Integra International Audit & Accounting Alert

Issue 2 |March 2018

Financial Reporting Impacts of Tax Cuts and Jobs Act

Passage late in the year presents challenges

While tax accountants have a year before their clients need to report on most of the changes brought about by the American Tax Cuts and Jobs Act (TCJA), those preparing financial statements do not have that luxury. With the Act signed into law on December 22, 2017, companies with calendar 2017 year-ends need to consider potential impacts on the 2017 financial statements. Making things more difficult, the Act, considered by some as the most comprehensive in the past fifty years, contains issues that may take months, if not years, to clarify.

Fortunately, the Financial Accounting Standards Board (FASB) and the Securities and Exchange Commission (SEC), quickly recognized the concerns and have jumped in with guidance on how to proceed. Though only public companies are required to take direction from the SEC, the current situation is one of the few where private companies and non-profits are not only allowed but given the green light by the FASB to follow along.

The various forms of guidance include an SEC Staff Accounting Bulletin, several FASB Staff Q & A's and an FASB Accounting Standards Update regarding SEC disclosure and accounting requirements.

From time to time the SEC staff issue a Staff Accounting Bulletin (SAB) to give their interpretations of how to apply SEC disclosure requirements to accounting pronouncements that may not be clear or are not readily determinable at the time for submitting a required filing. SAB 118 was issued to address disclosures arising from the TCJA that are generally required for the 2017 financial reporting filings. The guidance is designed for items arising from the TCJA where "the accounting for certain income tax effects of the Act will be incomplete by the time financial statements are issued for the reporting period," and "where a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting."

The SAB separates items into three components: (1) those for which the accounting is completed, (2) those for which the accounting is incomplete but for which a reasonable estimate can be made, and (3) those for which the accounting is incomplete and for which a reasonable estimate cannot be determined. For category (1) full recording should be made, for category (2) the reasonable estimate should be recorded as a provisional amount, subject to subsequent adjustment, and for category (3) no amount should be

recorded. For both categories (2) and (3), full recording should be completed when information is available, which should be no later than a year following enactment of the law. The period from enactment until full accounting is completed is known as the measurement period. Also, provisional amounts recorded during the measurement period are to be reflected in income from continuing operations.

The SAB also lists the disclosures that should be included "about material financial reporting impacts of the Act" when the accounting is incomplete. The disclosures are:

1. Qualitative disclosures of the income tax effects of the Act for which the accounting is incomplete;
2. Disclosures of items reported as provisional amounts;
3. Disclosures of existing current or deferred tax amounts for which the income tax effects of the Act have not been completed;
4. The reason why the initial accounting is incomplete;
5. The additional information that is needed to be obtained, prepared, or analyzed in order to complete the accounting requirements under ASC Topic 740;
6. The nature and amount of any measurement period adjustments recognized during the reporting period;
7. The effect of measurement period adjustments on the effective tax rate; and
8. When the accounting for the income tax effects of the Act has been completed.

In order to deal with "stranded tax effects" included in accumulated other comprehensive income (AOCI) as a result of the change in corporate tax rates under TCJA, the FASB issued an Accounting Standards Update (ASU) 2018-02 on February 14, 2018. Stranded tax effects are those elements created prior to the TCJA that would no longer be subject to the normal reversal as a consequence of new provisions of the TCJA. The ASU provides the option to reclassify stranded tax effects to retained earnings in each period to the extent affected by the change. "The ASU requires financial statement preparers to disclose a description of the accounting policy for releasing income tax effects from AOCI, whether they elect to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act, and Information about the other income tax effects that are reclassified."

Additionally, the FASB has issued four Staff Q & A documents to assist with implementation of specific issues in the TCJA.

The first deals with the one-time transition tax companies are permitted to pay on undistributed and previously untaxed post-1986 foreign earnings and profits. The tax is to be reported on the 2017 tax return, and then paid over eight years, interest free. The guidance indicates that the tax is to be reported without discount on the 2017 financials, since the imputed interest rules do not apply in this situation.

Similarly, the imputed interest rules do not apply in the case of the second Q & A topic. Here credit carryforwards arising from the corporate alternative minimum tax (AMT), which has been repealed, will now be fully realized or refunded by 2021. Even so, any related recorded deferred tax asset or receivable is not to be discounted.

The third Q & A considers how to record the impact of the Base Erosion Anti-Abuse Tax (BEAT), a new tax on large corporations, analogous to the AMT, created by the TCJA. Without getting into the details, the Q & A states that deferred taxes should be measured at the statutory tax rate of the regular tax system rather than the lower BEAT tax rate, since the BEAT tax "is designed to be an incremental tax in which an entity can never pay less, and may pay more, than their regular tax liability."

The final Q & A concerns a new category of income established by the TCJA known as global intangible low-taxed income (GILTI). This category generally relates to taxation on undistributed income in excess of a 10% return on assets from a controlled foreign corporation. Again, without getting into details, the FASB has determined that current accounting standards are not clear as to how to account for the GILTI related tax, so either of two alternatives are allowed with adequate disclosure. Staff will monitor how entities account for this item in the near future, and recommend improvements if necessary.

Additional details on this subject can be found at SEC Staff Accounting Bulletin 118 and FASB Accounting for the Tax Cuts and Jobs Act.

(https://www.sec.gov/interps/account/staff-accounting-bulletin-118.htm)

and (http://www.fasb.org/taxcutsjobsact).