



Tax reform

**Supplement to KPMG's Handbook,
Accounting for Income Taxes**

US GAAP

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Tax reform enacted in 2017; SEC staff provides relief to registrants

H.R. 1, originally known as the Tax Cuts and Jobs Act, was enacted on December 22, 2017 and has significantly impacted companies' accounting for and reporting of income taxes, and the related processes and controls.

Because Topic 740¹ requires companies to recognize the effect of tax law changes in the period of enactment, the effects must be recognized in companies' December 2017 financial statements, even though the effective date of the law for most provisions was January 1, 2018. However, the SEC staff issued SAB 118², which allows registrants to record provisional amounts during a 'measurement period'. The measurement period is similar to the measurement period used when accounting for business combinations.³ The SAB allows a company to recognize provisional amounts when it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the change in tax law. The measurement period ends when a company has obtained, prepared and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year.

The SEC's Division of Corporation Finance also issued Compliance and Disclosure Interpretation 110.02⁴ that clarifies that the SEC staff does not believe that remeasuring a deferred tax asset to reflect the impact of a tax law change is an impairment that would trigger an obligation to file under Item 2.06 of Form 8-K. In addition, if a company concludes that a valuation allowance due to the change in tax law is necessary during the measurement period, it can rely on the Instruction to Item 2.06 and disclose the impairment, or a provisional amount for possible impairment, in its next periodic report.

¹ ASC 740, Income Taxes

² SAB 118, [Income Tax Accounting Implications of the Tax Cuts and Jobs Act](#)

³ ASC 805, Business Combinations

⁴ SEC Compliance & Disclosure Interpretation, [Section 110. Item 2.06, Material Impairments](#)

About this supplement

This supplement to KPMG's Handbook, [Accounting for Income Taxes](#), considers the financial reporting implications under US GAAP of H.R. 1, originally known as the Tax Cuts and Jobs Act ('the Act' or 'tax reform'). The Act was enacted on December 22, 2017 and has significantly impacted companies' accounting for and reporting of income taxes, and the related processes and controls.

This is preliminary guidance

This guidance is preliminary, based on our current understanding of the indicated tax law provisions and our analysis to date. Certain of the tax law provisions require interpretation, which may be clarified through issuances of guidance by Treasury, regulations, or future technical corrections. In addition, we will continue to evaluate how the authoritative accounting guidance applies to some of the provisions. We will update our views as further information becomes available and further research and analysis is completed.

May 31, 2018 update

New Q&As and examples added to this edition of the supplement from the May 14 edition are identified with **.

This supplement includes cross-references and hyperlinks to the relevant sections of our Handbook, [Accounting for Income Taxes](#), at the end of each Q&A.

Related resources

KPMG has a website dedicated to the US tax reform: kpmg.com/us/tax-reform

As part of those resources, the following are particularly relevant to this publication:

- [KPMG Report on New Tax Law – Analysis and observations](#)
- [KPMG's Q&As on the financial reporting implications of Tax reform in the United States – IFRS](#)

Abbreviations and definitions

The following abbreviations are commonly used for the concepts discussed in this supplement.

AMT	Alternative minimum tax	AMT is designed to ensure that all corporations pay a minimum amount of tax. Tentative minimum tax (TMT) is the minimum amount of tax a corporation is required to pay. The total federal tax liability for each year is the greater of regular taxes payable and the calculated TMT. If TMT exceeds the regular taxes payable, the amount by which TMT exceeds regular tax is the AMT.
BEAT	Base erosion anti-abuse tax	New: The BEAT generally imposes a minimum tax on certain deductible payments made to a foreign affiliate, including payments such as royalties and management fees, but excluding cost of goods sold. Generally applies to payments paid or accrued in tax years beginning after December 31, 2017. Read more in KPMG Report on New Tax Law – Analysis and observations .
CFC	Controlled foreign corporation	A foreign corporation where more than 50% of the total combined voting power or value is owned directly, indirectly, or constructively by US shareholders.
E&P	Earnings and profits	Accumulated earnings and profits for US tax purposes.
GILTI	Global intangible low-taxed income	New: In general, GILTI is the excess of a shareholder's CFCs' net income over a routine or ordinary return. Read more in KPMG Report on New Tax Law – Analysis and observations .
NOL	Net operating loss	Net operating loss carryforwards for US tax purposes.
Subpart F	Subpart F income	Generally, income of foreign subsidiary operations is not taxable to its US 10% or greater shareholders (US shareholders) until distributed. However, certain income described under the Subpart F rules is deemed to be distributed for US tax purposes to the US shareholders when included in a CFC's earnings (limited to the foreign subsidiary's E&P), regardless of whether the income is actually distributed.

1. Overview and SEC relief

Tax reform overview

Tax reform contains several key provisions that may have significant financial statement effects. These effects include remeasurement of deferred taxes, recognition of liabilities for taxes on mandatory deemed repatriation and certain other foreign income, and reassessment of the realizability of deferred tax assets.

Corporate rate

The Act reduces the corporate tax rate to 21%, effective January 1, 2018.

Tax on deemed mandatory repatriation

Under the Act, a company's foreign earnings accumulated under legacy tax laws are deemed repatriated. The tax on those deemed repatriated earnings is no longer indefinitely deferred but may be paid over eight years.

Other international provisions

The law introduces a new tax on global intangible low-taxed income (GILTI). GILTI is based on a US shareholder's CFCs' net income in excess of a return on tangible business property.

The Act also creates a base erosion anti-abuse tax (BEAT), which would partially disallow deductions for certain related party transactions. BEAT will function like a minimum tax, but unlike the alternative minimum tax in the old law, there is no interaction through a credit mechanism with the regular tax system.

Valuation allowance assessment

Several new provisions are likely to affect companies' valuation allowances. These provisions include the 100% dividends received deduction that may affect the realizability of foreign tax credits, cost recovery provisions that accelerate depreciation on depreciable and real property, interest expense provisions that limit annual interest deductions and the use of disallowed interest carryforwards, annual limitation on the use of net operating loss (NOL) carryforwards (and the extension of their carryforward periods), elimination of the corporate AMT, and expansion of the executive compensation that is subject to the excessive executive compensation limit.

Relief issued by the SEC staff

SAB 118 affords registrants a measurement period similar to the measurement period used when accounting for business combinations. During the measurement period, adjustments for the effects of the law should be recorded to the extent a reasonable estimate for all or a portion of the effects of the law can be made. To the extent that all information necessary is not available, prepared or analyzed (including computations), companies may recognize provisional amounts. Companies should adjust their provisional amounts when

they obtain, prepare or analyze additional information about facts and circumstances that existed at the enactment date that, if known, would have affected the amounts that were initially reported as provisional amounts.

The SAB summarizes a three-step process that companies should apply each reporting period.

- First, a company should record the effects of the change in tax law for which the accounting is complete. Those completed amounts are not (or are no longer) provisional amounts.
- Second, the company should report provisional amounts (or adjustments to provisional amounts) for the effects of the tax law change for which the accounting is not complete, but for which a reasonable estimate can be determined. Companies should record the provisional amounts (and the adjustments to those amounts) in income tax expense or benefit from continuing operations in the period they are identified.
- Third, if a reasonable estimate cannot be made for a specific effect of the tax law change, the company should not record a provisional amount and should continue to apply Topic 740 based on the tax law in effect just before the enactment on December 22, 2017.

The staff does not believe it would be appropriate for a company to exclude a reasonable estimate from its financial statements if a reasonable estimate has been determined.

The measurement period ends when a company has obtained, prepared and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year.

Accounting considerations

The SAB does not specify how a company should determine whether it can make a reasonable estimate. We believe that determination depends on a company's individual facts and circumstances. This includes the availability of records necessary to complete the calculations, evolving analyses and interpretations of the law, and evolving analyses and interpretations of how Topic 740 should be applied. The SAB states that the SEC staff expects companies to act in good faith to complete their accounting.

The SAB provides three examples of how to apply the measurement period.

The first example illustrates a company that will be affected by mandatory deemed repatriation but has not previously recognized a deferred tax liability on its outside basis difference. At the time it issues its financial statements for the period including the enactment date, it does not have the necessary information available, prepared or analyzed to make a reasonable estimate of its liability (or how the tax law change will impact its indefinite reinvestment assertion). The SAB concludes that this company would not estimate a liability for mandatory deemed repatriation in its provisional accounting for the tax law change. However, the company should include a provisional amount in its financial statements in the first reporting period in which the necessary information becomes available, prepared or analyzed to develop a reasonable estimate.

The second example also illustrates a company that will be affected by mandatory deemed repatriation and has not previously recognized a deferred tax liability on its outside basis difference. However, this company was able to

make a reasonable estimate of its liability for the period including the enactment date. The SAB concludes that this company would record a provisional amount for its estimated liability and update that provisional amount as additional information is obtained, prepared and analyzed.

The third example illustrates a company with deferred tax assets, the realization of which may be affected by the tax law change. The company has remeasured its deferred tax assets for the corporate rate change but determined that it is unable to make a reasonable estimate of its valuation allowance under the new tax law. The SAB concludes that this company would not record a change to its existing valuation allowance in its provisional accounting for the tax law change. The company should update its provisional accounting as additional information is obtained, prepared and analyzed.

In determining whether to adjust provisional amounts, companies should pay careful attention to whether information obtained during the measurement period relates to facts and circumstances that existed at the date of enactment and, therefore, should result in an adjustment to provisional amounts recognized. The tax effects of events unrelated to the tax law change should be accounted for apart from the measurement period adjustments.

Disclosures

Companies should include in their notes to financial statements:

- qualitative disclosures of the income tax effects of the Act for which the accounting is incomplete;
- disclosures of items reported as provisional amounts;
- disclosures of existing current or deferred tax amounts for which the income tax effects of the Act have not been completed;
- the reason that the initial accounting is incomplete;
- the additional information that needs to be obtained, prepared or analyzed to complete the accounting requirements under Topic 740;
- the nature and amount of measurement period adjustments recognized during the reporting period;
- the effect of measurement period adjustments on the effective tax rate; and
- when the accounting for the income tax effects of the Act has been completed.

We believe that the disclosures each period should be sufficiently detailed for a reader to understand the nature of the items for which the accounting has been completed during the period. Accordingly, we would generally expect that adjustments to provisional amounts during the measurement period would have been disclosed as areas of potential adjustment in previous periods.

Form 8-K guidance

In addition to the SAB, the SEC's Division of Corporation Finance issued guidance that clarifies that the SEC staff does not believe that remeasuring a deferred tax asset because of a tax law change is an impairment that would require a company to file under Item 2.06 of Form 8-K. In addition, if a company concludes that a valuation allowance is necessary during the measurement period, it can rely on the Instruction to Item 2.06 and disclose the impairment, or a provisional amount for possible impairment, in its next periodic report. The

instruction to Item 2.06 states that, “No filing is required under this Item 2.06 if the conclusion is made in connection with the preparation, review or audit of financial statements required to be included in the next periodic report due to be filed under the Exchange Act, the periodic report is filed on a timely basis and such conclusion is disclosed in the report.”

Internal control considerations

In addition to the accounting implications of tax reform, we believe management should evaluate under its internal control framework (COSO 2013)⁵ whether it has the necessary controls in place to implement tax reform. This includes risk assessment controls and process and monitoring controls over the technical tax implications; applying Topic 740; identifying, estimating and finalizing provisional amounts; and disclosure. A company should identify and document its population of tax reform implications to properly differentiate provisional amounts from amounts for which the information and analysis is complete. The controls over the provisional amounts likely are different from the controls over finalized amounts and accordingly the company should adjust its documentation of the objective of the control, precision of the control and how the control is performed.

⁵ COSO Internal Control – Integrated Framework (2013)

2. Corporate rate

Questions & Answers

- 2.10** Does the rate reduction have an effect on deferred tax balances for companies with December 2017 year-ends?
- 2.15** Can a company disclose that its entire provision is provisional under SAB 118 because it hasn't yet prepared its tax return?
- 2.16** Can a calendar year-end company apply SAB 118 when estimating its 2018 annual effective tax rate?
- 2.20** When should a fiscal year-end company adjust its estimated annual effective tax rate?
- 2.30** How should a fiscal year-end company that will experience a phased-in tax rate change remeasure its deferred taxes?
- Example 2.30.1** Interim tax calculation for a September 30 fiscal year-end company
- 2.40** How should a company recognize the residual tax effects that remain in other comprehensive income after the tax law change?
- Example 2.40.1** Deferred tax asset with no valuation allowance
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- Example 2.40.3** Deferred tax asset with originating valuation allowance and subsequent release through continuing operations
- Example 2.40.4** Deferred tax asset with valuation allowance charge to continuing operations
- Example 2.40.5** Deferred tax liability on CTA
- 2.50** Should a company with investments in qualified affordable housing projects that applies the proportional amortization method under Subtopic 323-740 reevaluate those investments?
- 2.60** When a company that applies the proportional amortization method reevaluates its affordable housing investments based on its revised expectation of the tax benefits, how should it adjust its amortization schedule?
- 2.70** Should a company that accounts for its investments in qualified affordable housing projects under the equity method reevaluate them? If so, should impairment, if any, be recognized in income tax expense (benefit) from continuing operations?
- 2.80** Can an investor that applies the hypothetical liquidation at book value method to account for its calendar year-end equity method investments use enacted tax law in computing its equity method pick-up?
- 2.90** Should an acquirer that is still within its measurement period for a business combination remeasure the acquired deferred taxes through

an adjustment to income tax expense (benefit) or goodwill?

2.100 Should a company with investments in leveraged leases reevaluate those investments?

2.110 To which statutory rate should a company reconcile in its December 31, 2017 financial statements?

What the Act says

The centerpiece of the new law is the permanent reduction in the corporate income tax rate from 35% to 21%. The rate reduction generally takes effect on January 1, 2018.

The tax code already included special rules for determining how certain rate changes apply to taxpayers whose tax years straddle relevant effective dates – e.g. fiscal year filers in the case of law changes that are effective as of the beginning of the calendar year (as in this case). The Act does not repeal these special rules, but the application of the new law is not completely clear in all cases and future administrative guidance may be needed.

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).



Question 2.10

Does the rate reduction have an effect on deferred tax balances for companies with December 2017 year-ends?

Interpretive response: Yes. The law reduces the corporate tax rate to 21% effective January 1, 2018. A company must remeasure its deferred tax assets and liabilities to reflect the effects of enacted changes in tax laws or rates at the date of enactment, i.e. the date the President signed the law, even though the changes may not be effective until future periods. The effect of the remeasurement is reflected entirely in the interim period that includes the enactment date and allocated directly to income tax expense (benefit) from continuing operations. The effect on prior year income taxes payable (receivable), if any, is also recognized as of the enactment date. [[Handbook 5.007, 5.015](#)]



Question 2.15

Can a company disclose that its entire tax provision is provisional under SAB 118 because it hasn't yet prepared its tax return?

Interpretive response: No. The guidance for recognizing provisional amounts in SAB 118 is limited to evaluating the effect of tax reform on balances where the necessary information is not available, prepared or analyzed (including computations) in reasonable detail to complete the accounting under Topic 740. While the tax return may not be prepared and filed until several months after financial statements are issued, we believe that condition alone is neither unique to the annual period including the enactment date of tax reform or a basis to apply SAB 118 to the entire provision. The SEC staff expects companies to act in good faith to complete their accounting. See additional discussion on SAB 118 in [Overview and SEC relief](#).

Companies should pay careful attention when identifying and measuring deferred taxes at the end of the reporting period because misclassifications

between current and deferred taxes identified in the return-to-provision analysis are likely to result in an adjustment to income tax expense due to the tax rate differential.



Question 2.16

Can a calendar year-end apply SAB 118 when estimating its 2018 annual effective tax rate?

Interpretive response: Generally no. The guidance in the SAB addresses “situations where the accounting under Topic 740 is incomplete for certain income tax effects of the Act upon issuance of an entity’s financial statements *for the reporting period in which the Act was enacted*” [emphasis added].

We believe that companies generally cannot apply the SAB when accounting for the tax effects of transactions that arise in reporting periods that do not include the enactment date – e.g. transactions that arise in a calendar year-end company’s 2018 interim periods. We believe companies should evaluate changes to their annual effective tax rates throughout the year in normal course as changes in estimates or error corrections under Topic 250.

However, as discussed in Questions 4.35 and 4.65, a company may have policy choices with continuing effect that, if they are provisional as of December 31, 2017, may remain provisional throughout the measurement period, including interim periods within the measurement period. In that case, there may be portions of the annual effective tax rate that remain provisional.

For example, assume ABC Company expects to be subject to GILTI in 2018 but has not yet elected a policy about whether it will recognize deferred taxes for basis differences that are expected to result in GILTI when they reverse. We believe ABC should consider GILTI when estimating the *current* portion of its 2018 annual effective tax rate. That portion of the estimate is not within the scope of SAB 118.

However, if ABC has not yet made a policy choice at the end of its first quarter about whether to recognize deferred taxes for GILTI, it should not consider GILTI when estimating the *deferred* portion of its 2018 annual effective tax rate. That portion of the estimate is within the scope of SAB 118 until ABC elects its policy.



Question 2.20

When should a fiscal year-end company adjust its estimated annual effective tax rate?

Interpretive response: The tax effect of changes in tax laws or rates typically is recognized in the estimated annual effective tax rate beginning in the interim period that includes the effective date. However, the legislation requires a company to use a blended rate for its fiscal 2018 tax year by applying a pro-rated percentage of the number of days before and after the January 1, 2018 effective date. As a result, we believe the change in the tax rate becomes administratively effective at the beginning of the taxpayer’s fiscal year and

therefore will be factored into the estimated annual effective tax rate in the period that includes the December 22, 2017 enactment date.

For example, the rate change for a June 30, 2018 year-end taxpayer is administratively effective as of July 1, 2017 and the estimated annual effective tax rate is adjusted in the interim period ended December 31, 2017. This means that the estimated annual effective rate will be adjusted to approximately 28% $((184/365 \text{ days} \times 35\%) + (181/365 \text{ days} \times 21\%))$ as of December 31, 2017.

While we believe the rate change is administratively effective at the beginning of a fiscal year-end taxpayer's fiscal year, there are other provisions that have a future effective date. For example, some expenses incurred on or after January 1, 2018 are no longer deductible. Companies should further adjust their estimated annual effective tax rates for these items beginning in the period that includes the January 1, 2018 effective date – i.e. the June 30, 2018 year-end company above would further adjust its estimated annual effective tax rate in its interim period ended March 31, 2018 to consider the nondeductible expenses it expects to incur for the period from January 1, 2018 to June 30, 2018. [Handbook 5.017]

Example 2.30.1 illustrates how a fiscal year-end company that will experience a phased-in tax rate change may account for the change in tax law in the interim period including (1) the enactment date of the rate change, and (2) the effective date for those provisions that are not effective until January 1, 2018. There may be other acceptable approaches.



Question 2.30

How should a fiscal year-end company that will experience a phased-in tax rate change remeasure its deferred taxes?

Interpretive response: Companies should measure deferred taxes based on the applicable enacted tax rate when the temporary differences and carryforwards are expected to reverse. As a result, a fiscal year-end company should schedule the reversal of enactment date temporary differences and those that arise in fiscal year 2018 to determine which will reverse under the blended rate in fiscal 2018 and which will reverse once the 21% rate is fully effective.

For example, companies that are expecting to carry forward NOLs from fiscal 2018 into future fiscal years should measure their carryforwards at 21%; this is because the fully effective rate is expected to apply in the period those NOL carryforwards reverse. [Handbook 5.016]

Companies should apply their existing policies about whether to consider future originating temporary differences when scheduling the reversals of existing temporary differences. [Handbook A.010, Ex 3.8]

Example 2.30.1 illustrates how a fiscal year-end company that will experience a phased-in tax rate change may account for the change in tax law in the interim period including (1) the enactment date of the rate change, and (2) the effective date for those provisions that are not effective until January 1, 2018. There may be other acceptable approaches.



Example 2.30.1 Interim tax calculation for a September 30 fiscal year-end company

Background

ABC Co. is a US taxpayer with a September 30, 2018 year-end. ABC has (or is expected to have) the following taxable temporary differences as of October 1, 2017, December 22, 2017 and September 30, 2018.

	10/1/17	10/1/17 – 12/21/17		12/22/17	12/22/17 – 12/31/17		9/30/18
	Gross temp.	Reverse	Originate	Gross temp.	Reverse	Originate	Gross temp.
LT Temp 1	\$20,000	\$ (2,000)	\$ -	\$18,000	\$(2,000)	\$ -	\$16,000
ST Temp 2	10,000	(10,000)	-	-	-	-	-
ST Temp 3	-	-	8,000	8,000	-	-	8,000
ST Temp 4	-	-	-	-	-	12,000	12,000
Total	\$30,000	\$(12,000)	\$8,000	\$26,000	\$(2,000)	\$12,000	\$36,000

Before the tax law change, ABC's statutory and effective tax rate was 35%. After the tax law change, ABC's rates are:

- for its 2018 fiscal year, 24.5%: $(92/365 \text{ days} \times 35\%) + (273/365 \text{ days} \times 21\%)$; and
- for its 2019 fiscal year and beyond, 21%.

Based on effective tax law as of December 31, 2017, ABC expects to earn \$100,000 in pre-tax income for FY 2018, earns \$25,000 in actual pre-tax book income through December 22, 2017 and \$26,000 in actual pre-tax book income through December 31, 2017.

ABC expects to incur \$2,000 in expenses during the period from January 1, 2018 to September 30, 2018 that, while deductible under the old law, will become nondeductible as of January 1, 2018. Accordingly, in its quarter ended March 31, 2018 (the period including the effective date), ABC adjusts its expectation of taxable income for FY 2018. As of March 31, 2018, ABC still expects to earn \$100,000 in pre-tax income for FY 2018 and earns \$50,000 in actual year-to-date pre-tax book income.

Three-months ended December 31, 2017

ABC performs the following four steps to measure the effect of the tax change.

Step 1 – Remeasure beginning of year deferred taxes

Beginning of year deferred taxes at the old rate:

	Gross temp.	BOY tax rate	DTL
LT Temp 1	\$20,000	35%	\$ 7,000
ST Temp 2	10,000	35%	3,500
Total BOY DTL at old rate	\$30,000		\$10,500

Beginning of year deferred taxes at the new rate:

LT Temp 1—

	Gross temp.	New rate	DTL
Portion reversing in FY 2018	\$ 4,000	24.5%	\$ 980
Portion that reverses in FY 2019+	16,000	21%	3,360
Total LT Temp 1	\$20,000		\$4,340

ST Temp 2—

	Gross temp.	New rate	DTL
Portion reversing in FY 2018	\$10,000	24.5%	\$2,450
Portion that reverses in FY 2019+	-	21%	-
Total ST Temp 2	\$10,000		\$2,450
Total BOY DTL at new rate	\$30,000		\$6,790¹
Note: \$4,340 + \$2,450			

Adjustment to beginning of year deferred taxes: \$3,710 (\$10,500 - \$6,790):

	Debit	Credit
Deferred tax liability	3,710	
Deferred tax benefit		3,710

Step 2 – Adjust the effective tax rate and remeasure deferred taxes as of the enactment date

Effective tax rate calculation (actual through December 22, 2017 at the old rate):

	10/1–12/22	Old rate	Notes
Pre-tax income	\$25,000		
LT Temp 1	2,000		
ST Temp 2	10,000		
ST Temp 3	(8,000)		
ST Temp 4	-		
Taxable income	\$29,000		
Current tax expense/payable	\$10,150	35%	Stat. rate pre-12/22
DTL – LT Temp 1	\$ (700)	35%	FY 2018 reversal
DTL – ST Temp 2	(3,500)	35%	FY 2018 reversal
DTL – ST Temp 3	2,800	35%	FY 2019+ reversal
DTL – ST Temp 4	-	35%	FY 2019+ reversal
Deferred tax expense (benefit)	\$(1,400)		

Effective tax rate calculation (actual through December 22, 2017 at the new rate):

	10/1–12/22	New rate	Notes
Pre-tax income	\$25,000		
LT Temp 1	2,000		
ST Temp 2	10,000		
ST Temp 3	(8,000)		
ST Temp 4			
Taxable income	\$29,000		
Current tax expense/payable	\$ 7,105	24.5%	Stat. rate FY 2018
DTL – LT Temp 1	\$ (490)	24.5%	FY 2018 reversal
DTL – ST Temp 2	(2,450)	24.5%	FY 2018 reversal
DTL – ST Temp 3	1,680	21%	FY 2019+ reversal
DTL – ST Temp 4		21%	FY 2019+ reversal
Deferred tax expense (benefit)	\$(1,260)		

Adjustment to current tax expense as of December 22, 2017: \$3,045 (\$7,105 - \$10,150):

	<i>Debit</i>	<i>Credit</i>
Current taxes payable	3,045	
Current tax expense		3,045

Adjustment to deferred tax expense as of December 22, 2017: \$140 (\$1,260 - \$1,400):

	<i>Debit</i>	<i>Credit</i>
Deferred tax expense	140	
Deferred tax liability		140

Summary of total tax expense through December 22, 2017:

	Old rate	New rate	Difference
Current tax expense (benefit)	\$10,150	\$7,105	\$(3,045)
Deferred tax expense (benefit)	(1,400)	(1,260)	140
Total tax expense excluding remeasurement of deferred taxes as of Oct. 1, 2017	\$ 8,750	\$5,845	\$(2,905)
Deferred tax expense (benefit) – remeasurement of deferred taxes as of October 1, 2017	-	(3,710)	(3,710)
Total	\$ 8,750	\$2,135	\$(6,615)

Roll-forward of deferred tax liabilities:

Beginning of year (10/1/2017)	\$10,500
Adjustment to BOY deferred tax liabilities	(3,710)
Deferred tax expense (benefit) at old rate	(1,400)
Adjustment to enactment date deferred tax liabilities	140
Through enactment date (12/22/2017)	\$ 5,530

ABC would disclose in its December 31, 2017 Form 10-Q (and its September 30, 2018 Form 10-K) a downward adjustment to deferred tax liabilities of \$3,570 (\$3,710 - \$140) as result of the change in tax law.

Roll-forward of current taxes payable:

Beginning of year (10/1/2017)	\$ -
Current tax expense (benefit) at old rate	10,150
Adjustment to enactment date current payable	(3,045)
Through enactment date (12/22/2017)	\$ 7,105

Proof of deferred tax liabilities as of December 22, 2017:

LT Temp 1—

	Gross temp.	New rate	DTL
Portion reversing in FY 2018	\$ 2,000	24.5%	\$ 490
Portion that reverses in FY 2019+	16,000	21%	3,360
Total LT Temp 1	\$18,000		\$3,850

ST Temp 3—

	Gross temp.	New rate	DTL
All reverses in FY 2019+	\$ 8,000	21%	\$1,680
Total 12/22/17 DTL at new rate	\$26,000		\$5,530¹
Note:			
1. \$3,850 + \$1,680			

Step 3 – Compute the estimated annual effective tax rate for FY 2018

	FY 2018	New rate	Notes
Pre-tax income	\$100,000		
LT Temp 1	4,000		
ST Temp 2	10,000		
ST Temp 3	(8,000)		
ST Temp 4	(12,000)		
Taxable income	\$ 94,000		
Current tax expense/payable	\$ 23,030	23.0%	Current effect. rate
DTL – LT Temp 1	\$ (980)	24.5%	FY 2018 reversal
DTL – ST Temp 2	(2,450)	24.5%	FY 2018 reversal
DTL – ST Temp 3	1,680	21%	FY 2019+ reversal
DTL – ST Temp 4	2,520	21%	FY 2019+ reversal
Deferred tax expense (benefit)	\$ 770	0.8%	Deferred effect. rate
Annual effective tax rate		23.8%	\$23,800 / \$100,000

Step 4 – Apply the estimated annual effective tax rate to pre-tax income through December 31, 2017 and true-up total tax expense (benefit)

	Pre-tax income through 12/31/17	AETR	YTD tax expense (benefit)
Year-to-date operations 10/1–12/31	\$26,000	23.8%	\$6,188
Tax expense through 12/22/17 excluding remeasurement of deferred taxes as of Oct. 1, 2017			(5,845)
Adjustment for 12/23–12/31			\$ 343

Total tax expense for the quarter ended December 31, 2017:

	New rate
Current tax expense through 12/22	\$7,105
Deferred tax expense (benefit) through 12/22	(1,260)
Adjustment for 12/23–12/31	343
YTD total tax expense as of 12/31/2017 excluding remeasurement of deferred taxes as of Oct. 1, 2017	\$6,188
Deferred tax expense (benefit) – remeasurement of deferred taxes as of Oct. 1, 2017	(3,710)
YTD total tax expense as of 12/31/2017	\$2,478

Rate reconciliation through December 31, 2017:

Income tax expense (benefit) at the 24.5% statutory rate	\$6,370
Remeasurement of deferred taxes as of Oct. 1, 2017	(3,710)
Effect of phased-in tax rate (21% after FY 2018)	(182) ¹
YTD total tax expense as of 12/31/2017	\$2,478

Notes:

All reconciling items (including those that may be insignificant individually) are shown for illustrative purposes.

1. Estimated annual effective tax rate of 23.8% - statutory rate of 24.5% × pre-tax book income of \$26,000.

Six-months ended March 31, 2018

ABC computes its estimated annual effective tax rate for FY 2018:

	FY 2018	New rate	Notes
Pre-tax income	\$100,000		
LT Temp 1	4,000		
ST Temp 2	10,000		
ST Temp 3	(8,000)		
ST Temp 4	(12,000)		
Nondeductible expenses	2,000		
Taxable income	\$ 96,000		
Current tax expense/payable	\$ 23,520	23.5%	Current effect. rate
DTL – LT Temp 1	\$ (980)	24.5%	FY 2018 reversal
DTL – ST Temp 2	(2,450)	24.5%	FY 2018 reversal
DTL – ST Temp 3	1,680	21%	FY 2019+ reversal
DTL – ST Temp 4	2,520	21%	FY 2019+ reversal
Deferred tax expense (benefit)	\$ 770	0.8%	Deferred effect. rate
Annual effective tax rate		24.3%	\$24,290 / \$100,000

ABC applies the estimated annual effective tax rate to year-to-date pre-tax income through March 31, 2018:

	YTD pre-tax income through 3/31/18	AETR	YTD tax expense (benefit)
Year-to-date operations 10/1–3/31	\$50,000	24.3%	\$12,150
YTD tax expense through 12/31/17 excluding remeasurement of deferred taxes as of Oct. 1, 2017			(6,188)
Q2 tax expense			\$ 5,962

Rate reconciliation through March 31, 2018:

Income tax expense (benefit) at the 24.5% statutory rate	\$12,250
Effect of phased-in tax rate (21% after FY 2018)	(350) ¹
Nondeductible expenses	250 ²
Remeasurement of deferred taxes as of Oct. 1, 2017	(3,710)
YTD total tax expense as of 3/31/2018	\$ 8,440
Notes:	
All reconciling items (including those that may be insignificant individually) are shown for illustrative purposes.	
¹ Estimated annual effective tax rate (before considering nondeductibility of expenses) of 23.8% - statutory rate of 24.5% × pre-tax book income of \$50,000.	
² Estimated annual effective tax rate (before considering nondeductibility of expenses) of 23.8% - estimated annual effective tax rate (after considering nondeductibility of expenses) of 24.3% × pre-tax book income of \$50,000.	



Question 2.40

How should a company recognize the residual tax effects that remain in other comprehensive income after the tax law change?

Interpretive response: Recognizing the entire effect of the change in tax law in income tax expense (benefit) from continuing operations will result in residual tax effects within accumulated other comprehensive income for a company that recognized deferred tax balances through other comprehensive income. Those income tax effects are released when the item giving rise to the tax effect is disposed, liquidated or terminated or when the entire portfolio of similar items (e.g. available-for-sale securities) is liquidated. A company should apply its existing accounting policy for releasing those income tax effects or adopt a new policy if it did not establish one in the past. [[Handbook 5.050, 9.032](#)]

On February 14, 2018, the Board issued Accounting Standards Update No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 provides companies the option to reclassify from accumulated other comprehensive income to retained earnings the income tax effects arising from the change in the US federal corporate tax rate. When computing the amount to reclassify, companies should include the effect of the change in tax rate on the gross deferred tax amounts and related valuation allowances, if any, that relate to items that remain in accumulated other comprehensive income as of the enactment date. The effect of the change in tax rate on gross valuation allowances that were originally charged to income from operations should not be included.

Companies electing to reclassify those effects also have the option to reclassify other income tax effects arising from the Act. One example of an 'other income tax effect' is the income tax effect that arises when a company recognizes through income from continuing operations the liability for deemed repatriation of foreign earnings when it had previously recognized in other comprehensive

income a deferred tax liability for the translation adjustment portion of that future obligation.

The amount of the reclassification is limited to the income tax effects arising from the Act. Residual income tax effects not arising from the Act will remain in accumulated other comprehensive income – e.g. the residual income tax effect that arises when a company releases with a credit to income from continuing operations a valuation allowance that was initially established with a charge to other comprehensive income.

We do not believe the reclassification represents a component of other comprehensive income in the period of adoption and therefore it would not appear on the statement of comprehensive income.

All companies are required to disclose a description of their accounting policy for releasing residual income tax effects from accumulated other comprehensive income.

Companies that elect to reclassify the income tax effects of the Act also are required to disclose in the first interim and annual period of adoption:

- a statement that the election was made to reclassify the income tax effects of the corporate rate change; and
- a description of the other income tax effects related to the Act that have been reclassified.

Companies that do not elect to reclassify the income tax effects of the Act should disclose in the period of adoption a statement that they did not elect to reclassify.

The guidance is effective for all entities for annual and interim periods in fiscal years beginning after December 15, 2018 (i.e. January 1, 2019 for companies with a calendar year end). Early adoption is permitted for interim and annual period financial statements that have not yet been issued or made available for issuance. Companies have the option to apply the ASU as of the beginning of the period (annual or interim) of adoption or retrospectively to each period (or periods) in which the income tax effects of the Act related to items remaining in accumulated other comprehensive income are recognized.

The Board also decided at its February 7, 2018 meeting to add backwards tracing to its existing research agenda project on income tax simplification. This project may in the future lead to additional guidance on the accounting for residual income tax effects that are not related to the Act that remain in accumulated other comprehensive income.

The Examples below illustrate how we believe a company may compute its reclassification in several different circumstances. Other approaches may be acceptable.



Example 2.40.1

Deferred tax asset with no valuation allowance

Background

As of December 22, 2017, ABC Company has a portfolio of available-for-sale securities for which it has recognized in other comprehensive income \$5,000 in

unrealized losses and a \$1,750 ($\$5,000 \times 35\%$) deferred tax benefit. On December 22, 2017, ABC remeasures its deferred tax asset to \$1,050 ($\$5,000 \times 21\%$) to reflect the newly enacted 21% corporate tax rate.

Between December 22 and December 31, 2017, ABC recognizes \$100 in additional unrealized losses and a \$21 ($\$100 \times 21\%$) additional deferred tax asset.

ABC adopts ASU 2018-02 retrospectively in its period ended December 31, 2017 and elects to reclassify the direct effect of the change in the federal corporate income tax rate.

ABC recorded the following entries in the periods ended December 22, 2017 (before the rate change):

	<i>Debit</i>	<i>Credit</i>
Other comprehensive income	5,000	
Investments		5,000
<i>To recognize unrealized losses on available-for-sale securities</i>		
Deferred tax asset	1,750	
Other comprehensive income		1,750
<i>To recognize deferred taxes on the originating deductible temporary difference ($\\$5,000 \times 35\%$)</i>		

ABC records the following entries in the period from December 22 (after the rate change) to December 31, 2017:

	<i>Debit</i>	<i>Credit</i>
Deferred tax expense	700 ¹	
Deferred tax asset		700
<i>To remeasure the deferred tax asset for the change in the corporate tax rate as of 12/22/17</i>		
Other comprehensive income – unrealized loss	100	
Deferred tax asset ($\$100 \times 21\%$)	21	
Investments		100
Other comprehensive income – tax benefit		21
<i>To recognize unrealized losses and related tax effect for the period from 12/22/17 to 12/31/17</i>		
Accumulated other comprehensive income	700 ²	
Retained earnings		700
<i>To reclassify income tax effects resulting from the Tax Cuts and Jobs Act of 2017 (TCJA)</i>		

1

Deferred tax asset as of 12/22/17 before rate change	\$1,750
Temporary difference at 21 % ($\$5,000 \times 21\%$)	1,050
Deferred tax expense	\$ 700

2

Gross amount of deferred tax benefit credited directly to OCI that remains in AOCI at the 12/22/17 enactment date	\$1,750
Amount that would have been credited using TCJA rate	1,050
Debit to AOCI	\$ 700

Roll-forward of deferred tax asset:

Balance as of 12/22/17 before rate change	\$1,750
Change in tax rate	(700)
Tax benefit of unrealized losses arising 12/22 – 12/31	21
Ending balance as of 12/31/17	\$1,071

Roll-forward of AOCI – tax effects only:

Balance as of 12/22/17 before rate change	\$(1,750)
Reclassification to retained earnings	700
Tax effect of unrealized losses arising 12/22 – 12/31	(21)
Ending balance as of 12/31/17	\$(1,071)



Example 2.40.2 Deferred tax asset with originating valuation allowance

Background

As of December 22, 2017, ABC Company has a portfolio of available-for-sale securities for which it has recognized in other comprehensive income \$5,000 in unrealized losses. ABC has also recognized in OCI a \$1,750 ($\$5,000 \times 35\%$) deferred tax benefit on the unrealized losses and a corresponding valuation allowance.

On December 22, 2017, ABC remeasures its deferred tax asset and related valuation allowance to \$1,050 ($\$5,000 \times 21\%$) to reflect the newly enacted 21% corporate tax rate.

Between December 22 and December 31, 2017, ABC recognizes \$100 in additional unrealized losses and a \$21 ($\$100 \times 21\%$) additional deferred tax asset with a corresponding valuation allowance.

ABC adopts ASU 2018-02 retrospectively in its period ended December 31, 2017 and elects to reclassify the direct effect of the change in the federal corporate income tax rate.

ABC recorded the following entries in the periods ended December 22, 2017 (before the rate change):

	<i>Debit</i>	<i>Credit</i>
Other comprehensive income	5,000	
Investments		5,000
<i>To recognize unrealized losses on available-for-sale securities</i>		
Deferred tax asset	1,750	
Other comprehensive income		1,750
<i>To recognize deferred taxes on the originating deductible temporary difference (\$5,000 × 35%)</i>		
Other comprehensive income	1,750	
Valuation allowance		1,750
<i>To recognize a valuation allowance on the deferred tax asset</i>		

ABC records the following entries in the period from December 22 (after the rate change) to December 31, 2017:

	<i>Debit</i>	<i>Credit</i>
Deferred tax expense	700 ¹	
Deferred tax asset		700
<i>To remeasure the deferred tax asset for the change in the corporate tax rate as of 12/22/17</i>		
Valuation allowance	700 ²	
Deferred tax benefit		700
<i>To remeasure the valuation allowance for the change in the corporate tax rate as of 12/22/17</i>		
Other comprehensive income – unrealized loss	100	
Deferred tax asset (\$100 × 21%)	21	
Investments		100
Valuation allowance		21
<i>To recognize unrealized losses and related tax effect for the period from 12/22/17 to 12/31/17</i>		

	<i>Debit</i>	<i>Credit</i>
Accumulated other comprehensive income – deferred tax asset	700 ³	
Retained earnings – valuation allowance	700	
Retained earnings – deferred tax asset		700
Accumulated other comprehensive income – valuation allowance		700 ⁴
<i>To reclassify income tax effects resulting from the Tax Cuts and Jobs Act of 2017 (TCJA)</i>		

1

Deferred tax asset as of 12/22/17 before rate change	\$1,750
Temporary difference at 21% (\$5,000 × 21%)	1,050
Deferred tax expense	\$ 700

2

Valuation allowance as of 12/22/17 before rate change	\$1,750
Valuation allowance at 21% (\$5,000 × 21%)	1,050
Deferred tax benefit	\$ 700

3

Gross amount of deferred tax benefit credited directly to OCI that remains in AOCI at the 12/22/17 enactment date	\$1,750
Amount that would have been credited using TCJA rate	1,050
Debit to AOCI	\$ 700

4

Gross amount of valuation allowance charged directly to OCI that remains in AOCI at the 12/22/17 enactment date	\$1,750
Amount that would have been charged using TCJA rate	1,050
Credit to AOCI	\$ 700

When computing the reclassification adjustment, a company includes the effect of the rate change on the gross deferred tax amounts and related valuation allowances that relate to items that remain in accumulated other comprehensive income as of the enactment date. Because ABC initially credited to other comprehensive income its deferred tax asset and initially charged to other comprehensive income its valuation allowance, and both remain as of the enactment date, both are considered when computing the reclassification adjustment.

Roll-forward of deferred tax asset:

Balance as of 12/22/17 before rate change	\$1,750
Change in tax rate	(700)
Tax benefit of unrealized losses arising 12/22 – 12/31	21
Ending balance as of 12/31/17	\$1,071

Roll-forward of valuation allowance:

Balance as of 12/22/17 before rate change	\$(1,750)
Change in tax rate	700
Tax benefit of unrealized losses arising 12/22 – 12/31	(21)
Ending balance as of 12/31/17	\$(1,071)

Roll-forward of AOCI – tax effects only:

Balance as of 12/22/17 before rate change	\$ -
Net reclassification to retained earnings	-
Net tax effect of unrealized losses arising 12/22 – 12/31	-
Ending balance as of 12/31/17	\$ -



Example 2.40.3

Deferred tax asset with originating valuation allowance and subsequent release through continuing operations

Background

As of December 22, 2017, ABC Company has a portfolio of available-for-sale securities for which it has recognized in other comprehensive income \$5,000 in unrealized losses. ABC has also recognized in OCI a \$1,750 ($\$5,000 \times 35\%$) deferred tax benefit on its unrealized losses. ABC had previously charged a \$1,500 valuation allowance to other comprehensive income when it initially recorded the valuation allowance. However, the valuation allowance was subsequently released with a credit to continuing operations under Topic 740.

On December 22, 2017, ABC remeasures its deferred tax asset to \$1,050 ($\$5,000 \times 21\%$) to reflect the newly enacted 21% corporate tax rate.

Between December 22 and December 31, 2017, ABC recognizes \$100 in additional unrealized losses and a \$21 ($\$100 \times 21\%$) additional deferred tax asset.

ABC adopts ASU 2018-02 retrospectively in its period ended December 31, 2017 and elects to reclassify the direct effect of the change in the federal corporate income tax rate.

ABC recorded the following entries in the periods ended December 22, 2017 (before the rate change):

	<i>Debit</i>	<i>Credit</i>
Other comprehensive income	5,000	
Investments		5,000
<i>To recognize unrealized losses on available-for-sale securities</i>		
Deferred tax asset	1,750	
Other comprehensive income		1,750
<i>To recognize deferred taxes on the originating deductible temporary difference (\$5,000 × 35%)</i>		
Other comprehensive income	1,500	
Valuation allowance		1,500
<i>To recognize a valuation allowance on deferred tax assets</i>		
Valuation allowance	1,500	
Deferred tax benefit		1,500
<i>To release the valuation allowance previously charged to other comprehensive income</i>		

ABC records the following entries in the period from December 22 (after the rate change) to December 31, 2017:

	<i>Debit</i>	<i>Credit</i>
Deferred tax expense	700 ¹	
Deferred tax asset		700
<i>To remeasure the deferred tax asset for the change in the corporate tax rate as of 12/22/17</i>		
Other comprehensive income – unrealized loss	100	
Deferred tax asset (\$100 × 21%)	21	
Investments		100
Other comprehensive income – tax benefit		21
<i>To recognize unrealized losses and related tax effect for the period from 12/22/17 to 12/31/17</i>		
Accumulated other comprehensive income – deferred tax asset	700 ²	
Retained earnings – deferred tax asset		700
<i>To reclassify income tax effects resulting from the Tax Cuts and Jobs Act of 2017 (TCJA)</i>		

1

Deferred tax asset as of 12/22/17 before rate change	\$1,750
Temporary difference at 21 % (\$5,000 × 21%)	1,050
Deferred tax expense	\$ 700

2

Gross amount of deferred tax benefit credited directly to OCI that remains in AOCI at the 12/22/17 enactment date	\$1,750
Amount that would have been credited using TCJA rate	1,050
Debit to AOCI	\$ 700

When computing the reclassification adjustment, a company includes the effect of the change in tax rate on the gross deferred tax amounts and related valuation allowances, if any, that relate to items that remain in accumulated other comprehensive income as of the enactment date.

Because ABC does not have a valuation allowance as of the enactment date (and therefore there is no related income tax effect of the rate change), we do not believe the previous charge to other comprehensive income is considered when computing the reclassification adjustment. This calculation isolates the income tax effect arising from TCJA; the residual income tax effect from the previous valuation allowance release will remain in accumulated other comprehensive income.

Roll-forward of deferred tax asset:

Balance as of 12/22/17 before rate change	\$1,750
Change in tax rate	(700)
Tax benefit of unrealized losses arising 12/22 – 12/31	21
Ending balance as of 12/31/17	\$1,071

Roll-forward of AOCI – tax effects only:

Balance as of 12/22/17 before rate change	\$(250)
Reclassification to retained earnings	700
Tax effect of unrealized losses arising 12/22 – 12/31	(21)
Ending balance as of 12/31/17	\$429



Example 2.40.4

Deferred tax asset with valuation allowance charge to continuing operations

Background

As of December 22, 2017, ABC Company has a portfolio of available-for-sale securities for which it has recognized in other comprehensive income \$5,000 in unrealized losses. ABC has also recognized in OCI a \$1,750 ($\$5,000 \times 35\%$) deferred tax benefit on its unrealized losses. At enactment, ABC has a \$1,750 valuation allowance of which \$1,400 was charged to continuing operations (related to \$4,000 of the unrealized losses) and \$350 was charged to other comprehensive income (related to \$1,000 of the unrealized losses).

On December 22, 2017, ABC remeasures its deferred tax assets and related valuation allowance to \$1,050 ($\$5,000 \times 21\%$) to reflect the newly enacted 21% corporate tax rate.

Between December 22 and December 31, 2017, ABC recognizes \$100 in additional unrealized losses and a \$21 ($\$100 \times 21\%$) additional deferred tax asset with a corresponding valuation allowance.

ABC adopts ASU 2018-02 retrospectively in its period ended December 31, 2017 and elects to reclassify the direct effect of the change in the federal corporate income tax rate.

ABC recorded the following entries in the periods ended December 22, 2017 (before the rate change):

	<i>Debit</i>	<i>Credit</i>
Other comprehensive income	5,000	
Investments		5,000
<i>To recognize unrealized losses on available-for-sale securities</i>		
Deferred tax asset	1,750	
Other comprehensive income		1,750
<i>To recognize deferred taxes on the originating deductible temporary difference ($\\$5,000 \times 35\%$)</i>		
Deferred tax expense	1,400	
Valuation allowance		1,400
<i>To recognize a valuation allowance on \$1,400 of deferred tax assets that originated in a prior period</i>		
Other comprehensive income	350	
Valuation allowance		350
<i>To recognize a valuation allowance on \$350 of originating deferred tax assets</i>		

ABC records the following entries in the period from December 22 (after the rate change) to December 31, 2017:

	<i>Debit</i>	<i>Credit</i>
Deferred tax expense	700 ¹	
Deferred tax asset		700
<i>To remeasure the deferred tax asset for the change in the corporate tax rate as of 12/31/17</i>		
Valuation allowance	700 ^{2,3}	
Deferred tax benefit		700
<i>To remeasure the valuation allowance for the change in the corporate tax rate as of 12/22/17</i>		
Other comprehensive income – unrealized loss	100	
Deferred tax asset (\$100 × 21%)	21	
Investments		100
Valuation allowance		21
<i>To recognize unrealized losses and related tax effect for the period from 12/22/17 to 12/31/17</i>		
Accumulated other comprehensive income – deferred tax asset	700 ⁴	
Retained earnings – valuation allowance	140	
Retained earnings – deferred tax asset		700
Accumulated other comprehensive income – valuation allowance		140 ⁵
<i>To reclassify income tax effects resulting from the Tax Cuts and Jobs Act of 2017 (TCJA)</i>		

1

Deferred tax asset as of 12/22/17 before rate change	\$1,750
Temporary difference at 21% (\$5,000 × 21%)	1,050
Deferred tax expense	\$ 700

2

Valuation allowance charged to income from continuing operations as of 12/22/17 before rate change	\$1,400
Valuation allowance at 21% (\$5,000 × 21%)	840
Deferred tax benefit	\$ 560

3

Valuation allowance charged to other comprehensive income as of 12/22/17 before rate change	\$350
Valuation allowance at 21% (\$1,000 × 21%)	210
Deferred tax benefit	\$140

4

Gross amount of deferred tax benefit credited directly to OCI that remains in AOCI at the 12/22/17 enactment date	\$1,750
Amount that would have been credited using TCJA rate	1,050
Debit to AOCI	\$ 700

5

Gross amount of valuation allowance charged directly to OCI that remains in AOCI at the 12/22/17 enactment date	\$350
Amount that would have been charged using TCJA rate	210
Credit to AOCI	\$140

When computing the reclassification adjustment, a company includes the effect of the rate change on the gross deferred tax amounts and related valuation allowances that relate to items that remain in accumulated other comprehensive income as of the enactment date. The effect of the change in tax rate on gross valuation allowances that were originally charged to income from operations should not be included. Because ABC established \$1,400 of its valuation allowance with a charge to income from continuing operations, it excludes that portion of the valuation allowance when computing the reclassification adjustment.

However, because ABC initially credited to other comprehensive income the gross amount of its deferred tax asset and initially charged to other comprehensive income \$350 of its valuation allowance, and both remain as of the enactment date, both are considered when computing the reclassification adjustment.

Roll-forward of deferred tax asset:

Balance as of 12/22/17 before rate change	\$1,750
Change in tax rate	(700)
Tax benefit of unrealized losses arising 12/22 – 12/31	21
Ending balance as of 12/31/17	\$1,071

Roll-forward of valuation allowance:

Balance as of 12/22/17 before rate change	\$(1,750)
Change in tax rate	700
Valuation allowance on tax benefit of unrealized losses arising 12/22 – 12/31	(21)
Ending balance as of 12/31/17	\$(1,071)

Roll-forward of AOCI – tax effects only:

Balance as of 12/22/17 before rate change	\$(1,400)
Net reclassification to retained earnings	560
Net tax effect of unrealized losses arising 12/22 – 12/31	-
Ending balance as of 12/31/17	\$ (840)



Example 2.40.5 Deferred tax liability on CTA

Background

As of December 22, 2017, ABC Company has a favorable \$1,000 translation adjustment that has accumulated in other comprehensive income related to its foreign subsidiary, DEF Company. ABC has never asserted indefinite reinvestment of its foreign earnings and has recognized in OCI \$350 ($\$1,000 \times 35\%$) of deferred tax expense related to the effects of the translation adjustments on the overall temporary difference related to its investment in DEF. In addition, ABC has recognized with a charge to continuing operations \$1,750 (undistributed earnings of $\$5,000 \times 35\%$) of deferred tax expense related to DEF's undistributed earnings. As a result, ABC has recognized a total deferred tax liability of \$2,100 ($\$350 + \$1,750$) related to its investment in DEF.

On December 22, 2017, ABC remeasures its deferred tax liabilities. The deferred tax liability is remeasured to \$480 ($\$6,000 \times 8\%$) to reflect the newly enacted rates applicable to the deemed repatriation of foreign earnings. This deferred tax liability also is reclassified to taxes payable.

Between December 22 and December 31, 2017, ABC recognizes an additional \$100 favorable translation adjustment and an \$8 ($\$100 \times 8\%$) additional deferred tax liability.

ABC adopts ASU 2018-02 retrospectively in its period ended December 31, 2017 and elects to reclassify the direct effect of the change in the federal corporate income tax rate AND the effect of mandatory deemed repatriation.

ABC recorded the following entries in the periods ended December 22, 2017 (before the rate change):

	<i>Debit</i>	<i>Credit</i>
Investment in DEF	5,000	
Income from continuing operations		5,000
<i>To recognize DEF's earnings</i>		
Deferred tax expense (\$5,000 × 35%)	1,750	
Other comprehensive income (\$1,000 × 35%)	350	
Deferred tax liability		2,100
<i>To recognize deferred taxes on the outside basis difference related to DEF</i>		
Investment in DEF	1,000	
Other comprehensive income (translation adjust)		1,000
<i>To recognize the foreign currency translation of DEF's financial statements</i>		

ABC records the following entries in the period from December 22 (after the rate change) to December 31, 2017:

	<i>Debit</i>	<i>Credit</i>
Deferred tax liability	1,620 ¹	
Deferred tax benefit		1,620
<i>To remeasure the deferred tax liability on DEF's undistributed earnings for the change in the tax rate as of 12/22/17</i>		
Deferred tax liability	480	
Current tax expense	480	
Deferred tax benefit		480
Current/noncurrent tax liability		480
<i>To reclassify the deferred tax liability to taxes payable resulting from mandatory deemed repatriation</i>		
Retained earnings	270 ²	
Accumulated other comprehensive income		270
<i>To reclassify income tax effects resulting from the Tax Cuts and Jobs Act of 2017 (TCJA)</i>		

1

Deferred tax liability on undistributed earnings as of 12/22/17 before deemed repatriation	\$2,100
Temporary difference at 8% (\$6,000 × 8%)	480
Deferred tax benefit	\$1,620

2

Gross amount of deferred tax expense charged directly to OCI that remains in AOCI	\$350
Amount that would have been charged using the deemed repatriation rate	80
Credit to OCI	\$270

Roll-forward of deferred tax liability:

Balance as of 12/22/17 before rate change	\$(2,100)
Change in tax rate	1,620
Reclassification to taxes payable	480
Ending balance	\$ -

Roll-forward of current/noncurrent tax liability:

Balance as of 12/22/17 before mandatory deemed repatriation	\$ -
Reclassification to taxes payable	(480)
Ending balance as of 12/31/17	\$(480)

Roll-forward of AOCI – tax effects only:

Balance as of 12/22/17 before rate change	\$350
Reclassification to retained earnings	(270)
Ending balance as of 12/31/17	\$80



Question 2.50

Should a company with investments in qualified affordable housing projects that applies the proportional amortization method under Subtopic 323-740⁶ reevaluate those investments?

Interpretive response: Yes. We believe a company should reevaluate its affordable housing investments based on its revised expectation of the tax benefits, and then assess those investments for impairment. We believe that a company would recognize adjustments due solely to the change in tax law with the other effects of the change in tax law, i.e. in income tax expense (benefit) from continuing operations. [\[Handbook B.011\]](#)

⁶ ASC 323-740, Investments-Equity Method and Joint Ventures—Income Taxes



Question 2.60

When a company that applies the proportional amortization method reevaluates its affordable housing investments based on its revised expectation of the tax benefits, how should it adjust its amortization schedule?

Interpretive response: We believe a company can elect to revise its proportional amortization schedule either:

- through a cumulative effect adjustment – i.e. recast the schedule as if the company had known from the purchase date that tax reform would be enacted December 22, 2017; or
- prospectively – i.e. adjust the future amortization of the carrying amount of its investment as of the enactment date based on the revised estimate of the remaining tax benefits.

We believe these approaches are acceptable because both maintain periodic investment amortization before and after the tax law change that is proportional to the tax benefits recognized.

Cumulative effect adjustment

A company that revises its amortization schedule through a cumulative effect will recognize an adjustment to catch up its investment amortization because the tax benefits after the December 22, 2017 enactment date likely will be a smaller proportion of the total after considering tax reform. We believe that a company would recognize its cumulative effect adjustment due solely to the change in tax law with the other effects of the change in tax law – i.e. in income tax expense (benefit) from continuing operations.

As discussed in [Question 2.50](#), after the company adjusts its investment balance for the revised amortization schedule, it should assess the investment for impairment and recognize the impairment in income tax expense (benefit) from continuing operations. Impairment is measured as the difference between the investment's carrying amount and its fair value.

Prospective adjustment

A company that elects to adjust prospectively has a greater likelihood of impairment at the enactment date because the carrying amount as of that date will need to be realizable based on the new, lower estimate of remaining tax benefits. As discussed in [Question 2.50](#), we believe that a company would recognize impairment due solely to the change in tax law with the other effects of the change in tax law – i.e. in income tax expense (benefit) from continuing operations. Impairment is measured as the difference between the investment's carrying amount and its fair value.

If a company's investment is not impaired and it adjusts its amortization prospectively, it will recognize lower margins after tax reform because the remaining tax benefits will be smaller with no change to the remaining amortization. [[Handbook B.016](#)]



Question 2.70

Should a company that accounts for its investments in qualified affordable housing projects under the equity method reevaluate them? If so, should impairment, if any, be recognized in income tax expense (benefit) from continuing operations?

Interpretive response: Yes. We believe the enactment of tax reform may indicate that a decrease in value has occurred that is other than temporary. The guidance in Subtopic 323-740 about investments in qualified affordable housing projects does not directly address how to measure impairment when an investment within its scope is accounted for under the equity method. However, it does include an illustrative example in which impairment is measured as the difference between the investment's carrying amount and the remaining tax credits allocable to the investor. This differs from the guidance in Subtopic 970-323 and Section 323-10-35, which require investors to write down impaired equity method investments to fair value. Given the inconsistency in the guidance, we believe either measurement approach is acceptable, as long as it is consistently applied.

While we believe that a company generally would recognize impairment on qualified affordable housing investments due solely to the change in tax law in income tax expense (benefit) from continuing operations, that presentation may not be appropriate for a company applying the equity method, depending on the facts and circumstances. For example, if the company is applying the equity method because substantially all of the projected benefits of the investment are not tax benefits (and therefore the investment would not qualify for the proportional amortization method), then it may not be appropriate to recognize the impairment in income tax expense (benefit). [[Handbook B.012](#)]



Question 2.80

Can an investor that applies the hypothetical liquidation at book value (HLBV) method to account for its calendar year-end equity method investments use enacted tax law in computing its equity method pick-up?

Interpretive response: Yes. We believe a company can adopt an accounting policy, assuming one has not already been adopted, to consider the newly enacted tax rate when computing its equity in earnings using HLBV, provided it is probable an actual liquidation event will not occur before the effective date of the tax rate change.

We understand this method is often applied by investors in tax-credit entities that are not within the scope of or accounted for under the proportional amortization method in Subtopic 323-740. For these investments, use of the lower 21% enacted rate may generate an HLBV-determined loss. We believe

that the HLBV-determined loss caused by the change in tax rate, if any, should be presented in the same line that a company presents equity method earnings in the income statement.



Question 2.90

Should an acquirer that is still within its measurement period for a business combination remeasure the acquired deferred taxes through an adjustment to income tax expense (benefit) or goodwill?

Interpretive response: We believe changes in deferred tax assets and liabilities resulting from a change in tax law after a business combination should be recognized in income tax expense (benefit), even if the measurement period for the business combination has not ended.

If a company makes business combination measurement period adjustments in reporting periods after the enactment date, we believe it should compute those adjustments to the acquired assets, liabilities and goodwill based on the enacted tax law as of the acquisition date. Then, outside of the business combination accounting, the company should make the necessary adjustments to the resulting deferred tax accounts for the change in tax law with a credit or charge to income tax expense (benefit) in the period the adjustment is identified. [[Handbook 5.041](#), [5.042](#), [6.112](#)]



Question 2.100

Should a company with investments in leveraged leases reevaluate those investments?

Interpretive response: Yes. All components of a leveraged lease should be recalculated from inception of the lease based on the residual after-tax cash flows arising from the change in tax law. The difference should be included in income tax expense (benefit) in the period that includes the December 22, 2017 enactment date. [[Handbook 5.051](#)]



Question 2.110

To which statutory rate should a company reconcile in its December 31, 2017 financial statements?

Interpretive response: Public entities are required to reconcile (using percentages or dollar amounts) the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax expense that would result from applying the domestic federal statutory rates to pre-tax income from continuing operations.

For a calendar year-end company, the statutory rate for 2017 is 35%. For a fiscal year-end company, the statutory rate for its 2018 fiscal year is the blended rate that the Act requires the company to use to compute its fiscal 2018 tax liability. As discussed in [Question 2.20](#), a fiscal year-end company computes the blended rate by applying a pro-rated percentage of the number of days before and after the January 1, 2018 effective date. [\[Handbook 9.086\]](#)

3. Tax on deemed mandatory repatriation

Questions & Answers

- 3.10** Should a US taxpayer classify the liability for taxes due on deemed repatriated earnings for a CFC with the same year-end as a deferred tax liability?
- 3.20** Should a US taxpayer classify the liability for taxes due on deemed repatriated earnings for a CFC with a different year-end as a deferred tax liability?
- 3.30** Should a company classify the liability for taxes due on deemed repatriated earnings as current or noncurrent?
- 3.40** Should a company consider the effects of discounting under Topic 835 for the liability related to the deemed repatriation?
- 3.50** Does mandatory deemed repatriation eliminate the need for a company to consider its assertion about indefinite reinvestment of accumulated undistributed earnings?
- 3.51** Must a company recognize a deferred tax liability related to offset previously taxed income (PTI)?
- Example 3.51.1** Offset PTI with no outside basis difference
- 3.55** How should a US parent present the change in a foreign-currency denominated withholding tax liability due to a change in exchange rates?
- Example 3.55.1** Deferred tax expense (benefit) related to outside basis differences
- 3.56** How should a US parent account for an intercompany loan that is no longer considered to be of a long-term investment nature?
- 3.60** How should a fiscal year taxpayer recognize the liability for taxes due on deemed repatriated earnings for interim reporting?
- 3.70** Should the deemed mandatory repatriation liability be disclosed in a company's contractual obligations table?

What the Act says

Under the Act, a company's foreign earnings and profits (E&P) accumulated in specified foreign corporations (SFCs) under legacy tax laws are deemed repatriated for the last taxable year of a SFC that begins before January 1, 2018. E&P are determined as the higher of the balance at November 2 or December 31, 2017. This is a one-time transition tax.

The tax on those deemed repatriated earnings is no longer indefinitely deferred but may be paid over eight years with no interest charged; the following proportions of the tax on deemed repatriated earnings are payable in each of the eight years:

- 8% in each of Years 1 to 5;
- 15% in Year 6;
- 20% in Year 7; and
- 25% in Year 8.

Payments would be accelerated upon the occurrence of certain triggering events.

This section focuses on the accounting for SFCs that are controlled foreign corporations (CFCs).

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).



Question 3.10

Should a US taxpayer classify the liability for taxes due on deemed repatriated earnings for a CFC with the same year-end as a deferred tax liability?

Interpretive response: No. We believe a US taxpayer should characterize those obligations as taxes payable because the liability no longer represents the tax effect of a basis difference. Instead, the liability is determined based on a company's accumulated foreign E&P for tax purposes.

That amount is unlikely to approximate either the existing outside basis differences in the company's CFCs or the existing retained earnings of those CFCs. Differences arise for many reasons, including GAAP versus tax accounting principles related to the recognition, timing and measurement of earnings; currency gains and losses; business combinations and restructurings.

[\[Handbook 2.003\]](#)



Question 3.20

Should a US taxpayer classify the liability for taxes due on deemed repatriated earnings for a CFC with a different year-end as a deferred tax liability?

Interpretive response: If a CFC has a 2017 tax year-end earlier than the US parent’s calendar year-end, then the deemed repatriation will not yet have occurred at the US parent’s calendar year-end. We believe a US parent may classify the liability for taxes due on deemed repatriated earnings for a CFC with a different year-end as either a deferred tax liability or taxes payable at its balance sheet date.

US taxpayers should make their best estimates of the undiscounted liability based on the facts and circumstances existing at the enactment date. In the period in which the deemed repatriation has occurred, we believe the US parent would account for the liability as discussed in Questions 3.30 and 3.40. [Handbook 2.003]



Question 3.30

Should a company classify the liability for taxes due on deemed repatriated earnings as current or noncurrent?

Interpretive response: We believe a company should classify the liability as current or noncurrent based on the anticipated timing of the payment (similar to classifying liabilities for unrecognized tax benefits). [Handbook 9.013, 9.018]



Question 3.40

Should a company consider the effects of discounting under Topic 835⁷ for the liability related to the deemed repatriation?

Interpretive response: As discussed at the January 10, 2018 Board meeting and the January 18, 2018 EITF meeting, the FASB believes that companies should not discount the liability related to mandatory deemed repatriation. The basis for this conclusion is Topic 740’s prohibition on discounting, Subtopic 835-30’s scope exception for transactions in which interest rates are affected by tax attributes and the possible variability in payment amount when the liability includes tax positions with uncertainty. A [FASB staff Q&A](#) on this issue was issued January 22, 2018. [Handbook 3.084]

⁷ ASC 835, Interest



Question 3.50

Does mandatory deemed repatriation eliminate the need for a company to consider its assertion about indefinite reinvestment of accumulated undistributed earnings?

Interpretive response: No. A company that does not plan to repatriate its existing undistributed foreign earnings should continue to evaluate its ability to assert indefinite reinvestment to avoid recognizing a deferred tax liability for other items that trigger a tax effect on repatriation – e.g. Section 986(c) currency gain/loss on previously taxed income (PTI), ‘offset’ PTI without tax basis, foreign withholding taxes and state taxes. A company that intends to distribute future earnings should consider the tax consequences of PTI as the law provides that PTI is deemed to be distributed before other earnings.

[Handbook 7.004]

The introduction of the new provision may in itself trigger a different intention on the part of the company – such that it does now plan to repatriate its undistributed foreign earnings. We believe that if the change is caused by a change in previously unforeseen circumstances, it would not raise questions about the original application of the exception. Further, we believe this change would not necessarily taint the continuing application of the indefinite reinvestment assertion for future earnings; however, we believe fewer companies may assert indefinite reinvestment after the tax law change because the US tax implications of repatriation are less punitive than before the change.

[Handbook 7.009]

A company that does not assert indefinite reinvestment determines the liability based on the expected manner of recovery - e.g. remission of dividends, liquidation or sale. [Handbook 7.024]



Question 3.51

Must a company recognize a deferred tax liability related to ‘offset previously taxed income’ (PTI)?

Background: As part of determining the amount of taxable income to recognize due to the Act’s deemed repatriation requirements, in certain circumstances, a company can offset positive earnings and profits (E&P) in one subsidiary (S1) against an E&P deficit of a second subsidiary (S2) to reduce the amount of taxable income recognized with respect to S1’s E&P. As a result of the deemed repatriation, all of S1’s E&P would become PTI.

The US parent would receive additional tax basis in the stock of S1 only to the extent of the taxable income it recognized. As a result, the US parent would not receive tax basis in the stock of S1 to the extent S2’s E&P deficit reduced the taxable income inclusion. This results in the PTI of S1 being greater than the tax basis received by the US parent; this excess PTI is sometimes referred to as ‘offset PTI’.

If the US parent does not have tax basis in S1 from other sources, such as capital contributions upon the original formation of the subsidiary, then the distribution of the offset PTI may result in a capital gain to the US parent.

The same situation could occur in a multi-tier structure in which the US parent has a subsidiary with positive E&P (S1) and that subsidiary has a subsidiary with an E&P deficit (S2). US parent would receive tax basis in the stock of S1 equal to the net amount of E&P, but would have PTI equal to S1's E&P. The earnings in S1 that were not included in the US parent's income because of the deficit in S2 would be offset PTI.

When a foreign subsidiary makes distributions, the tax law generally will deem PTI as distributed before other earnings. Thus, a company that generates E&P in future years that is eligible for a 100% dividends received deduction may not be able to take advantage of that deduction when it distributes cash, because the tax law will deem the distribution to first be a distribution of offset PTI – i.e. before any non-PTI E&P is deemed distributed. If a distribution is deemed under the tax law to be a distribution of existing offset PTI, and if the investor does not have adequate tax basis, the US Parent may need to recognize a capital gain for tax purposes.

Interpretive response: Not necessarily. We believe there are three scenarios for accounting for current year offset PTI.

Company asserts indefinite reinvestment on its entire outside basis difference

If a company asserts indefinite reinvestment of its foreign earnings to the entire outside basis difference in the year it generates offset PTI, it would not consider the fact that a portion of the outside basis difference may become taxable if it distributes future earnings. Planned distributions contingent on future earnings of the foreign subsidiary generally would not preclude a company from applying the indefinite reversal criterion to an existing outside basis difference if the company has provided evidence of its specific plans to continue reinvestment of the existing undistributed earnings.

Under this scenario, no deferred tax liability would be recognized for the tax effect of possible future foreign subsidiary earnings that, if they materialize and are distributed, will be deemed a distribution of existing offset PTI and taxed as capital gain. If there are future earnings that would be taxed as capital gain and are not indefinitely reinvested, the tax will be recognized at the time the earnings are generated.

Company asserts indefinite reinvestment on a portion of its outside basis difference

A company could assert indefinite reinvestment only on the portion of the outside basis difference in excess of the amount of current and possible future earnings that, if they materialize and are distributed, will be deemed a distribution of existing PTI. This situation may arise if a company plans to distribute a fixed amount of funds in the near term, but expects to meet the indefinite reversal criterion relative to future earnings beyond the fixed amount.

Under this scenario, a deferred tax liability is recognized on the portion of the outside basis difference representing the tax effect of possible future foreign subsidiary earnings that, if they materialize and are distributed, will be deemed a distribution of existing offset PTI and taxed as capital gain. In addition, the

company would evaluate the need to recognize additional deferred tax liabilities related to this portion of the outside basis difference (in consideration of Section 986(c) currency gain/loss, withholding taxes and state taxes).

Company does not assert indefinite reinvestment on its outside basis difference

We believe a company that has a taxable outside basis difference for which it does not assert indefinite reinvestment generally would recognize a deferred tax liability for the portion of the outside basis difference that relates to the existing offset PTI. In addition, the company would evaluate the need to recognize additional deferred tax liabilities on the remainder of its outside basis difference (in consideration of Section 986(c) currency gain/loss, withholding taxes and state taxes).

However, if a company would not be subject to tax on the offset PTI unless it generates future earnings, we believe it would be acceptable for it to delay recognition until those future earnings materialize. The approach used is an accounting policy election that should be consistently applied and appropriately disclosed. [Handbook 7.082 – 7.085]



Example 3.51.1

Offset PTI with no outside basis difference

Background

US Parent owns Sub 1 (S1) who owns Sub 2 (S2). S1 was formed with a \$1 initial contribution from US Parent on January 1, 2016. Through September 30, 2016, S1 earns \$100 and forms S2 on October 1, 2016 with a \$100 contribution. S2 loses \$40 in 2016. S1 and S2 do not have any earnings or losses in 2017. US Parent, S1 and S2 use a calendar year-end for US tax and financial reporting purposes.

Under mandatory deemed repatriation, US Parent is taxed on the excess of S1's positive E&P over S2's E&P deficit, or \$60. Future earnings are expected to be a mix of PTI and newly generated non-PTI E&P that is eligible for the 100% dividends received deduction. Assume that under the tax law, all current and future PTI is deemed distributed before future non-PTI E&P is deemed distributed.

	Non-PTI E&P	PTI	Tax basis	US GAAP net equity
Sub 1:				
Initial contribution	\$ -	\$ -	\$ 1	\$ 1
Earnings	100			100
Equity in S2 earnings				(40)
PTI for deemed repatriation	(60)	60	60	
Offset PTI	(40)	40		
Total	\$ -	\$100	\$ 61	\$ 61

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Sub 2:				
Initial contribution	\$ -	\$ -	\$100	\$ 100
Earnings	(40)			(40)
Offset PTI	40			
Total	\$ -	\$ -	\$100¹	\$ 60¹
¹ No deferred tax asset would be recognized for the deductible outside basis difference related to S2 unless the basis difference is expected to reverse in the foreseeable future.				

In this situation, US Parent has no outside basis difference in its investment in S1 (tax basis and US GAAP carrying amount are both \$61). However, if S1 were to distribute future earnings, US Parent will be taxed on the \$39 excess of total PTI (\$100) over the tax basis in the stock (\$61, consisting of \$1 of tax basis from the initial capital contribution and \$60 from the mandatory repatriation income).

If US Parent asserts indefinite reinvestment of all of S1's foreign earnings, it would not recognize a deferred tax liability associated with the \$39 excess of total PTI over the tax basis in the stock.

If US Parent asserts indefinite reinvestment of S1's foreign earnings, but only in excess of the \$100 of PTI, it would recognize a deferred tax liability associated with the \$39 excess of total PTI over the tax basis in the stock even though it does not have an overall taxable outside basis difference related to its investment in S1. In addition, US Parent also would need to recognize additional deferred tax liabilities related to the excess of total PTI over the tax basis in the stock – e.g. Section 986(c) currency gain/loss, withholding taxes and state taxes.

If US Parent does not assert indefinite reinvestment of S1's foreign earnings, it can elect to either (a) not recognize a deferred tax liability associated with the \$39 excess of total PTI over the tax basis in the stock because a distribution of all *existing* assets would not result in taxable gain, or (b) recognize the deferred tax liability because a distribution of future earnings that could otherwise be distributed without federal tax consequences would be taxable due to the \$39 excess of total PTI over the tax basis in the stock. If US Parent recognizes the deferred tax liability associated with the excess of total PTI over the tax basis in the stock, it also would need to recognize additional deferred tax liabilities related to this basis difference – e.g. Section 986(c) currency gain/loss, withholding taxes and state taxes.



Question 3.55

How should a US parent present the change in a foreign-currency denominated withholding tax liability due to a change in exchange rates?

Background: As discussed in [Question 3.50](#), a company may decide to change its intention about indefinitely reinvesting its foreign earnings, particularly because historical earnings generally are subject to the one-time transition tax and future earnings may be repatriated with less punitive US tax consequences

than before tax reform. A company that no longer asserts indefinite reinvestment of its foreign earnings should recognize a tax liability for withholding taxes, if any. Withholding taxes generally are legal obligations of the US parent and denominated in the local currency of the CFC.

Interpretive response: We believe that the US parent should recognize in earnings changes to the withholding tax liability attributable to changes in exchange rates. The liability is a foreign-currency denominated monetary liability for which Topic 830 requires a company to recognize transaction gains and losses in earnings. A company can elect a policy to present these transaction gains and losses in pre-tax income or income tax expense (benefit) (as long as that policy is consistently applied), but should include them in the aggregate transaction gain or loss disclosed under Topic 830. [Handbook 7.047]

This guidance differs from the accounting for changes in US dollar denominated income tax liabilities when fluctuations in exchange rates result in an increase or decrease to a US parent's outside basis difference of its investment. For example, a US parent that recognizes a US dollar denominated state income tax liability on its outside basis difference in a CFC will adjust that liability through other comprehensive income when changes in exchange rates result in a translation adjustment that is recognized in other comprehensive income. The adjustment to that US dollar denominated tax liability for changes in exchange rates arises because the US parent's outside basis difference of its investment has changed and that basis difference change was allocated to other comprehensive income.

In contrast, the adjustment to the withholding tax liability for changes in exchange rates arises solely because it is denominated in a foreign currency. There has been no change in the US parent's outside basis difference from the foreign government's perspective – i.e. the US parent's withholding tax obligation to the foreign taxing authority (which is payable in foreign currency) does not change with a change in exchange rates. [Handbook 7.043, 7.046]



Example 3.55.1

Deferred tax expense (benefit) related to outside basis differences

Background

- US Parent is a calendar year-end company and a 100% shareholder of CFC1. CFC1 is a foreign subsidiary of US Parent and also has a calendar year-end.
- The functional currency of US Parent is the US dollar (USD) while the functional currency of CFC1 is FC for US GAAP, US income tax and local reporting purposes. The consolidated financial statements are presented in the group's reporting currency of the USD. Throughout 2017, the foreign exchange rate is 1.20 USD: 1 FC.
- CFC1 is not subject to local income taxes; however, there is a 10% withholding tax on distributions from statutory retained earnings of CFC1 to the United States. The withholding is remitted by CFC1 to the taxing authority in FC when distributions are made, but is attributed to US Parent as an income tax of US Parent for accounting purposes. There is also a 5%

3. Tax on deemed mandatory repatriation

state income tax due on distributions of earnings and profits (E&P) from CFC1 to the United States. The state income tax is paid in USD by US Parent.

- At December 31, 2017, CFC1 has accumulated statutory retained earnings of 1,000 FC and E&P of 1,000 FC. There are no book to tax basis differences in the calculation of statutory retained earnings and E&P.

During 2017, CFC1's statutory retained earnings and E&P are as follows:

	Foreign currency (FC)	Exchange rate (FC to USD)	USD
Unremitted earnings, 1/1/17	FC -	1.20	\$ -
Earnings	1,000	1.20	1,200
Unremitted earnings, 12/31/17	FC 1,000	1.20	\$1,200

- The Act requires US Parent to include in gross income for US federal income tax purposes, the USD equivalent of 1,000 FC of E&P as a one-time transition tax. US Parent pays tax at an 8% tax rate on the inclusion. After being subject to the transition tax, the 1,000 FC of E&P is considered previously taxed income (PTI) for US federal income tax purposes and US Parent receives \$1,200 of tax basis in the PTI. Based on the laws and Treasury guidance that exist at the balance sheet date, US Parent concludes it is more likely than not that it would receive a tax benefit at an 8% US federal tax rate on any currency losses associated with the PTI.
- Both the historic and future E&P will be subject to state income taxes at a 5% rate when remitted.
- US Parent historically asserted indefinite reinvestment on its outside basis differences related to CFC1. In Q4 2017, US Parent changes its internal treasury and funding plans and changes its assertion with respect to temporary differences associated with CFC1 because, in part, the Act results in a reduced tax cost on an actual remittance of CFC1 earnings.
- US Parent expects to recover its investment in CFC1 through periodic distributions of earnings over its life, followed by a liquidation at an indefinite point in the future. It is apparent that the PTI will be distributed in early 2019 and no valuation allowance would be required for any related US federal deferred tax assets.
- US Parent does not record US federal deferred taxes as of December 31, 2017 with respect to the PTI as its tax basis in the PTI of \$1,200 equals the USD equivalent of the PTI (1,000 FC x 1.20 = \$1,200).
- US Parent calculates its deferred tax liability (DTL) for withholding and state income taxes as follows:

	Withholding	State income taxes
Statutory retained earnings or E&P	FC 1,000	FC 1,000
12/31/17 spot rate	1.20	1.20
USD equivalent	\$1,200	\$1,200
Tax rate	10%	5%
Deferred tax liability	\$ 120	\$ 60

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As the entire deferred tax liability is attributable to 2017 earnings, the related deferred tax expense is allocated to income tax expense attributable to continuing operations.

During 2018, CFC1 generates an additional 600 FC of earnings. Accordingly, statutory retained earnings increases to 1,600 FC and E&P for state income tax purposes also increases to 1,600 FC. For US federal income tax purposes, all of the 600 FC of earnings are E&P eligible for a 100% dividends received deduction. The average exchange rate for 2018 is 1.10 USD: 1 FC and the December 31, 2018 exchange rate is 1.00 USD: 1 FC.

CFC1's balance sheet is summarized as follows:

	12/31/17		12/31/18	
	FC	USD	FC	USD
Assets	FC 1,000	\$1,200	FC 1,600	\$1,600
Equity:				
Retained earnings	1,000	1,200	1,600	1,860
Currency translation adjustment	-	-	-	(260)
Total equity	FC 1,000	\$1,200	FC 1,600	\$1,600

CFC1's statutory retained earnings activity and state E&P activity during 2018 is summarized as follows, along with a rollforward of the related deferred tax liability recognized by US Parent.

	Foreign currency (FC)	Exchange rate (FC to USD)	USD	Withholding DTL	State income tax DTL
Unremitted earnings, 1/1/2018	FC 1,000	1.20	\$1,200	\$120	\$ 60
Earnings	600	1.10	660	66	33
Currency related movement	-	-	(260)	(26)	(13)
Unremitted earnings, 12/31/2018	FC 1,600	1.00	\$1,600	\$160	\$ 80

US Parent would also recognize a US federal deferred tax asset for the currency loss related to the PTI of 1,000 FC.

CFC1 PTI	FC 1,000
12/31/18 exchange rate	1.00
USD equivalent	\$1,000
US Parent tax basis in PTI	\$1,200
Deductible temporary difference	200
Tax rate	8%
Deferred tax asset	\$ 16

As discussed in [Question 3.55](#), we believe the \$26 benefit arising from the remeasurement to current exchange rates of the FC denominated withholding deferred tax liability is a transaction gain under ASC 830. US Parent can elect a policy to present such transaction gains or losses in pre-tax income or in income tax expense as long as the policy is consistently applied, but must disclose them as part of total transaction gains and losses in the notes to financial statements.

If US Parent were expected to elect to take a foreign tax credit for the withholding taxes and could recognize the related deferred tax asset without a valuation allowance, we believe the benefit for the US federal effect of the withholding deferred tax liability likewise would be recognized in income tax expense (benefit) from continuing operations.

The \$13 deferred tax benefit from the remeasurement on the state deferred tax liability, along with any federal effect of the state deferred tax liability, and the \$16 deferred tax benefit from the remeasurement of the US federal deferred tax asset for the PTI would be allocated under the step-by-step approach, which we generally would expect to result in these amounts being allocated to the currency translation adjustment account within other comprehensive income.



Question 3.56

How should a US parent account for an intercompany loan that is no longer considered to be of a long-term investment nature?

Background: Foreign currency gains and losses on an intercompany foreign currency loan that is of a long-term investment nature are recognized in other comprehensive income when each of the companies that is party to the transaction is included (consolidated, combined or accounted for under the equity method) in the same financial statements. A transaction is considered to be of a long-term investment nature when settlement is not planned or anticipated in the foreseeable future.

Because cash may be repatriated with less punitive US tax consequences after tax reform, some companies are considering changes to their capital structures. These changes may involve settling intercompany foreign currency loans that were previously considered to be of a long-term investment nature.

Interpretive response: The characterization of an intercompany transaction as being of a long-term investment nature is largely based on management's intent, much like the intent to indefinitely reinvest a foreign subsidiary's undistributed earnings. As discussed in [Question 3.50](#), tax reform itself may trigger a different intention on the part of a company – such that it now does plan to settle (or anticipate settling) intercompany loans in the foreseeable future. We believe that if the change is caused by this change in previously unforeseen circumstances, it would not raise questions about the original assertion that the transaction was of a long-term investment nature.

If a company decides that an intercompany loan is no longer of a long-term investment nature, it should recognize in pre-tax income the transaction gains and losses that arise after the decision is made. The company should keep in accumulated other comprehensive income the cumulative transaction gain or

loss previously reported there until it sells, liquidates or substantially liquidates its investment in the foreign entity. For additional information about accounting for foreign currency translation, see KPMG's handbook, [Foreign currency](#).



Question 3.60

How should a fiscal year taxpayer recognize the liability for taxes due on deemed repatriated earnings for interim reporting?

Interpretive response: We believe a fiscal year taxpayer should recognize the liability entirely as a discrete item in the interim period that includes December 22, 2017 (subject to the measurement period guidance in SAB 118). It is also acceptable for a company to recognize the liability as a discrete item in the interim period that includes December 22, 2017 for the portion of the liability associated with its earnings and profits existing at the beginning of the fiscal year and as an adjustment to the estimated annual effective tax rate for the portion of the liability associated with its earnings and profits arising during the current fiscal year. Regardless of its policy, a company should allocate the entire effect of the change to income tax expense (benefit). [[Handbook 5.017, 10.085](#)]



Question 3.70

Should the deemed mandatory repatriation liability be disclosed in a company's contractual obligations table?

Interpretive response: It depends. Item 303 of Regulation S-K requires a registrant to present, on an annual basis, obligations due in less than 1 year, 1-3 years, 3-5 years and more than 5 years, aggregated by type of obligation. In 2010, the SEC issued Interpretive Release, *Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis* (FR-83), which indicates that if uncertainties exist about the timing or amounts of contractual obligations such that a company omits those amounts from the contractual obligations table, it should include footnotes to the table that describe the nature and extent of the obligations. FR-83 also indicates that if a portion of such obligations are included in the table and other portions are not, a company should elaborate on which contractual obligations are included in the table and which are not. The SEC staff confirmed at the September 2012 SEC/CAQ Regulations Committee meeting that this guidance applies to items such as interest payments and unrecognized tax benefits.

With respect to the deemed mandatory repatriation liability, some companies (e.g. those that have recognized provisional amounts for the liabilities and those that have done no accounting because they have been unable to make reasonable estimates of the liabilities) may conclude that the uncertainties about the amount and timing of the payment(s) are significant enough that they should simply disclose the nature and extent of the obligations in a footnote to the table. Other companies may have enough information to attribute the

3. Tax on deemed mandatory repatriation

liability to the maturity categories in the table based on the expected timing of cash settlement. In the course of filing its first tax returns after the enactment date, a company will need to report its deemed repatriation liability and elect its payment schedule. At that point, we believe a company may conclude that attribution of the liability amount to the maturity categories within the contractual obligations table is appropriate because the uncertainties about the amount of the liability and the timing of its settlement have been reduced.

[\[Handbook 9.127\]](#)

4. Other international provisions

Questions & Answers

- 4.10** Should a company recognize deferred taxes for basis differences expected to reverse as GILTI?
- 4.20** If deferred taxes are recognized for future expected GILTI, should the deduction for the return on the taxpayer's tangible business property be considered when determining the applicable tax rate?
- 4.30** If deferred taxes are recognized for future expected GILTI, should the deduction for 50% of the GILTI (37.5% after December 31, 2025) be considered when determining the applicable tax rate?
- 4.35** Must a company elect a policy for GILTI in the period including the December 22, 2017 enactment date?
- 4.36** Must a company elect a policy for recognizing deferred taxes for GILTI in its first quarter?
- 4.37** Should a company consider its expected GILTI when assessing its need for a valuation allowance?
- 4.40** Domestic corporations are allowed a 37.5% (21.875% after December 31, 2025) deduction for their foreign-derived intangible income (FDII). How should a company account for that deduction?
- 4.50** Does the ability to make a distribution eligible for the 100% dividends received deduction eliminate the need for a company to consider its assertion about indefinite reinvestment of undistributed earnings that are not previously taxed income (PTI)?
- 4.60** How is the accounting for the BEAT different from the accounting for AMT?
- 4.65** Must a company make a policy election for considering its BEAT status in the valuation allowance assessment in its first quarter?
- 4.70** If a company expects to pay BEAT, how should it measure its deferred taxes?

What the Act says

For tax years of foreign corporations beginning after December 31, 2017, the Act provides that a US shareholder of any CFC must include in taxable income its pro rata share of global intangible low-taxed income (GILTI).

GILTI is considered the excess of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. Additionally, a deduction is permitted for 50% of its GILTI for tax years beginning after December 31, 2017 and before January 1, 2026, with a reduction to 37.5% after December 31, 2025.

Further, for any amount of GILTI included in taxable income, a deemed paid foreign tax credit of 80 percent is permitted, with a corresponding gross-up of 100 percent. Any foreign tax credits generated under the GILTI regime represent a separate basket for purposes of determining whether the amounts are creditable with no carryforward or carryback of excess credits permitted.

The Act also creates a base erosion anti-abuse tax (BEAT), which would partially disallow deductions for certain related-party transactions. BEAT only applies to taxpayers with annual domestic gross receipts in excess of \$500 million. BEAT will function like a minimum tax, but unlike the alternative minimum tax (AMT) in the old law, there is no interaction through a credit mechanism with the regular tax system.

Read more about the legislation in KPMG's report, [KPMG Report on New Tax Law – Analysis and observations](#).



Question 4.10

Should a company recognize deferred taxes for basis differences expected to reverse as GILTI?

Interpretive response: As discussed at the January 10, 2018 Board meeting and the January 18, 2018 EITF meeting, the FASB believes that the application of Topic 740 in this circumstance is unclear and therefore companies can make a policy election. Companies can either account for taxes on GILTI as incurred or, like Subpart F, recognize deferred taxes when basis differences exist that are expected to affect the amount of the GILTI inclusion upon reversal. The policy election is available to all companies, regardless of whether they expect to be subject to GILTI. The FASB staff believes that companies should disclose under Topic 235 their accounting policies related to GILTI inclusions.

The staff plans to monitor how companies that pay tax on GILTI are accounting for and disclosing its effects by reviewing financial statements issued over the next few quarters. After its review, the staff plans to provide the Board an update to consider whether the accounting for or disclosure of GILTI needs improvement. A [FASB staff Q&A](#) on this issue was issued January 22, 2018.



Question 4.20

If deferred taxes are recognized for future expected GILTI, should the deduction for the return on the taxpayer's tangible business property be considered when determining the applicable tax rate?

Interpretive response: We believe the deduction for the return on the taxpayer's tangible business property may be akin to a special deduction because the amount of the deduction depends on current year interest expense. Special deductions are recognized no earlier than the year in which the deduction is available to be included on the tax return and, therefore, generally are not considered in the tax rate when measuring deferred taxes.

However, unlike the special deductions identified elsewhere in Topic 740, the return on tangible business property is not dependent on future income and is not reflected on the tax return as a deduction. As a result, we believe it is acceptable for a company to consider the return on its existing tangible business property (after consideration of the interest expense limitation) in its measurement of GILTI deferred taxes as long as it has the ability to reliably estimate the effect of the interest expense limitation. [[Handbook 3.074, 7.077](#)]

Based on discussions with the SEC staff, we believe a company's method for measuring deferred taxes may be provisional during the measurement period under SAB 118 as long as it is disclosed as such. A company can adjust its provisional measurement during the measured period, but if it changes its method after the measurement period (or after its method of estimating is no longer provisional), it should apply the guidance in Topic 250 on changes in accounting.



Question 4.30

If deferred taxes are recognized for future expected GILTI, should the deduction for 50% of the GILTI (37.5% after December 31, 2025) be considered when determining the applicable tax rate?

Interpretive response: We believe that the 50% of GILTI deduction may be akin to a special deduction because it is limited to future taxable income. As discussed in [Question 4.20](#), special deductions are recognized no earlier than the year in which the deduction is available to be included on the tax return.

However, if a company has concluded that it will pay incremental US tax on GILTI (and has chosen to recognize deferred taxes to reflect that – see [Question 4.10](#)), the deduction will immediately follow in many cases. As a result, we believe it is acceptable for a company to consider the deduction in the rate it applies when measuring deferred taxes as long as it can reasonably expect taxable income adequate to realize the lower effective rate.

We believe companies should consider the partial effects of foreign tax credits provided under the Act when measuring deferred taxes. [[Handbook 3.074, 7.077](#)]

As discussed in [Question 4.20](#), based on discussions with the SEC staff, we believe a company's method for measuring deferred taxes may be provisional during the measurement period under SAB 118 as long as it is disclosed as such. A company can adjust its provisional measurement during the measured period, but if it changes its method after the measurement period (or after its method of estimating is no longer provisional), it should apply the guidance in Topic 250 on changes in accounting. This conclusion is based on discussions with the SEC staff.



Question 4.35

Must a company elect a policy for GILTI in the period including the December 22, 2017 enactment date?

Interpretive response: Not necessarily. We believe a company may delay its policy election under SAB 118 if it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to make an informed policy decision. We believe this situation may be analogous to the situation described in Example 1 of the SAB in which Company X did not have the necessary information available, prepared or analyzed to develop a reasonable estimate of its deemed repatriation liability or evaluate how the Act would affect its existing policy to assert indefinite reinvestment of its foreign earnings.

A company that has not yet made a GILTI policy election should provide the same disclosures required under SAB 118 for other provisional items, including the reason its accounting is incomplete and the additional information that it needs to obtain, prepare or analyze to complete its accounting. Consistent with SEC staff expectations for provisional items, companies should act in good faith to complete their accounting. See additional discussion on SAB 118 in [Overview and SEC relief](#).

When a company makes a final policy decision, it must consistently apply that policy. Changes to that policy are subject to the guidance in Topic 250 on accounting changes. A company is deemed to have selected a final policy in the earliest period in which:

- it discloses it has selected its final policy (or alternatively no longer indicates its policy is provisional);
- it recognizes a material amount of deferred taxes (leading to the conclusion that it has selected a policy to recognize deferred taxes); or
- the measurement period lapses (the policy in place when the measurement period lapses is considered the company's elected policy).

Because a company establishes a policy by recognizing a material amount of deferred taxes, and changes to the policy would be subject to the guidance in Topic 250, companies that continue to gather data to inform their policy decisions should consider recognizing no deferred taxes related to GILTI (and disclose the policy election as an open item under SAB 118) until their analyses are complete.

These conclusions are based on discussions with the SEC staff.



Question 4.36

Must a company elect a policy for recognizing deferred taxes for GILTI in its first quarter?

Interpretive response: Not necessarily. We believe a company may continue to delay its deferred tax policy election under SAB 118 (as discussed in [Question 4.35](#)) at the end of any reporting period as long as it is acting in good faith to complete the accounting, it discloses that its policy election is open, and the measurement period has not lapsed. However, as discussed in [Question 4.35](#), a company is deemed to have made a policy election if it has recognized a material amount of deferred taxes. As a result, companies that have not yet selected a policy should not estimate deferred taxes as part of their annual effective tax rates.

As discussed in [GILTI](#) in [Question 7.10](#) while a company may elect not to provide deferred taxes on basis differences that are expected to result in GILTI, it should consider the current effects of GILTI when estimating its annual effective tax rate and consider disclosing those effects. A company that has estimated only current taxes as part of its annual effective tax rate is not deemed to have made a policy election to account for GILTI as a period expense until it discloses that it has selected its final policy (or alternatively no longer indicates that it has not yet made a policy election) or the measurement period has lapsed.

These conclusions are based on discussions with the SEC staff.



Question 4.37

Should a company consider its expected GILTI when assessing its need for a valuation allowance?

Interpretive response: Yes. Topic 740 requires companies to consider all available evidence, both positive and negative, to determine whether based on the weight of that evidence, it has sufficient taxable income to realize its deferred tax assets. Because a US shareholder must include in its taxable income its pro rata share of GILTI under the regular tax system, we believe the shareholder likewise should include it as a source of taxable income when (a) estimating future taxable income exclusive of temporary differences, and (b) considering future reversals of existing temporary differences, for those companies that elect to provide deferred taxes for GILTI (see [Question 4.10](#)).

When relying on the ability to generate future GILTI to realize the benefit of existing deferred tax assets, we believe companies generally would consider the potential displacement of one benefit by another. For example, assume a company expects to generate enough GILTI to use its NOL carryforward. However, at the same time, it expects to generate foreign tax credits that would have been sufficient to offset the US tax on GILTI absent the NOL. If the foreign tax credits would have been sufficient to reduce taxable income absent the existing NOL carryforward, the company would not realize an incremental benefit from its NOL carryforward. In these situations, companies may consider

using a with-and-without analysis to determine how much, if any, incremental benefit is realized from the existence of the NOL carryforward. [Handbook 4.123, Ex 4.24]

Another acceptable view is that when a company does not provide deferred taxes for basis differences expected to result in GILTI, the effect of future anticipated foreign tax credits is akin to special deductions that can only be realized after existing NOL carryforwards are utilized. Under that view, no valuation allowance would be necessary for the NOL carryforwards, but the ultimate write-off of the related deferred tax assets in the period the carryforwards are utilized may result in an effective tax rate higher than 21%.



Question 4.40

Domestic corporations are allowed a 37.5% (21.875% after December 31, 2025) deduction for their foreign-derived intangible income (FDII). How should a company account for that deduction?

Interpretive response: We believe the FDII deduction is akin to a special deduction because it is limited to taxable income. [Handbook 3.074]



Question 4.50

Does the ability to make a distribution eligible for the 100% dividends received deduction eliminate the need for a company to consider its assertion about indefinite reinvestment of undistributed earnings that are not previously taxed income (PTI)?

Interpretive response: No. As discussed in [Question 3.50](#), a company that does not plan to repatriate its undistributed foreign earnings that are not PTI should continue to evaluate its ability to assert indefinite reinvestment to avoid recognizing a deferred tax liability for other items triggering a tax effect on repatriation – e.g. foreign withholding taxes and state taxes. [Handbook 7.009]



Question 4.60

How is the accounting for the BEAT different from the accounting for AMT?

Interpretive response: For operations subject to tax in the United States, Topic 740 requires all companies to measure deferred taxes for temporary differences using regular tax rates regardless of whether the company expects to be a perpetual AMT taxpayer. This requirement was based primarily on the fact that AMT credit carryforwards (i.e. the amount of tax paid under the AMT system in excess of the amount payable under the regular tax system) could be used to offset future taxes paid under the regular tax system and those

carryforwards were available indefinitely. As a result, a company could expect to be subject to regular income tax rather than AMT over the course of its life.

Unlike the legacy AMT system, amounts paid under the BEAT in excess of the tax that would otherwise be payable under the regular income tax system are not permitted to be carried forward to offset future taxes payable under the regular income tax system. Due to the differences in how the BEAT interacts with regular tax, there have been differing views on whether the current accounting for AMT may be applied.

As discussed at the January 10, 2018 Board meeting and the January 18, 2018 EITF meeting, the FASB believes that because BEAT is similar to the AMT in that it is designed so that a company can never pay less than it would under the regular tax system, companies should measure their deferred taxes using the statutory rate based on the regular tax system (as they have historically for AMT) and account for the incremental tax owed under the BEAT system as it is incurred.

The FASB believes measuring deferred tax liabilities at the lower BEAT rate would not reflect the amount a taxpayer would ultimately pay because the BEAT would exceed the tax under the regular tax system. By accounting for the incremental effect of BEAT in the year BEAT is incurred, companies will recognize an effective tax rate equal to or in excess of the statutory rate under the regular tax system.

A company would not need to evaluate the effect of potentially paying the BEAT in future years when assessing the realizability of its deferred tax assets under the regular tax system because the realization of a deferred tax asset (e.g. for a tax credit) would reduce its regular tax liability even when an incremental BEAT liability would be owed for that period. While a company would not need to consider its BEAT status for valuation allowance assessments related to deferred tax assets under the regular tax system, we believe it can elect to do so as an accounting policy election that should be consistently applied. [Handbook 4.116, Ex 4.24, 4.25]

[A FASB staff Q&A on this issue was issued January 22, 2018.](#) [Handbook 3.069]



Question 4.65

Must a company make a policy election for considering its BEAT status in the valuation allowance assessment in its first quarter?

Interpretive response: Not necessarily. We believe a company may delay its policy election under SAB 118 if it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to make an informed policy decision, similar to the GILTI policy election (as discussed in [Question 4.35](#)).

We also believe a company can continue to delay its policy election under SAB 118 (as discussed in [Question 4.36](#)) at the end of any reporting period as long as it is acting in good faith to complete the accounting, it discloses that its policy election is open, and the measurement period has not lapsed. However, similar to the discussion in [Questions 4.35](#) and [4.36](#), we believe a company is

deemed to have made a policy election if it has recognized a material valuation allowance as a result of considering its BEAT status in the analysis.



Question 4.70

If a company expects to pay BEAT, how should it measure its deferred taxes?

Interpretive response: As discussed in [Question 4.60](#), the FASB believes that companies should measure their deferred taxes based on the regular tax rate and account for the incremental tax owed under the BEAT system as it is incurred. This conclusion was based, in part, on the same premise as the accounting for AMT – i.e. that although a company may expect to be subject to the AMT (or in this case BEAT) for the foreseeable future, no one can predict whether a company will always be an AMT (or BEAT) taxpayer.

Topic 740 requires that a company's expectation of its AMT status be considered when evaluating its valuation allowance on AMT credit carryforwards, because if preference items are large enough, a company could be subject, over its lifetime, to the alternative minimum tax system.

Historically, some AMT taxpayers applied this guidance to their valuation allowance analyses for all deferred tax assets recognized and measured under the regular tax system – i.e. they considered if their AMT status would limit their ability to realize their deferred tax assets. As discussed in [Question 4.60](#), the FASB staff clarified that a company would not need to consider whether it expects to pay BEAT when assessing the realizability of its deferred tax assets under the regular tax system.

5. Other matters

Questions & Answers

- 5.10** Could the provisions of the Act related to the repeal of corporate AMT and minimum tax credit carryforwards being partially refundable result in recharacterizing an existing deferred tax asset for an existing AMT credit carryforward?
- 5.20** If the asset associated with a refundable AMT credit carryforward does not retain its character as a deferred tax asset, should it be classified as current or noncurrent? Should it be discounted under Topic 835?
- 5.25** Should companies anticipate the reduction in AMT credit refunds resulting from sequestration?
- 5.30** What effect do the changes related to executive compensation have on existing deferred tax assets?
- 5.40** What effect could the reduction in the top individual tax rate have on the accounting for share-based payment awards?
- 5.50** Should the anticipated adjustments to the pension and other postretirement benefit liabilities resulting from the December 31, 2017 actuarial valuation be considered in the December 22, 2017 enactment date remeasurement of the pension deferred tax asset?
- 5.55** Should a company with an October 1, 2017 goodwill impairment testing date incorporate the enacted effects of tax reform?
- 5.56** May a company apply the guidance in SAB 118 to non-Topic 740 estimates affected by tax reform - e.g. fair value measurements or impairment analyses?
- 5.60** Can investment companies rely on SAB 118 when calculating their daily net asset value and reporting measurement period adjustments?
- 5.70** Can private companies and not-for-profit entities apply the guidance in SAB 118?
- 5.80** Can a company exclude from its performance measures the one-time effect from the change in tax law?
- 5.90** Could tax reform affect the results of significance testing of equity method investees under Rules 3-09 and 4-08(g) of Regulation S-X?
- 5.100** Can a company recognize provisional amounts under SAB 118 for expected changes in state tax laws?
- 5.105** How should a company consider SAB 118 when accounting for income tax uncertainties? What if SAB 118 does not apply?
- 5.106** How should a company consider Treasury guidance issued after the period that includes the enactment date ends but before that period's financial statements are issued?

5.107 How should a company consider Treasury guidance issued after the financial statements have been issued for the period that includes the enactment date?

5.110 What should companies consider when preparing their year-end disclosures?

5.120 What effect does tax reform have on a parent that is hedging its net investment in a foreign operation on an after-tax basis?

Example 5.120.1 Hedging a net investment in a foreign operation after-tax

Alternative Minimum Tax

The AMT tax regime is repealed under the Act. Existing AMT credit carryforwards will be fully refundable by 2021. For 2018, 2019, and 2020, the AMT credit carryforward can be used to reduce the regular tax obligation. Therefore, an existing AMT credit carryforward would be fully used if the regular tax obligation exceeds the AMT credit carryforward.

Any existing AMT credit carryforward that does not reduce regular taxes is eligible for a 50% refund in 2018–2020 and a 100% refund in 2021. Specifically, 50% of the AMT credit carryforward that is unused in 2018 will be refunded and then 50% of the remaining amount that is unused in 2019 will be refunded, and so on. This results in full realization of an existing AMT credit carryforward irrespective of future taxable income.

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).

Executive compensation

The Act will no longer allow deductions for compensation in excess of \$1 million for covered employees, even if paid as commissions or performance-based compensation. It also subjects the principal executive officer, principal financial officer and three other highest paid officers to the limitation and once an individual becomes a covered person, the individual will remain covered for all future years.

Read more about the legislation in [KPMG Report on New Tax Law – Analysis and observations](#).



Question 5.10

Could the provisions of the Act related to the repeal of corporate AMT and minimum tax credit carryforwards being partially refundable result in recharacterizing an existing deferred tax asset for an existing AMT credit carryforward?

Interpretive response: We believe the new provisions may effectively transform a deferred tax asset for an existing AMT credit carryforward into an income tax receivable (similar to how companies classify refundable credits) because realizing that amount over time, either through reduction in taxes currently payable or cash collection, does not rely on future taxable income. While we believe that receivable presentation generally is appropriate based on the nature of the asset after the tax law change, we believe it would be acceptable for a company to classify some or all of the carryforward as a deferred tax asset if it expects to use it to offset its income tax liability through 2021 or beyond due to a section 383 limitation, if any. [[Handbook 9.013](#), [9.155](#), [9.167](#)]



Question 5.20

If the asset associated with a refundable AMT credit carryforward does not retain its character as a deferred tax asset, should it be classified as current or noncurrent? Should it be discounted under Topic 835?

Interpretive response: Similar to our view about the liability for taxes due on deemed repatriation of foreign earnings, we currently believe that a company that characterizes its AMT credit carryforwards as a receivable and expects to realize it over time should classify the asset as current or noncurrent based on anticipated timing of receipt.

As discussed at the January 10, 2018 Board meeting and January 18, 2018 EITF meeting, the FASB believes that regardless of classification, companies should not discount the asset for their AMT credit carryforwards. Like the liability related to mandatory deemed repatriation, the basis for this conclusion is Topic 740's prohibition on discounting, Subtopic 835-30's scope exception for transactions in which interest rates are affected by tax attributes and the possible variability in refund amount when the carryforward includes tax positions with uncertainty. The FASB also believes that regardless of classification, a company should continue to disclose under Topic 740 the amounts and expiration dates of tax credit carryforwards for tax purposes because it provides investors useful information when evaluating the amounts that are expected to be used to offset taxes payable or refunded. A [FASB staff Q&A](#) on this issue was issued January 22, 2018. [[Handbook 3.084](#)]



Question 5.25

Should companies anticipate the reduction in AMT credit refunds resulting from sequestration?

Background: The Budget Control Act of 2011 amended the Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA) by reinstating its limits on the discretionary budget. The BBEDCA requires the Office of Management Budget (OMB) to compute adjustments to discretionary spending caps and sequestration of direct spending in order to reduce the deficit by approximately \$109 billion for each year from FY 2013 to FY 2021. Subsequent legislation extended sequestration through FY 2025.⁸

In its Report to the Congress on the Joint Committee Reductions for Fiscal Year 2018⁹, the OMB concluded that the required sequestration reduction for other

⁸ The mandatory sequestration provisions were extended beyond 2021 by the BBA of 2013, which extended sequestration through 2023; the Military Retired Pay Restoration Act (Public Law 113-82), which extended sequestration through 2024; and the BBA of 2015, which extended mandatory sequestration through 2025. Sequestration in these four years after 2021 is to be applied using the same percentage reductions for defense and non-defense as calculated for 2021.

⁹ Report dated May 23, 2017

non-exempt nondefense mandatory programs for FY 2018 is 6.6%. In its Report for FY 2019¹⁰, the OMB concluded that the required sequestration reduction for these programs will be 6.2%.

The Internal Revenue Manual¹¹ and the IRS' March 28 announcement¹² indicate that the 6.6% sequestration rate relates to corporate AMT transactions that meet the sequestration criteria and applies to transactions processed on or after October 1, 2017 and on or before September 30, 2018. While the IRS has not yet announced that the 6.2% rate will apply to transactions processed on or after October 1, 2018 and on or before September 30, 2019, the non-exempt nondefense sequestration rate has historically applied to corporate AMT transactions that meet the sequestration criteria. The reductions generally are applicable to AMT refunds, credit elect and refund offset transactions.

The sequestration reduction rates will be applied unless and until a law is enacted that cancels the sequester.¹³ The OMB recalculates the sequestration percentage each fiscal year.

Interpretive response: Yes. We believe that companies should estimate the effect of sequestration, if any, when accounting for their AMT credit carryforwards at the December 22, 2017 enactment of tax reform. While the sequestration percentage may change each year based on the OMB's calculations, current law requires some level of annual sequestration through the government's 2025 fiscal year. We believe the current sequestration rate may serve as a reasonable estimate of future sequestration rates.



Question 5.30

What effect do the changes related to executive compensation have on existing deferred tax assets?

Interpretive response: Eliminating the exceptions for commissions and performance-based compensation means less compensation will be deductible. That may further result in reducing existing deferred tax assets for compensation arrangements that do not qualify for transition relief. There are complex transition rules that may grandfather the deductibility of some previously existing compensation arrangements. Companies should carefully consider the transition requirements when evaluating the effect of the legislation on their existing compensation plans.

The two most common methods used to determine which compensation amounts are deductible are the 'pro rata' and 'stock compensation last' methods. Companies should apply their existing accounting policy.

[Handbook 8.036, C.070]

¹⁰ Report dated February 12, 2018

¹¹ IRM 21.7.4.4.9.3.3

¹² Effect of Sequestration on the Alternative Minimum Tax Credit for Corporations

¹³ The IRS confirmed in an April 16, 2018 announcement (IR-2018-99) that the federal sequester law remains in effect for the 2018 federal fiscal year and may affect companies' tax credits and refunds.



Question 5.40

What effect could the reduction in the top individual tax rate have on the accounting for share-based payment awards?

Background: The Act reduces the top individual tax rate to 37%.

Interpretive response: Equity classification for share-based payment awards is appropriate when a company withholds shares to meet the employer's statutory withholding requirements, provided that the amount withheld or the amount that may be withheld at the employee's discretion does not exceed the employee's maximum individual statutory tax rate in the applicable jurisdictions. A company should reduce its maximum tax withholding from 39.6% to 37% for 2018 to avoid liability classification of the related awards.



Question 5.50

Should the anticipated adjustments to the pension and other postretirement benefit liabilities resulting from the December 31, 2017 actuarial valuation be considered in the December 22, 2017 enactment date remeasurement of the pension deferred tax asset?

Interpretive response: No. Nothing in the postretirement benefit accounting guidance requires the benefit obligation to be remeasured due to a tax rate change. Companies should remeasure the temporary difference that exists as of the December 22, 2017 enactment date through earnings as part of the effect of the Act.

The adjustment to the benefit obligation resulting from the December 31, 2017 actuarial valuation will be initially recognized at the post-enactment 21% tax rate. Companies that recognize the remeasurement of the benefit obligation in other comprehensive income will record the tax effects in other comprehensive income. Companies that recognize the remeasurement in earnings will record the tax effects in the income tax provision, but separately from the effects of changes in tax law.



Question 5.55

Should a company with an October 1, 2017 goodwill impairment testing date incorporate the enacted effects of tax reform?

Background: An impairment test generally is a function of the difference between the fair value and the carrying amount for financial reporting purposes of an asset, asset group or reporting unit being evaluated (e.g. Topic 360 or Topic 350). Because tax reform may affect both fair values and financial

statement carrying amounts, it also may affect impairment tests, depending on the facts and circumstances.

Interpretive response: No. We believe a company should consider only the facts and circumstances existing as of the testing date. As a result, we believe a company should use in its assessment both the carrying amounts of its reporting units and the fair values of its reporting units as of October 1, 2017. The October 1, 2017 fair values should be based on the assumptions market participants would have considered as of that date, which we believe exclude the effects of tax reform.

However, we believe that as companies' testing dates approach the enactment date, fair value is more likely to reflect some expectation of enactment. Preparers should consult their advisors and valuation specialists to identify relevant components of the fair value measurement affected by tax reform. Further, in certain unique circumstances, such as when a reporting unit has significant deferred tax liabilities, the enactment of the new tax law may be an impairment trigger that requires the reevaluation of whether goodwill is impaired.



Question 5.56

May a company apply the guidance in SAB 118 to non-Topic 740 estimates affected by tax reform – e.g. fair value measurements or impairment analyses?

Interpretive response: No. SAB 118 was issued "to address any uncertainty or diversity of views in practice regarding the application of ASC Topic 740 in situations where a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting under ASC Topic 740 for certain income tax effects of the Act for the reporting period in which the Act was enacted." We do not believe its guidance extends to estimates made under other accounting standards even if tax reform affects those estimates.



Question 5.60

Can investment companies rely on SAB 118 when calculating their daily net asset value and reporting measurement period adjustments?

Interpretive response: Yes. The staff of the SEC's Division of Investment Management has confirmed¹⁴ that investment companies may rely on the guidance in SAB 118 for purposes of calculating NAV and reporting measurement period adjustments. The information update also reminds registrants that consistent with the requirements of the SAB, they must disclose to investors relevant information about the material impacts of tax

¹⁴ IM Information Update 2017-07, [Applicability of Staff Accounting Bulletin No. 118 to Investment Companies Impacted by the Tax Cuts and Jobs Act](#)

reform to their calculations of NAV and material provisions for which the accounting is incomplete, if applicable. The disclosure about those impacts may be made in a press release, website disclosure, or some other reasonable manner.



Question 5.70

Can private companies and not-for-profit entities apply the guidance in SAB 118?

Interpretive response: As discussed at the January 10, 2018 FASB Board meeting, while the views and interpretations of the SEC staff are not directly applicable to private companies and not-for-profit entities, the FASB staff will not object to those entities applying SAB 118. The FASB staff believes, however, that if a private company or a not-for-profit entity applies SAB 118, it should indicate its policy of applying the SAB and provide the SAB's required disclosures. This interpretation was issued as a FASB staff Q&A on January 11, 2018.



Question 5.80

Can a company exclude from its performance measures the one-time effect from the change in tax law?

Interpretive response: Yes. However, companies that exclude the effect of the change in tax law from their GAAP results create a new non-GAAP financial measure subject to the provisions of Regulation G and S-K Item 10(e). If a company had not previously excluded the effects of other changes in tax laws in prior periods, it should also disclose the reason for the change in its non-GAAP measure and depending on the significance, may need to recast prior measures to conform to the current presentation.

Companies are reminded to disclose the income tax effects of the reconciling adjustments of their non-GAAP financial measures and consider presenting (or disclosing) those effects separately from the one-time effects of the change in tax law.

The SEC staff has historically asked registrants to revise their presentations to separately identify one-time tax expense (benefit) items from the tax effects of the non-GAAP adjustments. For additional information about non-GAAP financial information, see KPMG's Issues In-Depth, [Non-GAAP financial measures](#).



Question 5.90

Could tax reform affect the results of significance testing of equity method investees under Rules 3-09 and 4-08(g) of Regulation S-X?

Background: Rule 3-09 of Regulation S-X requires registrants to file annual audited financial statements for significant investees accounted for under the equity method. Under S-X Rule 3-09, an equity method investee is significant if the income or investment test in S-X Rule 1-02(w), Significant Subsidiary, exceeds 20%. Under S-X Rules 4-08(g) and 8-03 (smaller reporting companies), summarized financial information for all equity investees must be presented in an audited note to the financial statements if individually or on a combined basis they exceed 10% or 20% (smaller reporting companies) under the asset, income or investment test in S-X Rule 1-02(w).

Interpretive response: Yes, however it does not affect the methodology used in performing significance testing. In performing the significance tests, registrants consider both the income and investment tests under S-X Rule 3-09. Registrants must consider all *three* tests in S-X Rule 1-02(w) when testing significance under S-X Rules 4-08(g) and 8-03. While tax reform may not affect the income test because it is performed on a pre-tax basis, it may affect the investment and asset tests because the registrant's or investee's total assets would include the effects of tax reform in tax-related accounts.

This could require a public company to file audited financial statements or disclose summarized financial information for investees that had not been previously filed or disclosed. Registrants that anticipate difficulty complying with these requirements should consider discussing their facts and circumstances with the Division of Corporation Finance Office of the Chief Accountant.



Question 5.100

Can a company recognize provisional amounts under SAB 118 for expected changes in state tax laws?

Interpretive response: No. We believe companies cannot account for anticipated future changes in tax law. While some states' income tax laws automatically conform entirely to the federal tax code on enactment of the federal legislation, others do not. Those states that do not automatically conform may later enact some or all of the provisions through future state legislation. We believe companies should prepare their state and local income tax provisions based on currently enacted state and local tax law and account for future state legislation in the period of enactment. [[Handbook 5.008](#), [5.011](#)]

If there is uncertainty about what tax law is enacted at the reporting date, companies should apply the guidance on accounting for uncertainty in income taxes. As discussed in [Question 5.105](#), when companies identify uncertainties associated with enactment of the new tax law, but have not finalized their accounting, they should consider the guidance and disclosure requirements in SAB 118. [[Handbook 3.015](#)]



Question 5.105

How should a company consider SAB 118 when accounting for income tax uncertainties? What if SAB 118 does not apply?

Interpretive response:

Items accounted for under SAB 118

When companies identify uncertainties associated with enactment of the new tax law, but have not obtained, prepared or analyzed (including computations) the information necessary to finalize their enactment date accounting, they should consider the guidance and disclosure requirements in SAB 118. Like other provisional items, the SEC staff expects companies to act in good faith to complete their accounting. See additional discussion on SAB 118 in [Overview and SEC relief](#).

There may be provisions in the current law that based on its preliminary review, a company believes may provide unintended benefits or detriments to taxpayers. As discussed above, if a company has yet to complete its analysis of such a provision based on current tax law, and that provision may affect enactment date accounting (see [Question 2.16](#)), the company may apply SAB 118 when accounting for that provision. Accordingly, if a company can make a reasonable estimate of an interpretation of current tax law, including Treasury guidance, companies should record a provisional amount based on that reasonable estimate. However, the company must finalize its accounting for that provision when its analysis is complete, but no later than when the measurement period ends.

Items not accounted for under SAB 118

When a company cannot apply SAB 118 – e.g. because the provision does not relate to enactment date accounting, it should recognize in its financial statements the benefit of a tax position that (a) it expects to report on a current or future tax return, (b) is more likely than not of being sustained based on its technical merits under current tax law, and (c) equals the largest amount of benefit that is greater than 50 percent likely of being realized on settlement with the taxing authority. This analysis should be based on existing tax law, including Treasury guidance, as of the reporting date, even if future guidance is anticipated to change or clarify the law. [[Handbook 3.019, 3.048](#)]

Additional considerations

As discussed above, a company may conclude that the tax law as currently written provides an unintended benefit or detriment to the taxpayer and may believe that the law will be interpreted or changed through future regulations or law changes. While these future changes may affect the analysis of the position's technical merits, a company can consider only information that is available at the reporting date. A company should account for its positions under currently enacted tax law, based on the filing position it would take if future guidance or law changes were never issued or enacted. Companies are reminded that:

- a notice of intent by the Treasury to issue regulations clarifying a particular provision does not necessarily change the technical merits of a position

when evaluating the more likely than not threshold; companies may want to consult with their tax specialists as to the effect of such notices;

- changes in tax law must be accounted for in the period of enactment and cannot be anticipated;
- there is a presumption that beneficial tax positions (based on currently enacted tax law) will be claimed;
- while the amount of recognized financial statement benefit is not based solely on the probability of sustaining the position on its technical merits, measurement of a tax benefit at less than 50 percent may raise questions as to whether the tax position meets the more-likely-than-not recognition threshold [Handbook 3.050]; and
- tax benefits should be recognized and measured based on enacted tax law and available information at the reporting date; not recognizing (and measuring) benefits in the first period in which an expected filing position meets the more-likely-than-not threshold may later result in an error for financial reporting purposes if (or when) that benefit is subsequently recognized. [Handbook 3.015]

In some cases, information about uncertainties becomes available after the balance sheet date but before the financial statements are issued or are available to be issued. See additional discussion in [Questions 5.106, 5.107](#).



Question 5.106

How should a company consider Treasury guidance issued after the period that includes the enactment date ends but before that period's financial statements are issued?

Interpretive response: Companies should consider whether Treasury guidance issued after the period including the December 22, 2017 enactment date ends but before the financial statements for that period are issued (or available to be issued) changes existing enacted tax law or interprets or clarifies existing enacted tax law.

Change in enacted tax law

If the guidance changes enacted tax law, we believe it should be accounted for as a change in tax law and recognized in the period it is issued.

Interpretation of existing enacted tax law

If the guidance interprets or clarifies a provision in the existing tax law, we believe a company can elect to:

- disclose under SAB 118 that its accounting for that item is provisional for the period including December 22, 2017 and account for the change, if any, in the following period as a measurement period adjustment (see [Question 5.105](#)); or
- account for the change, if any, in the period including December 22, 2017, as if the new guidance was available at that date.

While a company generally may only consider information that is available at the balance sheet date when accounting for uncertainties under Topic 740, we believe it is acceptable for a company in these circumstances to account for information that becomes available after the period including December 22, 2017 ends but before the financial statements are issued as if it was available at the enactment date as long as the measurement period is still open. While SAB 118 does not address this issue, its measurement period is similar to the measurement period used when accounting for business combinations. Under Topic 805, the acquirer calculates the adjustment to its financial statements for information obtained during the measurement period, including information related to income tax uncertainties, as if the information was available and the accounting had been completed as of the acquisition date. [Handbook 5.045, 5.046]

We believe companies should clearly disclose their policy election and consistently apply it throughout the measurement period.



Question 5.107

How should a company consider Treasury guidance issued after the financial statements have been issued for the period that includes the enactment date?

Interpretive response: Companies should consider whether Treasury guidance issued after the financial statements for the period including December 22, 2017 have been issued changes existing enacted tax law or interprets or clarifies existing enacted tax law.

Change in enacted tax law

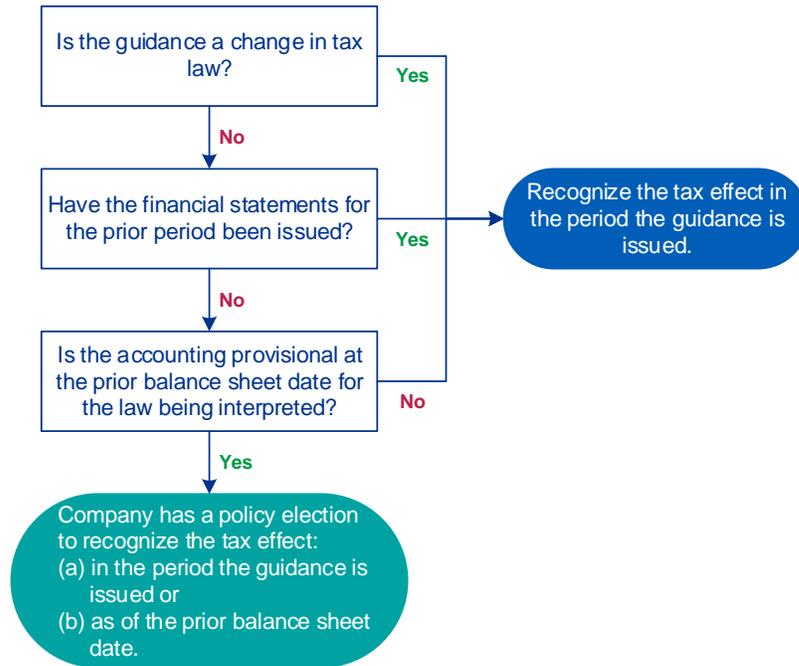
If the guidance changes enacted tax law, we believe it should be accounted for as a change in tax law and recognized in the period it is issued.

Interpretation of existing enacted tax law

If the guidance interprets or clarifies a provision in the existing tax law, we believe it should be accounted for as a change in estimate. Because only information that is available at the reporting date is considered in the recognition and measurement analyses of uncertainty in income taxes, the change in estimate (like a change in tax law) generally is recognized in the period in which the new guidance is issued.

However, if (a) the guidance is issued after the balance sheet date but before the financial statements have been issued (or made available for issuance), and (b) a company's accounting for the provision of the tax law that is being interpreted by the guidance has been identified as provisional under SAB 118 as of the balance sheet date, we believe the company can make a policy election to account for the change in estimate as of the balance sheet date.

The following diagram shows this decision sequence.



Because an entity is required to consider all available evidence when evaluating the need for a valuation allowance, a company should consider additional interpretive guidance issued after the balance sheet date but before the financial statements are issued, regardless of when the company accounts for the change in estimate. [Handbook 3.026, 5.045, 5.046]

Question 5.110 What should companies consider when preparing their year-end disclosures?

Interpretive response: The form and content of disclosures about tax reform will depend on a company’s facts and circumstances. However, companies may want to consider the following areas as they prepare their notes to financial statements. The following discussion is intended to be a guide about disclosure content that may be particularly affected by tax reform and does not include all the disclosures required by Topic 740 and the rules and regulations of the SEC. [Handbook Chapter 9]

Companies that elect to apply the measurement period guidance provided in SAB 118 should provide the relevant disclosures required by the SAB as discussed in [Overview and SEC relief](#).

Statement of financial position related disclosures

Topic 740 requires companies to disclose the components of their net deferred tax assets or liabilities recognized on the balance sheet, including total deferred tax assets, total deferred tax liabilities and the valuation allowance, if any. Public entities also must disclose the approximate effect of each temporary difference

and carryforward that gives rise to a significant portion of the deferred tax assets and deferred tax liabilities while nonpublic entities must disclose the types of significant temporary differences and carryforwards.

In making these disclosures after the enactment date, companies may consider highlighting the following changes from the prior period resulting from tax reform:

- the overall reduction in the balance of deferred tax assets and liabilities due to the change in the corporate tax rate (see [Question 2.10](#));
- a new deferred tax liability related to mandatory deemed repatriation for a fiscal year CFC, if the company has elected to classify it as such (see [Question 3.20](#));
- a new (or higher) deferred tax liability resulting from immediate expensing for tax purposes of investments in depreciable property (see [Question 6.10](#));
- new deferred tax assets and liabilities for basis differences expected to result in GILTI inclusion on reversal (if deferred taxes are provided, see [Question 4.10](#));
- reclassification from deferred tax assets of those amounts of AMT credit carryforwards that the company expects to realize in cash (see [Question 5.10](#));
- the reduction of deferred tax assets associated with executive compensation that is no longer deductible (see [Question 5.30](#)); and
- a new deferred tax liability resulting from a change in the company's assertion about indefinite reinvestment of foreign earnings (see [Questions 3.50, 4.50](#))

Topic 235 requires companies to disclose tax refunds receivable and amounts currently payable, including the amount of US federal, foreign, state and other taxes based on income. Companies may consider highlighting their liabilities related to mandatory deemed repatriation (see [Questions 3.10, 3.20](#)), the amounts they expect to receive resulting from the repeal of the AMT (see [Question 5.10, 5.25](#)), the adjustment made to current taxes for the corporate rate change (see [Questions 2.20, 2.30](#)) and immediate expensing of depreciable property acquired after September 27, 2017 (see [Question 6.10](#)).

Companies are required to disclose the net change in the valuation allowance. In making these disclosure after the enactment, companies may consider highlighting the following changes resulting from tax reform:

- a decrease in the valuation allowance on deferred tax assets for foreign tax credits expected to be used to offset the liability related to mandatory deemed repatriation (see [Questions 3.10, 3.20](#));
- an increase in the valuation allowance on deferred tax assets for foreign tax credits resulting from the 100% dividends received deduction decreasing taxable foreign source income (see [Question 6.10](#));
- a decrease in the valuation allowance on deferred tax assets for AMT credit carryforwards that are expected to be realized because the AMT system has been repealed (see [Question 6.10](#));
- a decrease in the valuation allowance on deferred tax assets resulting from an increase in the taxable income projection because less executive compensation is deductible (see [Question 6.10](#));

- a decrease in the valuation allowance on deferred tax assets resulting from an increase in taxable income because of the GILTI inclusion (see [Question 4.37](#), [6.10](#)); and
- a decrease in the valuation allowance on deferred tax assets resulting from an increase in the taxable income projection because less interest expense is deductible (see [Question 6.10](#)).

Companies are required to disclose the amounts and expiration dates of operating loss and tax credit carryforwards for tax purposes. A company should continue to provide these disclosures for AMT credit carryforwards regardless of classification (see [Question 5.20](#)).

Income statement related disclosures

Topic 740 requires companies to disclose the significant components of income tax expense attributable to continuing operations, including the adjustment to a deferred tax asset or liability for enacted changes in tax law or rate (see [Questions 2.10](#), [2.30](#), [Example 2.30.1](#)).

Companies also are required to disclose amounts separately allocated to other items, like other comprehensive income. While remeasurement related to tax reform of deferred tax assets and liabilities initially recognized in other comprehensive income may not be backwards traced to equity, companies have the option to reclassify certain income tax effects to retained earnings under ASU 2018-02 (see [Question 2.40](#)). Under the ASU, a company that elects to reclassify those effects should disclose in the first interim and annual period of adoption:

- a statement that the election was made to reclassify the income tax effects of the Act; and
- a description of the other income tax effects related to the Act that have been reclassified.

Rule 4-08(h) of Regulation S-X also requires SEC registrants to disclose the components of income (loss) before tax as either foreign or domestic. For each major component, companies should disclose separately amounts applicable to US federal income tax, foreign income tax and other taxes (unless those amounts are less than five percent of the total of income before tax or the component of tax expense).

Income tax expense compared to statutory expectations

Public entities should disclose a reconciliation using percentages or dollar amounts of the reported amount of income tax expense attributable to continuing operations for the year to the amount of income tax expense that would result from applying the domestic federal statutory tax rate to pre-tax income from continuing operations. These companies also should disclose the estimated amount and nature of each significant reconciling item. Nonpublic entities should disclose the nature of significant reconciling items but may omit the numerical reconciliation.

In making these disclosures after the enactment date, companies may consider highlighting the following as it relates to tax reform:

- the change to the statutory rate for fiscal year-end companies that will apply a blended rate to their 2018 tax years (see [Questions 2.20](#), [2.30](#), [2.110](#), [Example 2.30.1](#));

- a new reconciling item for remeasurement of deferred tax assets and liabilities resulting from the rate change (see [Questions 2.10, 2.30, Example 2.30.1](#));
- a new reconciling item for the cumulative effect of recasting the amortization schedule for affordable housing investments (if a company elects that policy) and impairments due solely to the change in tax law (see [Questions 2.50, 2.60](#));
- a new reconciling item for the effect of reevaluating leveraged leases (see [Question 2.100](#));
- a new reconciling item for the liability related to mandatory deemed repatriation (see [Questions 3.10, 3.20](#));
- a new reconciling item for changes in a company's intention about indefinitely reinvesting its foreign earnings (see [Questions 3.50, 4.50](#));
- a new reconciling item for the rate difference associated with deferred tax assets and liabilities for basis differences expected to result in GILTI inclusion upon reversal (if deferred taxes are provided, see [Questions 4.10, 4.20, 4.30, 4.50](#));
- a new reconciling item for changes in the valuation allowance (see previous discussion on changes in the valuation allowance); and
- a new reconciling item for the portion of AMT credit carryforwards that are not expected to be realized because of sequestration (see [Question 5.25](#)).

Topic 740 clarifies that companies should use the regular statutory rate in the rate reconciliation if there are alternative tax systems. Companies expecting to pay the BEAT should continue to use the regular rate, but consider disclosing their expectations about their BEAT status (see [Questions 4.60, 4.70](#))

Rule 4-08(h) of Regulation S-X states that reconciling items that are individually less than five percent of the amount computed by multiplying the income before tax by the statutory rate may be aggregated in the disclosure. If no individual reconciling item is more than five percent of the computed amount and the total difference to be reconciled is less than five percent of the computed amount, a company does not need to provide the reconciliation.

Unrecognized tax benefit disclosures

Companies should update their unrecognized tax benefit disclosures to incorporate changes in existing exposures (and new exposures that arise) as a result of tax reform.

When companies identify uncertainties associated with the new tax law but have not obtained, prepared or analyzed (including computations) the information necessary to make a reasonable estimate, they should consider the guidance and disclosure requirements in SAB 118. The SEC staff expects companies to act in good faith to complete their accounting. See additional discussion on SAB 118 in [Overview and SEC relief, Questions 5.100, 5.105, 5.106, 5.107](#).

Undistributed earnings related disclosures

Subtopic 740-30 requires companies to make certain disclosures whenever a deferred tax liability is not recognized because of the exceptions to comprehensive recognition of deferred taxes related to subsidiaries and corporate joint ventures. In making these disclosures after the enactment date, companies may consider highlighting the following changes resulting from tax reform:

- changes to a company's assertions about indefinite reinvestments of foreign earnings and intercompany loans being considered to be of a long-term investment nature (see [Questions 3.50, 3.56, 4.50](#));
- for those investments in which the company continues to assert indefinite reinvestment, changes to the following resulting from mandatory deemed repatriation, tax on GILTI, and the 100% dividends received deduction (see [Questions 3.50, 4.10, 4.50](#)):
 - the cumulative amount of the temporary differences;
 - the types of events that would cause those temporary differences; and
 - the amount of the unrecognized deferred tax liability (if it is practicable to determine).

Policy related disclosures

Topic 235 and Topic 740 require companies to disclose significant new accounting policies or changes to existing policies. As a result of tax reform, a company should consider disclosing:

- whether it has elected to apply the measurement period guidance provided in SAB 118 (see [Overview and SEC relief, Questions 4.35, 4.36, 5.70](#));
 - changes in its policy related to indefinite reinvestment of foreign earnings (see [Questions 3.50, 4.50](#));
 - its policy for accounting for basis differences expected to result in GILTI inclusion on reversal (see [Question 4.10](#)) and if deferred taxes are provided, its policies for identifying and measuring those deferred taxes (see [Questions 4.10, 4.20, 4.30](#));
 - its policy for adjusting its amortization schedule for affordable housing investments (see [Question 2.60](#));
 - its policy for considering the change in tax rate in applying HLBV to its tax credit investments accounted for under the equity method (see [Question 2.80](#));
 - its policy for classifying the liability for taxes due on deemed repatriated earnings for a CFC with a different year-end (see [Question 3.20](#));
 - its policy for recognizing the liability for taxes dues on deemed repatriated earnings for interim reporting (see [Question 3.60](#));
 - whether it has elected to consider its BEAT status when assessing realizability of its deferred tax assets under the regular tax system;
 - whether it has elected to reclassify income tax effects arising from the Act under ASU 2018-02 (see [Questions 2.40, 4.65](#));
 - a description of its accounting policy for releasing residual income tax effects from accumulated other comprehensive income (see [Question 2.40](#));
 - how it has elected to account for future taxes on offset PTI (see [Question 3.51](#));
 - whether it has elected to recognize transaction gains and losses on foreign-denominated deferred tax assets and liabilities in pre-tax income or income tax expense (benefit) (see [Question 3.55](#));
 - its policy for considering information that becomes available after the balance sheet date but before the financial statements for that period are issued when accounting for uncertainties (see [Questions 5.106, 5.107](#)); and
 - its policy for classifying its AMT credit carryforwards (see [Question 5.10](#)).
-



Question 5.120

What effect does tax reform have on a parent that is hedging its net investment in a foreign operation on an after-tax basis?

Background: Under Topic 815, a company is allowed to hedge the foreign currency exposure inherent in its net investment in a foreign operation on an after-tax basis. A company that uses this strategy often asserts indefinite reinvestment of the hedged investment's foreign earnings and thus does not recognize deferred taxes on the outside basis difference related to its investment. Because the company does recognize deferred taxes on the basis difference related to the hedging instrument, it generally tries to align the amount of its investment with the after-tax notional amount of the hedging instrument.

Interpretive response: The reduction of the corporate tax rate to 21% on December 22, 2017 affects the effectiveness of these hedging relationships because it results in an overhedge – i.e. if the tax rate had been 21% all along, the parent would have needed a hedging instrument with a smaller pre-tax notional to hedge the same investment.

If a company did not de-designate its hedging relationship on December 22, 2017, it should consider the effects of tax reform when assessing effectiveness and measuring ineffectiveness as of December 31, 2017. We understand that the SEC staff would not object to a company concluding that an after-tax net investment hedge was highly effective for the period in which tax reform was enacted (i.e. the period that includes December 22, 2017), but believes a company must calculate and recognize the amount of ineffectiveness for the period from December 22, 2017 to the end of the current quarter resulting from the reduction in the corporate tax rate (in addition to other sources of ineffectiveness already present in the relationship).

Topic 815, as amended by ASU 2017-12¹⁵, does not require companies to separately measure and recognize ineffectiveness as long as a hedging relationship is highly effective. If a company early adopted ASU 2017-12 in 2017, the SEC staff guidance applies except that the company would not be separately measuring and recognizing ineffectiveness.



Example 5.120.1

Hedging a net investment in a foreign operation after-tax

On October 1, 2017, US Parent designates a six-month euro for USD forward contract to hedge its beginning of the period €100 million net investment in Subsidiary S.

US Parent asserts indefinite reinvestment of Subsidiary S's foreign earnings and thus does not provide deferred taxes on its outside basis difference. It does

¹⁵ ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities

provide deferred taxes on the derivative's unrealized gains and losses because those amounts are not taxable or deductible until realized.

When designating its hedging relationship in October, US Parent considered its enacted tax rate of 35% and designated a forward contract with a notional amount of €153.85 million [$€100 \text{ million} \div (1-35\%)$] to perfectly offset, on an after-tax basis, the foreign currency changes in its €100 million net investment in Subsidiary S.

On December 22, 2017, US Parent's tax rate was reduced to 21% and US Parent did not de-designate the relationship.

As of December 31, 2017, US Parent:

- concludes that its hedging relationship remained highly effective for the period ended December 31, 2017;
- determines the perfectly effective hypothetical after-tax hedge to be a euro for USD forward contract with a notional amount of €126.6 million [$€100 \text{ million} \div (1-21\%)$]
- measures the ineffectiveness from December 22 to December 31 resulting from the overhedge based on the difference between the gain/loss on the €153.85 million forward contract and the gain/loss on the perfectly effective hypothetical after-tax hedge of €126.6 million forward contract. The ineffectiveness recognized in earnings will be tax effected at the new 21% corporate tax rate. For example, if the total loss on the actual derivative for the nine-day period was \$1.54 million before tax, and the gain on the perfectly effective hypothetical hedge was \$1.27 million before tax, the total ineffectiveness recognized in earnings is a loss of \$0.27 million [$\$1.54 \text{ million} \text{ less } \1.27 million]. The net after tax ineffectiveness is \$0.21 million [$\$0.27 \text{ million} \times (1-21\%)$].

In accordance with ASC paragraph 815-35-35-27, on January 1, 2018, US Parent de-designates its existing hedging relationship and designates a new after-tax hedging relationship using a forward contract with a notional amount of €126.6 million, expecting the new relationship to be perfectly effective.

6. Valuation allowance assessment

Questions & Answers

New Q&A added in this edition: **

6.10 What provisions of the Act are likely to affect valuation allowance assessments?

Example 6.10.1 Valuation allowance – interest limitation

6.20 How does the limit on using NOLs to offset 80% of taxable income affect intraperiod tax allocation when there is a loss from continuing operations? **

Example 6.20.1 Loss from continuing operations with end of year net deferred tax asset **

Example 6.20.2 Loss from continuing operations with end of year net deferred tax liability **



Question 6.10

What provisions of the Act are likely to affect valuation allowance assessments?

Interpretive response: There are several provisions that are likely to affect companies' valuation allowances.

Mandatory deemed repatriation

The amount of E&P subject to tax under the mandatory deemed repatriation provisions is a source of foreign source income to support existing foreign tax credits or other deferred tax assets that may have previously been subject to a valuation allowance. [Handbook 4.117]

Interest expense limitations

A company should consider the annual limitations on the deductibility of interest expense and the ability to use disallowed interest carryforwards, including the ordering rules. The ordering rules require a company to take future net interest expense into account first, before an incremental deferred tax benefit is recognized at the balance sheet date for net interest expense carryforwards. Accordingly, this may result in an inability to realize the benefit of the disallowed interest expense carryforwards even though the carryforwards have an unlimited carryforward period. [Handbook 4.016, 4.027]

Example 6.10.1 illustrates how a company should consider interest expense limitations and carryforwards in its valuation allowance assessment.

100% dividends received deduction

Dividend income will no longer be a source of foreign source income to support realizability of deferred tax assets for foreign tax credits. If a company determines that it is not more likely than not that it will be able to realize its FTC carryforwards, it should recognize a valuation allowance against the deferred tax assets. A deferred tax asset for existing tax attributes (and related valuation allowance) generally should not be written off even if the company expects the attribute to expire unused. Write-offs generally are appropriate only when the gross deferred tax asset exceeds the amount that can be used under the tax law. [Handbook 4.117, 4.136]

100% expensing for investments in depreciable property other than real property

The 100% expensing provision creates new taxable temporary differences in 2017 for assets purchased after September 27, 2017 and may affect valuation allowance assessments at the enactment date. Immediate expensing also may put some companies in a taxable loss position that generates NOL carryforwards that should be analyzed for a valuation allowance.

Limitation to 80% of taxable income for NOLs incurred in tax years beginning after December 31, 2017; unlimited carryforward period

The annual limitation on the use of NOL carryforwards may result in changes to the valuation allowance assessment because the NOL may offset only 80% of the reversal of taxable temporary differences in an annual period. Other future taxable income would have to exist to support realization of NOL carryforwards that remain after applying the limitation and must continue to be carried

forward. In addition, if a company's deductible temporary differences are expected to reverse in a loss year, the annual benefits of those deferred tax assets will similarly be limited. This will require some companies to perform more detailed scheduling to evaluate the realizability of their deferred tax assets. [Handbook 4.016, 4.027, 4.139]

The unlimited NOL carryforward period also may result in changes to the valuation allowance assessment, including the ability to consider the deferred tax liability associated with indefinite-lived intangible assets as a source of future taxable income to support existing deferred tax assets that are expected to reverse in a loss year and other future net operating loss carryforwards (subject to the limitation previously discussed). [Handbook 4.017]

We believe companies should also continue to evaluate whether prudent and feasible tax-planning strategies are available to generate future taxable income sufficient to realize the deferred tax assets associated with indefinite NOL carryforwards. However, a tax-planning strategy by itself is not a separate source of taxable income; it is an action that a company would take to generate additional future taxable income. In order to consider a tax-planning strategy to support realization of deferred tax assets, the strategy must be:

- more likely than not of being sustained if examined by the taxing authority;
- prudent – e.g. a strategy in which the transaction costs exceed the tax benefits would not be prudent; and
- feasible – i.e. a strategy that is not primarily within management's control would not be feasible.

In addition, when a tax-planning strategy is intended to generate incremental taxable income, that income is not considered in isolation – it is just one additional component of the company's overall estimate of future taxable income. If the income from the tax-planning strategy (e.g. a gain from a sale of an asset when the company has overall appreciated net assets) is expected to be offset by future operating losses, that potential income would not provide sufficient evidence to support realization of deferred tax assets. [Handbook 4.058, 4.061, 4.072]

Refundable AMT credit carryforwards

Companies should release valuation allowances on existing AMT credit carryforwards that are expected to be realized. As discussed in [Question 5.25](#), we believe companies should consider whether their AMT credits may be subject to sequestration.

Expansion of executive compensation that is subject to the excessive executive compensation limit

This provision of the Act may affect valuation allowance judgments resulting from the reduction of deferred tax assets for compensation arrangements and increase in future taxable income.

GILTI

Topic 740 requires a company to consider all available evidence, both positive and negative, to determine whether based on the weight of that evidence, it has sufficient taxable income to realize its deferred tax assets. Because a US shareholder must include in its taxable income its pro rata share of GILTI under the regular tax system, we believe the shareholder likewise should include it as a source of taxable income. See additional discussion in [Question 4.37](#).



Example 6.10.1 Valuation allowance – interest limitation

Background

ABC Co. is a US taxpayer with a \$1,500 NOL carryforward and an \$800 taxable temporary difference as of January 1, 2018. ABC expects to indefinitely (a) incur annual interest expense in excess of the Act's annual limitation and (b) maintain (through reversal and origination) an \$800 taxable temporary difference at the end of each year.

In evaluating the need for a valuation allowance as of December 31, 2018, ABC first analyzes whether the reversal of taxable temporary differences is adequate to realize its deferred tax assets. The following table summarizes ABC's actual taxable income in 2018 and its forecasted taxable income for 2019 and beyond, including only the reversal of its \$800 taxable temporary difference. Assume the NOL can offset only 80% of taxable income.

	2018	2019 and beyond
Income statement:		
EBITDA	\$1,000	\$ 800
Depreciation	(400)	-
Interest	(800)	-
Pre-tax income	\$ (200)	\$ 800
Interest incurred	800	-
Allowed interest	(300)	(240)
Taxable income before NOLs	\$ 300	\$ 560
NOLs	(240)	(448)
Taxable income	\$ 60	\$ 112
Ending temporary differences and carryforwards:		
NOL ¹	\$1,260	\$ 812
Disallowed interest	500	260
Total carryforward	\$1,760	\$1,072
Taxable temporary difference	(800)	-
Net	\$ 960	\$1,072
Note:		
1. As discussed in Question 6.10 , NOL carryforwards may offset only 80% of taxable income in an annual period.		

ABC concludes that of its \$1,760 in total carryforwards at December 31, 2018, \$688 (\$240 in disallowed interest carryforwards and \$448 of NOL carryforwards) will be realized through reversal of its existing taxable temporary difference. [[Handbook 4.043](#), 4.114]

6. Valuation allowance assessment

Next, ABC analyzes whether it expects future taxable income (exclusive of reversing temporary differences and carryforwards) to be adequate to realize its remaining deferred tax assets.

	Interest limitation on EBITDA				Interest limitation based on EBIT			
	2018	2019	2020	2021	2022	2023	2024	2025
Income statement:								
EBITDA	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000	\$1,000
Depreciation	(400)	(400)	(400)	(400)	(400)	(400)	(400)	(400)
Interest	(800)	(800)	(800)	(800)	(800)	(800)	(800)	(800)
Pre-tax income	\$ (200)	\$ (200)	\$ (200)	\$ (200)	\$ (200)	\$ (200)	\$ (200)	\$ (200)
Interest incurred	800	800	800	800	800	800	800	800
Allowed interest	(300)	(300)	(300)	(300)	(180)	(180)	(180)	(180)
Taxable income before NOL	\$ 300	\$ 300	\$ 300	\$ 300	\$ 420	\$ 420	\$ 420	\$ 420
NOL ¹	(240)	(240)	(240)	(240)	(336)	(204)	\$ -	\$ -
Taxable income	\$ 60	\$ 60	\$ 60	\$ 60	\$ 84	\$ 216	\$ 420	\$ 420
Ending temporary differences and carryforwards:								
NOL	\$1,260	\$1,020	\$ 780	\$ 540	\$ 204	\$ -	\$ -	\$ -
Disallowed interest	500	1,000	1,500	2,000	2,620	3,240	3,860	4,480
Total carryforward	\$1,760	\$2,020	\$2,280	\$2,540	\$2,824	\$3,240	\$3,869	\$ 4,480
Taxable temporary difference	(800)	(800)	(800)	(800)	(800)	(800)	(800)	(800)
Net	\$ 960	\$1,220	\$1,480	\$1,740	\$2,024	\$2,440	\$3,060	\$3,680
Note:								
1. As discussed in Question 6.10 , NOL carryforwards may offset only 80% of taxable income in an annual period.								

At December 31, 2018, ABC concludes that it is *not* more likely than not that it will realize incremental benefit from its remaining \$260 in interest carryforwards (after considering the \$240 supported by the reversal of ABC's taxable temporary differences) because it is not projecting enough adjusted taxable income to use the disallowed interest carryforwards – i.e. the conditions that generate the carryforwards are expected to persist indefinitely.

Even if the previous year's carryforward were to be used first (which it is not – i.e. the tax law ordering rules require that current year interest incurred be used first), it would simply be displaced by a newly originating carryforward.

However, it is still appropriate for ABC to consider the reversal of its taxable temporary difference to support realization of \$240 of its interest carryforwards (as illustrated in step 1) because companies should not consider displacement of future credits when future taxable income is generated by the reversal of existing taxable temporary differences. [Handbook 4.123, 4.124]

ABC concludes that it is more likely than not that it will realize the benefit from its remaining \$1,260 in NOL carryforwards because, assuming it can reliably project future taxable income, those carryforwards will be fully realized by December 31, 2022.



Question 6.20**

How does the limit on using NOLs to offset 80% of taxable income affect intraperiod tax allocation when there is a loss from continuing operations?

Background: Generally, under the step-by-step approach to intraperiod tax allocation, a company determines the income tax effect of income from continuing operations without considering the tax effect of items that are not included in continuing operations. However, Topic 740 provides an exception to this general approach by requiring a company to consider all components, including discontinued operations and other comprehensive income, when determining the income tax benefit of a loss from continuing operations.

For example, assume a company has a loss from continuing operations for which it would recognize a valuation allowance absent income being generated from another component outside continuing operations. However, assume the company also has income from discontinued operations that under the tax law would be available to offset the loss in continuing operations. While the step-by-step approach normally would require that a valuation allowance be established through continuing operations, Topic 740 requires that a company consider the income from discontinued operations when allocating total income tax expense or benefit to continuing operations.

Interpretive response: When considering the ability to use the income from components outside continuing operations to support an income tax benefit from a loss from continuing operations, we believe a company should consider the provisions of income tax law, including the effect of different jurisdictions, the character of the gains and losses, the tax rate that applies to the component providing the tax benefit and limitations that may exist, such as the limitation that companies may use NOL carryforwards to offset only 80% of taxable income each year (see [Question 6.10](#) for additional discussion). The effect of the limitation will differ depending on a company's facts and circumstances. Examples [6.20.1](#) and [6.20.2](#) illustrate two scenarios. [Handbook 9.027 – 9.028]



Example 6.20.1 **

Loss from continuing operations with end of year net deferred tax asset

Background

At January 1, 20X9, ABC Corp. had a \$4,200 deferred tax asset for \$20,000 of NOL carryforwards that are subject to the 80% limitation under the tax law. ABC also had a \$630 deferred tax asset for a \$3,000 unrealized loss on a cash flow hedge that was recognized in other comprehensive income. ABC had a \$4,830 valuation allowance on all of its deferred tax assets.

For the year ended December 31, 20X9, ABC has a \$5,000 loss in continuing operations and a \$1,000 unrealized gain in other comprehensive income and no current tax. ABC needs a full valuation allowance as of December 31, 20X9 and has a 21% tax rate.

Step 1: Compute total income tax expense

Rollforward of deferred taxes:

	January 1, 20X9	Change	December 31, 20X9
Deferred tax asset - NOL	\$ 4,200	\$1,050 ¹	\$ 5,250
Deferred tax asset - other comprehensive income	630	(210) ²	420
Valuation allowance	(4,830)	(840) ³	(5,670)
Total	\$ 0	\$ 0	\$ 0

¹ \$1,050 = \$5,000 (loss in continuing operations) × 21%
² \$210 = \$1,000 (income in other comprehensive income) × 21%
³ \$840 = \$4,000 (net loss) × 21%

In this example, ABC has \$0 total income tax expense because it has only deferred tax assets at the beginning and end of the year that are fully offset by a valuation allowance.

Step 2: Allocate total income tax expense to continuing operations

When allocating the \$0 total income tax expense, the \$1,000 of income in other comprehensive income supports partial realization of the loss in continuing operations resulting in a \$210 (\$1,000 × 21%) income tax benefit allocated to continuing operations.

	(Loss) Income	Tax (expense) benefit
Continuing operations	\$(5,000)	\$ 210
Other comprehensive income	1,000	(210)
Total	\$(4,000)	\$ 0

Step 3: Allocate the remaining income tax expense to other comprehensive income

ABC has \$0 total income tax expense and a \$210 income tax benefit allocated to continuing operations leaving a remaining \$210 income tax expense allocated to other comprehensive income.



Example 6.20.2**

Loss from continuing operations with end of year net deferred tax liability

Background

At January 1, 20X9, ABC Corp. had a \$4,200 deferred tax asset for \$20,000 of NOL carryforwards that are subject to the annual limitation under the tax law. ABC also had a \$630 deferred tax liability for a \$3,000 unrealized gain on a cash flow hedge that was recognized in other comprehensive income. ABC had a \$3,696 valuation allowance on its deferred tax assets because its \$3,000 taxable temporary difference provides only \$2,400 of taxable income to support its NOL ($\$3,000 \times 80\%$).

NOLs	\$20,000
Taxable temporary difference (limited to 80%: $\$3,000 \times 80\%$)	(2,400)
Net NOLs	17,600
Tax rate	21%
Valuation allowance	\$ 3,696

For the year ended December 31, 20X9, ABC has a \$5,000 loss in continuing operations and a \$1,000 unrealized gain in other comprehensive income and no current tax. ABC needs a valuation allowance against deferred tax assets not supported by reversing taxable temporary differences as of December 31, 20X9 and has a 21% tax rate.

Step 1: Compute total income tax expense

Rollforward of deferred taxes:

	January 1, 20X9	Change	December 31, 20X9
Deferred tax asset - NOL	\$ 4,200	\$1,050 ¹	\$ 5,250
Deferred tax liability - other comprehensive income	(630)	(210) ²	(840)
Valuation allowance	(3,696)	(882) ³	(4,578)
Total	\$ (126)	\$ (42)	\$ (168)

¹ \$1,050 = \$5,000 (loss in continuing operations) × 21%	
² \$210 = \$1,000 (income in other comprehensive income) × 21%	
³ NOLs as of December 31, 20X9	\$25,000
Taxable temporary difference (limited to 80%: \$4,000 × 80%)	<u>(3,200)</u>
Net NOLs	21,800
Tax rate	21%
Valuation allowance as of December 31, 20X9	\$ 4,578
Valuation allowance as of January 1, 20X9	<u>(3,696)</u>
Change	\$ 882

In this example, ABC has total income tax expense of \$42 (despite its net loss for 20X9) because only 80% of its beginning and end of year taxable temporary differences provide a source of taxable income.

Step 2: Allocate total income tax expense to continuing operations

When allocating the \$42 of total income tax expense, only \$800 of the \$1,000 of income in other comprehensive income is available to support partial realization of the loss in continuing operations resulting in a \$168 (((\$1,000 × 80%) × 21%)) income tax benefit allocated to continuing operations.

	(Loss) Income	Tax (expense) benefit
Continuing operations	\$(5,000)	\$168
Other comprehensive income	1,000	(210)
Total	\$(4,000)	\$ (42)

Step 3: Allocate the remaining income tax expense to other comprehensive income

ABC has \$42 total income tax expense and a \$168 income tax benefit allocated to continuing operations leaving a remaining \$210 income tax expense allocated to other comprehensive income.

7. Interim considerations

Questions & Answers

- 7.10** Which new provisions are most likely to significantly affect the estimated annual effective tax rate?
- 7.15** Should a company include a loss jurisdiction in its overall estimated annual effective tax rate if the only tax benefit it contributes is a reduction in the GILTI inclusion?
- Example 7.15.1** Estimating the annual effective tax rate – loss jurisdiction that reduces GILTI
- 7.20** Which new provisions are most likely to significantly affect income tax expense (benefit) in the period they occur – i.e. as discrete items?
- 7.30** Are return-to-provision adjustments measurement period adjustments?
- 7.40** What effect may the 2018 decrease in the top individual tax rate have on the accounting for share-based payments?
- 7.50** What changes to balance sheet classification may arise in interim periods?
- 7.60** Does the ASU 2018-02 reclassification from AOCI to retained earnings represent a component of other comprehensive income?
- 7.70** How do the adoptions of ASU 2018-02 and ASU 2016-01 interact?

Interim guidance

When accounting for income taxes in interim periods, each interim period is treated as an integral part of the annual period. Companies use the estimated annual effective tax rate to allocate expected annual income tax expense to interim periods.

The annual effective tax rate is the ratio of estimated annual income tax expense to estimated pre-tax ordinary income (which is defined as pre-tax income, excluding discontinued operations, cumulative effects of changes in accounting principles and significant unusual or infrequently occurring items reported separately, or reported net of their related tax effect). Recognizing the tax effects of items that are not part of ordinary income in the period in which those items occur is often referred to as recognizing those items 'discretely' or as 'discrete items.' [Handbook 10.066]

The estimated annual effective tax rate is applied to the current period's ordinary income to determine the income tax expense allocated to the interim period. The annual effective tax rate is revised at the end of each interim period as necessary.

A company generally should consider when estimating its annual income tax expense (used to estimate the annual effective tax rate) all events expected to occur in the fiscal year for which it can make a reliable estimate. This includes the effects of (a) initially recognizing a valuation allowance that a company expects to need by the end of the year for originating deferred tax assets, and (b) reducing a beginning-of-year valuation allowance that a company expects to reverse as a result of using current year ordinary income to realize the related deferred tax asset. [Handbook 10.067]

A company should recognize the effect of a change in a beginning-of-year valuation allowance as a result of a change in judgment about the realizability of a deferred tax asset in future years as a discrete item in the interim period in which the change in judgment occurs. [Handbook 10.078]

If a company cannot reliably estimate ordinary income (or loss) in total, its best estimate of the annual effective tax rate may be the actual effective tax rate for the year-to-date period. Similarly, if a company cannot reliably estimate individual items within ordinary income (or loss), it should recognize the tax expense (or benefit) related to those items in the interim period in which those items are recognized – i.e. recognize them as discrete items. [Handbook 10.077]

We believe that companies generally cannot apply SAB 118 when estimating the annual effective tax rate. See additional discussion in [Question 2.16](#) and [Application of SAB 118](#) in Question 7.10.



Question 7.10

Which new provisions are most likely to significantly affect the estimated annual effective tax rate?

Interpretive response:

Application of SAB 118

As discussed in [Question 2.16](#), we believe that companies generally cannot apply SAB 118 when accounting for the tax effects of transactions that arise in reporting periods that do not include the enactment date – e.g. transactions that arise in a calendar year-end company's 2018 interim periods. We believe companies should evaluate changes to their annual effective tax rates throughout the year in normal course as changes in estimates or error corrections under Topic 250.

However, a company may have policy choices with continuing effect that, if they are provisional as of December 31, 2017, may remain provisional throughout the measurement period, including interim periods within the measurement period. In that case, there may be portions of the annual effective tax rate that remain provisional.

For example, if a company has not yet elected a policy about whether it will recognize deferred taxes for basis differences that are expected to result in GILTI when they reverse, it would not consider GILTI when estimating the *deferred* portion of its 2018 annual effective tax rate. That portion of the estimate is within the scope of SAB 118 until it elects its policy. However, a company should consider GILTI when estimating the *current* portion of its 2018 annual effective tax rate. That portion of the estimate is not within the scope of SAB 118.

See additional discussion about the application of SAB 118 in [Question 2.16](#) and additional discussion about GILTI in [Questions 4.50](#) and [4.65](#) and [GILTI](#).

Corporate rate reduction

As discussed in [Question 2.10](#), the law reduces the corporate tax rate to 21% effective January 1, 2018. Calendar year-end companies should apply the 21% rate when estimating the annual effective tax rate.

Fiscal year-end companies are required under the Act to use a blended rate for their fiscal 2018 tax years by applying a prorated percentage of the number of days before and after the January 1, 2018 effective date. As a result, we believe the change in tax rate becomes administratively effective at the beginning of the fiscal year for those taxpayers and therefore will be factored into the estimated annual effective tax rate in the period that includes the December 22, 2017 enactment date. See additional discussion in [Question 2.20](#) and illustration in [Example 2.30.1](#).

Changes to deductibility

Some expenses incurred on or after January 1, 2018 that would have historically been deductible are no longer deductible. For example, entertainment expenses that were once 50% deductible are no longer deductible and deductions for expenses for employee transportation are limited.

Other expenses have limited deductibility. For example, annual interest expense deductions generally are limited to 30% of a taxpayer's adjusted taxable income, and NOL carryforwards that arise in tax years beginning after December 31, 2017 may be used to offset only 80% of taxable income in an annual period.

Other deductions are new – e.g. the 100% dividends received deduction – or are accelerated – e.g. 100% expensing for investments in depreciable property.

Companies should consider these new provisions when estimating the annual effective tax rate.

Companies should also consider how these provisions and others may affect valuation allowance assessments. For example, while the annual amounts that have been limited for interest expense and net operating losses may be carried forward indefinitely, the limitations still may affect a company's ability to ultimately realize the entire benefit (see additional discussion in [Question 6.10](#) and illustration in [Example 6.10.1](#)).

A company should consider when estimating its annual effective tax rate the effects of (a) initially recognizing a valuation allowance that it expects to need by the end of the year for originating deferred tax assets, and (b) reducing a beginning-of-year valuation allowance that it expects to reverse as a result of using current year ordinary income to realize the related deferred tax asset.

As discussed in [Changes to existing valuation allowances](#) in [Question 7.20](#), a company should recognize the effect of a change in a beginning-of-year valuation allowance as a result of a change in judgment about the realizability of a deferred tax asset in future years as a discrete item in the interim period in which the change in judgment occurs.

Executive compensation

As discussed in [Question 5.30](#), eliminating the exceptions for commissions and performance-based compensation means less compensation will be deductible for awards granted to covered persons if those awards do not qualify for transition relief. Companies should consider when estimating their annual effective tax rate whether current year compensation will be deductible under the new guidance.

FDII

As discussed in [Question 4.40](#), the deduction for a company's foreign-derived intangible income is akin to a special deduction. As a result, while companies will not consider the 37.5% (21.875% after 12/31/2015) FDII deduction when measuring their deferred taxes, they should include the expected current effect when estimating their annual effective tax rate and consider disclosing that effect.

GILTI

Effect on the current tax provision

While a company may elect not to provide deferred taxes on basis differences that are expected to result in GILTI (or may defer its policy election, see [Questions 4.35, 4.36](#) and [Effect on the deferred tax provision](#)), it should consider the current effects of GILTI when estimating its annual effective tax rate and consider disclosing those effects.

When estimating the effect on the current tax provision, a company should consider the statutory rate applied to GILTI as well as the related deductions and credits (e.g. the return on tangible business property deduction, the 50% of GILTI deduction, foreign tax credits) and valuation allowance implications. See related discussion about GILTI in Questions [4.10](#), [4.20](#), [4.30](#), and [4.37](#).

As discussed in [Question 4.36](#), a company that has estimated only current taxes as part of its annual effective tax rate is not deemed to have made a policy election to account for GILTI as a period expense until it discloses that it has selected its final policy (or alternatively no longer indicates that it has not yet made a policy election) or the measurement period has lapsed.

Effect on the deferred tax provision

As discussed in [Question 4.36](#), companies that have not yet decided whether to provide deferred taxes for GILTI should not estimate deferred taxes as part of their annual effective tax rates.

However, if a company has made an election to recognize deferred taxes on GILTI, it should include the effect related to temporary differences originating in the current year when estimating its annual effective tax rate.

As discussed in [GILTI provisional amounts](#) in [Question 7.20](#), a company that identified the measurement of deferred taxes as provisional should recognize the effect of a change in estimate related to beginning-of-year temporary differences as a discrete item in the interim period of the change, and the effect related to temporary differences originating in the current year as an adjustment to its estimate of the annual effective tax rate.

BEAT

As discussed in [Questions 4.60](#) and [4.70](#), a company should measure its deferred taxes using the statutory rate based on the regular tax system (as it has historically for AMT) and account for the incremental tax owed under the BEAT system as it is incurred. As a result, a company should include the current effects of BEAT when estimating its annual effective tax rate and consider disclosing those effects.

As discussed in [BEAT provisional amounts](#) in [Question 7.20](#), we believe a company that makes a policy election for the first time in an interim period to incorporate its BEAT status into its valuation allowance assessment should recognize the effect related to (a) beginning-of-year deferred tax assets as a discrete item in the interim period of the election, and (b) deferred tax assets originating in the current year as an adjustment to its estimate of the annual effective tax rate.

Changes to the deemed repatriation liability for fiscal-year CFCs

As discussed in [Question 3.20](#), when a CFC has a 2017 tax year-end earlier than the US parent's calendar year-end, the amount of the US parent's ultimate liability related to deemed repatriation is likely to change based on events arising in periods after the period that includes December 22, 2017. We believe the US parent should include the expected changes to the liability arising due to 2018 operations when estimating its annual effective tax rate and consider disclosing that effect.

Adoption of Topic 606

New Section 451 generally requires accrual method taxpayers to conform their tax income recognition policies to their financial reporting revenue recognition policies. For example, Section 451 requires a company to allocate the 'transaction price' to each 'performance obligation' the same way it does for financial reporting purposes and to recognize taxable income no later than when it recognizes revenue for financial reporting purposes (unless the company can use the limited one-year deferral that was previously provided by Rev. Proc. 2004-34, now codified in Section 451(c)). Companies that are adopting Topic 606 in 2018 should consider these provisions when estimating the annual effective rates.



Question 7.15

Should a company include a loss jurisdiction in its overall estimated annual effective tax rate if the only tax benefit it contributes is a reduction in the GILTI inclusion?

Background: If a company expects an ordinary loss for the fiscal year (or has an ordinary loss year-to-date) in a tax jurisdiction for which no benefit can be recognized, ASC 740 requires it to calculate a separate estimated annual effective tax rate for that jurisdiction and apply that rate to the ordinary loss in that jurisdiction. [[Handbook 10.093](#)]

Interpretive response: Not necessarily. We believe there are two acceptable interpretations of ASC 740's requirement to exclude from the overall estimated annual effective tax rate loss jurisdictions for which no benefit can be recognized.

One interpretation (method A) is that a loss jurisdiction is excluded from the overall estimated annual effective tax rate if no benefit can be realized in *any* jurisdiction. Under method A, a US parent company includes in its overall estimated annual effective tax rate a foreign loss jurisdiction that reduces a company's GILTI inclusion, even if it cannot realize the benefits of its losses in the foreign jurisdiction.

A second interpretation (method B) is that a loss jurisdiction is excluded from the overall estimated annual effective tax rate if no benefit can be realized in *the foreign* jurisdiction. Under method B, a US parent company excludes from its overall estimated annual effective tax rate a foreign loss jurisdiction if it cannot realize the benefits of its losses in the foreign jurisdiction, even if its losses reduce a company's GILTI inclusion.

A company's choice of method will affect the rate it applies to year-to-date ordinary income at its interim periods but will not affect total income tax expense for the year.



Example 7.15.1

Estimating the annual effective tax rate – loss jurisdiction that reduces GILTI

Background

ABC Corp. is a US parent company with two foreign subsidiaries (Country A and Country B). Country A has historically been profitable, while Country B has not. Other than deemed repatriation as a result of tax reform, ABC historically was indefinitely reinvested in its foreign subsidiaries and did not recognize any US taxes associated with its foreign subsidiaries. Historically, ABC has excluded Country B's ordinary loss when estimating its annual effective tax rate under ASC 740 because it concluded that it is not more likely than not to realize the tax benefits of its losses and did not recognize a benefit for those losses.

In 2018, ABC continues to expect Country B to incur an ordinary loss for which it is not more likely than not to realize the benefits in Country B's local tax jurisdiction. However, Country B's ordinary loss will provide tax benefits for US tax purposes because its ordinary loss is expected to reduce ABC's worldwide GILTI inclusion.

The illustrations assume the following:

- US domestic ordinary income: \$100,000
- US domestic tax rate: 21%
- Country A's ordinary income: \$70,000
- Country A's tax rate: 5%
- Country B's ordinary loss: \$40,000
- Country B's tax rate (after considering its valuation allowance): 0%
- GILTI rate: 10.5%
- Foreign tax credit rate: 80%
- Foreign tax credit inclusion percentage resulting from tested losses reducing tested income: 43% (\$30,000 of net tested income ÷ \$70,000 of tested income).

For simplicity, the example ignores the deduction of foreign taxes in determining tested income, the section 78 gross-up, and US expense allocations. It also assumes that all of the income or loss of the foreign subsidiaries is tested income or tested loss included in ABC's net tested income for GILTI purposes, and there is no deduction for qualified business asset investment (QBAI).

Method A: Include Country B

	Ordinary income: all jurisdictions	Tax expense (benefit): all jurisdictions	Tax rate
ABC domestic operations (21%)	\$100,000	\$21,000	21%
GILTI (net tested income of Country A and Country B taxed at 10.5%, less 80% of 43% of the foreign taxes paid)		1,950	
Total United States	100,000	22,950	

	Ordinary income: all jurisdictions	Tax expense (benefit): all jurisdictions	Tax rate
Country A (local tax expense: \$70,000 × 5%)	70,000	3,500	5%
Country B (local tax benefit: \$40,000 × 0%)	(40,000)	-	0%
Total worldwide	\$130,000	\$26,450	20.3%

Under Method A, ABC applies a 20.3% estimated annual effective tax rate to its worldwide consolidated ordinary income (loss) each quarter.

If through its first quarter, ABC's US domestic operations and Country A collectively earned \$30,000 and Country B incurred a \$12,000 ordinary loss, ABC's consolidated tax expense would be \$3,654 ($30,000 - 12,000 \times 20.3\%$).

Method B: Exclude Country B

	Ordinary income: US plus Country A	Tax expense (benefit): all jurisdictions	Tax rate
ABC domestic operations (21%)	\$100,000	\$21,000	21%
GILTI (net tested income of Country A and Country B taxed at 10.5%, less 80% of 43% of the foreign taxes paid)		1,950	
Total United States	100,000	22,950	
Country A (local tax expense: \$70,000 × 5%)	70,000	3,500	5%
Total worldwide without Country B	\$170,000	\$26,450	15.6%

	Ordinary loss: Country B	Local tax (benefit): Country B	Tax rate
Country B (local tax benefit: \$40,000 × 0%)	\$40,000	\$0	0%

Total worldwide	\$130,000	\$26,450	20.3%
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Under Method B, ABC applies a 15.6% estimated annual effective tax rate to the sum of its domestic and Country A ordinary income (loss) each quarter and separately applies a 0% rate to Country B's ordinary income (loss) each quarter.

If through its first quarter, ABC's US domestic operations and Country A collectively earned \$30,000 and Country B incurred a \$12,000 ordinary loss, ABC's consolidated tax expense would be \$4,680 ($(30,000 \times 15.6\%) + (12,000 \times 0\%)$).



Question 7.20

Which new provisions are most likely to significantly affect income tax expense (benefit) in the period they occur – i.e. as discrete items?

Interpretive response:

Measurement period adjustments

As discussed in [Section 1](#), SAB 118 allows a company to recognize provisional amounts in its financial statements for the period including the enactment date if all the information necessary to complete its accounting for tax reform is not available, prepared or analyzed when the financial statements for that period are issued.

A company adjusts its provisional amounts during the 'measurement period' that follows when it obtains, prepares or analyzes additional information about facts and circumstances that existed at the enactment date that, if known, would have affected the amounts that were initially reported as provisional amounts. The measurement period ends when a company has finalized its accounting, but cannot extend beyond one year.

In interim periods following the period including the enactment date, a company should continue to act in good faith to complete its accounting and adjust its provisional amounts in the first reporting period in which the necessary information becomes available, prepared or analyzed.

Companies should recognize measurement period adjustments discretely in the period the adjustments are identified. Measurement period adjustments are only those adjustments to provisional amounts that are made based on additional analysis of the facts and circumstances that existed at the enactment date. The tax effects of events unrelated to the tax law change should be accounted for apart from the measurement period adjustments.

As discussed in [Section 1](#), companies should include in their notes to financial statements the disclosures required by SAB 118 throughout the measurement period. Those disclosures include the nature and amount of measurement period adjustments recognized during the reporting period, the effect of measurement period adjustments on the effective tax rate and when the accounting for the income tax effects of the Act has been completed.

Changes to the deemed repatriation liability arising in 2018

Companies whose liabilities related to deemed repatriation were identified in prior periods as provisional likely will refine their estimates during the measurement period. As discussed in [Measurement period adjustments](#), companies should recognize these changes in estimates discretely in the period the adjustments are identified.

As discussed in [Changes to the deemed repatriation liability for fiscal-year CFCs](#) in Question 7.10, a US parent company should consider expected changes to the liability arising due to 2018 operations when estimating its annual effective tax rate and consider disclosing that effect.

GILTI provisional amounts

A company that elects for the first time in an interim period to provide deferred taxes on basis differences that are expected to result in GILTI should recognize the effect related to beginning-of-year basis differences as a discrete item in the interim period of the election. A company should recognize the effect related to basis differences originating in the current year as an adjustment to its estimate of the annual effective tax rate. A company that accounts for the return on tangible business property and 50% of GILTI deductions as special deductions will exclude those effects when estimating deferred taxes (see additional discussion in [Questions 4.20](#) and [4.30](#)).

A company may have elected in a prior period to provide deferred taxes for basis differences expected to result in GILTI, but identified the *measurement* of those deferred taxes as provisional (see discussion in [Questions 4.20](#) and [4.30](#)). We believe changes to the measurement of those deferred taxes are changes in estimates. A company should recognize the effect of a change in estimate related to beginning-of-year temporary differences as a discrete item in the interim period of the change, and the effect related to temporary differences originating in the current year as an adjustment to its estimate of the annual effective tax rate.

As discussed in [GILTI](#) in [Question 7.10](#), a company should consider the current effects of GILTI when estimating its annual effective tax rate.

BEAT provisional amounts

As discussed in [Questions 4.60](#), [4.65](#) and [4.70](#), we believe a company has a policy election about whether it considers its BEAT status in the valuation allowance assessment and may delay that policy election under SAB 118. A company that elects for the first time in an interim period to incorporate its BEAT status into its valuation allowance assessment should recognize the effect related to (a) beginning-of-year deferred tax assets as a discrete item in the interim period of the election, and (b) deferred tax assets originating in the current year as an adjustment to its estimate of the annual effective tax rate.

As discussed in [Question 4.70](#), we believe a company is deemed to have made a policy election if it has recognized a material valuation allowance as a result of considering its BEAT status in the analysis.

As discussed in [BEAT](#) in [Question 7.10](#), a company should consider the current effects of BEAT when estimating its annual effective tax rate.

Changes to state tax laws

As discussed in [Question 5.100](#), while some states' income tax laws automatically conformed entirely to the federal tax code on enactment of the federal legislation, others did not. Those states that did not automatically conform likely will enact some changes to their tax laws through legislation in 2018 or later. We believe companies should prepare their state and local income tax provisions based on currently enacted state and local tax law and account for changes to state legislation in the period those changes are enacted.

Accounting for uncertainties

As discussed in [Question 5.107](#), because only information that is available at the reporting date is considered in the recognition and measurement analyses

of uncertainty in income taxes, changes in enacted tax law and changes in estimates resulting from guidance that interprets or clarifies existing tax law generally are recognized in the period in which the new information becomes available.

However, if (a) guidance that interprets or clarifies existing tax law is issued after the balance sheet date but before the financial statements have been issued (or made available for issuance), and (b) a company's accounting for the provision of the tax law that is being interpreted by the guidance has been identified as provisional under SAB 118 as of the balance sheet date, we believe the company can make a policy election to account for the change in estimate as of the balance sheet date.

Because an entity is required to consider all available evidence when evaluating the need for a valuation allowance, a company should consider additional interpretive guidance issued after the balance sheet date but before the financial statements are issued, regardless of when the company accounts for the change in estimate.

Companies should consider whether disclosures of such changes are required under Topic 740.

Changes to indefinite reinvestment assertions

As discussed in [Questions 3.50](#) and [3.51](#), a company that does not plan to repatriate its existing undistributed foreign earnings should continue to evaluate its ability to assert indefinite reinvestment to avoid recognizing a deferred tax liability for other items that trigger a tax effect on repatriation – e.g. Section 986(c) currency gain/loss on previously taxed income (PTI), 'offset' PTI without tax basis, foreign withholding taxes and state taxes. [[Handbook 7.004](#)]

Companies whose plans for indefinite reinvestment change during the period because of a change in previously unforeseen circumstances (or because their indefinite reinvestment assertions were provisional in the previous period), should determine the liability based on the expected manner of recovery (e.g. remission of dividends, liquidation or sale) and consider the effects of offset PTI, if any. See additional discussion of offset PTI in [Question 3.51](#). [[Handbook 7.009](#), [7.024](#)]

As discussed in [Question 3.60](#), we believe a company that changes its indefinite reinvestment assertion in an interim period should recognize the liability entirely as a discrete item in that period, regardless of whether the company changed its assertion during the period because of a change in circumstances or because its policy was provisional at the end of the previous reporting period (see [Measurement period adjustments](#)). It is also acceptable for a company to recognize the liability as a discrete item in the interim period of the change for the portion of the liability associated with its outside basis difference at the beginning of the year, and as an adjustment to the estimated annual effective tax rate for the portion of the liability associated with earnings in the current year. [[Handbook 5.017](#), [10.085](#)]

As discussed in [Question 5.110](#), Topic 740 requires companies to disclose changes in their indefinite reinvestment assertions.

Transaction gains/losses on withholding tax liabilities

As discussed in [Question 3.55](#), we believe that a US parent that recognizes a liability for withholding taxes should recognize in earnings changes to that liability attributable to changes in exchange rates under Topic 830.

Under Topic 830, a company recognizes these transaction gains/losses in the interim period they arise regardless of whether it elects to present them in pre-tax income or income tax expense (benefit). All companies should include these gains/losses in the aggregate transaction gain or loss disclosed under Topic 830.

Measurement of AMT credit carryforwards

As discussed in [Question 5.25](#), we believe companies should estimate the effect of sequestration, if any, when accounting for their AMT credit carryforwards at the December 22, 2017 enactment of tax reform. Companies should account for a change to that estimate (e.g. based on revised sequestration rates) as a discrete item in the period of the change.

In its Report to the Congress on the Joint Committee Reductions for Fiscal Year 2018, the OMB concluded that the required sequestration reduction for other non-exempt nondefense mandatory programs for FY 2018 is 6.6%. In its February 2018 report for FY 2019¹⁶, the OMB concluded that the required sequestration reduction for these programs will be 6.2%. While the IRS has not yet announced that the 6.2% rate will apply to transactions processed on or after October 1, 2018 and on or before September 30, 2019, the non-exempt nondefense sequestration rate has historically applied to corporate AMT transactions that meet the sequestration criteria.

Changes to existing valuation allowances

As discussed in [Changes to deductibility](#) in [Question 7.10](#), some expenses incurred on or after January 1, 2018 that would have historically been deductible are no longer deductible and other expenses have limited deductibility. For example, annual interest expense deductions generally are limited to 30% of a taxpayer's adjusted taxable income, and NOL carryforwards that arise in tax years beginning after December 31, 2017 may be used to offset only 80% of taxable income in an annual period. These provisions and others may affect valuation allowance assessments.

A company should recognize the effect of a change in a beginning-of-year valuation allowance as a result of a change in judgment about the realizability of a deferred tax asset in future years as a discrete item in the interim period in which the change in judgment occurs.

As discussed in [Changes to deductibility](#) in [Question 7.10](#), a company should consider when estimating its annual effective tax rate the effects of (a) initially recognizing a valuation allowance that a company expects to need by the end of the year for originating deferred tax assets, and (b) reducing a beginning-of-year valuation allowance that a company expects to reverse as a result of using current year ordinary income to realize the related deferred tax asset.

¹⁶ Report dated February 12, 2018

Business combination measurement period adjustments

As discussed in [Question 2.90](#), if a company makes a business combination measurement period adjustment in reporting periods after December 22, 2017 that relate to business combinations that were consummated before enactment, we believe it should compute those adjustments to the acquired assets, liabilities and goodwill based on the enacted tax law as of the acquisition date.

Then, outside of the business combination accounting, the company should make the necessary adjustments to the resulting deferred tax accounts for the change in tax law with a credit or charge to income tax expense (benefit) in the period the adjustment is identified. That adjustment is not considered when estimating the annual effective tax rate.



Question 7.30

Are return-to-provision adjustments measurement period adjustments?

Interpretive response: As discussed in [Question 2.15](#), a return-to-provision adjustment is a 'measurement period adjustment' only if it represents a change in the estimated amount that was previously identified as provisional under SAB 118 based on additional analysis of the facts and circumstances that existed at the enactment date.

Companies that identify return-to-provision adjustments (or adjustments they expect to make when filing the tax return) that are not measurement period adjustments should evaluate whether each adjustment (or expected adjustment) results from new information or information that existed and was reasonably knowable at the balance sheet date.

If the adjustment (or expected adjustment) results from new information, it represents a change in estimate and the company should recognize it discretely in the period of the change.

If the adjustment (or expected adjustment) results from reasonably knowable information that existed at the balance sheet, it represents an error correction. Material errors are corrected through restatement of prior period financial statements and immaterial errors generally are corrected discretely in the period they are identified. [[Handbook 10.096](#), [10.097](#)]



Question 7.40

What effect may the 2018 decrease in the top individual tax rate have on accounting for share-based payments?

Interpretive response: As discussed in [Question 5.40](#), equity classification for share-based payment awards is appropriate when a company withholds shares to meet the employer's statutory withholding requirements as long as the amount withheld does not exceed the employee's maximum individual

statutory tax rate. A company should reduce its maximum tax withholding from 39.6% to 37% for 2018 to avoid liability classification of the related award.



Question 7.50

What changes to balance sheet classification may arise in interim periods?

Interpretive response:

Classification of the liability related to deemed repatriation of foreign earnings

As discussed in [Question 3.30](#), we believe a company should classify the liability as current or noncurrent based on the anticipated timing of the payment relative to the balance sheet date.

Classification of AMT credit carryforwards

As discussed in [Question 5.20](#), we believe a company should classify a receivable for AMT credit carryforwards as current or noncurrent based on the anticipated timing of the payment relative to the balance sheet date.



Question 7.60

Does the ASU 2018-02 reclassification from AOCI to retained earnings represent a component of other comprehensive income?

Interpretive response: We do not believe the reclassification from AOCI to retained earnings represents a component of other comprehensive income in the period of adoption and therefore it would not appear on the statement of comprehensive income.

As discussed in [Question 2.40](#), Accounting Standards Update No. 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, provides companies the option to reclassify from accumulated other comprehensive income to retained earnings the income tax effects arising from the change in the US federal corporate tax rate. Companies electing to reclassify those effects also have the option to reclassify other income tax effects arising from the Act.

ASU 2018-02 is effective for all entities for annual and interim periods in fiscal years beginning after December 15, 2018 (i.e. January 1, 2019 for companies with a calendar year end). However, early adoption is permitted for interim and annual period financial statements that have not yet been issued or made available for issuance. Companies have the option to apply the ASU as of the beginning of the period (annual or interim) of adoption or retrospectively to each period (or periods) in which the income tax effects of the Act related to items remaining in accumulated other comprehensive income are recognized.

A company that elects to reclassify residual tax effects under the ASU as of the beginning of an interim period – e.g. January 1, 2018 – should provide the

disclosures required by the ASU, including a statement that it elected to reclassify amounts under the Act and which income tax effects it reclassified.

All companies adopting the ASU should disclose a description of their accounting policy for releasing residual income tax effects from accumulated other comprehensive income.



Question 7.70

How do the adoptions of ASU 2018-02 and ASU 2016-01 interact?

Interpretive response: As discussed in [Question 7.60](#), companies may reclassify from AOCI to retained earnings residual income tax effects resulting from the Act. ASU 2018-02 can be adopted retrospectively to the period (or periods) in which the income tax effects of the Act were recognized or as of the beginning of the period (annual or interim) of adoption. The magnitude of the residual income tax effects that are eligible for reclassification under ASU 2018-02 may depend on when a company adopts Accounting Standards Update No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities.

Under ASU 2016-01, companies generally are required to measure equity securities with readily determinable fair values (and may elect to measure equity securities without readily determinable fair values) at fair value and recognize changes in fair value through net income. ASU 2016-01 is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017 and for other entities for annual periods in fiscal years beginning after December 15, 2018 and interim periods in fiscal years beginning after December 15, 2019.

Because ASU 2016-01 requires recognition of a cumulative effect adjustment as of the beginning of the fiscal year of adoption, companies with equity securities with readily determinable fair values (or with equity securities without readily determinable fair values for which fair value measurement has been elected) that were previously classified as available-for-sale will reclassify from AOCI to retained earnings their unrealized gains/losses related to those equity securities. In addition, companies will reclassify the related tax effects, which may or may not include residual tax effects arising from the Act.

Whether a company includes the residual tax effects arising from the Act in the transition adjustment for ASU 2016-01 or ASU 2018-02 depends primarily on whether, and when, ASU 2018-02 is applied.

Companies that apply ASU 2018-02 in periods before they adopt ASU 2016-01

A company that applies ASU 2018-02 in a period before it adopts ASU 2016-01 (e.g. applies ASU 2018-02 as of December 31, 2017 and adopts ASU 2016-01 on January 1, 2018) will have already reclassified from AOCI to retained earnings most of the residual tax effects arising from the Act and disclosed those effects as resulting from adopting ASU 2018-02.

However, if residual tax effects associated with an equity security portfolio remain (arising from unrelated tax law changes, valuation allowance changes, etc.), we believe a company should evaluate whether to reclassify those effects

under its current accounting policy for releasing residual tax effects (see additional discussion in [Question 2.40](#)):

- If a company uses specific identification, it would reclassify from AOCI to retained earnings the residual tax effects related to the specific equity securities for the unrealized gain/loss being reclassified.
- If a company uses a portfolio approach, we believe it has the option to either (a) reclassify nothing if it continues to have an available-for-sale debt security portfolio after adopting ASU 2016-01, or (b) identify two portfolios – i.e. an equity securities portfolio and a debt securities portfolio – and reclassify only those residual tax effects related to the equity securities portfolio.

If a company reclassifies remaining residual tax effects under its current accounting policy, we believe it should disclose its approach for identifying those effects and include those amounts when disclosing the effect of adopting ASU 2016-01.

Companies that apply ASU 2018-02 at the same time they adopt ASU 2016-01

While the order of which ASU is adopted first will not affect the journal entries a company would make (because both transitions require reclassification from AOCI to retained earnings), we believe a company that adopts the standards on the same date generally would apply ASU 2018-02 first for disclosure purposes.

We believe applying ASU 2018-02 an instant before ASU 2016-01 will ease users' understanding of the financial statements:

- Step 1: Apply ASU 2018-02 and reclassify from AOCI to retained earnings residual income tax effects arising from the Act, including those related to equity securities whose unrealized gains/losses reside in AOCI. Disclose the effect of applying ASU 2018-02 (see [Questions 2.40, 5.110](#)).
- Step 2: Apply ASU 2016-01 and reclassify from AOCI to retained earnings the unrealized gains/losses on equity securities, including the related tax effect. Reclassify any remaining residual tax effects (i.e. after applying Step 1) under the current policy for releasing those effects (i.e. specific identification or portfolio approach, see [Question 2.40](#) and [Companies that apply ASU 2018-02 in periods before they adopt ASU 2016-01](#)). Disclose the effect of applying ASU 2016-01 under the ASU's transition requirements.

Companies that adopt ASU 2018-02 after they apply ASU 2016-01

A company that adopts ASU 2016-01 in a period before it applies ASU 2018-02 (e.g. adopts ASU 2016-01 on January 1, 2018 and adopts ASU 2018-02 on January 1, 2019) may have already reclassified from AOCI to retained earnings the residual tax effects associated with its equity security portfolio, depending on its existing policy for releasing those effects (i.e. specific identification or portfolio approach, see [Question 2.40](#) and [Companies that apply ASU 2018-02 in periods before they adopt ASU 2016-01](#)). If so, the company will have already disclosed those effects under ASU 2016-01's transition requirements.

However, there may continue to be residual tax effects arising from the Act that remain in AOCI – e.g. because a company continues to have debt securities with residual tax effects or equity securities whose residual tax effects were not reclassified under the company's existing policy when adopting ASU 2016-01. If so, a company then may apply ASU 2018-02 and reclassify from AOCI to

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