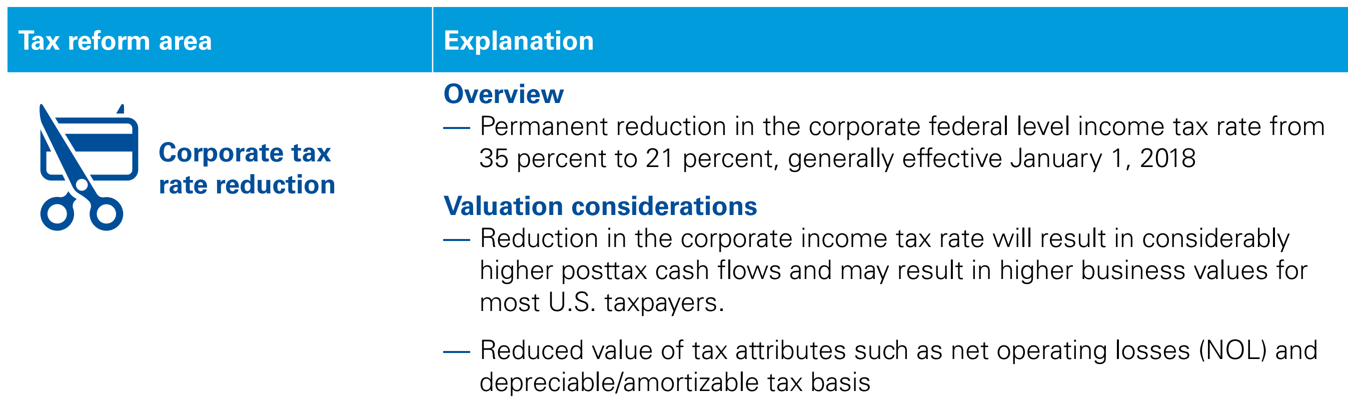
Valuation & Business Modeling Services

Top tax reform valuation considerations

On December 22, 2017, President Trump signed H.R. 1, originally known as the Tax Cut and Jobs Act, into law as Public Law 115-97 (the "Act"). The Act represents the most significant revisions of the Internal Revenue Code since 1986. The legislation includes substantial changes to the taxation of individuals, businesses in all industries, multinational enterprises, and others.

The following table discusses valuation considerations for the key provisions in the Act.



Tax reform area	Explanation
Corporate tax rate reduction	**Overview** — Permanent reduction in the corporate federal level income tax rate from 35 percent to 21 percent, generally effective January 1, 2018 **Valuation considerations** — Reduction in the corporate income tax rate will result in considerably higher posttax cash flows and may result in higher business values for most U.S. taxpayers. — Reduced value of tax attributes such as net operating losses (NOL) and depreciable/amortizable tax basis

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Tax reform area	Explanation
International taxation system	**Overview** The current system of worldwide taxation with deferral shifts to a hybrid territorial system, featuring a participation exemption regime with the following general highlights: – 100 percent deduction for dividends received from 10 percent owned foreign corporations, eliminating U.S. federal income tax on dividends from controlled foreign corporations (CFC). – The Base Erosion and Anti-Abuse Tax (BEAT) targets outbound payments to related foreign persons that reduce the U.S. tax base. Where it applies, it effectively eliminates the tax benefits arising from related party payments and from certain tax credits. – Global Intangible Low Tax Income (GILTI) tax based on the excess of a U.S. shareholder's share of certain income of a CFC over a 10 percent return on tangible depreciable property. Foreign Derived Intangible Income (FDII) is income earned directly from foreign sales/services, in excess of a 10 percent return on tangible depreciable property. FDII provides a 37.5 percent (21.875 percent after December 31, 2025) deduction for income deemed derived from FDII, which effectively reduces tax rates to 13.125 percent through 2025. – Accumulated foreign earnings and profits (E&P) will be deemed repatriated at a rate of 15.5 percent for cash and cash equivalents and 8 percent for illiquid assets. The tax can be paid in the current year or in installments over eight years. **Valuation considerations** — Particularly for multinational corporations that derive substantial income from markets outside of the United States, significant complexities arising from changes in the international taxation system require a more thorough assessment of these provisions and their impact on the worldwide tax rate assumption. — The appropriate tax rate assumption from a valuation perspective should consider the relative share of income derived from each country, as well as impacts from BEAT, GILTI, FDII, and other provisions. — The deemed repatriation tax liability will affect companies differently depending on their planned use of cash. It may have a positive effect for companies with significant offshore cash balances earning negligible returns, allowing for repatriation at lower rates back in to the United States; on the other hand, the provision is detrimental for companies with significant foreign capital needs. — 10 percent return on tangible depreciable property is directly impacted by the results of the tax purchase price allocation (PPA) for recent acquisitions.

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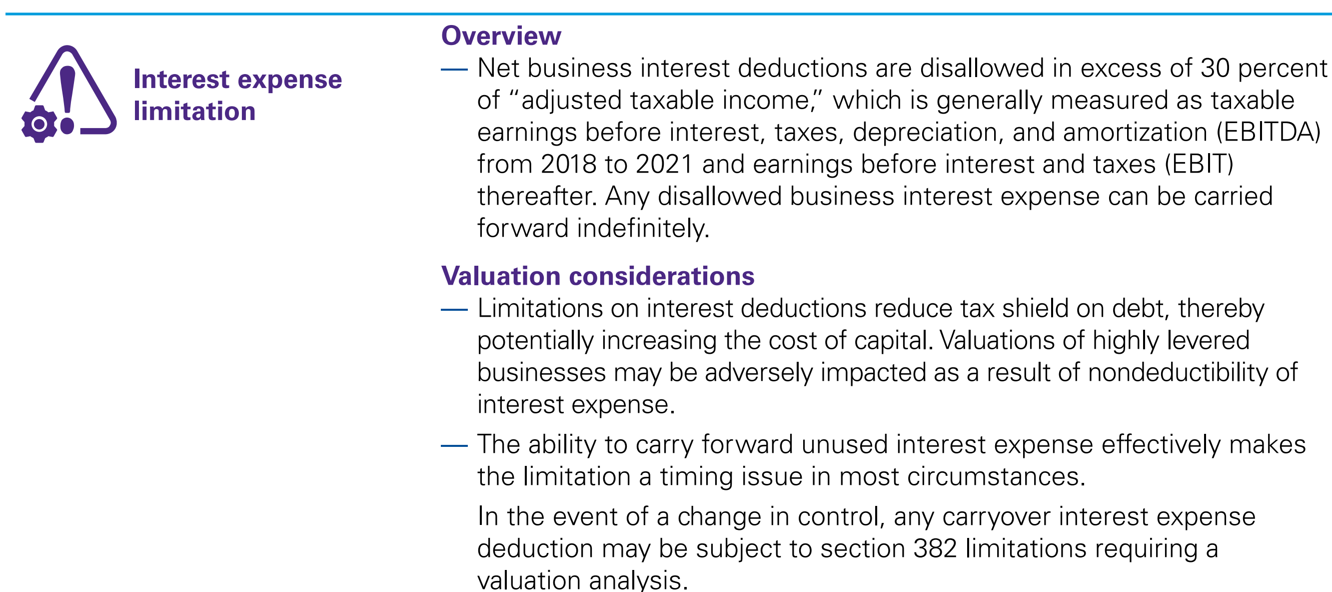
Tax reform area	Explanation
Immediate expensing	**Overview** — Bonus depreciation is increased from 50 percent to 100 percent for qualified depreciable property and applies to original use and used property acquired after September 27, 2017 and before January 1, 2023. The provision phases out in years 2023 to 2026. — Immediate expensing is applicable only to asset sales or deemed asset sales. **Valuation considerations** — Immediate capital expensing for qualified property would result in lower taxable income in the earlier years, potentially resulting in greater business value arising from differences in time value. Phasing out from 2023 to 2026 is anticipated to bring depreciation back to prior levels. — Immediate expensing creates an incentive to negotiate asset deal structures, particularly for fixed asset intensive businesses. — A PPA may provide an opportunity to assign a substantial portion of the purchase price to qualifying depreciable property. Additional diligence should be performed if relying on the asset's financial reporting net book value (NBV) as a proxy for fair market value (FMV). While it is possible that NBV can be a reasonable proxy for FMV in limited cases, numerous factors can cause an asset's FMV to be substantially higher or lower than its NBV. Preacquisition valuation of depreciable property should be considered to quantify potential benefit. — Due to significant tax savings from immediate expensing, scrutiny of values allocated to qualifying depreciable property is expected to increase and robust documentation to support the values is recommended.
 **Interest expense limitation**	**Overview** — Net business interest deductions are disallowed in excess of 30 percent of "adjusted taxable income," which is generally measured as taxable earnings before interest, taxes, depreciation, and amortization (EBITDA) from 2018 to 2021 and earnings before interest and taxes (EBIT) thereafter. Any disallowed business interest expense can be carried forward indefinitely. **Valuation considerations** — Limitations on interest deductions reduce tax shield on debt, thereby potentially increasing the cost of capital. Valuations of highly levered businesses may be adversely impacted as a result of nondeductibility of interest expense. — The ability to carry forward unused interest expense effectively makes the limitation a timing issue in most circumstances. In the event of a change in control, any carryover interest expense deduction may be subject to section 382 limitations requiring a valuation analysis.

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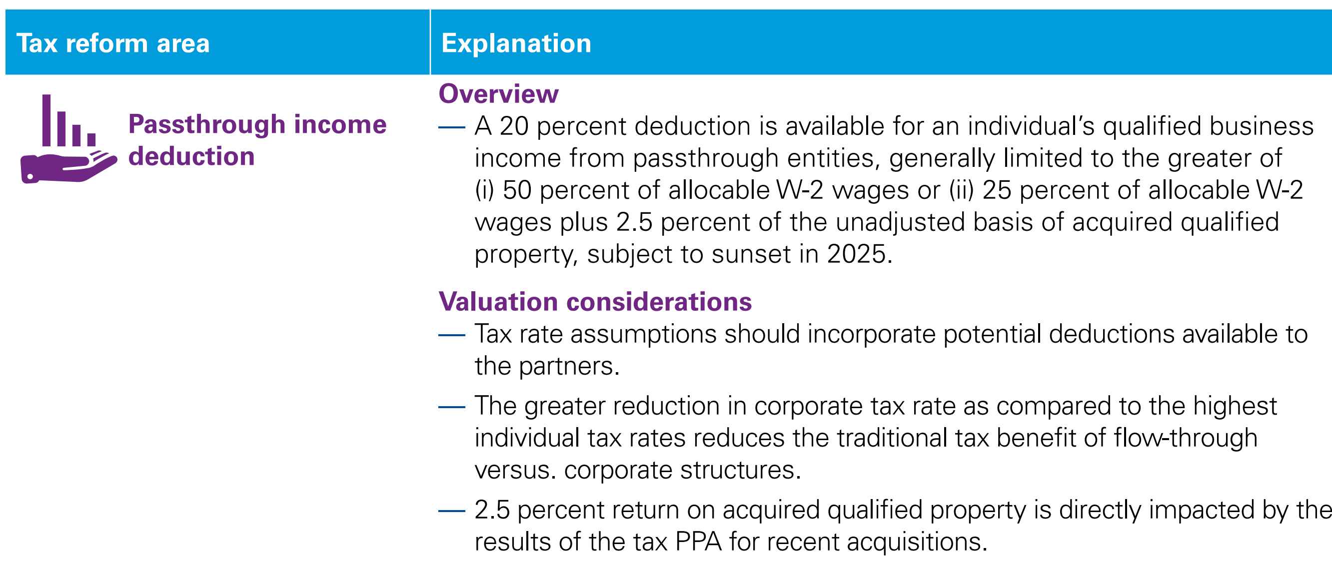

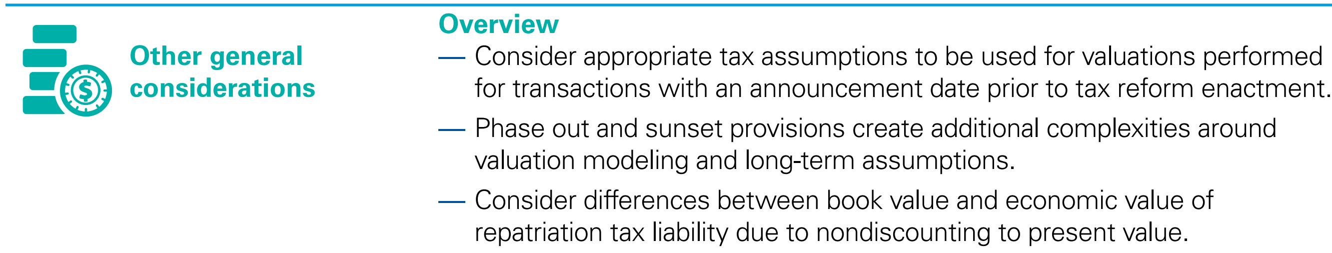

Tax reform area	Explanation
Passthrough income deduction	**Overview** — A 20 percent deduction is available for an individual's qualified business income from passthrough entities, generally limited to the greater of (i) 50 percent of allocable W-2 wages or (ii) 25 percent of allocable W-2 wages plus 2.5 percent of the unadjusted basis of acquired qualified property, subject to sunset in 2025. **Valuation considerations** — Tax rate assumptions should incorporate potential deductions available to the partners. — The greater reduction in corporate tax rate as compared to the highest individual tax rates reduces the traditional tax benefit of flow-through versus. corporate structures. — 2.5 percent return on acquired qualified property is directly impacted by the results of the tax PPA for recent acquisitions.
Other general considerations	**Overview** — Consider appropriate tax assumptions to be used for valuations performed for transactions with an announcement date prior to tax reform enactment. — Phase out and sunset provisions create additional complexities around valuation modeling and long-term assumptions. — Consider differences between book value and economic value of repatriation tax liability due to nondiscounting to present value.

Planning considerations and opportunities

- Valuations of legal entities and assets to assess tax liability and feasibility of alternate acquisition structures
- Consider additional valuation requirements for intangible assets during tax PPAs arising from the modified treatment of certain self-created property from capital gain to ordinary income.
- In an acquisition context, consider the quality and completeness of target's fixed asset records. Poor records may provide an opportunity to perform a physical inventory or other fixed assets procedures to identify additional qualifying depreciable property to allocate purchase price.
- Assess the impact that allocating a substantial portion of purchase price to qualifying depreciable property will have on other tax areas such as personal property tax, sales and use tax, deferred tax liabilities, and state income tax.
- Valuations may be required for potential modifications or redemptions of outstanding debt in order to determine gain/loss and deductibility of repurchase premium.
- Consider additional valuation needs for passthrough entities arising from new provisions regarding the taxation of gain on the sale of a partnership interest on a look-through basis for foreign holders and modification of definition of substantial built-in loss.
- Consider whether a valuation is required in the determination of a "U.S. shareholder" based on the 10 percent of vote or value criteria under section 951(b).

Valuation & Business Modeling Services and tax reform

The KPMG Valuation & Business Modeling Services practice is closely embedded with the Tax service line allowing for robust teaming on tax technical issues. Dedicated valuation specialists within the KPMG Washington National Tax office stay current on the latest developments as well as emerging topics and collaborate with engagement teams on complex tax valuation issues.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

Contact

Yuwon Pak
Managing Director
Washington National Tax - Valuation
T: 202-533-4021
E: ywpak@kpmg.com

Milind Shah
Principal
Washington National Tax - Valuation
T: 202-533-8984
E: milindshah@kpmg.com

kpmg.com/socialmedia

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