FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout

Financial Reporting Effects of the Tax Cuts and Jobs Act

January 10, 2018

Meeting Purpose

1. On December 22, 2017, the U.S. federal government enacted a tax bill, H.R.1, *An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018*, (Tax Cuts and Jobs Act). Because of the Tax Cuts and Jobs Act, stakeholders in the banking and insurance industries raised financial reporting issues by submitting unsolicited comment letters to the Financial Accounting Standards Board (FASB).

2. The purpose of this Board meeting is to:

   (a) Decide whether to add a project to the Board's agenda on the reclassification of certain tax effects from accumulated other comprehensive income to retained earnings.

   (b) Make technical decisions if the Board decides to add the project to its agenda.

   (c) Determine whether to grant the staff permission to begin drafting a proposed Accounting Standards Update for vote by written ballot.

   (d) Provide the Board with an update on implementation issues related to the Tax Cuts and Jobs Act.

Questions for the Board
1. Should a project be added to the technical agenda to address the reclassification of certain tax effects presented in accumulated other comprehensive income to retained earnings? 2. Does the Board agree with the staff recommendation (that is, require a one-time reclassification for the newly enacted corporate tax rate and perform further research on the broader issue of backwards tracing as part of a separate research project)? 3. Does the Board agree with the staff recommendation on transition method, transition disclosures, and early adoption? 4. Subject to what we learn through comment letters, has the Board received sufficient information and analysis to make an informed decision on the perceived costs of the change? If not, what other information or analysis is needed?

5. Would the Board like to direct the staff to draft a proposed Accounting Standards Update for vote by written ballot?
6. If yes, what comment period does the Board select for the proposed Accounting Standards Update?

Issue Background

3. Through unsolicited comment letters, stakeholders in the banking and insurance industries (two banking trade groups, three banks, and five insurance trade groups) expressed concerns about the guidance in generally accepted accounting principles (GAAP) that requires deferred tax liabilities and assets to be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date of the change. That guidance is applicable even in situations in which deferred tax liabilities and assets are related to items presented in accumulated other comprehensive income. Therefore, the effects of the reduction in the corporate tax rate (from 35 percent to 21 percent) 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.

4. Those stakeholders asserted that because the adjustment of deferred taxes due to the reduction of the corporate tax rate to 21 percent is required to be included in income from continuing operations, the tax effects of items within accumulated other comprehensive income (referred to as stranded tax effects for purposes of this handout) do not reflect the appropriate tax rates. Those stakeholders noted that such accounting is confusing to financial statement users. In addition, recording those effects through income from continuing operations, and ultimately retained earnings, would have a negative effect on regulatory capital for some banks. Therefore, those stakeholders requested that the Board allow the effects of the change in tax rate on deferred taxes that were originally recorded in other comprehensive income to be reflected within other comprehensive income (that is, allow backwards tracing). Lastly, those stakeholders urged the Board to take immediate action through standard setting so that backwards tracing would be available for the 2017 financial reporting season.

5. A broader project on backwards tracing does not lend itself to a project that could be completed in the short term. Therefore, because of the urgent need for standard setting resulting from the Tax Cuts and Jobs Act, this meeting will focus on a targeted improvement to reclassify stranded tax effects related to this tax law change from accumulated other comprehensive income to retained earnings.

Backwards Tracing

6. *Backwards tracing* is a term used in practice that refers to the process of recognizing the effects of changes in deferred tax amounts in the current year in the same line item in which the deferred tax amounts were originally recognized (for example, other comprehensive income, income from discontinued operations) in prior years. GAAP generally prohibits *backwards tracing*. In the Basis for Conclusions in FASB Statement No. 109, *Accounting for Income Taxes* (issued February 1992), the Board decided that the entire tax effect of a change in enacted tax rates should be allocated to continuing operations to avoid the sometimes-complex problem of tracing back to events of prior years.

7. In 2014, the Board considered whether to add a project to its agenda on backwards tracing. The issue was raised by stakeholders as part of the Board's simplification initiative. Ultimately, the Board decided not to add the project to its agenda, noting at the time that it did not meet the initiative's objective, which is intended to improve or maintain the usefulness of the information reported to investors while reducing cost and complexity in financial reporting.

Alternatives

Alternative A: Require a One-Time Reclassification for the Newly Enacted Corporate Tax Rate

8. Alternative A would require a one-time reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted corporate tax rate. 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.

Alternative B: Require Reclassification for the Newly Enacted Corporate Tax Rate, Previous Changes in Other Tax Rates, and All Future Tax Rate Changes

9. Alternative B would require a reclassification of the stranded tax effects within accumulated other comprehensive income to retained earnings, including both the change to the newly enacted corporate tax rate and previous changes in other tax rates (for example, state and local tax rates). Alternative B would eliminate all mismatches for changes in tax rates and reset the ending accumulated other comprehensive income balances to reflect the current federal, state, and local tax rates. Alternative B also would require a reclassification from accumulated other comprehensive income to retained earnings for all future tax rate changes (federal, state, and local). As such, reclassification adjustments would be ongoing as tax rates change, which would result in the tax effects of items in other comprehensive income being consistently reflected at the enacted tax rate.

Transition

Transition Method

10. One proposed alternative for the transition method would be to apply the new guidance to each period in which the effect of the Tax Cuts and Jobs Act (or portion thereof) is recorded, which may be retrospectively to the date of enactment (December 2017) in some cases.

Transition Disclosures

11. A proposed alternative for transition disclosures would be to require an entity to disclose the following in the period in which a reclassification adjustment is made:

    (a) The nature of and reason for the change

    (b) A description of the prior period information that has been retrospectively adjusted

    (c) The effect of the change on affected financial statement line items.

Early Adoption

12. The Board could decide to allow early adoption of the proposed amendments that would result from the selected alternative by all entities for financial statements of fiscal years or interim periods that have not yet been issued or that have not yet been made available for issuance.

Other Implementation Issues

13. The FASB staff is currently researching five implementation issues related to the Tax Cuts and Jobs Act. The following is a summary of those five issues.

Application of Staff Accounting Bulletin 118 by Private Companies and Not for Profit Entities

14. The U.S. Securities and Exchange Commission (SEC) staff recently issued Staff Accounting Bulletin (SAB) No. 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act,* on the application of Topic 740, Income Taxes, in the reporting period that includes the date on which the Tax Cuts and Jobs Act was signed into law. The views and interpretations of the SEC staff are not directly applicable to private companies and not-for-profit entities (as defined in the Master Glossary of the *FASB Accounting Standards Codification*®). However, in the past some private companies and not-for-profit entities have voluntarily applied the

guidance in SABs. Stakeholders have questioned whether private companies and not-for-profit entities may apply SAB 118.

Whether to Discount the Tax Liability on the Deemed Repatriation

15. Under the Tax Cuts and Jobs 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.

Whether to Discount Alternative Minimum Tax Credits That Become Refundable

16. Under the Tax Cuts and Jobs 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. Any AMT credit carryforwards that do not reduce regular taxes are eligible for a 50 percent refund in 2018–2020 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.

Accounting for the Base Erosion Anti-Abuse Tax

17. An entity must pay a base erosion anti-abuse tax (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 or the lower BEAT tax rate if the taxpayer expects to owe BEAT in future years.

Accounting for Global Intangible Low-Taxed Income

18. The global intangible low-taxed income (GILTI) provisions of the Tax Cuts and Jobs 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. 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.