PacificCPE

COURSE

21901A

GAAP Income Tax Accounting and OBBBA Overview

Get oriented to GAAP financial reporting for income taxes and understand how the One Big Beautiful Budget Act changes the landscape. This opening section walks through course objectives, learning assignments, and the exam outline before diving into the foundational concepts of accounting for income taxes under GAAP. Whether you're refreshing your knowledge or approaching this topic for the first time, this section sets the stage for the practical and technical content that follows.

CREDIT HOURS 2 | FIELD OF STUDY ACCOUNTING | EXAM QUESTIONS 10

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Final Exam Copy ↓

LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify a factor that primarily explains the decline in the federal effective taxes-paid rate for C corporations under OBBBA beginning in 2025.
- Review the tax treatment for domestic research and experimental (R&E) expenditures found in the OBBBA of 2025.
- Review how to present the tax benefit from using an NOL on the income statement.
- Identify a feature of Section 1202 stock that was expanded by the OBBBA to encourage C corporation conversion or formation.
- Recall how to present the adjustment of the deferred tax asset and liability from a change in tax status from S to C corporation.
- Recall when an auditor must quantify the effect of a GAAP departure in the audit report.
- Identify types of carryforwards for which deferred tax assets must be recognized.
- Review the disclosures that are required by a nonpublic entity when it has not recorded any uncertain tax positions.

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GAAP AND FINANCIAL REPORTING FOR SELECTED INCOME TAX ISSUES INCLUDING CHANGES MADE BY THE OBBBA

Chapter Objective

After completing this chapter, you should be able to:

- Identify a factor that primarily explains the decline in the federal effective taxes-paid rate for C corporations under OBBBA beginning in 2025.
- Review the tax treatment for domestic research and experimental (R&E) expenditures found in the OBBBA of 2025.
- Review how to present the tax benefit from using an NOL on the income statement.

SECTION 1: GAAP INCOME TAX ISSUES – 2025 AND 2026

A. Impact of the OBBBA Tax Changes for Businesses

The 2025 Reconciliation Act, P.L. 119-21, commonly known as the *One Big Beautiful Bill Act* (OBBBA), offers significant tax benefits for businesses that will result in a decline in the amount of federal income taxes paid in years 2025 and later, as these benefits are permanent.

Examples of some of the tax benefits included:

- 100% Bonus depreciation and higher Section 179 depreciation thresholds
- 100% expensing of qualified production property (QPP)
- Expensing of domestic research and experimental (R&E) expenditures, and
- Restores the use of a 30% of EBITDA threshold for interest expense deduction limits under IRC 163(j).

Most, but not all, of these items are permanent extensions of provisions that were in the TCJA, which was effective in 2018.

In 2018, the first year in which the TCJA became effective, SEC companies surveyed paid only 9.2% in federal income taxes, with book-tax temporary differences of approximately 11.8% of book income, based on a University of Pennsylvania analysis summarized as follows:

Statutory tax rate 21.0%	21.0%
Book-tax differences and credits	(11.8%)
Effective taxes-paid rate*	9.2%

What this means is that initially, the TCJA created significant tax deferrals (11.8% of book income before taxes in 2018) that provided companies with additional cash flow for operations, investment, and overall growth. In the previous example, although the corporate effective tax rate was 21%, companies only paid 9.2%, with the remaining 11.8% deferred and representing book-tax differences that will ultimately reverse.

The challenge with temporary differences is that they ultimately reverse. For example, an entity that receives immediate write-offs from bonus depreciation in 2018 to 2021 must pay back those benefits in future years, when there is no longer any depreciation remaining for tax purposes. This is the situation in which companies found themselves in starting in 2023, with anticipation of 2027.

The following table illustrates the impact of the accelerated, front-loaded write-offs from the 2017 Tax Act, the reversal in 2023, and the anticipated reversal in 2027 if the OBBBA of 2025 had not been passed.

Effective Tax Rates (Taxes-Paid Rate) - SEC Companies

	Tax Cuts and Jobs Act			OBBBA 2025
	2018 Actual	2023 Actual	2027 Was Expected	2025 and later Expected
Statutory tax rate 21.0%	21.0%	21.0%	21.0%	21.0%
Book-tax differences and credits	(11.8%)	(3.7%)	(2.1%)	(11.8%)
Effective taxes-paid rate*	9.2%	17.3%	18.9%	9.2%

***: % taxes paid based on book income**

Source: University of Pennsylvania as modified by the Author

Notice that, starting in 2023, the book-tax temporary differences dropped to only 3.7% of book income and will further decline to 2.1% in 2027. The reduction in book-tax differences is fueled by reversals of tax benefits from the TCJA, many of which expired from 2022 through 2027. The

following table summarizes the larger items, namely the phase-out of bonus depreciation and research and experimental expenditures. Further, the interest deduction limitation under IRC 163(j) is limited by the adjusted taxable income (ATI) formula, which no longer permits an add-back of depreciation and amortization starting in 2022.

Major TCJA Provisions That Were Scheduled to Impact Higher Effective Tax Rate (Taxes-Paid Rate)

2018: First Year- Tax Cuts and Jobs Act

- Increased 179 Expensing and 100% Bonus Depreciation
- Limitation of Net Interest Deductions
- Limitation of Net Operating Loss Deduction

2022:

- Amortization of Research and Experimental Expenditures only (no expensing option)
- More restrictive change in rules for Limitation of Net Interest Deductions (based on EBIT instead of EBITDA)

2023:

- Start of phase-out of 100% Bonus Depreciation.

2027:

- Complete phase-out of Bonus Depreciation (zero allowed in 2027)

Source: The Author

Observation

The previous analyses are based on the 2017 Tax Act, exclusive of the effects of extensions of the 2017 provisions and the impact of the new 2025 OBBBA on tax rates.

Assume that in 2025, the following tax changes are made to C corporations:

- The 21% C corporation tax rate remains in effect.
- There is 100% expensing of bonus depreciation and an increase in Section 179 limits
- There is 100% expensing of qualified production property (QPP)
- There is expensing of R&E expenditures in IRC 174
- The interest deduction formula under IRC 163(j) is restored to 30% of EBITDA, rather than 30% of EBIT (before the add-back of depreciation and amortization).

What is the impact of these tax changes in 2025, 2026, and beyond under the OBBBA?

Looking back at the University of Pennsylvania study regarding the 2017 TCJA, the study concluded that the book-tax differences and credits related to the TCJA in year one (2018) reduced the effective tax rate from 21.0% to 9.2%.

The TCJA effect in its first year (2018) is anticipated to be the same in 2025 under the OBBBA, as key changes have been expanded, such as 100% bonus depreciation and 100% expensing of R&E, two key drivers of the effective corporate tax rates.

Effective Federal Tax Rates (Taxes-Paid Rate)

	TCJA	OBBBA	GOAL
	2018 Actual	2025 +	Did not pass
Statutory tax rate	21.0%	21.0%	(1) 15.0%
Book-tax differences and credits	(11.8%)	(11.8%)	(11.8%)
Effective taxes-paid rate*	9.2%	9.2%	3.2%

***: % taxes paid based on book income**

Source: The Author based on previous study performed by Univ of Pennsylvania

(1): The OBBBA had targeted reducing the corporate rate to 15% from 21%, but Congress could not fit this change in under the limited Reconciliation approach to passing the OBBBA. The Trump administration has noted that it still has a targeted corporation tax rate of 15%, which, coupled with other corporation deductions, would yield an effective (federal taxes paid) tax rate of about 3.2%.

The previous chart illustrates what is expected to occur in 2025 and beyond due to changes made by the OBBBA.

Consider the following from the previous chart:

a. An extension of the 100% bonus depreciation and R&D expensing is expected to yield results similar to 2018, which would create a book-tax difference (M-1) of about 11.8%, driving the federal income tax rate down to 9.2% (21% less 11.8%).
b. For manufacturers and non-manufacturers, deferred tax liabilities would increase to reflect future federal income taxes payable when the book-tax differences (from bonus depreciation and R&D deductions) reverse.

c. With the expansion of Section 1202 stock for C corporations, it may warrant a change from S corporation or LLC status to C corporation status.

B. R&E costs under the OBBBA 2025

The OBBBA dramatically changes the tax treatment of R&E costs starting in 2025.

- Domestic R&E costs are expensed effective for tax years after December 31, 2024.
- Businesses may choose to capitalize and amortize R&E costs over a minimum of 60 months.

Comparison of Tax Treatment for R&E Costs Versus GAAP R&D Costs

OBBBA 2025 Versus ASC 730

Feature	R&E Under IRC 174 (OBBBA 2025)	R&D Under U.S. GAAP (ASC 730)	Deferred Income Taxes?
Treatment of Domestic R&E Costs	Expensed immediately starting in 2025. Exception: • Businesses may elect to capitalize and amortize R&E costs over a minimum of 60 months.	Expensed immediately as R&D per ASC 730. Exceptions: May be capitalized for GAAP if: • Internal-use software, or • Software for sale, lease or marketed	No deferred tax asset or liability is required if expensed for both tax and GAAP. Exceptions: DIT asset or liability may apply if: • Capitalized for GAAP as internal-use software or software for sale, lease or marketed, a temporary difference and deferred tax liability. • Capitalized for tax under 60-month election.
Treatment of Foreign R&E Costs	Capitalized and amortized over 15 years	Expensed immediately as R&D per ASC 730. Exceptions: May be capitalized for GAAP if: • Internal-use software, or • Software for sale, lease or marketing	Yes. Deferred tax asset or liability required.