

# Financial Statements

The tax function is under increasing pressure. Legislative changes and new disclosure rules will make accounting for income taxes more complex and challenging. Plus, it's not enough to be reactive: The tax function also must proactively identify and manage tax risk while incorporating planning considerations into key business decisions. Automation, data management, and analytics can help. It's important to give tax leaders a seat at the decision-making table and to be aware of major changes in the legal, regulatory, and economic landscapes.

## OBBA Implications for Income Tax Accounting

The OBBA made important tax law changes that will affect U.S. income tax accounting under Accounting Standards Codification (ASC) 740, *Income Taxes*, including current and deferred taxes, valuation allowances, and financial disclosures. The changes have varied effective dates and will affect corporate tax provisions, international tax rules, energy credits, and state tax considerations.

Key corporate provisions include:

- Restoring 100% bonus depreciation;
- Reinstating expensing for domestic research and experimental (R&E) expenditures;
- Modifying the Section 163(j) interest limit;
- Amending the rules for energy credits;
- Expanding Section 162(m) aggregation requirements; and
- Updating the rules for GILTI (now NCTI) and FDII (now FDDEI)

President Trump signed the bill July 4, 2017, which is considered the enactment date under U.S. generally accepted accounting principles (GAAP).

## Tax Law Changes

Changes in taxes payable or receivable resulting from the new law are reflected in the annual effective tax rate (AETR) in the period including the enactment date, with discrete recognition of prior-year adjustments. Law changes affecting deferred taxes on temporary differences are also recognized discretely at enactment.

Some companies may be considering an alternative policy to use beginning-of-year temporary differences and related deferred tax balances when evaluating the impact of tax law changes during an interim period. Companies should discuss the approach with their auditors and tax advisors.

## Planning Considerations

If a tax law change is retroactive, the accounting treatment depends on whether the impact relates to prior periods or the current year. For prior-period deferred taxes and taxes payable or receivable, the effect is recognized discretely in the period of

enactment. However, if the retroactive change affects current-year taxes payable or receivable – when the effective date is before the enactment date but still within the current year – the impact is recognized through an adjustment to the AETR. The updated AETR is then applied to year-to-date ordinary income, resulting in a catch-up adjustment for taxes payable or receivable in earlier interim periods.

Companies should consider that rule when assessing the financial reporting implications of some provisions enacted in July 2025 that are retroactive to the beginning of 2025. That includes provisions such as R&E expensing, Section 163(j) limitation on interest deductions, and 100% bonus depreciation (for property acquired and placed in service after January 19, 2025).

### **Valuation Allowance**

Adjustments to valuation allowances for deferred tax assets (DTAs) existing at enactment are discrete items, while allowances for temporary differences arising after enactment are incorporated into the estimated AETR.

The major corporate provisions discussed above could affect projections of future taxable income, potentially triggering a change in judgment about the realizability of DTAs.

### **Planning Considerations**

Before, companies might have recorded a full valuation allowance on their Section 163(j) DTA as a result of the interest deduction limitation being based on 30% of adjusted taxable income, which included amortization, depreciation, and depletion (that is, the earnings before income and taxes limitation). The reinstatement of the earnings before income, taxes, depreciation, and amortization limitation under Section 163(j) for tax years beginning after December 31, 2024, might require a reassessment of the realizability of the current-year disallowed interest deduction and Section 163(j) carryforward DTAs from prior years that were previously subject to a full valuation allowance.

### **International Taxation**

The OBBBA modifies the rules for GILTI (now NCTI) and FDII (now FDDEI) by raising effective tax rates and altering deductions and expense allocations effective for tax years after 2025. It also raises the base erosion and anti-abuse tax (BEAT) rate from 10% to 10.5% for tax years beginning after 2025 and repeals a scheduled 2026 change that would have increased BEAT liability by the sum of all income tax credits.

Because most of the OBBBA international provisions do not take effect until tax years beginning after December 31, 2025, companies will likely see an immediate accounting impact at enactment only if the law change affects their valuation allowance assessments.

### **Other Changes**

The OBBBA curtails Inflation Reduction Act energy tax incentives, imposes new restrictions, and phases out credits.

Companies must assess uncertain tax positions under ASC 740 and analyze state and local tax effects based on conformity with federal tax changes, especially regarding bonus depreciation, R&E expensing, FDII, GILTI, and interest deductibility.

### **Planning Considerations**

Companies need to consider disclosing the expected effects of new tax laws in the notes to the financial statements, management's discussion and analysis, and risk factors.

Tax law changes enacted after interim balance sheet dates but before financial statements are issued are considered nonrecognized subsequent events, requiring disclosure of nature and estimated effects if material. Annual statements must detail tax effects of enacted changes and reconcile the effective tax rate accordingly.

Companies must assess the impact of the tax legislation on their income tax provision calculations, including current and deferred tax balances, the AETR, valuation allowances, and related financial statement disclosures. The provisions are highly interconnected, so the analysis will likely require extensive modeling and planning. Further, it is important to consider how the changes apply to specific facts and circumstances.

## **New Income Tax Disclosures**

Public companies preparing their annual financial statements now must contend with new rules meant to increase the transparency and usefulness of income tax disclosures by improving those related to the rate reconciliation and income taxes paid.

Accounting Standards Update (ASU) No. [2023-09](#), "Income Taxes (Topic 740): Improvements to Income Tax Disclosures," is effective for public business entities (PBEs) for fiscal years beginning after December 15, 2024. Early adoption is allowed.

The new rate reconciliation rules involve standardized categories and greater disaggregation of information based on a quantitative threshold. The income taxes paid disclosures must be disaggregated by jurisdiction. ASU 2023-09 further mandates disaggregation of pretax income or loss and income tax expense or benefit from continuing operations and eliminates some disclosures.

### **Income Taxes Paid**

Information on taxes paid (net of refunds) must be disaggregated for federal, state, and foreign taxes. Further disaggregation is required for specific jurisdictions if the income taxes paid (net of refunds) meet or exceed the quantitative 5% threshold.

The quantitative threshold is calculated by dividing the income taxes paid (net of refunds) in a jurisdiction by the total income taxes paid (net of refunds). In quantifying the 5% threshold for income taxes paid, the numerator of the fraction should be the absolute value of any net income taxes paid or income taxes received for each jurisdiction and the denominator should be the absolute value of total income taxes paid or refunds received for all jurisdictions in the aggregate.

The ASU made no changes to interim disclosure requirements.

## **Rate Reconciliation**

In the annual rate reconciliation disclosures, PBEs must include (in both percentages and dollar amounts):

1. State and local income taxes in the country of domicile net of related federal income tax effects;
2. Foreign tax effects, including state or local income taxes in foreign jurisdictions;
3. Effects of changes in tax laws or rates enacted in the current period;
4. Effect of cross-border tax laws;
5. Tax credits;
6. Changes in valuation allowances;
7. Nontaxable or nondeductible items; and
8. Changes in unrecognized tax benefits.

Items 3-7 should reflect federal income taxes imposed by country of domicile.

All reconciling items should be presented on a gross basis.

Reconciling items in the foreign tax effects category are to be disaggregated by jurisdiction and nature. If a foreign jurisdiction meets the 5% threshold, it must be disclosed as a reconciling item. Irrespective of whether any foreign jurisdiction satisfies the 5% threshold, any individual reconciling item meeting the threshold must be disclosed by nature. Similarly, separate disaggregation is required for items 4, 5, and 7 if the reconciling items in those categories meet the 5% threshold.

The quantitative threshold is determined by multiplying 5% by the product of pretax income (or loss) from continuing operations and the applicable federal income tax rate of the jurisdiction of domicile.

The state and local income tax category should reflect income taxes imposed at the state or local level (net of federal benefit) in the jurisdiction of domicile.

## **Income Statement**

The ASU made minor changes to the required income statement disclosures relating to income taxes to conform to existing SEC requirements, stipulating that income or loss from continuing operations before income tax expense or benefit be disclosed and disaggregated between domestic and foreign sources.

The update also requires the disclosure of income tax expense or benefit from continuing operations disaggregated by federal, state, and foreign jurisdictions. Income tax expense and taxes paid relating to foreign earnings that are imposed by the entity's country of domicile would be included in tax expense and taxes paid for the country of domicile.

## **Eliminated Disclosures for PBEs and Non-PBEs**

Entities no longer are required to disclose information concerning unrecognized tax benefits that have a reasonable possibility of significantly changing in the 12 months following the reporting date, nor must they make a statement that an estimate of the range cannot be made.

ASU 2023-09 also removed the requirement to disclose the cumulative amount of each type of temporary difference when a deferred tax liability is not recognized because of the exceptions to

comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures. Entities still must disclose the types of temporary differences for which deferred tax liabilities have not been recognized under ASC 740-30-50-2(a), (c), and (d).

## Using Year-End Lessons to Improve Process

Effective management of the year-end close process is crucial for companies to adapt to changing financial numbers, regulatory environments, and business transformations. Improving the process enhances the tax function's strategic role and supports accurate, timely financial reporting. Starting it months in advance helps address resource constraints and regulatory complexities, enabling more efficient and accurate closings.

Companies benefit from understanding tax- and accounting-related risks, which prepares them for growth and regulatory changes. To build trust with leadership, tax departments should implement comprehensive reporting that explains key performance indicators (KPIs) and any differences between forecasted and actual results from both GAAP and non-GAAP perspectives.

A flight plan, or a detailed checklist covering calculation methodologies, documentation, and key milestones, can help tax teams manage adjustments (especially late changes) and supports audit readiness. If some adjustments cannot be automated, it is crucial to document estimation methodologies and involve the audit function to achieve accuracy and compliance.

Post-close discussions with C-suite executives about KPI variances and internal reviews of the close process foster transparency and identify areas for enhancement.

Integrating tax provision software and other technologies reduces reliance on spreadsheets, improves accuracy, accelerates calculations, and lowers risk. All that positions the tax function for future challenges.

## How Mature Are Your Operations?

Tax function maturity significantly affects risk management. Mature tax functions possess effective processes and technology and are involved in key business decisions, thereby helping reduce operational tax risks. Less mature functions are susceptible to unanticipated tax issues.

Strategic tax goals enhance any overall company impact, making it imperative for tax leaders to have a seat at the decision-making table. Including them in C-suite agendas helps proactively manage tax implications across an array of business lines and initiatives. That in turn drives sustainable value.

Companies must also consider adequate resourcing and strive to build tax teams with the right personnel, processes, and technology. Compliance and reporting benefit from a deep tax bench, and mature tax departments leverage advanced technology for automation, data management, and analytics to improve accuracy and mitigate potential tax risks. Further, tax leaders must develop strategies to improve transparency and align sustainability and tax goals.

The bottom line? Proactivity reduces risk. Tax strategists are proactive in anticipating and mitigating tax risks. Less mature tax tacticians tend to be reactive, which makes their companies more vulnerable to risks and underscores the need for ongoing maturity improvement.

## Key Considerations in Addressing Tax Risk

Rapid changes in regulatory requirements, technology, and growth patterns have made tax risk management critical. Despite an increased business and regulatory focus on tax, many organizations have yet to adopt comprehensive tax risk mitigation strategies or fully leverage tax technology. Effective management involves upgrading technology, ensuring the internal tax team is focused on strategy (with possible outsourcing of more routine tasks), and conducting global tax risk reviews with cross-functional collaboration.

Common contributors to heightened risk include:

- Noncompliance, or an inability to keep up, with new laws;
- Organizational changes such as market expansion or mergers;
- Under-resourced tax teams;
- A lack of automation; and
- Failure to seek external advisory services.

To mitigate potential financial, legal, and reputational consequences, tax leaders should consider conducting global tax risk reviews to better understand and manage risk by identifying strengths and weaknesses. Those reviews should involve members from cross-functional teams to anticipate scenarios that could lead to tax risk. Prioritizing those risks and planning mitigation strategies may include implementing tax internal controls, maintaining process documentation, developing contingency plans, and ensuring tax leaders have a seat at the table during business decision-making processes.

As the end of 2025 nears, businesses should consider a full range of tax planning strategies to help manage their long-term total tax liability and cash flow.