FASB Addresses 2017 Tax Act Issues

Not surprisingly, the first major tax reform in 32 years and its signing so close to year-end have generated a multitude of implementation questions. The Financial Accounting Standards Board (FASB) recognizes the urgency of the concerns and recently met to address some of the financial reporting issues that have arisen and are summarized below.

Although the tax reform does not go into effect until 2018, current accounting guidance in Accounting Standards Codification (ASC) 740, Income Taxes, requires companies to account for the effects of changes in income tax rates and deferred tax balances in the period when the legislation is enacted. Since President Donald Trump signed the Tax Cuts and Jobs Act (Tax Act) on December 22, 2017, the impact reporting must be reflected in 2017's year-end and fourth-quarter financial statements.

Deferred Tax Assets & Liabilities

As noted above, companies must reflect the effect of tax changes in 2017. The accounting for changes in tax rates is complicated; sometimes the deferred tax liabilities and assets relate to items held in accumulated other comprehensive income (AOCI). This most frequently occurs in banks, insurance companies and other entities that hold available-for-sale securities or engage in hedging as well as companies with defined benefit pension plans and those with foreign currency translation. Current generally accepted accounting principles (GAAP) require the effects of the change in the corporate tax rate (from 35 percent to 21 percent) on deferred tax liabilities and assets to be recognized as an adjustment to income tax expense and included in income from continuing operations even though the tax effects were initially recognized directly in OCI. This would leave stranded balances in AOCI that would not reflect the appropriate tax rates.

FASB agreed to provide relief. An exposure draft will be issued shortly that would permit a one-time reclassification from AOCI to retained earnings for stranded tax effects resulting from the new tax rates. (Any prior stranded effects would remain in AOCI.) The amount of the reclassification would be the difference between the 35 percent historical corporate tax rate and the newly enacted 21 percent corporate tax rate. The guidance could be applied to each period in which the Tax Act's effect is recorded, which may be retrospectively to the date of enactment in some cases (see Staff Accounting Bulletin (SAB) 118 guidance below).

If a reclassification is made, entities would be required to disclose the nature and reason for the change, a description of the prior period information that has been retrospectively adjusted and the change's effect on affected financial statement line items.

The final standard, if approved, would be effective for all entities for annual reporting periods beginning after December 15, 2018. Early adoption would be permitted for interim or annual financial statements that have not been issued or made available for issuance.

Cognizant of the urgency of timely resolution, FASB elected the shortest comment period allowed—15 days—and has already solicited positive feedback from key stakeholders, including banking trade groups, tax professionals, banking regulators and accounting firms. This will substantially reduce the time frame for issuance of a final standard.

However, if the standard is finalized after 2017 financial statements have been issued, an entity could still early adopt for first-quarter 2018 interim reports and make the reclassification retrospective to the 2017 period presented.

While this proposal will not change the effect on net income, the adjustment between AOCI and retained earnings will allow ending regulatory capital to be appropriately stated and also avoid onerous operational requirements to keep track of the amounts that would have been "stranded" within AOCI.

Other Implementation Issues

FASB addressed several other Tax Act implementation issues that will not require standard setting. FASB has issued a frequently asked questions (FAQ) document summarizing its conclusions on the first issue. An FAQ document is being drafted for the other issues and will be reviewed at a January 18, 2018, meeting and posted to FASB's implementation webpage shortly afterward.

Application of SAB 118 by Private Companies & Not-for-Profits (NFP)

In December, the U.S. Securities and Exchange Commission (SEC) issued SAB No. 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act*, which provides timing relief in accounting for the tax reform changes. These SEC interpretations are not directly applicable to private companies and NFP entities. However, in the past some private companies and NFP entities have voluntarily applied the guidance in SABs.

FASB concluded that due to the long-standing practice of nonregistrants voluntarily applying SAB guidance, private companies and NFPs may choose (but are not required) to apply the Tax Act relief provided by SAB 118. Financial statements of nonregistrants electing this relief would be in compliance with GAAP.

SAB 118

Due to the magnitude of the tax changes and the urgency of quarter-end and year-end filing deadlines, the SEC recognizes that a registrant may not have the necessary information available, prepared or analyzed to complete the required accounting. SAB 118 creates a measurement period—up to a year from the Tax Act's signing on December 22, 2017—to give companies sufficient time to finalize their accounting for the tax law changes. During the measurement period, the SEC expects that entities will act in good faith to complete the accounting under ASC 740. The guidance highlights three possible scenarios, which are noted below. An entity may need to apply all three scenarios in finalizing its accounting for the Tax Act based on its available information.

- **Measurement of certain income tax effects is complete.** Registrants must reflect the tax effects of the Tax Act for which the accounting is complete. These amounts are final and **not** provisional.
- **Measurement of certain income tax effects can be reasonably estimated.** Registrants must report provisional amounts for tax effects with incomplete accounting when they can determine a reasonable estimate. The provisional amount should be included in the financial statements in the first reporting period it was determined to be a reasonable estimate.
- **Measurement of certain income tax effects cannot be reasonably estimated.** An entity should **not** adjust its current or deferred taxes until a reasonable estimate can be determined. In this case, an entity would continue to apply ASC 740 based on the tax laws in effect immediately prior to the Tax Act's enactment.

During the measurement period, an entity may adjust provisional amounts or report additional tax effects for items not initially provisioned for based upon additional information about facts and circumstances that existed as of the enactment date that, if known, would have affected the income tax effects initially reported as provisional amounts. These changes should be included in income from continuing operations as an adjustment to tax expense in the reporting period the amounts are determined. Any income tax effects of events unrelated to the Tax Act should **not** be reported as measurement period adjustments.

The following disclosures are required:

- Qualitative disclosures of the Tax Act's income tax effects for which the accounting is incomplete
- Disclosures of items reported as provisional amounts
- Disclosures of existing current or deferred tax amounts for which the Tax Act's income tax effects have not been completed
- The reason why the initial accounting is incomplete
- The additional information that is needed to be obtained, prepared or analyzed to complete the accounting requirements under ASC 740
- The nature and amount of any measurement period adjustments recognized during the reporting period
- The effect of measurement period adjustments on the effective tax rate
- When the accounting for the Tax Act's income tax effects has been completed

Whether to Discount the Tax Liability on the Deemed Repatriation

Under the Tax Act, companies are taxed on undistributed and previously untaxed post-1986 foreign earnings and profits. This deemed repatriation tax may be paid over an eight-year period. The new tax does not impose interest on the unpaid portion of the liability. Stakeholders have questioned whether the tax liability should be discounted, following the current guidance in ASC 835-30, *Interest – Imputation of Interest*.

*FASB concluded that entities **cannot** discount this tax liability.*

Several board members noted this conclusion may not reflect the economic situation; however, it does reflect GAAP as it is currently written. ASC 740 prohibits the discounting of deferred taxes—FASB analogized this prohibition also would extend to the unique liability created by the tax on the deemed repatriate of foreign earnings. In addition, FASB noted that ASC 835 generally applies to liabilities resulting from arm's-length bargained transactions and not tax liabilities and pointed to the exception in ASC 835-30-15-3(e): "Transactions where interest rates are affected by the tax attributes or legal restrictions prescribed by a governmental agency (for example, industrial revenue bonds, tax exempt obligations, government guaranteed obligations, income tax settlements)."

Whether to Discount Alternative Minimum Tax (AMT) Credits That Become Refundable

The Tax Act repeals the AMT. Any existing AMT credit carryforwards can reduce the regular tax obligation in 2018, 2019 and 2020. Any AMT credit carryforwards that do not reduce regular taxes are eligible for a 50 percent refund in 2018 through 2020 and a 100 percent refund in 2021. This results in full realization of an existing AMT credit carryforward irrespective of future taxable income. Stakeholders have questioned whether the AMT credits that will be used or ultimately refunded should be discounted.

*FASB concluded that AMT carryforwards presented at a receivable **cannot** be discounted, for the same reasons noted in the issue above.*

FASB highlighted guidance in ASC 740-10-50-3 that requires an entity to disclose the amounts and expiration dates of tax credit carryforwards. This disclosure would apply whether an entity presents the AMT credit carryforward as a deferred tax asset or a receivable.

Accounting for the Base Erosion Anti-Abuse Tax (BEAT)

An entity must pay a BEAT if the BEAT is greater than its regular tax liability. The BEAT calculation eliminates the deduction of certain base erosion payments made to foreign corporations, but the calculation includes a lower tax rate on the resulting income. Some stakeholders have questioned whether deferred tax assets and liabilities should be measured at the regular tax rate (21 percent) or the lower BEAT tax rate (10 percent) if the taxpayer expects to be subject to BEAT in future years.

> *FASB concluded entities should apply their regular tax rate to deferred tax assets/liabilities. Incremental effects of BEAT should only be reflected in the year BEAT occurs.*
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> *FASB analogized accounting for BEAT to the treatment of AMT taxes under prior tax law. Even if an entity believes it will be subject to BEAT for the foreseeable future, the logic in ASC 740-10-30-11 is still applicable: "No one can predict whether an entity will always be an alternative minimum tax taxpayer."*
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> *FASB will closely monitor subsequent financial statement accounting and disclosures to determine if further action is required.*

Accounting for Global Intangible Low-Taxed Income

The Tax Act imposes a tax on global intangible low-taxed income (GILTI) on foreign income in excess of a deemed return on tangible assets of foreign corporations. In general, this income will be effectively taxed at a 10.5 percent tax rate. Some stakeholders have questioned if deferred tax assets and liabilities should be recognized for basis differences expected to reverse as GILTI in future years or if the tax on GILTI should be included in the period in which it is incurred.

> *FASB concluded that either approach would be acceptable, since the language in ASC 740 is ambiguous. Entities should disclose the policy elected.*

BKD will continue to follow developments on this topic. For more information on how the new tax law could affect your organization, contact your BKD advisor.

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