmg.com/socialmedia