Dear Technical Director:

I want to write to you to let you know that we have seen a variance in practice in assessing a Company's valuation allowance in light of the Tax Cuts & Jobs Act ("TCJA"). With the TCJA, net operating losses generated beginning in 2018 may be carried forward indefinitely but subject to an 80% limitation. In addition, the TCJA imposed a limitation on the deductibility of interest. Interest that is not currently deductible may also be carried forward indefinitely.

Based interpretation of the ASC 740 guidance coupled with the discussions with external auditors including the Big 4, it is generally understood that the reversal of a taxable temporary differences from an indefinite-lived intangible asset is as a source of future taxable income that may be used to support the realizability of net operating losses or deferred interest carryforwards that do not expire (as long as they are in the same jurisdiction and of the same character).

I currently consult on ASC 740 matters for about 30 clients (both public and private). Several issues, I wanted to raise:

1) Scheduling the reversal of taxable temporary differences requires significant judgements. Changes to the estimated reversal patterns from year to year or interim period to interim period impacts the deferred tax asset realizability assessment and for interim periods, may impact the annual estimated effective tax rate.

2) For companies with 3-year cumulative losses, these entities generally cannot rely on forecasts of future income and are generally limited to the reversal pattern of existing taxable temporary differences in their deferred tax asset realizability assessment. As such, these entities can rely on reversal of exiting taxable temporary differences to support the net operating losses and interest carryforwards that exist as of 12/31/18 (as an example). With respect to interest, these Companies may be subject to recurring limitations. It is odd that this fact is ignored in the deferred tax asset realizability assessment as you assume future income is zero as you cannot forecast losses.

3) For companies that can forecast future income, recurring interest is included as part of the deferred tax asset realizability assessment. As such, for these companies, it is harder to access the interest carryforwards at 12/31/18 with general existing taxable temporary difference as they may have recurring limitations.

4) A question has arisen in the scheduling in connection with the basis differential between book and tax basis goodwill of Component 2 goodwill. In these circumstances, companies do not record a deferred tax liability as the Day 1 business combination accounting is iterative. However, there is an economic and tax basis differential that would nevertheless reverse and represent a source of future taxable income. Currently, the thought is to ignore this in the deferred tax asset realizability assessment.

Just wanted to share my thoughts. Hopefully we can get some clarity. Please call me if you would like to speak.
Thanks,
Peter

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