ASC 740: Year-end provision considerations for 2021

Jan. 10, 2022

Throughout 2021, much of the attention of the tax world was on Congress and whether it would pass the Build Back Better Act (BBBA) prior to the end of the year. While Congress ultimately did not pass the BBBA prior to Dec. 31, 2021, there were several significant events throughout the year that companies should consider in preparing their year-end tax provisions. The following update provides insights on federal, state and local, and international tax laws that may impact a company's 2021 provision and some considerations for the future as the global tax landscape continues to change. The federal quarterly ASC 740 considerations are also available from the first, second and third quarters of 2021.

Build Back Better Act

After months of deliberation, the highly anticipated Build Back Better Act (BBBA) was not enacted prior to Dec. 31, 2021. Accordingly, even if the Senate does take up some form of the legislative package in early 2022, any such changes in tax law would not be reflected in calendar year-end provisions.

CARES Act

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, passed in early 2020 in response to the COVID-19 pandemic, provided economic relief to many businesses. While the pandemic persists, many elements of the CARES Act were temporary. Accordingly, for 2021 a company's interest deductions are once again limited to 30% of adjusted taxable income (ATI), NOLs generated in the current year can only be carried forward, and if a company is planning on utilizing NOLs, to the extent they were generated in years beginning after Jan. 1, 2018, utilization is once again limited to 80% for 2021 and beyond (e.g., NOLs generated in 2020, but utilized in the year ending Dec. 31, 2021, would still be subject to the 80% limitation). NOLs generated in years beginning prior to Jan. 1, 2018, continue to be available to offset 100% of the current year income.

Accounting for forgiveness of Paycheck Protection Program loans

In December of 2020, Congress passed the Consolidated Appropriations Act, 2021 (CAA, 2021), ensuring that income from the forgiveness of PPP loans was exempt from federal tax while allowing companies a deduction for the related expenses. Therefore, in the year the book income is recognized, calendar year companies would treat any book recognition of income as a favorable permanent adjustment to reverse the book income recognized. Taxpayers with a fiscal year-end prior to the December enactment of the CAA, 2021, need to ensure any temporary differences recorded in the prior year are reversed and record the permanent adjustment for the benefit of the non-taxable income.

Meals and entertainment deductions

As part of the CAA, 2021, companies are temporarily able to deduct 100% (rather than 50%) of the cost of food or beverages provided by a restaurant if paid or incurred during the 2021 or 2022 calendar years as long as the costs are otherwise deductible under section 274(n)(2). On April 8, 2021, the IRS issued guidance in Notice 2021-25, which brings clarity to taxpayers by defining the term 'restaurant' as a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business's premises. Under this guidance, meal expense that is incurred at grocery stores, convenience stores, and the like will continue to be subject to the 50% limitation under section 274. The notice also addresses that on-premises cafeterias operated under section 119 or section 132(e)(2) may not be treated as restaurants subject

to the temporary exception. You can find a summary of the guidance in RSM's alert: [IRS provides guidance on deductions for food or beverages].

The IRS recently released Notice 2021-63 which provides guidance related to per diems for employee travel, clarifying that meal portion of the per diem is 100% deductible if the general per diem rules outlined in Rev. Proc. 2019-48 are followed. Read more in RSM's alert: IRS clarifies temporary deductibility of per diem meal expenses.

Section 174 capitalization

One of the expected changes under the BBBA was the delay of the section 174 capitalization rules enacted as part of the Tax Cuts and Jobs Act. Without additional legislation, companies are required to capitalize and amortize research and experimental expenditures under section 174 for tax years beginning after Dec. 31, 2021. While this requirement has no impact on current calendar year-end provisions, public companies will need to consider any expected impacts on interim provisions if Congress does not take action prior to the end of the first quarter of 2022. The Build Back Better Act (BBBA) legislation proposed delaying required capitalization until tax years beginning after Dec. 31, 2025. Companies will have to consider the implications on provisions in 2022 while monitoring for legislative action.

Adjusted Taxable Income

Another of the provisions included in the Tax Cuts and Jobs Act with a delayed effective date was a change to the definition of Adjusted Taxable Income (ATI) in determining the limitation on deductible interest expense under section 163(j). For years beginning on or after Jan. 1, 2022, the determination of ATI no longer includes an addback for depreciation, amortization, or depletion. While this effect does not impact current calculations until 2022, companies should ensure any scheduling exercises for supporting the amount of interest carryforwards more-likely-than-not to be realized reflect the appropriate amount of ATI.

American Rescue Plan Act of 2021

On March 11, 2021, the American Rescue Plan Act of 2021 was signed which provided funding to families, state and local governments, and others. The $1.9 trillion pandemic relief bill also included a number of tax provisions, including an expansion to the number of employees covered by section 162(m), which limits the deductibility of compensation over $1 million for select employees of public companies. Publicly traded companies will be denied a deduction for compensation more than $1 million for the eight highest-paid employees (i.e., regardless of whether the individuals are officers of the company), plus the CEO or CFO. Previously, the deduction was only denied for the three highest-paid officers, plus the CEO or CFO. It is important to note that the new group of five will be covered employees only for the year they are in the highly compensated group. As such, the law does not include them in the forever-covered provision that applies to the other officers. The provision is set to take effect for taxable years beginnings after Dec. 31, 2026. Given the delayed effective date, companies may have difficulty in identifying who those highest paid persons might be in 2027. However, public companies should continue to evaluate how this expansion of section 162(m) may impact future limits on deductible compensation.

Updates from the Financial Accounting Standards Board (FASB)

FASB issued four accounting standards updates (ASUs) during the last three months of the year, bringing the total for 2021 to 10 ASUs. While none of these made significant changes directly to ASC 740, the FASB's issuance of ASU 2021-08 regarding business combinations may impact a company's accounting for deferred revenue and the related deferred tax items in a business combination. Additionally, while ASU 2019-12 is already effective for public business entities, non-public entities may want to consider adoption in the current year.

ASU 2021-08 - Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers

On Oct. 28, 2021, FASB released ASU 2021-08 — Business Combinations (Topic 805): *Accounting for Contract Assets and Contract Liabilities from Contracts with Customers*. The ASU modifies the business combination accounting rules for contract assets and contract liabilities (e.g., deferred revenue) to conform to Topic 606 *Revenue from Contracts with Customers.*

The amendments in the update require the acquirer, as of the acquisition date, to account for revenue as if it had originated the contracts. This should generally result in the same accounting as recorded on the acquiree's financial statements prior to the transaction. Prior to the ASU, these amounts were measured at fair value which resulted

in a haircut to the amounts historically recorded to recognize the cost to complete the work on the contracts. The new guidance requires public business entities to adopt for fiscal years beginning after Dec. 31, 2022, including related interim periods within those fiscal years. All other entities are required to adopt for fiscal years beginning after Dec. 15, 2023, including interim periods within those fiscal years. The guidance in the ASU may be adopted prior to the effective dates; however, companies that early adopt in an interim period should apply the amendments retrospectively to all business combinations that occurred earlier in the fiscal year. Otherwise, the ASU should be applied prospectively to business combinations occurring on or after the effective date of the amendments.

Accounting for deferred revenue as part of a business combination has historically resulted in some complexity for tax purposes related to the 'haircut' recorded for book purposes as part of the transaction. While the ASU makes the book accounting more straightforward, companies must consider the various tax rules regarding deferred revenue and record the resulting deferreds where basis differences exist. For instance, basis differences will arise in taxable transactions where sellers are required to accelerate the recognition of deferred revenue for tax purposes and the buyer records a liability to service the deferred revenue. Meanwhile, in a stock transaction, a company may have the same amount of DTA as prior to the transaction for situations in which the company recognizes income for tax purposes prior to book purposes (the one-year deferral). Companies should be mindful of how these basis differences may impact their accounting for income taxes after adoption.

ASU 2019-12 - Income Taxes (Topic ASC 740): Simplifying the Accounting for Income Taxes

Non-public entities are required to adopt the guidance in ASU 2019-12 effective for fiscal years beginning after Dec. 15, 2021, and interim periods within fiscal years beginning after Dec. 15, 2022. For more information on the ASU and the eight simplifications to ASC 740, please refer to the following alert: Simplifying the accounting for income taxes. While the method of adoption for much of the new guidance in ASU 2019-12 is on a prospective basis, companies with past changes in ownership of foreign entities and companies that file returns in jurisdictions with both capital and income based measures will need to spend some time evaluating the impact of the guidance on prior periods. Companies should include disclosures in their financial statements regarding the adoption of ASU 2019-12 and its material impacts.

State and local

The following state tax law developments were enacted during the fourth quarter of 2021 and should be considered in determining a company's current and deferred tax provision pursuant to ASC 740, Income Taxes, for the quarter ended Dec. 31, 2021. This information summarizes the listed developments and may not provide additional nuanced considerations when addressing for provision purposes. For questions about these quarterly updates, or other recent legislative and regulatory developments, please reach out to your tax adviser for more information. For information on state ASC 740 developments from prior quarters, please see our separate alerts from the first, second, and third quarters of 2021, as well as our comprehensive 2021 state and local tax year end guide.

MTC guidance on P.L. 86-272

In the third quarter of 2021, the Multistate Tax Commission (MTC) adopted an updated version of its guidance on Public Law 86-272 (P.L. 86-272) and the associated limitations on a state's ability to impose an income tax on sellers of tangible personal property (TPP) whose in-state activities are limited to solicitation of sales. The updated guidance is focused on interactions with customers conducted over the internet and has broad implications, potentially impacting any seller of TPP with a web presence. The guidance on P.L. 86-272 from the MTC has historically been widely accepted and referenced by states and courts. The expectation is that many states will eventually adopt the updated MTC guidance in whole or in part. For more information, please read our article, MTC adopts new P.L. 86-272 guidance: What you need to know.

Remote workforce

In response to COVID-19, a number of states have addressed whether income or franchise tax nexus is created for a business by its employees temporarily teleworking in a state during the pandemic, in situations where the business has no other nexus-creating presence or activities within the state. Without official state guidance to the contrary, the presence of an employee working in a state is typically sufficient presence to create corporate income tax nexus in that state. More than 20 states provided some temporary nexus protection for income and franchise tax purposes related to employee teleworking as a result of the pandemic. Many of these nexus protection provisions have already ended or are set to expire before the 2021 year-end. Of note during the fourth quarter of 2021, Wisconsin provided guidance that its income tax nexus relief provisions would no longer apply beginning Jan. 1, 2022.

State pass-through entity tax workarounds

The Tax Cuts and Jobs Act (TCJA, P.L. 115-97) limited the individual taxpayer deduction for state and local tax (SALT) payments to $10,000 a year ($5,000 for a married person filing a separate return). SALT payments (including income and real property taxes) that exceed these amounts are no longer deductible by individual taxpayers unless the payments are in pursuit of a trade or business.

As a response to the TCJA's limitation, several states began to adopt a pass-through entity-level tax intended as a workaround. Beginning in 2022, at least 20 states will allow a workaround. In the fourth quarter of 2021, and as of the date of this article, the following states have adopted a workaround (with the first effective year in parentheses): Massachusetts (2021), Michigan (2021) and North Carolina (2022). Unique among elective pass-through entity workarounds, the Massachusetts law provides that the entity's members are allowed a refundable state tax credit of 90% of the tax imposed, instead of a full credit, deduction or exclusion.

Other states that have adopted workarounds include Alabama (2021), Arizona (2022), Arkansas (2022), California (2021), Colorado (2022), Connecticut (2018 and mandatory), Georgia (2022), Idaho (2021), Illinois (2021), Louisiana (2019), Maryland (2020), Minnesota (2021), New Jersey (2020), New York (2021), Oklahoma (2019), Oregon (2022), Rhode Island (2019), South Carolina (2021) and Wisconsin (2018).

Arkansas

On Dec. 9, 2021, Arkansas enacted SB 1, which includes changes to the corporate income tax rate for tax years 2023 and beyond. For tax years beginning on or after Jan. 1, 2023, the highest marginal rate will be reduced from 5.9% to 5.7%. The legislation also contains provisions for further rate reductions in 2024 and 2025 to 5.5% and 5.3%, respectively, but these changes are contingent upon whether the state has a need to use its long-term reserve funds in 2022 through 2024.

Georgia

On Dec. 8, 2021, Georgia enacted HB 7EX to update its conformity to the Internal Revenue Code. For tax years beginning on or after Jan. 1, 2021, Georgia conforms to the IRC as enacted on or before March 11, 2021. The provisions of the bill preserve Georgia's existing nonconformity to specific provisions of the IRC and add specific nonconformity provisions for the changes made by the American Rescue Plan Act of 2021 to section 461(l).

Illinois

On Aug. 31, 2021, the Illinois Department of Revenue issued General Information Letter IT21-0004-GIL to provide guidance on the corporate income tax treatment of sales of Bitcoin and other cryptocurrencies. The department clarified that it views Bitcoin as within the definition of "intangible personal property" as used in state statute and that gross receipts related to the sale of Bitcoin may be included in the Illinois sales apportionment factor. The department's guidance explicitly distinguishes the apportionment treatment of Bitcoin from the previously established treatment of patents, copyrights, trademarks and other similar items of intangible property.

On Nov. 16, 2021, Illinois enacted HB 1769, extending the carryforward period for corporate net operating losses from 12 years to 20 years. The updated carryforward applies to net operating losses generated in taxable years ending on or after Dec. 31, 2021, and to any net operating loss generated in a prior period and carried forward to a taxable year ending on or after Dec. 31, 2021, to the extent the net operating loss has not already expired under the previously effective 12-year carryforward rules. The updated provisions do not alter the previously enacted net operating loss limitations, which provide no allowable carryover for losses generated for taxable years ending after Dec. 31, 2010, and prior to Dec. 31, 2012 and limit the allowable net operating loss carryforward utilization for taxable years ending on or after Dec. 31, 2021 and prior to Dec. 31, 2024 to $100,000.

Iowa

Effective Dec. 8, 2021, Iowa adopted ARC 6030C, which amended Rule 701—42.44(422) to change the order in which credits against income tax should be applied. The amendment updates the guidance to remove previously repealed credits and to incorporate recently enacted or updated credits. Of note, the amendments change the ordering of the application of the alternative minimum tax credit for corporate taxpayers for tax years beginning during 2021.

Louisiana

On Nov. 13, 2021, Louisiana voters approved a constitutional amendment to eliminate the deduction for federal income tax on Louisiana corporate returns and reduce the corporate tax rate. The provisions were previously codified in the passage of HB 292 in June of this year but remained contingent on voter approval of the constitutional amendment. Louisiana's current rate structure with five brackets and a top marginal rate of 8% will be reduced to three brackets with a top marginal rate of 7.5%. Both the repeal of the federal income tax deduction and the change to the corporate rate will be effective on Jan. 1, 2022.

New York

On Nov. 19, 2021, New York released Technical Memorandum TSB-M-21(2)C to notify taxpayers that the MTA surcharge rate will remain at 30% for tax years beginning on or after Jan. 1, 2022, and before Jan. 1, 2023.

North Carolina

On Nov. 18, 2021, North Carolina enacted SB 105, which contains significant changes to the state's tax regime, most notably the phase-out of the state's corporate income tax over the 2025-2030 tax years. The state's current income tax rate of 2.5% will reduce to 2.25% for the 2025 tax year, 2% for 2026 and 2027, and 1% for 2028 and 2029. The corporate income tax is eliminated in 2030; the state's corporate franchise tax will remain in place, subject to simplified computation rules also enacted with the passage of SB 105.

In addition to the phase-out of income tax, SB 105 updates North Carolina's conformity to the Internal Revenue Code as of April 1, 2021, from its previous conformity date of May 1, 2020. The change in conformity will impact the state treatment of key federal provisions, most notably that the state will conform to federal deductibility for expenses associated with Paycheck Protection Program loans through 2022.

SB 105 also provides for changes to the state's treatment of interest expense limited under section 163(j). North Carolina decoupled from the increased 50% limitation for federal purposes for tax years 2019 and 2020, as provided for in the CARES Act. Before the passage of SB 105, to the extent that the difference in the 30% and 50% interest limitation computations created a state modification, that modification had no expected future reversal and was a permanent difference. SB 105 now provides that taxpayers may take a 20% of the total amount added back in 2019 and 2020 as a deduction in 2021 and the subsequent four tax years.

For more information, please see our article North Carolina budget cuts income taxes, adopts SALT workaround.

Oregon

In October 2021, the Oregon Tax Court reversed a previous decision on the proper treatment of subpart F income for income tax apportionment purposes. The original decision concluded that the 20% of subpart F income not eligible for a subtraction modification could not be included in the Oregon apportionment factor, based on the fact that these receipts did not meet the definition of "gross receipts" under Oregon statute. The revised decision concludes that the statutory definition of "gross receipts" is meant to be interpreted in light of the taxpayer's tax accounting method, and that the provisions of subpart F operate similar to a mandatory tax accounting method for affected taxpayers. Therefore, to the extent that the primary business activity of the taxpayer is the same business activity of the CFC connected to the subpart F income, the court concluded that the net amount of subpart F income included in the Oregon corporate income tax base may be eligible for inclusion in the Oregon sales factor computation.

Texas

On Oct. 15, 2021, Texas enacted substantial changes to Texas Admin Code Sec. 3.599 related to the computation of the research and development credit for franchise tax. The changes in the final version are largely consistent with the proposed amendments released in April 2021 and contain provisions that depart significantly from federal definitions and regulations surrounding the computation of qualified research expenditures. Among other changes, the amendments provide that activities and expenses related to internal use software are not eligible for the credit and include provisions that may result in the loss of the credit carryforward for a combined taxpayer when there is a change in the combined group.

In early December 2021, Texas released updates to the no tax due threshold for franchise tax as well as the limitation on the compensation deduction. The no tax due threshold for report years 2022 and 2023 is now $1,230,000 of receipts, and the compensation deduction limitation is $400,000.

Vermont

Effective on Dec. 1, 2021, Vermont released Reg. Sec. 1.5833 to provide details and clarification related to apportionment changes previously enacted through the passage of H. 514 in June 2019. The regulations contain several revised definitions that may influence the determination of what falls under the definition of apportionable or allocable income as well as sales apportionment sourcing. Additionally, the regulations provide further guidance on previously enacted changes, including the change to a three-factor apportionment formula with double weighted sales and a change from cost of performance to market-based sourcing for sales of intangibles of services.

International tax

On Oct. 8, 2021, the Organisation for Economic Co-operation and Development followed up on its July 1, 2021, announcement to reform international taxation and to address the tax challenges arising from the digitalization of the economy. The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) has agreed on a two-pillar solution. The two-pillar package aims to ensure that large internationally active companies pay tax where they operate and earn profits, while adding much-needed certainty and stability to the international tax system. The agreement included 136 countries (such as China, the United States, U.K. and India) representing more than 90% of global GDP.

Please see RSM's alert for more information: Global tax policy developments continue to be clearer.

Australia

Earlier this year, the Australian government extended the temporary full expensing of depreciable assets through June 30, 2022, and has currently introduced legislation to extend the temporary full expensing of depreciating assets measures once more by 12 months to June 30, 2023, in an effort to support economic recovery from the COVID-19 pandemic by encouraging businesses to make further investments. The extension was originally proposed as part of the 2021-22 Budget as the temporary full expensing budget measure. These measures allow eligible entities to deduct the cost of tangible depreciating assets acquired up front. These arrangements expire on June 30, 2022, under the current law.

In addition, draft legislation and an explanatory memorandum have been released to give effect to the Australian Government's 2021-22 Federal Budget Announcement that taxpayers will be able to self-assess the effective lives of tangible depreciating assets. This change would apply to assets acquired from July 1, 2023, after the temporary expensing measure has concluded. Currently intangible assets are subject to a statutory effective life. The legislation is an attempt to provide taxpayers with the option to match tax treatment of certain intangible assets to the time these assets would provide economic benefits and further encourage investments in these assets and hiring in research and development.

Brazil

On Sep. 24, 2021, Brazil's Supreme Federal Court judged the Extraordinary Appeal No. 1.063.187, with general repercussion, to define that amounts received by the taxpayer due to the application of the Selic rate (combined interest plus monetary update federal rate) when tax withheld in error is refunded is not subject to corporate income tax (IRPJ) and the social contribution on net income (CSLL). Therefore, the Supreme Court concluded that interest on late tax refunds should not be considered a tax-triggering event for IRPJ or CSLL purposes and should not be included in their calculation base. The Institute of Independent Auditors in Brazil (IBRACON) has issued the Circular letter 09/21 related to the accounting procedures to be adopted for booking the amounts according to Normative ICPC 22.

In addition, on Nov. 10, 2021, the federal government issued the Decree n. 10,854/21 which reduces the deductible amount related to the Worker's Meal Program (PAT). There is a discussion regarding the initial date of effects of the decree, but as the decree mentions it should be set to take effect as of Dec. 11, 2021. However, there may be litigation over the effective date, as according to the federal constitution, any increase in income taxes should only take effect in the next calendar year, which would be 2022 in this case. The federal government's objective behind the issuance is to reduce the number of norms that regulate labor relations, which are notorious for being extensive and make it difficult for employers to understand and comply.

Germany

On July 8, 2021, [The German Federal Constitutional Court (BverfGE)]() ruled that interest on taxes and tax refunds pursuant to section 233a of the German tax law (AO) is unconstitutional for the calculation of interest for interest periods Jan. 1, 2014 as it is based on an interest rate of 0.5% per month (6% annually). However, the previous law continues to apply for interest periods up to and including 2018. The provisions are inapplicable for periods beginning in 2019. The legislature is obliged to introduce a new constitutional provision by July 31, 2022 (with retroactive effect from Jan. 1, 2019). The interest provision applies to income tax, corporate income tax, property tax, sales tax or trade tax, turnover tax, and applies to both open tax liabilities and refunds.

For more information on the ruling, please see: Per annum interest of 6% on back taxes and refunds is unconstitutional from 2014 onwards.

Hong Kong

HKSAR Government responds to inclusion of Hong Kong in EU's watchlist on tax co-operation

On Oct. 5, 2021, the Government of the Hong Kong Special Administration Region (HKSAR) responded to media enquiries on the announcement of the inclusion of Hong Kong in its watchlist on tax co-operation by the European Union (EU). The EU is concerned that corporates with no substantial economic activity in Hong Kong are not subject to tax in respect of certain offshore passive income (e.g., interest and royalties), which leads to circumstances of "double taxation." To support combating of cross-border tax evasion, the HKSAR government agrees to co-operate with and has committed to the EU to amend the Inland Revenue Ordinance (IRO) by the end of 2022 and implement relevant measures in 2023.

The HKSAR government clarifies that the proposed legislative amendments will merely target corporations, particularly those with no substantial economic activity in Hong Kong, that make use of passive income to evade tax across a border. No increase in tax burden is expected for financial institutions, as their offshore interest income is already subject to profits tax under the IRO. The HKSAR government will also consult the stakeholders on the specific contents of the legislative amendments and strive to minimize the compliance burden of corporates.

Ireland

Global minimum tax

The 15% global minimum tax proposed by the Organisation for Economic Co-operation and Development (OECD) continues to gain support, with the Irish government agreeing in October of 2021 that Ireland will sign on to a global deal on corporate tax rates. This agreement provides that the minimum effective tax rate for companies with an annual revenue in excess of €750 million will be 15%. Companies who do not breach the threshold may still benefit from Ireland's 12.5% corporate tax rate on trading profits. It is estimated that there are over 1,550 multinational companies, employing over 500,000 people, that will be subject to the 15% corporate tax rate. The new rules are expected to be in place in 2023.

Finance bill 2021

On Oct. 21, 2021, Ireland's Minister of Finance, published the Finance bill 2021, which includes a number of tax provisions affecting reverse hybrid provisions, interest limitations, and transfer pricing rules, among others. While the bill passed both houses in December, as of Dec. 31, 2021, the Finance bill 2021 was not signed into law. The bill introduces rules to bring into line Ireland's commitment to the EU's anti-tax avoidance directives. The reverse hybrid rules would be set to take effect for taxable years beginning after Jan. 1, 2022. In addition, the bill would bring a 30% of EBITDA cap on interest deductions, however, the rules will consider if the Irish company is part of a consolidated group. Therefore, depending on the overall debt of the group, additional relief may be available if the Irish company's debt or interest ratios are lower than the groups. There are also new rules introduced around transfer pricing to make it clearer in scope and serve the policy aim of excluding bona fide non-trading "Ireland to Ireland" transactions from the scope of transfer pricing. The bill also included a few other provisions related to CFC rules, climate change, and a digital gaming credit.

Netherlands

In December, the upper chamber of the Dutch parliament approved the Dutch budget day proposals. The legislation contains several changes to corporate tax law, which are now final and will be effective as of Jan. 1, 2022.

The top corporate income tax in the Netherlands will become 25.8%, while the lower rate will continue to be 15%. The first bracket for the lower tax rate is to be increased and will apply to profits of up to €395,000 (in 2021 the first income bracket was up to €245,000).

Additionally, the legislation includes new tax loss utilization rules that result in an indefinite loss carryforward period as of Jan. 1, 2022. However, losses can only be fully deducted (on an annual basis) up to an amount of €1 million plus 50% of the taxable profit that exceeds €1 million.

For example, a company with a deductible loss of €3 million and a profit in the following year of €4 million would be able to offset €2.5 million of prior year losses (i.e., €1 million and 50% of the remaining €3 million). Corporate income tax is payable on the remaining €1.5 million. The background to the proposed scheme is that larger profitable companies always pay corporate income tax in years of profit. The new scheme also contains transitional law. For the carryforward of losses, losses incurred in financial years that started on or after Jan. 1, 2013, fall under the new scheme that comes into effect on Jan. 1, 2022. The State Secretary promised to adopt a policy of approval for the situation in which the concurrence of the so-called compensatory tax levy test of the measures limiting the interest deduction and the amended loss set-off regime, turns out to be unreasonable.

As of 2022, reverse hybrid entities (transparent according to Dutch law but non-transparent according to foreign law) will be liable to Dutch corporate income tax. This measure stems from the EU ATAD2. Furthermore, the concept of affiliation is to be extended to natural persons. The reverse-hybrid rule is likely to affect Dutch transparent CV's (i.e., limited partnerships) used in a CV-BV structure, where the CV is considered to be transparent for Dutch tax purposes and related non-resident participants are located in a jurisdiction that view the CV as non-transparent (e.g., under the U.S. check-the-box regime).

The earning stripping measure will also be tightened, effective from Jan. 1, 2022, by limiting the interest deduction to 20% of the EBITDA for tax purposes, down from the current 30%. For now, the €1 million threshold will not be affected.

Additionally, in situations where a controlled foreign company (CFC) is subject to a profit tax, the setoff of such tax is limited to the actual amount of Dutch corporate income tax due. In case of several CFCs, a certain setoff sequence is used, which is now also laid down by law: The smallest amount of foreign profit tax is to be settled first. The profit tax that remains unsettled in a year can still be settled in later years.

United Kingdom

Extension of temporarily increased annual investment allowance

In his Autumn Budget announcement on Oct. 27, 2021, the chancellor of the exchequer announced that the annual investment allowance (AIA), which provides a 100% in-year allowance for capital expenditure on qualifying plant and machinery to encourage businesses to invest in such equipment, will remain at £1m per year until March 31, 2023. It had been due to be reduced to £200,000 per year from Jan. 1, 2022.

This measure will be generally beneficial for business entities other than companies. However, it may not have a substantial impact for many companies because the more beneficial superdeduction, announced at the Chancellor's March 2021 Budget, will be available for much of the AIA qualifying expenditure incurred in the period of the extension. The super-deduction provides an enhanced deduction of up to 130% on capital expenditure by companies on new qualifying plant and machinery, but those with significant expenditure on assets that do not qualify for the super-deduction, such as secondhand plant and machinery and certain integral features of buildings, will benefit from this change.

While these measures to encourage capital investment are beneficial in the short term, a potential cliff-edge arises on April 1, 2023, for businesses that incur significant capital expenditure, when the super-deduction is scheduled to end, the AIA is expected to reduce to £200,000, and the main rate of corporation tax rate is due to increase to 25%. The amount of the AIA and the rate of super-deduction are both also scaled down for accounting periods straddling March 31, 2023.

Read more about the superdeduction and potential tax planning opportunities in: U.K. capital allowances super-deduction and impact on GILTI calculation.

Transfer pricing documentation requirements to be extended

The U.K. government has confirmed that it intends to require members of multinational groups with group revenue of €750m or more to maintain master file and local file transfer pricing documentation in accordance with Action 13 of the OECD's base erosion and profit shifting action plan. It will consult on detailed legislation during 2022, with the new rules, which are expected to require taxpayers to provide the master file and local file within 30 days of a request from the U.K. tax authority, likely to take effect from April 2023.

De minimis thresholds to establish which related party transactions need to be detailed in local files are expected, and transactions between U.K. entities that do not present a material U.K. tax risk will not need to be included. Taxpayers will be required to maintain summary audit trail documentation of the work undertaken in arriving at the conclusions stated in their transfer pricing documentation, but proposals that would have required U.K. businesses to prepare and submit an international dealings schedule as part of the annual tax compliance process are not being pursued at this time.

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