



## US tax changes update

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Headline corporation tax rate falls from 35% to 21%	Moving towards territorial rather than international taxation	A one-time repatriation tax of 15.5% for cash and 8% for other assets held outside the US	Deduction of 100% capex in year 1 (at least until 2022)	BEPS versus BEAT	BEAT – Base Erosion and Anti-Avoidance Tax on intra company transfer pricing
BEAT – limitations of interest deductibility to 30% of Tax calculated EBITDA; from 2022 30% of EBIT	Net Operating Losses carry forward at 21% indefinitely – but limited to 80% of income	Limits on tax deductibility of executive compensation and staff expenses	Impact on financial analysis	Impact on valuation	Impact on financial modeling

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## Bonus depreciation / Capex and Similar Deductions

Certain research or experimental expenditures to be expensed until 2021, from 2022 they must be amortized over 5 years (or 15 years if research is carried out outside the United States)

Year	% deduction of capex
2018	100%
2019	100%
2020	100%
2021	100%
2022	100%
2023	80%
2024	60%
2025	40%
2026	20%
2027	0%

Applies to both new and used assets purchased

Applies to most tangible assets, most intangible not included

Remaining percentage depreciated normally from 2023

Will create an incentive to pursue asset M&A transactions

## BEAT and BEPS

### Company threshold

- At least \$500m in domestic sales
- Foreign deduction / domestic deductions => 3%

### Transfer payments

- e.g. royalties and management fees to foreign corporations
- BEAT tax of 5% in 2018, 10% from 2019, and 12.5% from 2026

### Interest deductibility

- Interest expense limited to 30% of EBITDA from 2018
- 30% of EBIT from 2022
- Will impact existing as well as new debt

### Global reach

- An OECD initiative
- Most countries will institute transfer pricing and interest deduction limits

## NOL Carry Backs and Carry Forwards

Issue	Commentary
Loss carry backs banned	Only effective from year ends on Dec. 31 2017 onwards.
New tax rate	Calculate carry forwards based on the new tax rate
Carry forward losses indefinitely	Previously corporations had 20 years to capture carry forwards, now they can be carried forward indefinitely for tax losses after Dec. 31 2017
Limitations on tax loss use	For tax losses created after Dec. 31 2017 only 80% of taxable income can be shielded. Historical tax losses can be 100% utilized
Tracking tax loss carry forwards	Track both old and newly created tax losses to be able to correctly model them
Tax losses value	May increase value as they are now indefinite, or decrease them due to 80% limit
Exceptions	Farming and insurance as well as some others

## Historical International Earnings

Adjusted approach	For non-patriated foreign earnings	Carry forwards
<ul style="list-style-type: none"> <li>Previously worldwide earnings taxed, but only paid on repatriation</li> <li>Moving to a territorial based system</li> </ul>	<ul style="list-style-type: none"> <li>Monetary assets 15.5%</li> <li>Other assets 8%</li> <li>Payable over 8 years</li> </ul>	<ul style="list-style-type: none"> <li>Existing carry forwards can be used to offset the one-time transition tax</li> </ul>

## Foreign Earnings Going Forward

Foreign Subsidiaries	Direct Foreign Earnings
Minimum tax on 50% (moving to 62.5% in 2026) of Global Intangible Low-Taxed Income (GILTI)	Minimum tax on 62.5% (moving to 78.125% in 2026) of Foreign Derived Intangible Income (FDII)
Usually GILTI = all foreign income over a return on tangible assets (10% of depreciated tax basis)	Income earned directly from foreign sales, leases, licenses, and services, reduced by a 10% return on deprec. assets
A lower effective tax rate on foreign derived intangible income (10.5% = 21% x 50%)	13.125% effective tax rate (increasing to 16.406% from 2026)
Tax credit allowed of up to 80% of foreign taxes paid	

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## Other changes (not an exhaustive list)

- Deduction limit on top executive compensation (\$1m)
- General tightening up of employee expense deductions
- Carried interest changes – relevant for private equity
- Other changes to personal taxes and some specific changes for different industries
- No Alternative Minimum Tax (AMT)

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## US Tax Code Financial Statement Impacts

Effective tax rate	Marginal tax rate	Deferred taxes
<ul style="list-style-type: none"> <li>• Will fall going forward</li> <li>• 21% plus state taxes and permanent differences</li> </ul>	<ul style="list-style-type: none"> <li>• Will fall to 21% plus relevant state taxes</li> </ul>	<ul style="list-style-type: none"> <li>• These will be written down</li> <li>• Will impact leverage ratios</li> <li>• Will impact OCI in some cases</li> </ul>

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## Modeling / Valuation Impacts

Item	Commentary
Net operating losses	Model two types: old and new both with a lower tax rate, but 80% limit only on the new NOLs
Model cash taxes separately	Particularly while depreciation deduction is 100%. Remember the bonus depreciation deduction declines over time. Will increase cash for firms with high asset intensity
M&A	Depreciation deductions will increase the attractiveness of asset deals and 338 elections. NOL changes will require amendments to valuation models
LBO models	Interest expense deduction limited to 30% of EBITDA and 30% of EBIT from 2022 will require LBO models to be updated
Cash flow forecasts	One-time transition tax to be paid over 8 years will need to be modeled
DCF models	Tax rates change over time so careful consideration will need to be made for terminal value tax rates. Changing cash taxes will also impact value
Credit models	Changing SE, and deferred taxes will impact leverage ratios

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## Modeling taxes

Item	Commentary
Depreciation	<ul style="list-style-type: none"> <li>Assume pre-tax reform D&amp;A runs off over time</li> <li>Upfront expensing of new capex - 100% until 2023 when reduces by 20% per year (e.g. 80% in 2024 and 60% in 2025)</li> <li>When new capex drops down to 80% remainder depreciated normally</li> </ul>
Interest deduction	<ul style="list-style-type: none"> <li>Minimum of 30% of tax EBITDA (to 2021 or EBIT from 2022) or interest expense whichever is smaller</li> <li>Carry over used interest deduction to later years</li> </ul>
Net Operating Losses	<ul style="list-style-type: none"> <li>Pre-2018 NOLs use as normal</li> <li>Post 2018 NOLs cap at usage at 80% of taxable income in any year</li> <li>Model new and old NOLs separately</li> </ul>
Taxes	<ul style="list-style-type: none"> <li>Federal tax rate at 21%</li> <li>Add relevant state taxes</li> </ul>