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FASB Discusses Accounting Issues Arising from Tax Reform

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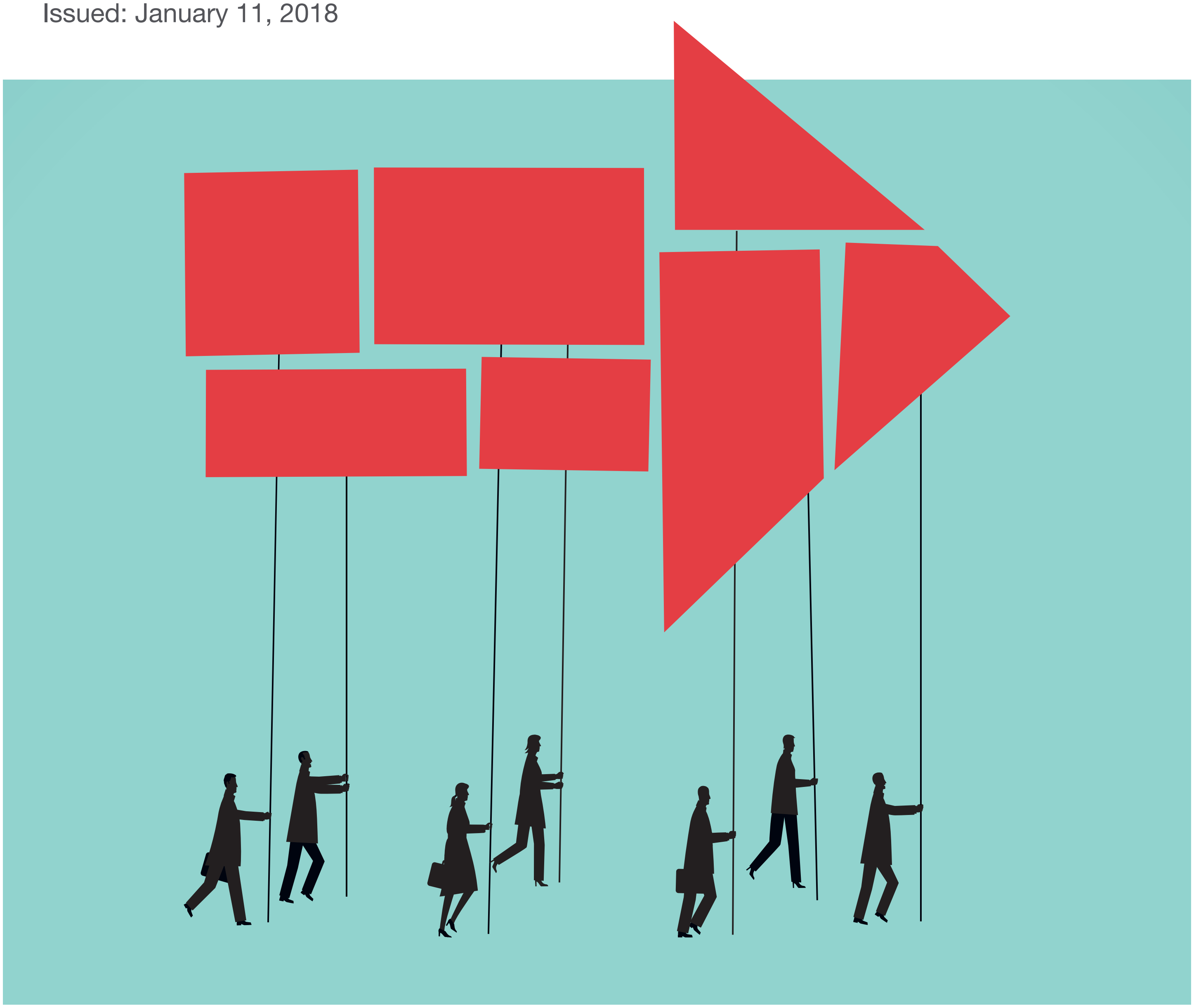

DIXON HUGHES GOODMAN LLP

FASB DISCUSSES ACCOUNTING ISSUES ARISING FROM TAX REFORM

On January 10, 2018, the Financial Accounting Standards Board (FASB) met in order to discuss various accounting issues arising from the Tax Cuts and Jobs Act (the "Tax Act") enacted on December 22, 2017. We have included below a summary of the topics discussed and tentative decisions reached during this meeting.

At a Glance

At its January 10, 2018 Board meeting, the Board directed the FASB staff to prepare a proposed Accounting Standards Update for exposure that would require a one-time reclassification from accumulated other comprehensive income to retained earnings for the "stranded tax effects" of the newly enacted corporate tax rates related to deferred tax assets or liabilities originally recorded in other comprehensive income.

In addition, the Board discussed the following topics, and while no decisions were made, the Board was supportive of the staff's preliminary views on these topics:

+ To not object to private companies and not-for-profit entities applying the guidance in SEC Staff Accounting Bulletin No. 118 regarding reporting the effects of the Tax Act when determination of the impact of all of the provisions has not been completed.
+ The tax liability related to the deemed repatriation of undistributed and untaxed foreign earnings and profits should not be discounted to reflect the time value of money.
+ Alternative minimum tax (AMT) tax credits that will be used or ultimately refunded should not be discounted to reflect the time value of money.
+ Deferred tax assets and liabilities that may reverse and be taxed under the base erosion anti-abuse tax (BEAT) regime should be measured and recognized under the regular tax regime, not based on the lower tax rates of BEAT.
+ Under the global intangible low-taxed income (GILTI) provisions of the Tax Act, entities will have an accounting policy election with respect to treatment of basis differences that may be taxed as GILTI in the future as to whether they should be recognized currently or included in the period incurred.

None of the above conclusions have been finalized. The reclassification of the stranded tax effects in accumulated other comprehensive income will go through an accelerated, but complete, standard setting process of exposure, comment, re-deliberation, and if approved, adoption. The other matters are expected to be addressed as staff technical questions and answers, considered at the January 18 meeting of the Emerging Issues Task Force, and ultimately posted to the "Implementing New Standards" information section of the FASB's website.

The following provides additional background and information on the discussions of the January 10 Board meeting.

Should a narrow-scope project on the reclassification of certain tax effects stranded in accumulated other comprehensive income be added?

Under current guidance, when deferred tax accounts are adjusted for the effect of a change in tax laws or rates, the effect shall be included in income from continuing operations for the period that includes the enactment date (Accounting Standards Codification (ASC) 740-10-45-15). This guidance is applicable even in situations in which deferred tax liabilities and assets are related to items presented in accumulated other comprehensive income. Based on these circumstances, the effects of the reduction in the corporate rate on deferred tax liabilities and assets would 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 other comprehensive income. Stakeholders are requesting that the FASB allow the effects of the change in tax rate on deferred taxes that were originally recorded in other comprehensive income ("OCI") to be reflected within OCI or in other words allow backwards tracing.

As discussed in the Board meeting handout, a broader project on backwards tracing does not lend itself to a project that could be completed in the short term. Accordingly, the discussion focused on the "stranded tax effects" in accumulated other comprehensive income (AOCI) resulting from recognizing in income from continuing operations the change in the tax rates on deferred tax assets and liabilities originally recognized in OCI. Two alternatives were discussed – Alternative A, which would require a one-time reclassification from AOCI to retained earnings limited solely to the stranded tax effects from the newly enacted Federal tax rates, and Alternative B, which would require reclassification from AOCI to retained earnings for all existing stranded tax effects from the current and prior tax rate changes (including tax rate changes in state and foreign jurisdictions). Under alternative B, the guidance would require similar reclassifications for the effects of future tax rate changes when enacted. Concern was expressed with the amount of time required for research, outreach and understanding of the effort and cost that implementation of Alternative B would require, and given the timeframe needed for adoption of guidance if it was to be beneficial, the Board decided on Alternative A.

Accordingly, the Board directed the staff to prepare a draft proposed Accounting Standards Update ("ASU") for exposure that would require reclassification of the stranded tax effects resulting from the newly enacted Federal corporate tax rate from AOCI to retained earnings. The exposure period is expected to be fifteen days from issuance of the proposed ASU. The Board indicated the effective date for all entities would be for fiscal years beginning after December 15, 2018, with early adoption permitted for financial statements that have not been issued/available to be issued.

The Board decided to add a broader project on backwards tracing to its research agenda.

Application of Staff Accounting Bulletin by private companies and not-for-profit entities

The SEC staff recently issued Staff Accounting Bulletin No. 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act* (SAB 118), to provide guidance for public companies in accounting for income tax effects of the Act. Stakeholders have questioned whether this guidance can be applied to private companies and not-for-profit entities.

The Board was supportive of the FASB staff's position that they would not object to a private company or not-for-profit entity voluntarily applying the guidance set forth in SAB 118, and concluded such application would be in accordance with accounting principles generally accepted in the United States (US GAAP).

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 causing stakeholders to question whether the tax liability should be discounted to reflect the time value of money.

The Board was supportive of the FASB staff's position that under extant US GAAP, the amounts should not be discounted.

Whether to discount AMT credits that become refundable

Under the Tax Act, the alternative minimum tax is repealed for corporations. Any existing AMT credit carryforwards can offset future federal income tax and/or can be refundable over the next several years. This results in full realization of an existing AMT credit carryforward regardless of future taxable income. Stakeholders have raised the question on whether the AMT credits that will be used or ultimately refunded should be discounted to reflect the time value of money.

Similar to the question on discounting the deemed repatriation liability, the Board was supportive of the FASB staff's position that under extant US GAAP, the amounts should not be discounted. While no indication was given as to whether such amounts should be considered deferred tax assets or reclassified to a tax receivable, comments indicated there should be no discounting in either case.

Accounting for BEAT

An entity must pay a base erosion anti-abuse tax 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, while the calculation includes a lower tax rate (10% compared to the new corporate rate of 21%) on the resulting income. Stakeholders have raised the question of whether deferred taxes should be calculated using the corporate tax rate or the lower BEAT tax rate if the taxpayer expects to owe BEAT in future years.

The Board was supportive of the staff's position that the BEAT tax regime could be closely analogized to the AMT system, and consistent with treatment of the AMT, deferred tax assets and liabilities should be determined under the regular tax system, not under the BEAT regime.

Accounting for tax on GILTI

The Act includes provisions concerning the global intangible low-taxed income that impose a tax on foreign income in excess of a deemed return on tangible assets of foreign corporations. In most cases this income will be effectively taxed at a 10.5 percent tax rate. Stakeholders have questioned if deferred taxes should be recognized for basis differences expected to reverse as GILTI in the future or if the tax on GILTI should be included in the period in which it is incurred.

The provisions concerning GILTI are not believed to be as closely analogized to existing guidance in ASC Topic 740 as perhaps the BEAT provisions can be, and, accordingly staff and Board views, as well as views of stakeholders obtained in outreach efforts were mixed. Some believed there is an issue determining unit of account as the tax is determined in the aggregate versus at an individual investment level, and advocate recognizing the tax from GILTI be recognized in the period incurred. Others analogized to the practice that has evolved regarding Subpart F earnings and believe the tax should be recognized if it is probable the basis differences will reverse as GILTI in future years.

The staff indicated ASC Topic 740 is not clear on how to treat tax under the GILTI provisions of the Tax Act, and the Board was supportive of the staff's views that entities would have an accounting policy election with respect to treatment of basis differences that may be taxed as GILTI in the future.