Financial Reporting Alert 18-2
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Contents

FASB Makes Decisions About the Application of Income Tax Guidance to Certain Tax Reform Provisions

At a meeting on January 10, 2018, the FASB made a number of decisions related to the application of ASC 740[1] to certain provisions of the new tax reform legislation commonly known as the Tax Cuts and Jobs Act (the "Act").[2]

Proposed Accounting Standards Update — Accumulated Other Comprehensive Income

Some constituents in the banking and insurance industries have expressed concerns about the requirement in ASC 740 that the effect of a change in tax laws or rates on deferred tax assets and liabilities must be included in income from continuing operations in the reporting period that contains the enactment date of the change. That guidance applies even in situations in which the tax effects were initially recognized directly in other comprehensive income at 35 percent, resulting in "stranded" amounts in accumulated other comprehensive income (AOCI) related to the income tax rate differential. Such accounting could have a negative effect on regulatory capital for certain banks and is viewed by some to be confusing to investors.

For more information and analyses related to tax reform, visit our **U.S. Tax Reform Insights** page on Deloitte.com.

1 FASB Accounting Standards Codification (ASC) Topic 740, *Income Taxes*.
2 H.R. 1/Public Law 115-97, "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."

At the meeting, the Board voted to add a project to its technical agenda and issue a proposed Accounting Standards Update (ASU) that would require entities to make a one-time reclassification from AOCI to retained earnings for stranded tax effects resulting from the newly enacted corporate tax rate. The amount of the reclassification would be calculated on the basis of the difference between the historical and newly enacted tax rates. The Board considered but rejected an alternative that would include the foregoing **plus** all prior and future changes in tax rates (federal, foreign, state, and local). The proposed ASU will have a 15-day comment period.

The guidance in the proposed ASU would be effective for fiscal years beginning after December 15, 2018, and for interim periods within that year. It would be applied to each period in which the effect of the Act (or portion thereof) is recorded, and would be applied retrospectively as of the date of enactment if early adoption is not elected. The Board decided to permit early adoption for public business entities for which financial statements have not yet been issued and for all other entities for which financial statements have not yet been made available for issuance.

As noted in the meeting handout, the Board decided to require the following transition disclosures:

- "The nature of and reason for the change [in accounting principle]."
- "A description of the prior period information that has been retrospectively adjusted."
- "The effect of the [reclassification] on affected financial statement line items."

The Board also decided to add a broader project to its research agenda on the accounting for subsequent effects of changes in deferred tax assets and liabilities that were originally charged or credited directly to equity ("backwards tracing," which is generally prohibited under existing GAAP).

At its meeting on February 7, 2018, the FASB reached tentative conclusions related to its proposed ASU *Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income*. See Deloitte's February 12, 2018, *Financial Reporting Alert* for more information.

Implementation Issues

At the meeting, the FASB discussed five implementation issues and directed the staff to draft Q&A documents to reflect the views expressed on those issues. The drafts were circulated to the Emerging Issues Task Force for discussion at its meeting on January 18, 2018, the FASB then issued Q&A documents and posted them to its Web site. While the guidance in these documents will not be codified in the ASC, we expect that entities will apply it. The five implementation issues are as follows:

SAB 118[3]

The views and interpretations of the SEC staff (such as those expressed in SAB 118) are not directly applicable to private companies and not-for-profit entities. However, in the past, some private companies and not-for-profit entities have voluntarily applied the guidance in SABs.

The Board agreed with the FASB staff that private companies and not-for-profit entities may apply SAB 118.

The Q&A can be found here.

[3] SEC Staff Accounting Bulletin Topic 5.EE, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act" (added by SAB 118).

Whether to Discount the Tax Liability for the Deemed Repatriation Transition Tax

Under the Act, companies are taxed on undistributed and previously untaxed post-1986 foreign earnings and profits. This deemed repatriation transition tax may be paid over an eight-year period. The new tax does not impose interest on the unpaid portion of the liability. Some have questioned whether the tax liability should be discounted.

The Board agreed with the staff that the liability should not be discounted. Reasons given included that the liability (1) is outside the scope of ASC 835-30[4] in accordance with ASC 835-30-15-3(e), (2) was imposed rather than established through an exchange transaction, and (3) is not fixed and determinable since it will be affected by uncertain tax positions. Some Board members observed that such accounting complies with the literature but does not reflect the economics. There was some discussion about whether the Board should undertake a separate project to reconsider ASC 835-30, but the Board elected not to do so.

The Q&A can be found here.

Whether to Discount Alternative Minimum Tax Credits That Become Refundable

Under the Act, the alternative minimum tax (AMT) regime is repealed. Any existing AMT credit carryforwards can reduce the regular tax obligation in 2018, 2019, and 2020. AMT credit carryforwards that do not reduce regular taxes are eligible for a 50 percent refund from 2018 to 2020 and a 100 percent refund in 2021. This results in full realization of an existing AMT credit carryforward irrespective of future taxable income. Some have questioned whether the AMT credits that will be used or ultimately refunded should be discounted.

The Board agreed with the FASB staff that refundable AMT credits should not be discounted, whether recognized as deferred tax assets or tax receivables. The staff's reasoning was similar to that described above for the deemed repatriation transition tax.

The Q&A can be found here.

Accounting for the Base Erosion Anti-Abuse Tax

An entity must pay a base erosion anti-abuse tax (BEAT) if 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 have questioned whether deferred tax assets and liabilities should be measured at the regular tax rate or the lower BEAT tax rate if the taxpayer expects to owe BEAT in future years. Under one view, BEAT would be treated as a parallel tax regime that could require deferred tax assets and liabilities to be measured at the BEAT rate to the extent that a taxpayer expects temporary differences to reverse during periods in which the BEAT rate would be applicable. The second view analogizes to the AMT guidance (even though there is no credit carryforward provision) under which deferred tax assets and liabilities are measured at the regular tax rate.

The Board agreed with the FASB staff that payment of incremental BEAT in any year would be reflected as a period expense. Deferred taxes should be computed by using the regular statutory rate and not the lower BEAT rate. The staff reasoned that because the BEAT can only be incremental to the regular tax, it is more similar to an AMT, and that reflecting deferred tax assets and liabilities at the lower BEAT rate could be misleading since the BEAT will only be paid when it is higher than the income tax computed at the statutory rate of 21 percent.

The Q&A can be found here.

[4] FASB Accounting Standards Codification Subtopic 835-30, *Interest: Imputation of Interest*.

Accounting for Global Intangible Low-Taxed Income

The global intangible low-taxed income (GILTI) provisions of the Act impose a tax 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 (21 percent statutory rate but with a deduction of up to 50 percent of the included taxable income). Some have questioned whether the tax on GILTI should be included in the period in which it is incurred or whether deferred tax assets and liabilities should be recognized for basis differences expected to reverse as GILTI in future years. Views supporting each method include the following:

- *Record the tax effects of GILTI when paid as a period expense* — GILTI is a tax on aggregate foreign earnings and is not imposed on an investment-by-investment basis, and the tax depends, in part, on future events such as future income.
- *Incorporate GILTI in the measurement of deferred taxes* — The GILTI inclusion is similar to an inclusion under Subpart F;[5] in existing practice, potential Subpart F income is typically incorporated into the measurement of deferred taxes. Also, some believe that this method better reflects the economics of the imposed tax.

The Board agreed with the FASB staff that ASC 740 does not provide guidance that is directly on point and that stakeholders have expressed support for both views. Hence, companies may elect either view and disclose the method being used. The FASB staff will monitor practice as it develops through the second quarter of 2018 and then assess whether it should propose further guidance.

The staff acknowledged that there are additional interpretive issues that exist if GILTI is factored into the measurement of deferred taxes, but it did not elaborate. We understand, however, that there are diverse views about how to measure temporary differences and what tax rate to use.

The Q&A can be found here.

[5] Internal Revenue Code Subpart F, "Controlled Foreign Corporations."