Accounting for income taxes considerations for the implementation of the Bermuda corporate income tax

The government of Bermuda recently enacted a corporate income tax (CIT). This article highlights selected accounting for income taxes considerations of the enactment of the regime under U.S. generally accepted accounting principles (US GAAP).

Background

On December 27, 2023, legislation implementing a CIT in Bermuda received governor's assent, which we believe represents the *enactment date* for US GAAP. The Bermuda income tax rules are intended to align as closely as possible to the Organisation for Economic Co-operation and Development's global anti-base erosion (GloBE) rules to support consistent and predictable tax outcomes.

Key provisions of the CIT include, but are not limited to, the following:

- Applies to certain Bermuda tax resident entities and Bermuda permanent establishments that are constituent entities of a multinational group with consolidated annual revenue of at least €750 million in at least two of the four preceding fiscal years, subject to certain exemptions

- Effective for fiscal years beginning on or after January 1, 2025, with a five-year deferred effective date for certain groups with a limited international footprint

- 15% statutory income tax rate

- The calculation of taxable income begins with *financial accounting net income or loss* (FANIL) determined in accordance with the acceptable financial accounting standard used in preparing the consolidated financial statements of the ultimate parent entity of the group or, at the election of the Bermuda constituent entity, another approved financial accounting standard. However, the amounts are subject to various mandatory and elective adjustments intended to mitigate potential distortions arising from the application of certain financial accounting standards.

- Introduces an economic transition adjustment (ETA), which allows for an elective increase or decrease in the tax basis of assets and liabilities (excluding goodwill) held as of September 30, 2023 to fair value

- Provides for an operating loss carryforward as follows:

    - The opening tax loss carryforward is based on amounts generated after September 30, 2023. However, if an entity does not elect to have an ETA, the statute provides the opening tax loss carryforward includes losses incurred in the five fiscal years preceding the effective date.

  - Operating loss carryforwards may be shared among members of the Bermuda constituent entity group.

- Provides relief from double taxation, including:

  - A foreign tax credit based on the adjusted amount of foreign current and deferred taxes accrued by the group

  - An entity may reduce its taxable income by the amount attributable to certain U.S. owners for 2025 and 2026

- Includes elections for certain entities to be considered fiscally transparent [1] or not fiscally transparent

Accounting for income taxes considerations of the Bermuda CIT

The enactment of the CIT regime will require Bermuda business entities to determine whether they are in scope, and, if so, to recognize Bermuda deferred taxes for the first time. As this represents the enactment of a regular tax system, and not an alternative minimum tax regime, deferred taxes should be recognized in the period that includes the date of enactment. Entities should allocate the entire adjustment to income from continuing operations in the period that includes the enactment date, regardless of where the underlying item was originally recognized.[2]

The CIT includes various transition adjustments that may affect the recognition of deferred taxes in the period of enactment and as such should be considered as part of the initial measurement in the period that includes the December 2023 enactment date. For example, an entity that expects to elect the ETA may need to measure the fair value of its assets and liabilities in order to determine the tax basis of those items to use in determining deductible or taxable temporary differences utilized in recognizing deferred taxes. Conversely, an entity that does not expect to elect the ETA may need to determine the amount of loss carryforwards that would have been generated during the preceding five years.

We would generally expect entities to schedule the reversal of basis differences as of the date of enactment and any subsequent balance sheet dates to determine which basis differences would reverse prior to the CIT becoming effective versus temporary differences that would reverse after it becomes effective. This would require an understanding of the future taxability of the entity, such as whether the entity is eligible for a five-year deferral of the effective date. In addition, when measuring deferred taxes, an entity should consider whether it will be subject to the full Bermuda statutory income tax rate, or if only part of its income will be subject to the full rate, such as when different elections around fiscal transparency have been made for different ownership interests or the entity is partially owned by U.S. owners as amounts that reverse in 2025 and 2026 that are attributable to U.S. owners are excluded from taxable income. Generally, we believe deferred taxes would be measured at a partial rate to account when a portion of the entity's income that will not be subject to tax as a result of the nature of its ownership interests.

Entities should also consider the extent to which deferred taxes for the Bermuda effect of temporary differences under non-Bermuda regimes should be recognized when those non-Bermuda temporary differences reverse. For example, a Bermuda entity for which a U.S. federal section 953(d) election is in place may generate a foreign tax credit for the U.S. federal current tax incurred and the credit generated

[1] Fiscally transparent means, in respect of an entity (other than a Bermuda Constituent Entity), that the income, expenditure, profit or loss of such entity shall be treated as if it were derived or incurred by the direct owner of such entity in proportion to the direct owner's interest in such entity.
[2] See paragraph 5.015 of KPMG's Accounting for Income Taxes handbook for additional considerations on measuring and allocating the effect of a change in income tax law.

may be affected by an adjusted amount of the U.S. federal deferred tax recognized by the entity. We believe deferred taxes for the Bermuda effect of such temporary differences under non-Bermuda regimes should be measured using either the *dollar-for-dollar* approach or *lesser-of* approach.[3]

We would generally expect the amount of deferred taxes recognized to be determined based on the elections that management expects to make. Further consideration should be given as to whether any of the elections are within the scope of the guidance on changes in tax status, which generally require recognition of the change in status in the period of filing or approval. However, we would not object if an entity concluded its initial election as a result of the new law is not a change in status, even if its initial election is to a status other than its default status.

Once recognized, any deferred tax assets established in accounting for the enactment of the new CIT should be evaluated for recoverability. As part of this analysis, an entity may conclude that a deferred tax asset provides no or limited incremental tax benefit if foreign tax credits generated in future years will be displaced by the related temporary difference or carryforward.[4]

The date of enactment impact of the Bermuda CIT may not be limited to Bermuda entities. To the extent an owner of a Bermuda entity or the head office of a Bermuda permanent establishment recognizes deferred taxes for temporary differences in Bermuda, the home country effect of the Bermuda deferred taxes should be considered. For example, if a U.S. owner of a Bermuda controlled foreign corporation is subject to Subpart F income, it may have a history of recognizing U.S. federal deferred taxes for temporary differences of the Bermuda entity. That U.S. owner may now need to also consider the U.S. federal effect of Bermuda deferred taxes on future U.S. foreign tax credits when recognizing its U.S. federal income taxes.[5]

As entities assess the impact of the new legislation, there may be elements where it is not entirely clear how a court would interpret the law. Accordingly, companies should also assess the impact the new law will have on the accounting for uncertainty in income taxes. Those assessments may need to be revised as future guidance is issued with any adjustments generally recognized in the period in which such guidance is issued. If there are tax positions expected to be reported on a tax return that are not more likely than not to be sustained upon examination based on the technical merits, an entity should not reflect the benefits within the financial statements.

As highlighted in this publication, the introduction of the Bermuda CIT law includes various provisions that affect the calculation of deferred tax that must be considered in preparing financial statements that include the date of enactment. The impact of the introduction of the tax law will depend on a company's specific facts and circumstances and each element will need to be analysed individually. In some cases, the impact will be easy to calculate. In other cases, we expect that a company will make its best estimate and may revise that estimate in future periods as a result of new information, clarifications of the application of the tax law and more experience. In all cases, the financial statements should include appropriate disclosures, including relevant information about major sources of estimation uncertainty in applying the new tax law.

Conclusion

This discussion highlights selective areas of accounting for income taxes that may be impacted by the new CIT, but it is not all inclusive. An entity's specific facts and circumstances should be assessed in determining the accounting for income taxes impact upon enactment.

[3] See paragraphs 7.068 through 7.069 of KPMG's *Accounting for Income Taxes* handbook (February 2023) for a discussion of the *dollar-for-dollar* approach and the *lesser-of* approach in a foreign branch context.
[4] See paragraphs 4.048, 4.123a and 4.123b of KPMG's *Accounting for Income Taxes* handbook (February 2023) for considerations of future credits.
[5] See paragraphs 7.077 through 7.085 and 7.068 through 7.069 of KPMG's *Accounting for Income Taxes* handbook (February 2023) for considerations around recognizing deferred tax for Subpart F income and deferred taxes for future foreign tax credits related to foreign deferred taxes.

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