

Tax Accounting Insights

A closer look at accounting for the effects of the Tax Cuts and Jobs Act

Revised 16 March 2018

Given the complexities involved, companies should not underestimate the effort needed to appropriately account for the financial reporting effects of the Act.

Highlights

- ▶ The Tax Cuts and Jobs Act (the Act) significantly changes US income tax law, and companies need to account for the effects of these changes in the period that includes the 22 December 2017 enactment date.
- ▶ The SEC staff issued Staff Accounting Bulletin 118 to provide guidance for companies that are not able to complete their accounting for the income tax effects of the Act in the period of enactment.
- ▶ The Act reduces the corporate income tax rate to 21%, creates a territorial tax system (with a one-time mandatory tax on previously deferred foreign earnings), broadens the tax base and allows for immediate capital expensing of certain qualified property. It also requires companies to pay minimum taxes on foreign earnings and subjects certain payments from corporations to foreign related parties to additional taxes.
- ▶ Companies with fiscal years that end on a date other than 31 December need to use a blended tax rate because the new rate is administratively effective at the beginning of their fiscal year.
- ▶ The financial reporting effects of the Act may be complex, especially for multinationals. Companies also need to make appropriate disclosures.

Overview

The Act, which President Donald Trump signed into law on 22 December 2017, aims to encourage economic growth and bring back jobs and profits from overseas by reducing US corporate income tax rates, creating a territorial tax system, allowing for immediate expensing of certain qualified property and providing other incentives. The Act also includes various base-broadening provisions (e.g., the elimination of existing deductions) and anti-base erosion provisions.

On 22 December 2017, the Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin (SAB) 118¹ to provide guidance for companies that are not able to complete their accounting for the income tax effects of the Act in the period of enactment. In doing so, the SEC staff acknowledged the challenges companies may face in accounting for the effects of the Act by their financial reporting deadlines and said the guidance is intended to help companies provide investors with timely, decision-useful information.

The SEC staff noted that Accounting Standards Codification (ASC) 740, *Income Taxes*, does not address these challenges and said a clarification was needed to address uncertainty or diversity in views about the application of ASC 740 in the period of enactment. If a company does not have the necessary information to determine a reasonable estimate to include as a provisional amount, the SEC staff said that it would not expect a company to record provisional amounts in its financial statements for the income tax effects for which a reasonable estimate cannot be determined. In these cases, the SEC staff said a company should continue to apply ASC 740 (e.g., when recognizing and measuring current and deferred taxes) based on the provisions of the tax laws that were in effect immediately prior to the Act being enacted. The Financial Accounting Standards Board (FASB) also issued an accounting standards update² to amend the SEC paragraphs in ASC 740 to reflect SAB 118.

The FASB staff has expressed views on implementation issues related to the accounting for the effects of the Act and finalized Staff question and answer (Q&A) documents on these matters. In one of the Q&As, the FASB staff said that if a private company or not-for-profit entity applies SAB 118, it would be in compliance with US GAAP.

This publication incorporates Ernst & Young LLP's views on the accounting implications of the Act and the SAB and provides additional discussion on other accounting effects from the Act. It also addresses the accounting implications for companies that use fiscal years that end on a date other than 31 December, among other things.

¹ SAB 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act*.

² ASU 2018-05, *Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No.118*.

Summary of key updates

The following sections and topics have been added or updated substantively since the last update on 22 February 2018:

Section 3: Effects of a lower corporate income tax rate

- Added section 3.1.2.3 *Adopting ASU 2016-01 may affect reclassification adjustments recorded under ASU 2018-02*

Section 15: Interim reporting

- Interim reporting topics including EAETR considerations and SAB 118 disclosure reminders and examples

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1 Summary of key provisions of the Tax Cuts and Jobs Act

The Act makes the following key changes to US tax law:

- ▶ Establishes a flat corporate income tax rate of 21% to replace current rates that range from 15% to 35% and eliminates the corporate alternative minimum tax (AMT)
- ▶ Creates a territorial tax system rather than a worldwide system, which will generally allow companies to repatriate future foreign source earnings without incurring additional US taxes by providing a 100% exemption for the foreign source portion of dividends from certain foreign subsidiaries
- ▶ Subjects certain foreign earnings on which US income tax is currently deferred to a one-time transition tax
- ▶ Creates a “minimum tax” on certain foreign earnings and a new base erosion anti-abuse tax (BEAT) that subjects certain payments made by a US company to a related foreign company to additional taxes
- ▶ Creates an incentive for US companies to sell, lease or license goods and services abroad by effectively taxing them at a reduced rate
- ▶ Reduces the maximum deduction for net operating loss (NOL) carryforwards arising in tax years beginning after 2017 to a percentage of the taxpayer’s taxable income, allows any NOLs generated in tax years ending after 31 December 2017 to be carried forward indefinitely and generally repeals carrybacks
- ▶ Eliminates foreign tax credits (FTCs) or deductions for taxes (including withholding taxes) paid or accrued with respect to any dividend to which the new exemption (i.e., the 100% exemption for the foreign source portion of dividends from certain foreign subsidiaries) applies, but foreign tax credits will continue to be allowed to offset tax on foreign income taxed to the US shareholder subject to limitations
- ▶ Limits the deduction for net interest expense incurred by US corporations
- ▶ Allows businesses to immediately write off (or expense) the cost of new investments in certain qualified depreciable assets made after 27 September 2017 (but would be phased down starting in 2023)
- ▶ May require certain changes in tax accounting methods for revenue recognition
- ▶ Repeals the Section 199 domestic production deductions beginning in 2018
- ▶ Eliminates or reduces certain deductions (including deductions for certain compensation arrangements, certain payments made to governments for violations of law and certain legal settlements), exclusions and credits and adds other provisions that broaden the tax base

Many of the provisions could have state and local tax implications. Most state income tax laws use federal taxable income as a starting point for determining state income tax. While some states automatically adopt federal tax law changes, other states conform their laws with federal law on specific dates. States also may choose to decouple from new federal tax provisions and continue to apply current law. A company may need to follow one set of rules when determining taxable income for US income tax purposes and multiple sets of rules when determining state and local taxable income.

Because states generally do not conform their income tax rates with changes in the federal tax rate but generally conform to the federal definition of taxable income, state income taxes could rise as the federal tax base expands. Companies should understand the conformity rules in the states in which they operate so they can appropriately account for the effects on their state income taxes.

How Ernst & Young LLP sees it

The law could have significant income tax accounting implications for companies, beginning in the period of enactment. As a result, companies should not underestimate the time needed to focus on their accounting and disclosure for the financial reporting effects of the new law.

2 Timing of accounting for enacted tax law changes

Accounting Standards Codification (ASC) 740, *Income Taxes*, requires the effects of changes in tax rates and laws on deferred tax balances (including the effects of the one-time transition tax discussed below) to be recognized in the period in which the legislation is enacted. See section 8.1, *Changes in tax laws and rates*, of Ernst & Young LLP's Financial reporting developments (the FRD) publication, *Income Taxes*. US income tax laws are considered enacted on the date that the president signs the legislation.

While the effective date of the new corporate tax rates is 1 January 2018, a company is required to calculate the effect on its deferred tax balances as of the enactment date. For companies with fiscal years that don't end on 31 December, the new lower corporate rate is applied by determining a blended tax rate for the fiscal year that includes the enactment date. Therefore, the effect of the rate change on a non-calendar year-end company's current and deferred income taxes is considered in the first interim period that includes the enactment date (refer to section 8, *Special considerations for non-calendar year-end companies*, below).

2.1 Subsequent events

If a company's fiscal year ended before the enactment date but it hadn't yet issued its financial statements on that date, the company should make appropriate disclosures about the change in tax law as a subsequent event. ASC 740 states that a company should not include the effect of a new tax law in its financial statements earlier than the period that contains the enactment date.

3 Effects of a lower corporate income tax rate

3.1 Accounting considerations related to deferred tax assets and liabilities

The Act established a flat corporate income tax rate of 21% to replace previous rates that ranged from 15% to 35%. Companies need to apply the new corporate tax rate when calculating the effects of the tax law change on their deferred tax balances as of the enactment date.

Calendar year-end companies may determine the effects of the rate change using year-end temporary differences if the temporary differences are expected to approximate the companies' deferred tax balances as of the enactment date. However, these companies may need to make adjustments for material unusual or infrequent transactions that occurred between the enactment date and year end. Further, any assets or liabilities that are measured at fair value on a recurring basis (e.g., available-for-sale-securities) should be adjusted to fair value at the enactment date. Companies that use a fiscal year ending on a date other than 31 December are also required to account for the effects of the change in the tax law on its deferred tax balances as of the enactment date. Estimating temporary differences as of the enactment date may present additional challenges for these companies (see section 8, *Special considerations for non-calendar year-end companies*, below).

Under the guidance in SAB 118, companies that have not completed their accounting for the effects of the lower corporate tax rate but can determine a reasonable estimate of those effects should include a provisional amount based on their reasonable estimate in their financial statements. If they cannot make a reasonable estimate of the effects of the Act, companies should continue to apply ASC 740 (e.g., when recognizing and measuring current and deferred taxes) based on the provisions of the tax laws that were in effect immediately prior to the Act being enacted. See section 9, *SEC guidance on accounting for US tax reform*, below.

The lower corporate income tax rate reduces the future tax benefits of existing deductible temporary differences, such as accruals for pension liabilities and net operating loss carryforwards. It also reduces the expected future taxes payable from the reversal of existing taxable temporary differences, such as those related to accelerated depreciation on property and equipment.

Companies need to remeasure existing deferred tax assets (including loss carryforwards) and liabilities and record an offset for the net amount as a component of income tax expense from continuing operations in the period of enactment. If a company changes the amount of a previously recorded valuation allowance as a result of remeasuring existing temporary differences and loss carryforwards, the amount of the change in the valuation allowance is also reflected in continuing operations.

Illustration 1 – How changing the tax rate affects taxable temporary differences

Assume that at the end of 2017, a calendar year-end company's only temporary difference is a \$1 million taxable temporary difference that arose in the prior year and is expected to reverse in 2018 and 2019. The deferred tax liability at the beginning of 2017 is \$350,000, reflecting the 35% corporate tax rate in effect at that date. On 22 December 2017, legislation was enacted that reduced the tax rate to 21%, effective 1 January 2018.

The company's deferred tax liability at 22 December 2017 would be \$210,000 (\$1 million x 21%). As a result of applying the new 21% tax rate, the deferred tax liability would be reduced by \$140,000 (\$350,000 – \$210,000) as of 31 December 2017. The \$140,000 adjustment would be recorded as an income tax benefit in continuing operations in 2017.

Note: If a portion of the temporary difference was expected to reverse in 2017, the company would first be required to estimate its temporary differences as of the enactment date rather than using the beginning of the year balance.

3.1.1 *Prohibition on backward tracing (updated 8 February 2018)*

In some situations, deferred tax assets and deferred tax liabilities relate to transactions that initially were accounted for as direct adjustments to shareholders' equity or other comprehensive income (OCI), and the offsetting tax effects also were accounted for as equity or OCI adjustments. Examples include the deferred tax effects on foreign currency translation adjustments, unrealized holding gains and losses for available-for-sale securities, and cash flow hedges and pensions and other postretirement benefits that are reported in OCI.

The effect of income tax law changes on deferred taxes initially recorded as shareholder equity or in OCI is recorded as a component of tax expense related to continuing operations in the period in which the law is enacted. Similarly, the effects of tax law changes on deferred tax assets and liabilities related to prior-year items reported in discontinued operations or initially recorded in connection with a prior business combination are reflected in continuing operations in the period the tax law is enacted. This is consistent with ASC 740's general prohibition on backward tracing (i.e., an entity would not consider where the previous tax effects were allocated in the financial statements). See section 8.6, *Change in tax law or rates related to items not recognized in continuing operations*, of the FRD on income taxes.

The following illustration shows the effect of the change in law when a deferred tax asset has been recognized for operating loss carryforwards.

Illustration 2 – Effect of income tax law change on items not originally recognized in continuing operations

Assume that a calendar-year company has only one deferred tax item, an NOL carryforward related to losses of \$100 million from discontinued operations recognized in the prior year. The carryforward is expected to reduce taxes payable in 2018 and beyond and the company does not have income in the carryback periods. The effect of a decrease in the tax rate to 21% from 35% (\$14 million) enacted in December 2017 would be reflected in continuing operations in 2017, despite the fact that the deferred tax asset was originally recorded in discontinued operations.

3.1.2 *Reclassification of certain tax effects from accumulated other comprehensive income (updated 16 March 2018)*

Stakeholders, particularly those with material amounts of unrealized losses on available-for-sale securities, expressed concerns about ASC 740's prohibition of backward tracing of the income tax accounting effects of the Act to items originally recognized through OCI. Because of the prohibition against backward tracing, debits or credits related to income taxes will be stranded in accumulated other comprehensive income (AOCI). The FASB issued guidance³ that gives entities the option to reclassify to retained earnings tax effects related to items in AOCI that the FASB refers to as having been stranded in AOCI as a result of tax reform. See section 3.1.2.2, *Effective date and transition*, below for additional information on the effective date of this guidance.

³ Accounting Standards Update (ASU) 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*.

Excerpt from Accounting Standards Codification

Income Statement – Reporting Comprehensive Income – Overall

Other Presentation Matters

Presentation of Income Tax Effects

220-10-45-12A

H.R.1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (Tax Cuts and Jobs Act), reduced the U.S. federal corporate income tax rate and made other changes to U.S. federal tax law. An entity may elect to reclassify the income tax effects of the Tax Cuts and Jobs Act on items within accumulated other comprehensive income to retained earnings. If an entity does not elect to reclassify the income tax effects of the Tax Cuts and Jobs Act, it shall provide the disclosures in paragraph 220-10-50-3. If an entity elects to reclassify the income tax effects of the Tax Cuts and Jobs Act, the amount of that reclassification shall include the following:

- a. The effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances, if any, at the date of enactment of the Tax Cuts and Jobs Act related to items remaining in accumulated other comprehensive income. The effect of the change in the U.S. federal corporate income tax rate on gross valuation allowances that were originally charged to income from continuing operations shall not be included.
- b. Other income tax effects of the Tax Cuts and Jobs Act on items remaining in accumulated other comprehensive income that an entity elects to reclassify, subject to the disclosures in paragraph 220-10-50-2(b).

An entity that elects to reclassify these amounts must reclassify stranded tax effects related to the change in federal tax rate for all items accounted for in OCI (e.g., available-for-sale securities, employee benefits, cumulative translation adjustments, hedging items). These entities can also elect to reclassify other stranded tax effects that relate to the Act but do not directly relate to the change in the federal rate (e.g., state taxes, changing from a worldwide tax system to a territorial system). Tax effects that are stranded in OCI for other reasons (e.g., prior changes in tax law, a change in valuation allowance) may not be reclassified.

3.1.2.1 ASU 2018-02 Disclosures

Excerpt from Accounting Standards Codification

Disclosure

General

Certain Income Tax Effects within Accumulated Other Comprehensive Income

220-10-50-1

An entity shall disclose a description of the accounting policy for releasing income tax effects from accumulated other comprehensive income.

220-10-50-2

An entity that elects to reclassify the income tax effects of H.R.1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (Tax Cuts and Jobs Act), in accordance with paragraph 220-10-45-12A shall disclose in the period of adoption both of the following:

- a. A statement that an election was made to reclassify the income tax effects of the Tax Cuts and Jobs Act from accumulated other comprehensive income to retained earnings.

- b. A description of other income tax effects related to the application of the Tax Cuts and Jobs Act that are reclassified from accumulated other comprehensive income to retained earnings, if any (see paragraph 220-10-45-12A(b)).

220-10-50-3

An entity that does not elect to reclassify the income tax effects of the Tax Cuts and Jobs Act in accordance with paragraph 220-10-45-12A shall disclose in the period of adoption a statement that an election was not made to reclassify the income tax effects of the Tax Cuts and Jobs Act from accumulated other comprehensive income to retained earnings.

When adopted, the standard requires all entities to make new disclosures, regardless of whether they elect to reclassify stranded amounts. Entities are required to disclose whether or not they elected to reclassify the tax effects related to the Act as well as their policy for releasing income tax effects from accumulated OCI.

Disclosures required by all entities

There is currently diversity in practice in how entities release tax effects remaining in accumulated OCI. Some entities release them as individual units of account are sold, terminated or extinguished (e.g., individual security approach for available-for-sale securities), while others release them only when an entire portfolio (i.e., all related units of account) of the type of item is liquidated, sold or extinguished (i.e., portfolio approach). Entities will be required to disclose their policy for releasing the income tax effects from accumulated OCI.

Disclosures required by entities that elect to reclassify stranded effects

In the period of adoption, entities that elect to reclassify the income tax effects of the Act from accumulated OCI to retained earnings must disclose that they made such an election. They must also disclose a description of other income tax effects related to the Act that are reclassified from accumulated OCI to retained earnings, if any.

Disclosures required by entities that do not elect to reclassify stranded effects

In the period of adoption, entities that do not elect to reclassify the income tax effects of the Act from accumulated OCI to retained earnings must disclose that such an election was not made.

3.1.2.2 *Effective date and transition*

The guidance is effective for all entities for fiscal years beginning after 15 December 2018, and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including in the period the Act was enacted (i.e., the reporting period including 22 December 2017). SEC registrants that do not adopt the guidance in the current period need to make disclosures about the anticipated effect of a new accounting standard, as required by SAB Topic 11.M. An entity that adopts the guidance in an annual or interim period after the period of enactment will be able to choose whether to apply the amendments retrospectively to each period in which the effect of the Act is recognized or to apply the amendments in the period of adoption. If retrospective application is selected, an entity would generally make a reclassification adjustment in the period of enactment (e.g., the fourth quarter of 2017 for a calendar-year entity) and any subsequent period when changes to provisional amounts recorded under SEC SAB 118 result in additional amounts stranded in accumulated OCI. An entity that elects to record the adjustment in the period of adoption will make an adjustment in the statement of shareholders' equity as of the beginning of the reporting period and any subsequent period if changes to provisional amounts result in additional amounts stranded in accumulated OCI.

An entity that elects to apply the new standard at the beginning of the period (annual or interim) of adoption shall disclose the following in the first interim and annual period of adoption:

- ▶ The nature of and reason for the change in accounting principle
- ▶ The effect of the change on the affected financial statement line items

An entity that elects retrospective transition shall disclose the following in the first interim and annual period of adoption:

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

3.1.2.3 *Adopting ASU 2016-01 may affect reclassification adjustments recorded under ASU 2018-02 (updated 16 March 2018)*

Under the new guidance on recognizing and measuring financial instruments in ASU 2016-01⁴, entities will measure equity investments (except those accounted for under the equity method, those that result in consolidation of the investee and certain other investments) at fair value and recognize any changes in fair value in net income. Entities with unrealized gains or losses on Available For Sale (AFS) equity securities are required to reclassify those amounts, along with the related tax effects, from AOCI to beginning retained earnings in the year of adoption.

Companies that historically classified equity securities as available for sale should consider how adopting ASU 2016-01 may affect the reclassification adjustment recorded under ASC 2018-02. Because both standards require tax amounts to be reclassified from AOCI upon adoption, companies with available-for-sale equity securities may want to consider adopting ASU 2018-02 in the same period that they adopt ASU 2016-01.

Calendar-year public business entities (PBEs) adopted ASU 2016-01 in the first quarter of this year because it is effective for PBEs for annual periods beginning after 15 December 2017, and interim periods therein. For all other entities, it is effective for fiscal years beginning after 15 December 2018, and interim periods within fiscal years beginning after 15 December 2019. Non-PBEs can early adopt the standard as of the effective date for PBEs.

3.2 **Changes in tax rates and adoption of new accounting standards (updated 16 January 2018)**

Many PBEs adopted new accounting standards (most notably, ASC 606, *Revenue from Contracts with Customers*) on 1 January 2018 (or shortly thereafter, depending on their fiscal year end). The following discussion focuses on ASC 606, but the concepts apply to any new accounting standard or accounting change that revises amounts previously reported for periods prior to the enactment date of the new tax law. For a broader discussion of the interaction of changes in tax law and the adoption of new accounting standards, see section 8.5, *Changes in tax rates following adoption of new accounting standards*, of the FRD on income taxes.

3.2.1 **Accounting for the year of enactment**

Companies that have not adopted a new accounting standard prior to the enactment date need to first calculate the tax accounting effects of the new tax law (e.g., remeasure deferred

⁴ ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*.

taxes for the tax rate change and record an offset to tax expense) without considering the change in accounting that will occur in the future. For example, if a calendar year-end company is adopting ASC 606 on 1 January 2018, its 2017 annual financial statements included in the 2017 10-K will show the effects of the enactment of the new tax law but not the effects of ASC 606.

3.2.2 Accounting in the year of adoption

Companies that account for the adoption of a new accounting standard after accounting for the effects of changes in the tax law will likely need to calculate the enactment-date effects of the Act for a second time if the new accounting standard changes the financial results for transactions that occurred prior to the enactment date. The first calculation would be for the reporting period that included the enactment date (e.g., the period ended 31 December 2017). The company will then need to account for the income tax effects of adopting the new standard, which will change the previously reported financial results (i.e., a change to the previously issued financial statements that included the period of enactment or a change reflected in the cumulative catch-up effect of adoption).

For example, if a company adopts the new revenue standard on 1 January 2018 and elects to use the full retrospective method, it will first recast its 2016 financial results and its 2017 financial results for the period prior to enactment based on the tax law in effect during those periods. The effects of tax reform on the enactment date will then be recalculated based on the revised ASC 606 results. This means that the enactment-date effects of the Act in a company's recast financial results will generally differ from the amounts reported in the 2017 financial statements that a company issues.

Under the modified retrospective method, a company will first need to elect either to apply the new revenue guidance to all contracts as of the date of initial application or only to contracts that are not completed as of that date. Based on that election, a company will recognize a cumulative catch-up adjustment to the opening balance of retained earnings on the date of initial application. Like companies that use the full retrospective approach, companies will need to consider the tax laws in effect during the contract period to calculate the income tax effects of the cumulative catch-up adjustment. Therefore, for companies electing to use the modified retrospective approach, the change in the enactment-date effects of the Act as a result of applying ASC 606⁵ will be embedded in the tax effect of the cumulative catch-up adjustment.

3.3 Measuring uncertain tax benefits, NOL carrybacks and carryforwards (updated 22 February 2018)

ASC 740 requires companies to remeasure deferred tax assets (including loss carryforwards) and liabilities existing as of the enactment date based on the new corporate tax rate. A company also needs to carefully consider how the Act affects existing uncertain tax positions (UTPs). Questions have arisen about the rate a company should use when measuring NOL carryforwards and tax uncertainties. This section provides additional discussion on remeasuring existing NOL carryforwards and tax uncertainties as a result of the Act.

Net operating losses

The tax rate applied to net operating loss carryforwards that exist as of the enactment date (and in subsequent periods) will depend on how the entity expects to realize them (i.e., carry back or carry forward). For example, if a calendar year-end company has a \$1 million loss carryforward as of 31 December 2017 and expects the loss carryforward to be realized by carrying it back to 2016, the loss carryforward should be tax effected at the 35% enacted rate

⁵ That is, the difference between (1) what was originally reported (and will continue to be reported in the 2017 financials) as the effects of enactment prior to the adoption of ASC 606 and (2) the recomputed effects of enactment after factoring in the adoption of ASC 606.

that was effective for 2016 (i.e., measured at \$350,000). Alternatively, if the loss carryforward is determined to be realizable and is expected to be carried forward and used in years ending after 31 December 2017, it should be tax effected at the newly enacted 21% rate (i.e., measured at \$210,000).

Tax uncertainties

Liabilities for tax uncertainties may exist for taxes that would be due for prior tax periods. In addition, a tax uncertainty may also affect a recorded temporary difference. The tax rate to be applied to a tax uncertainty is determined based on the nature of the tax uncertainty and the period to which it relates. For example, if a calendar year-end company has recorded a liability for a tax uncertainty that, if the company's position does not prevail in its tax position, would result in an increase in its tax liability for a tax return related to 2017 or prior years, that liability would be measured at the enacted rate effective for the related year (i.e., 35%). Alternatively, if the uncertainty affects the measurement of a temporary difference that existed as of 31 December 2017, and it is expected to reverse in subsequent years (i.e., it's expected to affect taxes payable in a year after 2017), that UTP is reflected in the related temporary difference that is measured at the new 21% tax rate.

3.3.1 *Interaction of uncertain tax benefits and NOLs*

Questions have arisen about the rate a company should use when measuring NOL carryforwards and tax uncertainties as a result of the change in the corporate income tax rate. Consider the following examples:

Illustration 3 – UTP related to a permanent difference

The company recorded in its 2015 tax return a \$1 million tax deduction for federal income tax purposes. The tax position did not meet the more-likely-than-not recognition criteria in ASC 740-10-25-6. As a result, the company recorded a liability for the uncertain tax benefit of \$350,000 (\$1 million x 35%). For illustration purposes, penalties and interest are ignored, and the tax position is assumed to be a permanent difference. The company did not have NOLs (carryforwards or carrybacks) available as of 31 December 2015 to offset the UTP.

During 2016, the company generated a \$1 million taxable loss and recognized a deferred tax asset of \$350,000 for the related NOL carryforward. On 31 December 2016, the company, based on the guidance in ASC 740-10-45-10A, offset the \$350,000 uncertain tax benefit with the NOL as permitted under the tax law. The company intends to carry back the loss to offset the tax position if the outcome of the settlement of the UTP is unfavorable to the company.

On 22 December 2017, the corporate tax rate is reduced to 21% from 35%. If the tax position is not settled in its favor, the company will be required to pay additional federal income taxes of \$350,000 (before penalties and interest) since that was the amount of the uncertain tax benefit from the \$1 million deduction it realized on its 2015 tax return. Since the tax law permits the 2016 NOL to be carried back, and the company intends to use the NOL to offset this amount, the company should continue to measure the NOL at \$350,000 after the enactment date.

Assume in 2020, the UTP settled in the company's favor. As a result, the company recognized a tax benefit of \$350,000. Further, since the company will no longer need the NOL carryback to offset the UTP and there are no other carryback periods available, the NOL is available to be carried forward to offset future taxable income (assuming it cannot be used to satisfy a 2017 liability). In the period the UTP is settled, the company remeasures the NOL at the current corporate tax rate and reduces the NOL from \$350,000 to \$210,000

(\$1 million x 21%). The company recognizes a net tax benefit of \$210,000 and records the following journal entries in 2020:

Journal entry to recognize tax benefit from the favorable settlement of the UTP:

Uncertain tax benefit	350,000	
Current tax benefit		350,000

Journal entry to remeasure the NOL carryforward at the new 21% corporate tax rate based on planned usage after the favorable resolution of the UTP:

Deferred tax expense	140,000	
Deferred tax asset (NOL carryforward)		140,000

If the UTP is resolved during an interim reporting period, the income tax effects should be treated as a discrete item in the period in which a change in judgment occurred or the UTP is settled.

Illustration 4 – UTP related to differences in timing

On 1 January 2016, the company acquired a separately identifiable intangible asset for \$15 million that has an indefinite life for financial reporting purposes and is not subject to amortization. The company deducted the entire cost of the asset in 2016. Based on its interpretation of the tax code, the company is certain that the full value of the intangible asset is deductible for tax purposes and only the timing of deductibility is uncertain. The company determined that the tax position qualifies for recognition and determined it could sustain a 15-year amortization for tax purposes (under the ASC 740 measurement principles).

At the end of 2016, the company recognized a deferred tax liability of \$350,000, representing the tax effect of the temporary difference created by the difference between the financial statement basis of the asset (\$15 million) and the tax basis of the asset computed in accordance with ASC 740 (\$14 million, representing the cost of the asset reduced by \$1 million of amortization). The entity recorded a liability for the uncertain tax benefit of \$4.9 million (\$14 million x 35%), the tax effect of the difference between the as-filed tax position (\$15 million) and the deduction that is considered more likely than not of being sustained (\$1 million). Interest and penalties are ignored for purposes of this example.

On 22 December 2017, the corporate tax rate is reduced to 21% from 35%. On the enactment date, the company estimated the deferred tax liability and uncertain tax benefit based on the temporary difference between the financial statement basis of the asset (\$15 million) and the tax basis of the asset computed in accordance with ASC 740 (\$13.02 million, which is the cost of the asset reduced by \$1.98 million of accumulated amortization through the enactment date). As a result, the company estimated its deferred tax liability to be \$416,000 (\$1.98 million x 21%). The company continues to measure the uncertain tax benefit using the tax rate related to the period the uncertainty originated. Therefore, the company recorded a liability of \$4.56 million (\$13.02 million x 35%).

Illustration 5 – UTP related to differences in timing – Company offsets UTP with available NOLs

Assume the same facts as in the previous example except that the company has sufficient NOL carryforwards to offset the tax position if the outcome is unfavorable to the company. Further, the company intends to and is permitted under the law to use the NOLs. Since the tax law permits the NOLs to be carried forward, and the company intends to use the NOL to offset this amount, the company continues to measure the portion of its NOL carryforward that would be used to settle the tax liability associated with the UTP for 2016 and 2017

based on the 35% tax rate or \$4.57 million (NOLs of \$13.02 million x 35%). For simplicity purposes, the additional 2017 liability post-enactment amortization has been ignored.

At 31 December 2018, the tax position remains uncertain. The company updated its analysis to reflect an additional year of amortization for tax purposes. The company estimated the deferred tax liability and uncertain tax benefit based on the temporary difference between the financial statement basis of the asset (\$15 million) and the tax basis of the asset computed in accordance with ASC 740 (\$12 million, which is the cost of the asset reduced by \$3 million of amortization recognized through 2018). As a result, the company estimated its deferred tax liability to be \$630,000 (\$3 million x 21%). The company continued to measure the uncertain tax benefit using the tax rate related to the period the uncertainty originated. Therefore, the company recorded a liability of \$4.2 million (\$12 million x 35%).

At 31 December 2018, the company recorded the following entries:

Journal entry to record the tax effects from \$1 million of additional tax amortization at 21%:

Deferred tax expense	210,000	
Deferred tax liability		210,000

Journal entry to adjust the UTP for the additional benefit from the additional tax amortization of \$1 million at 35%:

Uncertain tax position	350,000	
Current tax benefit		350,000

Journal entry to remeasure the NOL carryforward from 35% to 21% based on planned usage after the partial resolution of the UTP (\$1 million x (35% – 21%)):

Deferred tax expenses	140,000	
Net operating loss carryforward		140,000

Note: For simplicity purposes, these entries ignore possible interest and penalties.

A company presenting the tabular reconciliation required by ASC 740-10-50-15A would reflect the UTPs at the amounts consistent with the examples above and disclose the effect on the effective tax rate if the UTP settled in each subsequent year until the UTP is resolved.

4 One-time transition tax

Foreign earnings on which US income taxes were previously deferred are subject to a one-time tax as the company transitions to the new dividend-exemption system. Generally, US corporations need to include in income for each specified foreign subsidiary's last tax year beginning before 2018 their pro rata share of the net post-1986 historical earnings and profits (E&P) of the foreign subsidiaries if E&P has not been previously subject to US tax. The foreign earnings subject to the transition tax need to be measured on 2 November 2017 and on 31 December 2017, and the transition tax is based on the greater amount.

The portion of the E&P comprising cash and other specified assets is taxed at a 15.5% rate, and any remaining amount is taxed at an 8% rate. A company can elect to pay its tax liability over a period of eight years, interest free, based on the payment schedule included in the law.

4.1 Cash versus other specified asset rate

The portion of the E&P comprising cash and other specified assets is taxed at a 15.5% rate, and any remaining amount is taxed at an 8% rate. To determine the aggregate foreign cash position of the US shareholder, cash is measured on the following three dates:

- ▶ Date 1 – The close of the last taxable year beginning before 1 January 2018 (31 December 2017 for a calendar year-end company)
- ▶ Date 2 – The close of the last taxable year that ends before 2 November 2017 (31 December 2016 for a calendar year-end company)
- ▶ Date 3 – The close of the taxable year preceding Date 2 (31 December 2015 for a calendar year-end company)

The aggregate foreign cash position for a US taxpayer is the greater of the foreign cash position determined as of Date 1 or the average of the foreign cash positions determined as of Date 2 and Date 3.

A company with a non-calendar year-end foreign subsidiaries may not be able to determine its aggregate foreign cash position until the end of its 2018 fiscal year. As a result, such a company would need to consider whether the amount it recognized for its one-time transition tax payable can be completed earlier than that date (see section 8, *Special considerations for non-calendar year-end companies*, below).

Existing net operating loss and foreign tax credit carryforwards can be used to offset the transition tax. However, the Act sets certain limits that may restrict a company's use of any foreign tax credits generated from the one-time transition tax.

4.2 Accounting considerations related to the one-time transition tax (updated 24 January 2018)

A company needs to recognize the income tax accounting consequences of the one-time transition tax as a component of income tax expense from continuing operations in the period of enactment. Companies that recognized deferred taxes for prior foreign earnings may need to adjust previously recognized deferred tax liabilities and consider the classification of the transition income tax payable.

While the transition tax is intended to apply to all post-1986 taxable E&P of a company's non-US investees that were previously tax deferred, it does not necessarily eliminate book and tax basis differences. Companies still need to determine the outside basis differences for each of their foreign subsidiaries after taking into consideration payment of the transition tax. For example, there still may be a book and tax basis difference related to the investment that requires the company to evaluate whether any of the exceptions for recording deferred taxes under

ASC 740-30 apply (e.g., indefinite reinvestment assertion or the prohibition on recognizing deferred tax assets related to an investment in a subsidiary unless it will reverse in the foreseeable future). Also, there may be withholding taxes in foreign jurisdictions that are only triggered on distribution of earnings to shareholders and taxes that apply upon disposition of the investments.

Additionally, companies need to consider the effect on the balance sheet classification between current and noncurrent if they elect to pay the transition tax over the allowed period of time. Companies can elect to pay the transition tax without incurring interest over a period of up to eight years.

It is understandable that questions existed about whether the guidance in ASC 835-30, *Interest – Imputation of Interest*, applies to long-term income taxes payable. In response to these questions, the FASB staff made the following recommendations in its Staff Q&A:



FASB Staff question and answer on whether to discount the tax liability on the deemed repatriation

Question

Does the FASB staff believe that the tax liability on the deemed repatriation of earnings should be discounted?

Response

The FASB staff believes that the tax liability on the deemed repatriation of earnings should not be discounted. The FASB staff notes that paragraph 740-10-30-8 prohibits the discounting of deferred tax amounts. Due to the unique nature of the tax on the deemed repatriation of foreign earnings, the staff believes that the guidance in paragraph 740-10-30-8 should be applied by analogy to the payable recognized for this tax.

Further, the FASB staff does not believe that Subtopic 835-30 on the imputation of interest applies to the unique circumstances related to this tax liability. The guidance in Subtopic 835-30 addresses the accounting for business transactions that often involve the exchange of cash or property, goods, or services for a note or similar instrument. Subtopic 835-30 is premised on the fact that when a note is exchanged for property, goods, or services in a bargained transaction entered into at arm's length, the interest rate should represent fair and adequate compensation to the supplier. The FASB staff believes that the transition tax liability is not the result of a bargained transaction and that the scope exception in paragraph 835-30-15-3(e) for transactions where interest rates are affected by tax attributes or legal restrictions prescribed by a governmental agency (such as, income tax settlements) would apply.

The FASB staff also notes that the tax liability may not be a fixed obligation because it may be subject to estimation and future resolution of uncertain tax positions (for example, amount of earnings and profits from foreign subsidiaries, amount of earnings held in cash and cash equivalents, reduction of the tax for foreign tax credits). Any recognized uncertain tax position related to the deemed repatriation of foreign earnings would not be discounted, and the staff does not believe it is appropriate to have a discounted tax liability when the uncertain tax position is undiscounted.

See Appendix C for the full contents of the FASB Staff Q&A.

4.3 SAB 118 and documentation supporting the one-time transition tax (updated 24 January 2018)

Companies applying the guidance in SAB 118 when their accounting for the one-time transition tax is incomplete should include a provisional amount in their financial statements if they can determine a reasonable estimate. If they cannot make a reasonable estimate of the effects, companies should continue to apply ASC 740 based on the provisions of the tax laws that were in effect immediately prior to enactment. For example, if a company previously asserted indefinite reinvestment for a particular entity, Ernst & Young LLP believes the company could continue to follow its existing accounting until it has the necessary information to determine a reasonable estimate for the transition tax for that entity. See section 9, *SEC guidance on accounting for US tax reform*, below.

SAB 118 was issued to allow companies a reasonable period of time to finalize their accounting for the Act. Ernst & Young LLP expects that many companies will apply the provisions of SAB 118 when accounting for the transition tax as they seek additional information to support and refine their calculations during the SAB 118 measurement period. Questions have arisen in differentiating accounting that is provisional under SAB 118 from the assessment of an uncertain tax position – particularly as it related to the absence of supporting documentation of a tax position. For example, a company may have historical information to support income tax payments made by its foreign subsidiaries but may not have finished researching or gathering all the evidence that typically is required by the Internal Revenue Service (IRS) to support the company being able to claim a foreign tax credit (FTC). Ernst & Young LLP recognizes assessing the accounting effects of the absence of data or documentation during the SAB 118 measurement period will require the exercise of judgment.

Ernst & Young LLP believes that the SAB 118 measurement period is intended to provide a company with reasonable time to research and gather data to perform and support its analysis of a tax position. A company that is continuing to analyze the available support for a tax position, searching for additional data or analyzing the sufficiency of its information under the recognition and measurement provisions of ASC 740 (including those related to uncertain tax positions) would likely conclude that the accounting is provisional when applying the provisions of SAB 118.

As part of finalizing its accounting, a company will need to conclude on the adequacy of the support it has gathered for a tax position in accordance with ASC 740. In evaluating the effects of potential shortfalls in documentation as part of a company's final accounting, a company will need to consider the necessary information to support a conclusion that the tax position meets the more-likely-than-not recognition threshold in ASC 740 (including the applicability of the administrative practices of the IRS) as well as the effects of any deficiencies on the measurement of that tax position.

5 The new territorial system

Under the worldwide taxation system previously in effect, US corporate income tax applied to all of a company's income, regardless of whether it was earned in the US or overseas. However, foreign income earned by a foreign subsidiary of a US corporation was generally not taxed until the foreign earnings were repatriated to the US.

The Act created a territorial tax system that allows companies to repatriate certain foreign source earnings without incurring additional US tax by providing for a 100% dividend exemption. Under the dividend-exemption provision, 100% of the foreign source portion of dividends paid by certain foreign corporations to a US corporate shareholder are exempt from US taxation. The dividend exemption does not apply to foreign income earned by a domestic corporation through foreign branches (including foreign corporations for which the company made check-the-box elections) or to gain on sales attributable to the appreciation of stock. However, the dividend exemption generally applies to the gain on the sale of foreign stock attributable to the foreign subsidiary's E&P.

This provision applies to E&P distributions made after 31 December 2017.

5.1 Accounting considerations related to the territorial system

Outside basis differences represent the difference between the financial reporting basis and the tax basis of an investment. Under ASC 740, a company may have historically applied certain exceptions for recording deferred tax amounts related to the outside basis differences of its foreign subsidiaries or foreign corporate joint ventures (i.e., asserted indefinite reinvestment). In other instances, a company may have not met the criteria to apply those exceptions or may have been required to record the related deferred tax amounts, as would have been the case with an investee accounted for using the equity method (that did not meet the definition of a corporate joint venture).

Under the new territorial tax system, a company still needs to apply the guidance in ASC 740-30 to account for the tax consequences of outside basis differences from investments in foreign investees and consider the required disclosures. Companies need to carefully evaluate the provisions of the law for each individual foreign investee to determine whether they can assert indefinite reinvestment or otherwise are required to recognize deferred tax liabilities related to outside basis differences (even after considering the one-time transition tax discussed in section 4, *One-time transition tax*, above) and the appropriate tax effects of the outside basis differences.

The following are some of the matters related to outside basis differences that companies will need to consider in evaluating taxes that may need to be provided on outside basis differences and whether the exceptions in ASC 740-30 apply:

- Outside basis differences – The one-time transition tax applies to post-1986 tax E&P. That basis difference may not equate to the entire outside basis difference of some entities' international subsidiaries. The remaining outside basis difference will need to be examined to understand any federal, foreign or state taxes that could arise and whether the exceptions in ASC 740-30 related to indefinite reinvestment apply. In addition, companies will need to evaluate their intention for the reinvestment or continued reinvestment of E&P subject to the transition tax. There may be additional taxes (e.g., state, local, foreign) that would be due on these earnings, if remitted. While future earnings may be subject to 100% dividend exemption, companies will need to continue to evaluate their reinvestment intentions on future earnings and any other residual basis differences in order to determine whether they can continue to assert indefinite reinvestment or whether they will be required to provide for additional taxes that would be due on future earnings if remitted and/or the recognition of other basis differences.

- ▶ Foreign taxes (e.g., withholding taxes) – Companies will still need to assess whether they can assert indefinite reinvestment of foreign earnings (including E&P subject to the one-time transition tax). Although a company will need to provide US taxes on E&P due to the one-time transition tax, it will need to evaluate whether it can continue to assert indefinite reinvestment of those earnings with respect to withholding taxes and other foreign income taxes that could potentially be assessed.
- ▶ Gains on sale – Because gains from the sales of shares in a foreign investee are not eligible for the dividend exemption, companies need to separately track basis differences related to their investment balances and consider any intentions for disposal of a foreign investee.
- ▶ State and local taxes – Many states may have existing statutes, or will choose to enact legislation, to decouple from federal treatment of foreign sourced dividends. These differences could apply to both post-1986 E&P taxed under the federal one-time transition tax as well as pre-1987 E&P. As a result, companies will need to continue to assess their outside basis differences created by all book to tax differences and the state taxes that might apply. Individual state and local tax law changes should be accounted for when enacted in accordance with ASC 740.
- ▶ Foreign-to-foreign investments – The guidance in ASC 740-30 on accounting for outside basis differences still applies to the local country taxes applicable to foreign-to-foreign structures despite ultimate US ownership.

Companies may not have the necessary information to complete their analysis of the reversal of outside basis differences in their investments in foreign subsidiaries, after considering the one-time transition tax, by their financial reporting deadline. Companies applying the guidance in SAB 118 should include provisional amounts in their financial statements if they can determine reasonable estimates of the future tax effects of their outside basis differences and the tax cost of any transition taxes (see section 9, *SEC guidance on accounting for US tax reform*, below). If they cannot make a reasonable estimate, companies should continue to apply ASC 740 based on the provisions of the tax law that was in effect immediately prior to the enactment of the new law, including their historical accounting for outside basis differences for which they asserted indefinite reinvestment.

6 Anti-deferral and anti-base erosion provisions

The Act includes anti-deferral and anti-base erosion provisions targeting both US-based and foreign-based multinational companies, including:

- ▶ A new minimum tax on global intangible low-taxed income
- ▶ A lower effective tax rate (after deduction) on a US company's sales, leases or license of goods and services abroad that provides an incentive for these activities
- ▶ A new tax on certain payments from a corporation subject to US tax to a related foreign corporation that are otherwise deductible (e.g., royalty payments)

6.1 Global intangible low-taxed income

The Act subjects a US shareholder to current tax on "global intangible low-taxed income" (GILTI) of its controlled foreign corporations. GILTI is calculated based on the following formula: the excess of the aggregate of a US shareholder's pro rata share of net income of its controlled foreign corporations (CFCs) over a calculated return on specified tangible assets of the CFCs. The income inclusion under GILTI is eligible for a deduction that is intended to lower the effective tax rate to 10.5% for taxable years beginning after 31 December 2017 and ending in 2025. The deduction applied to GILTI income will be lowered resulting in the intended effective rate rising to 13.125% for taxable years beginning after 31 December 2025.

Further, the Act limits FTCs to 80% of the foreign tax paid and properly attributable to GILTI income. It also limits a company's ability to use these FTCs against other foreign source income or to carry these FTCs back or forward to other years.

6.1.1 Accounting considerations for GILTI provisions (updated 24 January 2018)

The income subject to tax under the GILTI provisions will be treated in a manner similar to a Subpart F income inclusion (i.e., it should be included in the US shareholder's taxable income in the current year) and included in its US income tax provision. However, questions existed about whether companies should include the effects of the Act in income tax in the future period the tax arises or as part of deferred taxes on the related investments. In response to these questions, the FASB staff issued the following response in a Staff Q&A:



FASB Staff question and answer on the accounting for global intangible low-taxed income

Question

Does the FASB staff believe that an entity should recognize deferred taxes for temporary basis differences expected to reverse as global intangible low-taxed income (GILTI) in future years or should the tax on GILTI be included in tax expense in the year it is incurred?

Response

The FASB staff does not believe that Topic 740 is clear as to the treatment of GILTI.

Some stakeholders believe that it would not be appropriate to provide deferred taxes on individual inside basis differences or the outside basis difference (or portion thereof) because a taxpayer's GILTI is based on its aggregate income from all foreign corporations. Because the computation is done at an aggregate level, the unit of account is not the taxpayer's investment in an individual foreign corporation or that corporation's assets and liabilities. These stakeholders believe that the guidance on deferred tax accounting in Topic 740 using the asset and liability approach does not address taxes on aggregated income because basis differences of a foreign corporation in one jurisdiction may be offset by basis differences in a foreign corporation in another jurisdiction and ultimately may never be taxed. Furthermore, these stakeholders believe that the GILTI computation is dependent on contingent or future events (for example, future foreign income versus loss, the amount of foreign qualified business asset investment in a given year, future foreign tax credits, or future taxable income), which suggests that taxes on GILTI should be accounted for as period costs similar to special deductions.

Other stakeholders believe that the current tax imposed on GILTI is similar to the tax imposed on existing Subpart F income. Deferred taxes generally are provided under Topic 740 for basis differences that are expected to result in Subpart F income upon reversal. Because GILTI is included in the US shareholder's taxable income when earned by the foreign corporations, similar to Subpart F income, these stakeholders believe that a US shareholder should recognize deferred tax assets and liabilities when basis differences exist that are expected to affect the amount of GILTI inclusion upon reversal.

Based on the different views provided, the FASB staff believes that Topic 740 is not clear as it relates to the accounting for GILTI, and an entity may apply either interpretation of Topic 740. The staff believes that an entity must disclose its accounting policy related to GILTI inclusions in accordance with paragraphs 235-10-50-1 through 50-3.

The staff plans to monitor how entities that pay tax on GILTI are accounting for and disclosing its effects by reviewing annual or quarterly reports issued over the next few quarters. Following this review, the staff will provide an update to the Board so it can consider whether improvements may be needed for the accounting or disclosures for the tax on GILTI.

See Appendix C for the full contents of the FASB Staff Q&A.

6.1.2 SAB 118 considerations for GILTI provisions (updated 31 January 2018)

As noted in section 9, *SEC guidance on accounting for US tax reform*, the FASB staff concluded that a company can elect an accounting policy to account for GILTI in either of the following ways:

- As a period charge in the future period the tax arises
- As part of deferred taxes related to the investment or subsidiary

Questions have arisen about whether companies can “provisionally” elect a GILTI accounting policy under the guidance in SAB 118 and change their election during the SAB 118 measurement period. SAB 118 does not address changes to an elected accounting policy. Instead, it recognizes that companies may need time to analyze and assess the effects of the Act and allows them to record provisional amounts until they complete their accounting.

Ernst & Young LLP understands that the SEC staff will not object to the following views:

- A company that records either a material provisional or final amount that reflects GILTI as a component of its deferred taxes has elected an accounting policy.

- ▶ If a company has elected to account for GILTI as part of deferred taxes (i.e., selected an accounting policy of recording GILTI as deferred taxes) but is still evaluating its accounting method for measuring those deferred tax amounts (i.e., recording GILTI taxes based on inside basis versus outside basis), it should disclose that its method for measuring GILTI is provisional and that method may be changed during the measurement period.
- ▶ When a company has not yet elected an accounting policy for GILTI during the SAB 118 measurement period, it should disclose that it is still evaluating the Act's GILTI provisions and has not yet elected an accounting policy.
- ▶ Once a company elects an accounting policy for GILTI, any change in that policy would be considered an accounting change that would be subject to ASC 250-10-45-2.

See Illustration 13 – *Disclosures a calendar year-end company might make in the period of enactment* regarding a company's GILTI accounting policy election and SAB 118.

6.1.2.1 *GILTI policy election during interim periods following the enactment date (updated 31 January 2018)*

Companies that have disclosed that they have not selected a GILTI accounting policy will also need to be mindful of how they consider GILTI in establishing the estimated annual effective tax rate (EAETR) in subsequent interim periods (e.g., the first quarter of 2018 for calendar year-end companies). A company that has not yet finalized its accounting policy for GILTI (i.e., determined whether to treat it as a period cost or as part of deferred taxes) should not compute its EAETR with GILTI as part of its deferred taxes. Consistent with the discussion in the section above, a company that calculates its EAETR including a significant effect from deferred tax balances triggered by GILTI has elected an accounting policy to treat GILTI as part of its deferred taxes.

6.2 **Export incentive on foreign-derived intangible income**

The law provides tax incentives to US companies to earn income from the sale, lease or license of goods and services abroad in the form of a deduction for foreign-derived intangible income (FDII). Foreign-derived intangible income is taxed at an effective rate of 13.125% for taxable years beginning after 31 December 2017 and 16.406% for taxable years beginning after 31 December 2025.

6.2.1 *Accounting considerations for the export incentive for foreign-derived intangible income*

Ernst & Young LLP believes the accounting for the deduction for foreign-derived intangible income is similar to a special deduction and should be accounted for based on the guidance in ASC 740-10-25-37. The tax benefits for special deductions ordinarily are recognized no earlier than the year in which they are deductible on the tax return. See section 5.7, *Special deductions*, of the FRD on income taxes.

6.3 **Tax on otherwise deductible payments to related foreign corporations**

The Act establishes a tax on certain payments from corporations subject to US tax to related foreign persons, also referred to as base erosion payments. Base erosion payments generally include payments from a corporation to foreign related parties for any amounts that are deductible, including royalty payments or payments to acquire depreciable or amortizable property. Base erosion payments do not include payments for costs of goods sold, payments for certain qualified services and qualified derivative payments, if certain requirements are met.

Companies that meet certain thresholds are required to pay the new minimum base erosion and anti-abuse tax (BEAT). The minimum BEAT is based on the excess of a percentage of the corporation's modified taxable income over its regular tax liability for the year reduced by certain credits, but the amount cannot be less than zero. The modified income is taxed at 5% in 2018, 10% in 2019 through 2025 and 12.5% for years beginning after 31 December 2025.

This provision generally applies to corporations that are subject to US net income tax with average annual gross receipts of at least \$500 million and that have made related-party deductible payments totaling 3% (2% for banks and securities dealers) or more of the corporation's total deductions for the year. The BEAT is effective for base erosion payments paid or accrued in taxable years beginning after 31 December 2017.

6.3.1 Accounting considerations for BEAT provisions (updated 24 January 2018)

For companies that meet certain thresholds, the base erosion provision of the Act creates additional tax on net income by effectively excluding deductions on certain payments to foreign related entities.

Questions existed about whether this tax should be considered part of the regular US tax system, which would require the effects of the BEAT to be included in income tax in the period the tax arises, or a separate parallel tax regime. If the tax is determined to be part of a separate parallel tax regime, a question would arise about the appropriate tax rate to be applied in measuring certain US deferred taxes, including temporary differences existing on the enactment date, by entities subject to the BEAT regime (i.e., the new US corporate tax rate of 21% or the BEAT rate). In response to these questions, the FASB staff issued the following response in a Staff Q&A:



FASB Staff question and answer on the accounting for the base erosion anti-abuse tax

Question

Does the FASB staff believe that deferred tax assets and liabilities should be measured at the statutory tax rate of the regular tax system or the lower BEAT tax rate if the taxpayer expects to be subject to BEAT?

Response

The FASB staff believes that the BEAT is similar to the alternative minimum tax (AMT) under prior tax law. The AMT was a parallel tax system that resulted in a minimum level of corporate taxation in situations in which regular taxable income was lower than the alternative minimum taxable income due to "preference items" that were not deductible for AMT purposes. An entity that paid the AMT received a tax credit for the tax paid in excess of the amount computed on the basis of the regular tax system. An entity subject to the BEAT does not receive a tax credit for the tax paid in excess of the amount computed on the basis of the regular tax system, but the FASB staff believes that the BEAT is similar to the AMT in that it is designed to be an incremental tax in which an entity can never pay less, and may pay more, than their regular tax liability.

Paragraphs 740-10-30-11 and 740-10-55-32 address the AMT and require an entity to measure deferred taxes using the statutory tax rate under the regular tax system.

Paragraph 740-10-30-11 states:

"...[I]t would be counterintuitive if the addition of alternative minimum tax provisions to the tax law were to have the effect of reducing the amount of an entity's income tax expense for financial reporting, given that the provisions of alternative minimum tax may be either neutral or adverse but never beneficial to an entity."

Therefore, the FASB staff believes that an entity that is subject to BEAT should measure deferred tax assets and liabilities using the statutory tax rate under the regular tax system. The FASB staff believes that measuring a deferred tax liability at the lower BEAT rate would not reflect the amount an entity would ultimately pay because the BEAT would exceed the tax under the regular tax system using the 21 percent statutory tax rate.

Although an entity may believe that it expects to be subject to the BEAT for the foreseeable future, paragraph 740-10-30-11 further states that “no one can predict whether an entity will always be an alternative minimum tax taxpayer.” The FASB staff believes that a similar conclusion could be applied to BEAT. In addition, taxpayers may take measures to reduce their BEAT exposure and, therefore, ultimately pay taxes at or close to the 21 percent statutory tax rate.

The FASB staff believes that the guidance in Topic 740 therefore indicates that the incremental effect of BEAT should be recognized in the year the BEAT is incurred. The staff also believes that an entity would not need to evaluate the effect of potentially paying the BEAT in future years on the realization of deferred tax assets recognized under the regular tax system because the realization of the deferred tax asset (for example, a tax credit) would reduce its regular tax liability, even when an incremental BEAT liability would be owed in that period. Regardless of any year-over-year effective tax rate fluctuations, the effective tax rate (excluding other permanent items) under this approach would always be equal to or in excess of the statutory tax rate of 21 percent.

See Appendix C for the full contents of the FASB Staff Q&A.

7 Effects of certain other key provisions

7.1 Changes to NOL carryback and carryforward rules (updated 16 January 2018)

The Act limits the amount taxpayers are able to deduct for NOL carryforwards generated in taxable years beginning after 31 December 2017 to 80% of the taxpayer's taxable income. The law also generally repeals all carrybacks for losses generated in taxable years ending after 31 December 2017. However, any NOLs generated in taxable years ending after 31 December 2017 can be carried forward indefinitely.

NOLs generated in taxable years ending after 31 December 2017

- Not eligible for carryback
- Eligible for indefinite carryforward

NOLs generated in taxable years beginning after 31 December 2017

- Usage limited to 80% of taxable income each year

7.1.1 Accounting implications of changes to NOL carryback and carryforward rules (updated 24 January 2018)

Companies need to reevaluate the realizability of any remaining NOL carryforwards (after appropriate remeasurement for the change in tax rates) after considering NOLs used to offset their transition tax, as discussed above. Further, a company that relies on projections of future taxable income when evaluating the realizability of existing deferred tax assets, including NOL and tax credit carryforwards, needs to consider whether other provisions of the Act will affect its ability to use NOLs in the future (e.g., the limitation on the use of an NOL created after 31 December 2017 to 80% of the taxable income in any year).

Companies applying the guidance in SAB 118 that have not completed the accounting for the effects of the Act but can determine a reasonable estimate of those effects on their NOL carryforwards should include a provisional amount based on their reasonable estimate in the financial statements. If they cannot make a reasonable estimate of the effects, companies should continue to apply ASC 740 and continue to account for their NOL carryforwards based on the provisions of the tax laws that were in effect immediately prior to enactment. See section 9, *SEC guidance on accounting for US tax reform*, below.

Companies need to consider other provisions in the law and how they may affect projections of future taxable income (e.g., interest limitations and expense deductibility discussed below) on valuation allowance conclusions.

It is not appropriate to assume deferred tax assets that will reverse in taxable years beginning after 31 December 2017 and will result in post-2017 NOLs will ultimately be realized simply because the related NOL does not expire. Similarly, NOLs that arise in taxable years beginning after 31 December 2017 also need to be evaluated for realizability, and the lack of an expiration date does not mean they are realizable. A valuation allowance for NOLs that do not expire, and deferred tax assets that will become that type of NOL, may still be necessary if, based on the weight of available evidence, it is more likely than not (likelihood of more than 50%) that the deferred tax asset will not be realized. See chapter 6, *Valuation allowances*, of the FRD on income taxes.

Naked credits

Because NOLs generated in taxable years beginning after 31 December 2017 can be carried forward indefinitely but are limited to 80% of taxable income in any year, questions have arisen about whether the reversal of taxable temporary differences related to indefinite-lived intangible assets (including tax-deductible goodwill) may be used as a source of future taxable income when assessing the realizability of these loss carryforwards. Ernst & Young LLP believes it is appropriate for a company to consider the reversal of a taxable temporary difference from an indefinite-lived intangible asset as a source of future taxable income when assessing the realizability of loss carryforwards that do not expire when they are in the same jurisdiction and of the same character.

Ernst & Young LLP also believes it is appropriate to consider the reversal of taxable temporary differences related to indefinite-lived intangible assets when assessing the realizability of deferred tax assets that upon reversal would give rise to NOLs that do not expire (i.e., NOLs that can be carried forward indefinitely). However, it is understandable that under an alternative view a company may have previously concluded that in certain jurisdictions it would not be appropriate to consider the future reversal of a taxable temporary difference associated with an indefinite-lived intangible asset (including tax-deductible goodwill) as the timing of recognition of the necessary taxable income cannot be predicted. Ernst & Young LLP does not object to this alternative view, but also recognizes that the significance of the change in tax law associated with the Act may lead companies to conclude that the most appropriate way to assess the realizability for NOLs under the Act that do not expire, and deferred tax assets that will reverse and become NOLs that do not expire, is to consider the reversal of temporary differences related to indefinite-lived intangible assets as a source of income to consider when evaluating their realizability.

For a company with NOL carryforwards that arose in a period prior to the change in NOL carryforward rules under the Act, Ernst & Young LLP continues to believe it is not appropriate to consider the reversal of taxable temporary differences related to indefinite-lived intangible assets when evaluating the realizability of those NOLs. Companies with US federal NOLs generated prior to the effective date of the new NOL rules under the Act are required to apply those NOLs first (after applying the reversal of deductible temporary differences in that year) before utilizing NOLs created in taxable years ending after 31 December 2017. These companies may need to schedule expected usage of their NOLs in performing this analysis.

Illustration 6 – Assessing the realizability of deductible temporary differences that will reverse and generate NOLs with an indefinite carryforward

At 31 December 2017, an entity has deductible temporary differences of \$500 and taxable temporary differences of \$700. These temporary differences are ordinary in nature (no capital gains or losses) and are in the same jurisdiction. Assume the company is projecting that it will break even in 2018 and 2019 and have no pretax book income in the related jurisdiction. The deductible temporary differences are expected to reverse over the next two years and will generate NOLs with an indefinite carryforward. Also assume loss carryback is prohibited. The taxable temporary differences relate to indefinite-lived intangible assets. Assume the company is projecting no pretax book income in 2018 and 2019.

	Balance as of 12/31/2017	Expected period of reversal	
		2018	2019
Deductible temporary differences	\$ 500	\$ (250)	\$ (250)
Taxable temporary differences (related to indefinite-lived intangible assets)	(700)	0	0
		\$ (250)	\$ (250)

In determining the realizability of the deductible temporary differences, the entity may consider the \$700 of taxable temporary differences related to the indefinite-lived intangible assets that currently exist, subject to the limits on using NOLs discussed below.

Companies need to consider that the usage of NOLs generated in the example is limited to 80% of the annual taxable income when performing this analysis. For example, when the taxable temporary difference reverses in the future, the NOLs could offset up to 80% of that year's taxable income. Therefore, if the \$700 of taxable temporary differences related to indefinite-lived intangibles reverses in the future and is the only source of taxable income in that year, an entity could use the NOL carryforwards up to \$560 in that year (80% of \$700). Because \$560 is greater than the \$500 of deductible temporary differences, the company may be able to conclude that those deductible temporary differences are realizable at 31 December 2017. See the *Consideration of the limits on usage of NOLs* section below for further discussion.

Consideration of the limits on usage of NOLs

The Act limits the amount taxpayers are able to utilize for NOL carryforwards generated in taxable years beginning after 31 December 2017 to 80% of the taxpayer's taxable income in any year. Companies that cannot rely on projections of future taxable income and rely on the reversal of taxable temporary differences as a source of future taxable income should carefully consider the reversal pattern of temporary differences when evaluating the realizability of deferred tax assets. A company may need to schedule the reversal of its temporary differences when performing this evaluation.

Illustration 7 – Limits on usage of NOLs

At 31 December 2017, Company A has \$1,200 of deductible temporary differences and \$1,200 of taxable temporary differences. These temporary differences are ordinary in nature (no capital gains or losses). The deductible and taxable temporary differences are expected to reverse over the next three and four years, respectively, starting in 2018. When they reverse, a portion of the deductible temporary differences will create NOLs with an indefinite carryforward but the usage of these NOLs is limited to 80% of the taxpayer's taxable income. Also assume loss carryback is prohibited. Assume that for each year presented, the company breaks even and has no pretax book income, the company cannot rely on its projections of taxable income and there are no available tax planning strategies. For purposes of this illustration, assume all of Company A's NOLs are subject to limitations (e.g., no NOL carryforwards exist at 31 December 2017).

Company A assesses the realizability of its deductible temporary differences as of 31 December 2017, and schedules the reversal of its existing taxable temporary differences as follows:

	Balance at 12/31/2017	2018	2019	2020	2021
Deductible temporary differences	\$ 1,200	\$ (400)	\$ (400)	\$ (400)	\$ -
Taxable temporary differences	(1,200)	300	300	300	300
Taxable income (loss)		\$ (100)	\$ (100)	\$ (100)	\$ 300
NOL used subject to limit of 80% of current-year taxable income		N/A	N/A	N/A	240
NOL carryforward generated		(100)	(100)	(100)	-
Cumulative NOL carryforward		(100)	(200)	(300)	(60)

In 2021, Company A uses a portion of its NOL carryforwards that is limited to 80% of that year's taxable income, or \$240. Based on this analysis, even though Company A has \$1,200 of taxable temporary differences at 31 December 2017, it can consider only \$1,140 (\$300 in each year from 2018 to 2020 and \$240 in 2021) of the taxable temporary differences as a source of future taxable income when assessing the realizability of its deductible temporary differences. As a result, Company A recorded a valuation allowance of \$13 (\$60 x 21% tax rate).

How Ernst & Young LLP sees it

Companies should consider the effects of changes to NOL carryback and carryforward rules, including the new limits on using NOLs, on the realizability of their deferred tax assets and NOL and tax credit carryforwards. This may require companies to perform more precise scheduling or additional scheduling of the reversal of temporary differences than they have in the past. Non-calendar year-end companies may need to perform additional analysis regarding the realizability of their deferred tax balances.

7.2 Repeal of the corporate alternative minimum tax

The corporate alternative minimum tax was repealed. Taxpayers with AMT credit carryovers can use the credits to offset regular tax liability for any taxable year. In addition, the AMT credit is refundable in any taxable year beginning after 2017 and before 2022 in an amount equal to 50% (100% in the case of taxable years beginning in 2021) of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability. Thus, a taxpayers' entire AMT credit carryforward amounts are fully refundable by 2022.

7.2.1 Accounting implications of AMT repeal (updated 24 January 2018)

How Ernst & Young LLP sees it

Ernst & Young LLP believes it would be appropriate for a company to either continue to classify AMT credits along with its other deferred tax balance or reclassify credits that are expected to be refundable in future periods to an income tax receivable. If AMT credits are significant, a company should disclose in the notes to its financial statements how it classified the AMT credits.

Ernst & Young LLP understands that questions existed about whether it is appropriate to discount a receivable for amounts refundable and how to classify the related accretion. In response to these questions, the FASB staff issued the following response in a Staff Q&A:



FASB Staff question and answer on whether to discount alternative minimum tax credits that become refundable

Question

Does the FASB staff believe that AMT credit carryforwards should be discounted at December 31, 2017, because they will be refundable in future years?

Response

The FASB staff notes that paragraph 740-10-30-8 prohibits discounting deferred taxes. Accordingly, any AMT credit carryforwards presented as a deferred tax asset would not be discounted. Likewise, the FASB staff believes that any AMT credit carryforward presented as a receivable should not be discounted because the staff does not believe that Subtopic 835-30 on the imputation of interest applies.

The guidance in Subtopic 835-30 addresses the accounting for business transactions that often involve the exchange of cash or property, goods, or services for a note or similar instrument. Subtopic 835-30 is premised on the fact that when a note is exchanged for property, goods, or services in a bargained transaction entered into at arm's length, the interest rate should represent fair and adequate compensation to the supplier. The FASB staff believes that the AMT credit carryforward is not the result of a bargained transaction and that the scope exception in paragraph 835-30-15-3(e) for transactions where interest rates are affected by tax attributes or legal restrictions prescribed by a governmental agency (such as, income tax settlements) would apply.

The FASB staff notes that paragraph 740-10-50-3 requires an entity to disclose the amounts of tax credit carryforwards for tax purposes. The staff believes this disclosure would apply whether an entity presents the AMT credit carryforward as a deferred tax asset or a receivable and would provide useful information to investors in evaluating the amount that is to be utilized or refunded.

See Appendix C for the full contents of the FASB Staff Q&A.

Since AMT credits can either be credited against future income or refunded, a company that previously recorded a full valuation allowance against its AMT credits will need to reevaluate realizability.

7.3 Interest expense deduction limits

The law limits the deduction for net interest expense that exceeds 30% of the taxpayer's adjusted taxable income (ATI) for that year. ATI is computed initially excluding depreciation, amortization or depletion (approximating earnings before interest, taxes, depreciation and amortization) and includes these items beginning in 2022 (approximating earnings before interest and taxes).

The Act permits an indefinite carryforward of any disallowed business interest. This provision applies to taxable years beginning after 31 December 2017 and provides exceptions to the interest limitation for companies with gross receipts not exceeding \$25 million.

7.3.1 Accounting implications of interest expense deduction limits (updated 8 February 2018)

Going forward, companies with interest limited under the new law will have to assess the realizability of any resulting deferred tax assets for interest carried forward. A company whose interest deduction is already limited may not be able to realize the benefits of amounts carried forward. This is because the annual limitation on deductions for interest expense will also apply in future years, and it applies to not only the interest expense incurred in those future years but also to the utilization of any amounts carried forward.

While the resulting deferred tax asset can be carried forward indefinitely, companies may be prevented from considering the full reversal of an indefinite-lived intangible asset as a source of future income when assessing the realizability of disallowed business interest carryforwards due to the limitation on the amount of net interest a company can deduct in an annual period. For example, if a company recorded a \$1,000 deferred tax asset related to interest carryforwards and a \$2,000 deferred tax liability related to an indefinite-lived intangible asset, as a result of the taxable income limitation on the deduction of interest, the company could only consider \$600 ($\$2,000 \times 30\%$) as a source of future taxable income from the reversal of the deferred tax liability. See section 7.1, *Changes to NOL carryback and carryforward rules*, for further discussion on using the reversal of an indefinite-lived intangible asset as a source of future income.

In addition, if a company is relying on projections of future taxable income, it will also need to consider the effects of the limitations in its projections of future taxable income, including any projections of future interest expense, as it does for other originating temporary differences.

7.4 Immediate expensing

Companies are able to claim bonus depreciation to accelerate the expensing of the cost of certain qualified property acquired and placed in service after 27 September 2017 and before 1 January 2024. For the first five-year period (through 2022), companies can deduct 100% of the cost of qualified property. During the period starting in 2023, the additional bonus depreciation is gradually phased out by 20% each year through 2027.

Companies need to implement processes to identify eligible capital expenditures and revise tax depreciation to properly measure deferred tax liabilities related to qualified property.

7.4.1 Accounting implications of immediate expensing

Companies need to carefully determine the appropriate rate to apply when calculating their deferred taxes and current taxes at the enactment date when claiming the bonus depreciation. Given the retroactive nature of this provision, a calendar year-end company should record deductions in the 2017 current tax provision calculation at 35%, while measuring the related deferred tax liability at the newly enacted rate.

7.5 Limit on employee remuneration

The Act expanded the number of individuals whose compensation is subject to a \$1 million cap on deductibility under Section 162(m) and includes performance-based compensation such as stock options and stock appreciation rights in the calculation.

Until now, a public company has been able to deduct up to \$1 million of compensation paid to covered employees consisting of the chief executive officer and the next three highest compensated officers (but not the chief financial officer (CFO)). However, the limit didn't apply to performance-based compensation.

The new law expands the definition of covered employees to include the CFO and any individual who has been considered a covered employee, even if that individual is no longer a covered employee. Thus, once an individual is a covered employee, the deduction limitation applies to compensation paid to that individual at any point in the future, including after a separation from service. Any individual who is a covered employee for a tax year after 31 December 2016 will remain a covered employee for all future years. The law also eliminates the exception for performance-based compensation.

The provision generally applies to taxable years beginning after 31 December 2017 and provides a transition for compensation paid pursuant to a written binding contract that is in effect on 2 November 2017. Companies will need to carefully review the terms of their compensation plans and agreements to assess whether they are considered to be written binding contracts in effect on 2 November 2017.

7.5.1 Accounting implications of limits on employee remuneration

Companies need to evaluate the effect of these changes on their deferred tax assets in the period of enactment as well as the effect on their effective tax rate.

7.6 Tax method changes

In certain cases, the Act requires companies to change their tax accounting methods for revenue recognition to conform with their financial reporting methods. The law generally requires a taxpayer to recognize revenue no later than the taxable year in which it is recognized in the taxpayer's financial statements. As a result, a company will automatically conform its tax method

with its book method for all revenue items recognized sooner under the book method. This provision is effective for years beginning after 31 December 2017. See section 8.7, *Changes in tax accounting method*, of the FRD on income taxes.

7.7 Restriction or elimination of exclusions, deductions and credits

The Act repeals or limits deductions for amounts previously deductible (beginning in 2018 unless otherwise noted), including:

- ▶ Repeals the Section 199 domestic production deduction (see section 5.7.1, *Domestic production activities deduction*, of the FRD on income taxes)
- ▶ Creates additional restrictions on deductions for meals and entertainment
- ▶ Reduces the allowable deduction against the dividends received from a domestic corporation other than certain small businesses or those treated as “qualifying dividends” from 70% to 50%, and from 80% to 65% for dividends received from 20% owned corporations
- ▶ Extends the amortization period of research and experimental expenses incurred in the US to five years and for expenses incurred outside the US to 15 years, beginning in years after 2021
- ▶ Eliminates the deductibility of payments made or incurred to a government after 22 December 2017 in connection with the violation of a law, except for restitution payments to come into compliance with the law and amounts subject to a binding agreement as of the enactment date, meaning deferred tax assets related to the accrual of such settlements may need to be adjusted at the enactment date
- ▶ Eliminates the deductibility of payments made for settlements of certain harassment suits, meaning any deferred tax amounts related to accruals for potential settlements before the enactment date will need to be adjusted

Companies applying SAB 118 should include a provisional amount based on a reasonable estimate of the effects of these provisions in their financial statements. If they cannot make a reasonable estimate of the effects they should continue to apply ASC 740 based on the provisions of the tax laws that were in effect immediately prior to enactment. See section 9, *SEC guidance on accounting for US tax reform*, below.

8 Special considerations for non-calendar year-end companies

8.1 Effects of a lower corporate income tax rate for non-calendar year-end companies – blended rate (updated 16 January 2018)

Based on language in the Act, non-calendar year-end companies might conclude that the 21% corporate tax rate would be effective in the first taxable year beginning on or after 1 January 2018. However, existing tax law,⁶ which was not amended by the Act, governs when a change in tax rate is effective. The tax law provides that if the taxable year includes the effective date of any rate changes (unless the effective date is the first day of the taxable year), taxes should be calculated by applying a blended rate to the taxable income for the year. To compute the blended rate, a company calculates the weighted average tax rate based on the ratio of days in the fiscal year prior to and after enactment.

Illustration 8 – Blended rate			
Assume Company A has a fiscal year ending 30 June 2018. To determine its blended rate, Company A calculates an average tax rate weighted based on the ratio of days in the fiscal year prior to and after the enactment date, as follows:			
Days prior to enactment	184		
Days after enactment	<u>181</u>		
Total days	365		
		Percentage of days at that rate	Weighted average tax rate
Tax based on 35% tax rate		50.41%	17.65%
Tax based on 21% tax rate		49.59%	<u>10.41%</u>
Blended rate for the year ended 30 June 2018			28.06%
Company A's blended tax rate for its year ended 30 June 2018 is 28.06%.			

As explained above, the blended rate does not depend on a company's taxable income for the period and therefore can be calculated using only its fiscal year end. The following table lists the blended rates based on certain fiscal 2018 year-end dates. Companies with periods ending on dates other than the end of the month will need to determine their blended tax rate based on their specific fiscal year end.

Fiscal year ending on	Blended rate	Fiscal year ending on	Blended rate
31 January 2018	33.81%	31 July 2018	26.87%
28 February 2018	32.74%	31 August 2018	25.68%
31 March 2018	31.55%	30 September 2018	24.53%
30 April 2018	30.40%	31 October 2018	23.34%
31 May 2018	29.21%	30 November 2018	22.19%
30 June 2018	28.06%	31 December 2018	21.00%

ASC 740-10-50-12 requires a public company to disclose a reconciliation 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 pretax income from continuing operations.

⁶ Internal Revenue Code, Section 15 *Effect of changes*.

How Ernst & Young LLP sees it

Ernst & Young LLP believes the blended rate calculated as described in this section is the appropriate domestic federal statutory tax rate for non-calendar year-end companies to use in their rate reconciliation.

8.2 Accounting considerations related to deferred tax assets and liabilities for non-calendar year-end companies

Companies with a non-calendar year end may face additional complexities in calculating their deferred tax assets and liabilities at the enactment date and determining the appropriate rate to use. These companies need to schedule when temporary differences are expected to reverse to apply the appropriate rate. Temporary differences reversing during the fiscal year that includes the enactment date should be remeasured using the blended rate described in section 8.1, *Effects of a lower corporate income tax rate for non-calendar year-end companies – blended rate*, above. Temporary differences reversing after that fiscal year should be remeasured at the new 21% rate.

Estimating temporary differences as of the most recent quarter end (e.g., 31 December) for purposes of remeasuring deferred tax amounts at the enactment date is often adequate with appropriate consideration of significant adjustments between the enactment date and the quarter end. However, if the enactment date is not near the beginning or end of a reporting period, companies need to estimate temporary differences as of the enactment date (i.e., estimate temporary differences (to the extent significant) using a short-period tax return or estimate that temporary differences will be generated and reverse ratably or will be generated in the same period as the financial reporting income occurs during the year). Since non-calendar year-end companies do not typically estimate the reversal of temporary differences during interim periods, they may require additional effort to determine the effect on their temporary differences at the enactment date.

The effects of a change in tax laws or rates on deferred tax assets or liabilities should be recognized as a discrete event as of the enactment date and should not be allocated to subsequent interim periods by an adjustment of the estimated annual effective tax rate.

For a company that is applying the guidance in SAB 118, the remeasurement of deferred tax balances should be recorded in the period of enactment if it can complete its accounting or a reasonable estimate can be made. If a company cannot complete its accounting or make a reasonable estimate, it should continue to account for its deferred taxes based on the provisions of the tax laws that were in effect immediately prior to enactment. See section 9, *SEC guidance on accounting for US tax reform*, below.

8.3 Non-calendar year-end interim reporting considerations (updated 24 January 2018)

Non-calendar year-end companies also need to consider the effects of the tax rate change on interim reporting if the enactment date is in an interim period. Under ASC 740-270-25-5, the tax effect of a change in tax laws or rates on taxes currently payable or refundable for the current year must be recorded after the effective dates prescribed in the statutes and reflected in the EAETR beginning no earlier than the first interim period that includes the enactment date of the new legislation. In addition, the implementation guidance in ASC 740-270-55-49 and 50 indicates that the effect of new legislation would not be reflected until it is effective or administratively effective.

ASC 740 indicates that tax legislation may prescribe changes that become effective during an entity's fiscal year that are administratively implemented by applying a portion of the change to the full fiscal year. Existing tax law provides that if the taxable year includes the effective date of any rate changes (unless the effective date is the first day of the taxable year), taxes should be calculated by applying a blended rate to the taxable income for the entire year. The tax rate changes thus are administratively effective on the enactment date.

In addition, a non-calendar year-end company may need to consider temporary differences that originate or reverse between the enactment and the end of its fiscal year when estimating its EAETR. Since these temporary differences will affect the current-year income tax payable at the non-calendar year-end company's blended rate and the related deferred tax will be measured at the new 21% corporate income tax rate at the end of the year, the effects of this rate differential should be considered in computing the EAETR.

8.3.1 Accounting for the effects of rate change on EAETR

The effects of new tax law legislation on taxes currently payable must be recognized in the period of enactment with allocation to earlier or later interim periods prohibited. See sections 8.1, *Changes in tax laws and rates*, and 15.1.2, *Changes in tax laws, rates or tax status*, of the FRD on income taxes.

Illustration 9 – Effects of rate change on EAETR

Assume that for the full fiscal year, an entity with a 30 June year end anticipates ordinary taxable income of \$100,000. All income is taxable in one jurisdiction at a 35% rate. All anticipated transactions will have tax consequences.

New legislation enacted in the second quarter of the entity's fiscal year reduces the tax rate to 21%. The new tax rate is administratively effective as of the beginning of the company's fiscal year. The new legislation is administratively implemented by applying a portion of the change to the full fiscal year. As a result, the entity revises its EAETR computation using the appropriate blended rate as described above.

Tax at statutory rate (\$100,000 at 28.06%) \$ 28,060

The effect of the new legislation is not reflected until it is effective or administratively effective. Accordingly, quarterly tax computations are as follows:

Reporting period	Ordinary income			Tax		
	Quarter	Year to date	EAETR	Year to date	Less previously reported	Reporting period
Q1	\$ 20,000	\$ 20,000	35.00%	\$ 7,000	\$ -	\$ 7,000
Q2	20,000	40,000	28.06%	11,224	7,000	4,224
Q3	20,000	60,000	28.06%	16,836	11,224	5,612
Q4	40,000	100,000	28.06%	28,060	16,836	11,224
	<u>\$ 100,000</u>					<u>\$ 28,060</u>

8.3.2 Accounting for changes in provisional amounts

For companies that are applying the guidance in SAB 118 during an interim period of enactment, the accounting for the effects of certain aspect of the Act may be incomplete. Until a company can complete its analysis, it may not be able to determine the effects certain aspects of the Act may have on its tax provision. See section 9, *SEC guidance on accounting for US tax reform*, below.

8.4 Non-calendar year-end transition tax considerations

The portion of E&P comprising cash and other specified assets is taxed at a 15.5% rate, and any remaining amount is taxed at an 8% rate, as discussed in section 4, *One-time transition tax*, above. To determine the aggregate foreign cash position of the US shareholder, cash is measured on the following three dates:

- ▶ Date 1 – The close of the last taxable year beginning before 1 January 2018
- ▶ Date 2 – The close of the last taxable year that ends before 2 November 2017
- ▶ Date 3 – The close of the taxable year preceding Date 2

The aggregate foreign cash position for a US taxpayer is the greater of the foreign cash position determined as of Date 1 or the average of the foreign cash position determined as of Date 2 and Date 3. For example, a company with a 30 September fiscal year end, Dates 1, 2 and 3 would fall on 30 September 2018, 2017 and 2016 respectively.

Because a company with non-calendar year-end CFCs may not be able to determine the aggregate foreign cash position until the CFC completes its 2018 fiscal year, a company needs to consider whether the amounts recognized for its one-time transition tax payable can be completed earlier than that date. Companies applying SAB 118 may need to consider the disclosure requirements until they can complete their analysis of the one-time transition tax payable.

The tax effect of the one-time transition tax should be recognized as a discrete event as of the enactment date (or, if the company is applying SAB 118, in the period when a reasonable estimate can be made) and should not be allocated to subsequent interim periods by adjusting the EAETR.

8.5 Non-calendar year-end entities' interim disclosures

For financial reporting purposes, ASC 740 requires disclosure of the effect of adjustments to deferred tax amounts for enacted changes in tax laws or rates as well as, for interim periods, the effect of the change in the estimated annual effective rate. See section 18.4, *Disclosure of changes in tax laws or rates*, of the FRD on income taxes.

Illustration 10 – Disclosure example for a 30 June year-end company

In the second quarter, the Company revised its estimated annual effective rate to reflect a change in the federal statutory rate from 35% to 21%, resulting from legislation that was enacted on 22 December 2017. The rate change is administratively effective at the beginning of our fiscal year, using a blended rate for the annual period. As a result, the blended statutory tax rate for the year is 28.06%.

In addition, we recognized a tax benefit in our tax provision for the period related to adjusting our deferred tax balance to reflect the new corporate tax rate. As a result, income tax expense reported for the first six months was adjusted to reflect the effects of the change in the tax law and resulted in a decrease in income tax expense of \$400,000 during the second quarter. This amount comprises a reduction of \$100,000 in income tax expense for the six-month period ended 31 December 2017 related to the lower corporate rate and \$300,000 from the application of the newly enacted rates to existing deferred balances.

The accounting for the effects of the rate change on deferred tax balances is complete and no provisional amounts were recorded for this item.

Note: If the company also recorded provisional amounts, additional disclosure would be required by SAB 118. See section 11, *Disclosures*, below for an example disclosure for the period of enactment.

9 SEC guidance on accounting for US tax reform (updated 16 January 2018)

The SEC staff issued SAB 118⁷ to provide guidance for companies that have not completed their accounting for the income tax effects of the Act in the period of enactment. The SEC staff noted that ASC 740 does not address these challenges and said a clarification was needed to address uncertainty or diversity in views about the application of ASC 740 in the period of enactment.



FASB Staff question and answer on whether private companies and not-for-profit entities can apply SAB 118

Question

Given the longstanding practice of private companies electing to apply SABs, would the FASB staff object to private companies and not-for-profit entities applying SAB 118?

Response

Based upon the longstanding practice of private companies electing to apply SABs, the FASB staff would not object to private companies and not-for-profit entities applying SAB 118. If a private company or not-for-profit entity applies SAB 118, they would be in compliance with GAAP.

The FASB staff believes, however, that if a private company or a not-for-profit entity applies SAB 118, it should apply all relevant aspects of the SAB in its entirety. This would include the disclosures listed in SAB 118. The FASB staff also believes that a private company or a not-for-profit entity that applies SAB 118 should disclose its accounting policy of applying SAB 118 in accordance with paragraphs 235-10-50-1 through 50-3 of the Accounting Standards Codification

See Appendix B for the full contents of the FASB Staff Q&A.

Excerpt from SAB 118

Applicability

This staff guidance is only applicable to the application of ASC Topic 740 in connection with the Act and should not be relied upon for purposes of applying ASC Topic 740 to other changes in tax laws.

SAB 118 provides the following guidance:

- ▶ **Accounting for income tax effects is completed** – When reporting the effects of the Act on the enactment date, a company must first reflect in its financial statements the income tax effects of the Act for which the accounting under ASC 740 is complete. These completed amounts will not be provisional amounts.
- ▶ **Accounting for income tax effects is incomplete but the company has a reasonable estimate** – If a company's accounting for certain income tax effects of the Act is incomplete but it can determine a reasonable estimate of those effects, the SEC staff said that it will not object to a company including the reasonable estimate in its financial statements. The staff said it would not be appropriate for a company to exclude a reasonable estimate from its financial statements if one had been determined. The reasonable estimate should

⁷ SAB 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act*.

be included in a company's financial statements in the first reporting period in which a company is able to determine the estimate. The estimate would be reported as a provisional amount in the financial statements⁸ during a "measurement period."⁹ Provisional amounts could include, for example, reasonable estimates that give rise to new current or deferred taxes based on certain provisions of the Act, as well as adjustments to current or deferred taxes that existed prior to the Act's enactment date.

- ▶ **Accounting for income tax effects is incomplete and the company does not have a reasonable estimate** – If a company does not have the necessary information to determine a reasonable estimate to include as a provisional amount, the SEC staff said that it would not expect a company to record provisional amounts in its financial statements for the income tax effects for which a reasonable estimate cannot be determined. In these cases, the SEC staff said a company should continue to apply ASC 740 (e.g., when recognizing and measuring current and deferred taxes) based on the provisions of the tax laws that were in effect immediately prior to enactment. That is, the staff does not believe a company should adjust its current or deferred taxes to account for the income tax effects of the Act until the first reporting period in which a reasonable estimate can be determined.

How Ernst & Young LLP sees it

The Act's one-time transition tax requires companies that have deferred recognizing income taxes on certain foreign earnings and profits earned in prior periods (i.e., asserted indefinite reinvestment) to now pay income taxes on those earnings. If a company previously asserted indefinite reinvestment, Ernst & Young LLP believes the company could continue to follow its existing accounting until it has the necessary information to determine a reasonable estimate for the transition tax.

Excerpt from SAB 118

Question 1: If the accounting for certain income tax effects of the Act is not completed by the time Company A issues its financial statements that include the reporting period in which the Act was enacted, what amounts should Company A include in its financial statements for those income tax effects for which the accounting under ASC Topic 740 is incomplete?

Interpretive Response: To the extent that Company A's accounting for certain income tax effects of the Act is incomplete, but Company A can determine a reasonable estimate for those effects, the staff would not object to Company A including in its financial statements the reasonable estimate that it had determined. Conversely, the staff does not believe it would be appropriate for Company A to exclude a reasonable estimate from its financial statements to the extent a reasonable estimate had been determined. The reasonable estimate should be included in Company A's financial statements in the first reporting period in which Company A was able to determine the reasonable estimate. The reasonable estimate would be reported as a provisional amount in Company A's financial statements during a "measurement period". The measurement period is described in further detail below.

⁸ The SEC staff also said it would not object to a foreign private issuer reporting under IFRS applying a measurement period solely for purposes of completing the accounting requirements for the income tax effects of the Act under International Accounting Standard 12, *Income Taxes*.

⁹ SAB 118 says, "The staff was informed, in part, by the measurement period guidance applied in certain situations when accounting for business combinations under ASC Topic 805, *Business Combinations*. The measurement period guidance in ASC paragraph 805-10-25-13 addresses situations where the initial accounting for a business combination is incomplete upon issuance of the financial statements that include the reporting period the business combination occurred."

The staff believes reporting provisional amounts for certain income tax effects of the Act will address circumstances in which an entity does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting under ASC Topic 740.

An entity may not have the necessary information available, prepared, or analyzed (including computations) for certain income tax effects of the Act in order to determine a reasonable estimate to be included as provisional amounts. The staff would expect no related provisional amounts would be included in an entity's financial statements for those specific income tax effects for which a reasonable estimate cannot be determined. In circumstances in which provisional amounts cannot be prepared, the staff believes an entity should continue to apply ASC Topic 740 (e.g., when recognizing and measuring current and deferred taxes) based on the provisions of the tax laws that were in effect immediately prior to the Act being enacted. That is, the staff does not believe an entity should adjust its current or deferred taxes for those tax effects of the Act until a reasonable estimate can be determined.

Therefore, to summarize the above and for the avoidance of doubt, in Company A's financial statements that include the reporting period in which the Act was enacted, Company A must first reflect the income tax effects of the Act in which the accounting under ASC Topic 740 is complete. These completed amounts would not be provisional amounts. Company A would then also report provisional amounts for those specific income tax effects of the Act for which the accounting under ASC Topic 740 will be incomplete but a reasonable estimate can be determined. For any specific income tax effects of the Act for which a reasonable estimate cannot be determined, Company A would not report provisional amounts and would continue to apply ASC Topic 740 based on the provisions of the tax laws that were in effect immediately prior to the Act being enacted. For those income tax effects for which Company A was not able to determine a reasonable estimate (such that no related provisional amount was reported for the reporting period in which the Act was enacted), Company A would report provisional amounts in the first reporting period in which a reasonable estimate can be determined.

9.1 SAB 118 and subsequent event considerations (updated 16 January 2018)

Questions have come up about whether companies need to update provisional amounts through the date the financial statements are issued or are available to be issued.

How Ernst & Young LLP sees it

While SAB 118 does not address this question, Ernst & Young LLP believes it is appropriate for a company to record provisional amounts based on the information available through the date it closes its books, unless it identifies a significant error. Ernst & Young LLP believes that significant errors need to be corrected in the current period.

Under this approach, any changes to provisional amounts that would result from a company obtaining additional information or analyzing information after it closes its books but before it issues its financial statements or makes them available to be issued would be recorded in the next reporting period. Ernst & Young LLP believes a company that has identified significant unrecorded adjustments between the date it closes its books and the date it issues its financial statements should consider disclosing the pending adjustments.

9.2 Measurement period

The measurement period begins in the reporting period that includes the Act's enactment date and ends when a company has obtained, prepared and analyzed the information needed to complete the accounting requirements under ASC 740. The measurement period should not extend beyond one year from the enactment date (i.e., the measurement period must be

completed by 22 December 2018). During the measurement period, the staff said it expects companies to act in good faith to complete the accounting under ASC 740.

Excerpt from SAB 118

The measurement period begins in the reporting period that includes the Act's enactment date and ends when an entity has obtained, prepared, and analyzed the information that was needed in order to complete the accounting requirements under ASC Topic 740. During the measurement period, the staff expects that entities will be acting in good faith to complete the accounting under ASC Topic 740. The staff believes that in no circumstances should the measurement period extend beyond one year from the enactment date.

A company should carefully evaluate the Act prior to reaching the conclusion that its accounting for the enactment-date effects of the Act is complete. Appendix A includes some of the considerations a company should evaluate, along with questions management should ask itself before reaching the conclusion that its accounting is complete.

9.3 Initial and subsequent reporting of provisional amounts

Any provisional amounts or adjustments to provisional amounts included in a company's financial statements during the measurement period (including the period of enactment) should be included in income from continuing operations as an adjustment to tax expense or benefit in the reporting period the amounts are determined.

During the measurement period, a company may need to reflect adjustments to its provisional amounts if it obtains, prepares or analyzes additional information about facts and circumstances that existed as of the enactment date that, if known, would have affected the income tax effects initially reported as provisional amounts. A company may also need to report additional tax effects during the measurement period that were not initially reported as provisional amounts, if it obtains, prepares or analyzes additional information about facts and circumstances that existed as of the enactment date. While SAB 118 allows a company to make changes to provisional amounts during the measurement period, a company may still need to evaluate whether those changes result from obtaining additional information about the facts that existed on the enactment date or are a result of errors. This evaluation should be made based on the guidance in ASC 250.¹⁰

As discussed throughout this publication, several of the provisions of the Act could affect a company's DTA realizability assessment. A company should disclose that its valuation allowance is provisional until the accounting for all provisions that could affect the conclusion is complete.

Any income tax effects of events unrelated to the Act should not be reported as measurement period adjustments. Hence, companies will need to make sure they have procedures in place to distinguish between changes to provisional amounts that are related to the Act and transactions entered into after the enactment date. For example, a company may enter into a business combination after the enactment date. The tax accounting consequences of the business combination, including the effects on a company's pre-business combination tax attributes (e.g., realizability of deferred tax assets) will need to be considered separately from any changes in provisional amounts related to the accounting for the tax consequences of the Act.

SAB 118 does not address the accounting effects of the Act in interim periods.

¹⁰ ASC 250, *Accounting changes and error corrections*.

How Ernst & Young LLP sees it

- ▶ Ernst & Young LLP believes that, if a company is unable to estimate the effects of certain aspects of the Act on its estimated annual effective rate, the company should make disclosures describing what part of the Act the company did not consider in calculating its estimated annual effective tax rate. Because companies can make reasonable estimates or adjust those estimates, the effect of those changes should be included in the first interim period that those estimates can be made (or can be adjusted) as an adjustment to the estimated annual effective tax rate.
- ▶ Ernst & Young LLP also believes the effects of initially recording provisional amounts related to the enactment date of the Act and making adjustments to those amounts, if significant, should be recognized as a discrete event similar to the accounting for tax law changes in the period of enactment. Accordingly, companies should not allocate the effect of changes in the enactment-date provisional amounts to subsequent interim periods by adjusting the EAETR.

Excerpt from SAB 118

Changes in subsequent reporting periods

During the measurement period, an entity may need to reflect adjustments to its provisional amounts upon obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the enactment date that, if known, would have affected the income tax effects initially reported as provisional amounts. Further, an entity may also need to report additional tax effects during the measurement period, based on obtaining, preparing, or analyzing additional information about facts and circumstances that existed as of the enactment date that was not initially reported as provisional amounts. Any income tax effects of events unrelated to the Act should not be reported as measurement period adjustments.

Reporting

Any provisional amounts or adjustments to provisional amounts included in an entity's financial statements during the measurement period should be included in income from continuing operations as an adjustment to tax expense or benefit in the reporting period the amounts are determined.

SAB 118 does not specify how a company should determine whether it can make a reasonable estimate. A company will need to determine whether a reasonable estimate can be made based on its facts and circumstances. This includes the availability of records to complete the necessary calculations, technical analysis of the new tax law and finalization of its accounting analysis, including its assessment of how certain provisions of the Act may affect its outside basis differences related to foreign subsidiaries.

To help companies with their accounting during the measurement period, SAB 118 provides the following examples. Each example assumes the company has only one foreign subsidiary. A company that has more than one foreign subsidiary may reach different conclusions for each subsidiary, depending on the facts and circumstances, including the availability of information necessary to complete the analysis.

Excerpt from SAB 118

Example 1 – Analysis is incomplete and company cannot reasonably estimate provisional amounts

Prior to the reporting period in which the Act was enacted, Company X did not recognize a deferred tax liability related to unremitted foreign earnings because it overcame the presumption of the repatriation of foreign earnings.¹¹

Upon enactment, the Act imposes a tax on certain foreign earnings and profits at various tax rates. Based on Company X's facts and circumstances, it was not able to determine a reasonable estimate of the tax liability for this item for the reporting period in which the Act was enacted by the time that it issues its financial statements for that reporting period; that is, Company X did not have the necessary information available, prepared, or analyzed to develop a reasonable estimate of the tax liability for this item (or evaluate how the Act will impact Company X's existing accounting position to indefinitely reinvest unremitted foreign earnings).

As a result, Company X would not include a provisional amount for this item in its financial statements that include the reporting period in which the Act was enacted, but would do so in its financial statements issued for subsequent reporting periods that fall within the measurement period, beginning with the first reporting period falling within the measurement period by which the necessary information became available, prepared, or analyzed in order to develop the reasonable estimate, and ending with the first reporting period within the measurement period in which Company X was able to obtain, prepare, and analyze the necessary information to complete the accounting under ASC 740.

Excerpt from SAB 118

Example 1a – Analysis is incomplete and company can reasonably estimate provisional amounts

Assume a similar fact pattern as Example 1; however, Company Y was able to determine a reasonable estimate of the income tax effects of the Act on its unremitted foreign earnings for the reporting period in which the Act was enacted.

Company Y, therefore, reported a provisional amount for the income tax effects related to its unremitted foreign earnings in its financial statements that included the reporting period the Act was enacted. In a subsequent reporting period within the measurement period, Company Y was able to obtain, prepare and analyze the necessary information to complete the accounting under ASC 740, which resulted in an adjustment to Company Y's initial provisional amount to recognize its tax liability.

Excerpt from SAB 118

Example 2 – Analysis is incomplete and company may need to recognize a valuation allowance

Company Z has deferred tax assets (assume Company Z was able to comply with ASC Topic 740 and re-measure its deferred tax assets based on the Act's new tax rates) for which a valuation allowance may need to be recognized (or released) based on application of certain provisions in the Act.

If Company Z determines that a reasonable estimate cannot be made for the reporting period [in which] the Act was enacted, no amount for the recognition (or release) of a valuation allowance would be reported.

¹¹ ASC 740-30-25-17.

In the next reporting period (following the reporting period in which the Act was enacted), Company Z was able to obtain, prepare and analyze the necessary information in order to determine that no valuation allowance needed to be recognized (or released) in order to complete the accounting under ASC 740.

Ernst & Young LLP developed the following example of another situation that might arise.

Illustration 11 – Analysis is incomplete and company can reasonably estimate provisional amounts related to the one-time transition tax but cannot reasonably estimate tax effects of remaining outside basis difference

Facts

Assume a similar fact pattern to Example 1, but assume that Company W was able to determine a reasonable estimate of the income tax effects of the Act on its unremitted foreign earnings for the reporting period in which the Act was enacted as it relates to the one-time transition tax (i.e., the tax due based on accumulated earnings and after 1986).

Company W did not have the necessary information available, prepared or analyzed to develop a reasonable estimate of the tax liability, if any, for its remaining outside basis difference as well as any other current or deferred tax accounting that may be required for foreign earnings subject to the transition tax. In addition, remaining outside basis differences may have deferred tax consequences due to other provisions in the Act.

Analysis

Company W reported a provisional amount for the income tax effects of the one-time transition tax in its financial statements that included the reporting period the Act was enacted. In a subsequent reporting period within the measurement period, Company W was able to obtain, prepare and analyze the necessary information to complete the accounting under ASC 740 for the one-time transition tax, and Company W adjusted the provisional amount it had previously reported to recognize its tax liability.

Company W was not able to determine a reasonable estimate of the tax liability, if any, under the Act for its remaining outside basis difference (or evaluate how the Act will affect Company W's existing accounting position to indefinitely reinvest unremitted foreign earnings) by the time it issued its financial statements for the reporting period in which the Act was enacted. As a result, Company W would not include a provisional amount for this item in its financial statements for the reporting period in which the Act was enacted, but would do so in its financial statements issued for subsequent reporting periods that fall within the measurement period, beginning with the first reporting period in the measurement period in which the necessary information became available, prepared or analyzed so Company W could develop the reasonable estimate, and ending with the first reporting period in the measurement period in which Company W was able to obtain, prepare and analyze the necessary information to complete the accounting under ASC 740.

9.4 Investment companies affected by the Act

The SEC's Division of Investment Management issued guidance in IM Information Update 2017-07 in which the SEC staff confirmed that investment companies can rely on SAB 118 for purposes of calculating their net asset value (NAV) and reporting measurement period adjustments. The SEC staff also reminded investment companies to make disclosures, where applicable, about any material effects of the Act on their NAV calculations and information about material provisions for which the accounting is incomplete. Such disclosures could be made in a press release, on a website or in another reasonable manner.

10 Other effects

10.1 Investments in qualified affordable housing projects accounted for using the proportional amortization method

Investors in qualified affordable housing projects that meet certain conditions can elect to use the proportional amortization method to account for their investment. In applying the proportional amortization method, an investor amortizes the cost of its investment in proportion to the tax credits and other tax benefits it receives and presents the amortization as a component of income tax expense. Investors in these projects receive tax benefits in the form of tax deductions from operating losses and low-income housing tax credits over a 10-year period.

Under the proportional amortization method, an investment shall be tested for impairment when events or changes in circumstances indicate that it is more likely than not that the carrying amount of the investment will not be realized. An impairment loss is measured as the amount by which the carrying amount of the investment exceeds its fair value. While ASC 323-740 does not address how an impairment loss should be presented, Ernst & Young LLP believes that it should be included as a component of income tax expense from continuing operations. Previously recognized impairment losses cannot be reversed.

Although the Act does not change existing tax law for low-income housing tax credits, investors in these projects will need to consider the effects of the reduction in the corporate tax rate to 21% from 35% when applying the proportional amortization method. Companies should first consider whether it is more likely than not that the carrying amount of the investment will not be realized. If events or changes in circumstances indicate that it is more likely than not that the carrying amount of the investment will not be realized, an impairment would be recorded. If a company concludes that the investment is not impaired, it should revise its proportional amortization schedule to reflect the revised expected future tax benefits from the remaining tax credits and the lower corporate tax rate. The reduction in the corporate rate will likely reduce the expected tax benefits during the remaining investment period.

How Ernst & Young LLP sees it

ASC 323-740-35 does not provide guidance on how to account for the effects of a change in a tax rate during the investment period when the investment is not impaired. Ernst & Young LLP believes one acceptable approach is to record a “cumulative catch-up” adjustment to the proportional amortization balance so that it reflects the remaining tax benefits at the new rate. Consistent with the guidance in ASC 323-740-45-2, the catch-up charge should be recognized in the income statement as a component of income tax expense from continuing operations. There may be other acceptable ways to account for the effects of a tax rate change.

10.2 Tax effects of intercompany asset transfers prior to the enactment of the Act

Transactions may occur among entities that are part of a consolidated reporting entity. In accordance with ASC 810-10-45-1, intercompany balances and transactions are eliminated in the preparation of the consolidated financial statements. However, income tax consequences may result from intra-entity transactions. Companies may have entered into intra-entity transfers of assets prior to the Act’s enactment date and deferred the taxes paid or accrued on the intra-entity profit that is eliminated in consolidation in accordance with ASC 810-10-45-8. Prepaid (accrued) taxes arising from intercompany transactions are different from deferred taxes under ASC 740. Since prepaid (accrued) taxes on intercompany transactions are attributable to taxes paid (incurred) on prior transactions, the reversal of those amounts will generally not be subject to the new tax laws or rates and, therefore, are generally not subject to remeasurement due to a change in tax rate or law.

A company with a non-calendar year end will need to consider the Act's new corporate tax rates by applying a blended tax rate retroactively to the beginning of its 2018 fiscal year (see section 8, *Special considerations for non-calendar year-end companies*). These companies will need to consider the effects of using a blended tax rate and adjust the related prepaid or accrued income taxes from intercompany transfers arising in fiscal 2018 in the reporting period that includes the enactment date.

In 2016, the FASB issued ASU 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*. ASU 2016-16 requires companies to recognize the income tax effects of intra-entity transfers of assets, other than inventory, in the period the sale or transfer occurs. Unless a company early adopted the ASU, the ASU is effective for annual periods beginning after 15 December 2017 for PBEs and one year later for all other entities. Companies that have not yet adopted the ASU prior to the Act's enactment date first need to account for the tax effects of the Act prior to considering the tax consequences of ASU 2016-16 on their deferred tax balances.

10.3 Leveraged leases

For companies with existing leveraged leases, the Act may require the recognition of an additional adjustment in the reporting period that includes 22 December 2017. Income tax rates are an important assumption in determining the rate of return on a leveraged lease. If tax rates change, all components of a leveraged lease must be recalculated from inception of the lease. That is, lessors must recalculate the allocation of income on the leveraged lease based on after-tax cash flows as revised for the change in tax rates.

If a lessor considered the effects of the AMT in its assumptions, it must also consider the effects of AMT being repealed. The difference between the amounts originally recorded and the recalculated amount would be included as a cumulative catch-up in pretax income. Additionally, if the effect of the change in tax rates results in a significant variation from the customary relationship between income tax expense and pretax accounting income and the reason for that variation is not otherwise apparent, the reason for that variation should be disclosed.

10.4 Business combinations (updated 18 January 2018)

10.4.1 Acquisitions before the enactment date

New information about the facts and circumstances that existed at the acquisition date for tax positions acquired in or that arose from a business combination may result in an adjustment to goodwill during the business combination measurement period. However, a change in tax rate after the business combination occurred would not result in a business combination measurement period adjustment. That is, a change in income tax position attributable to a change in tax law, including the remeasurement of deferred tax balances or a change in the assessment of realizability of acquired deferred tax assets, should be recognized in income tax expense attributable to continuing operations.

Questions have arisen about how to account for the tax effects of changes to a company's preliminary purchase accounting made during the ASC 805 measurement period but after the enactment date. Ernst & Young LLP believes that ASC 805 measurement period adjustments should consider the tax effects based on the law in place at the acquisition date. That is, the deferred tax effects from ASC 805 measurement period adjustments would first be measured using the tax rate as of the acquisition date (e.g., 35%). A second adjustment would be recorded to adjust those deferred tax balances to the new tax rate under the Act (e.g., 21%). The second adjustment would be recorded as a component of income tax expense attributable to continuing operations.

Illustration 12 – Accounting for a business combination that occurred before the enactment date

Assume that a company entered into a business combination on 1 September 2017. At that date, the company did not finalize its accounting for intangible assets and expects to finalize its accounting during the ASC 805 measurement period. On the date of the acquisition, the company recorded a provisional amount of \$1 million for the fair value of its intangible assets. Assume that the tax basis is zero. At the date of the acquisition, the company would have recorded a \$350,000 deferred tax liability for the book and tax basis difference, with an offsetting adjustment to goodwill (based on the tax law in effect on that date).

The company records the following journal entries on 1 September 2017 to recognize the intangible asset and related tax effects:

Dr. Intangible assets	1,000,000	
Cr. Goodwill		1,000,000
Dr. Goodwill	350,000	
Cr. Deferred tax liabilities		350,000

On 22 December 2017, the new tax law was enacted and it reduced the tax rate to 21%. The company reduces the deferred tax liability associated with the acquired intangible asset by \$140,000, with the offsetting adjustment to income tax expense.

The company records the following journal entry on 22 December 2017:

Dr. Deferred tax liabilities	140,000	
Cr. Income tax expense		140,000

On 1 May 2018, the company finalizes its accounting under ASC 805 for the intangible assets and increases the business combination provisional amount by \$100,000. The company records the following entries to record the ASC 805 measurement period adjustment and related deferred tax effects based on the tax law that was in place at the acquisition date:

Dr. Intangible assets	100,000	
Cr. Goodwill		100,000
Dr. Goodwill	35,000	
Cr. Deferred tax liabilities		35,000

Also on 1 May 2018, the company would adjust the deferred tax liability to reflect the effects of the new tax rate on the final adjustment:

Dr. Deferred tax liability	14,000	
Cr. Income tax expense		14,000

10.4.2 Acquisitions after the enactment date

If a business combination occurs after the enactment date, the acquirer may recognize provisional amounts associated with income tax assets and liabilities in accordance with ASC 805-740. These amounts may include an estimate for the effects of the new tax law. Ernst & Young LLP believes that changes to provisional amounts resulting from new information about the facts and circumstances that existed at the acquisition date, including additional information about estimates related to the new tax law, should be recognized as measurement period adjustments under ASC 805 rather than under SAB 118.

10.5 Goodwill impairment testing (updated 18 January 2018)

Many companies performed their annual goodwill impairment testing on a date prior to the enactment date that fell within the reporting period that includes the enactment date (e.g., a 1 October 2017 annual goodwill impairment assessment date for a calendar year-end company). Questions have arisen about whether the effect of US tax reform should be considered in performing annual goodwill impairment testing during the quarter that includes the enactment date when the annual goodwill impairment testing date precedes the enactment date.

The annual goodwill impairment test, including the determination of fair value, should be based on the facts and circumstances that existed as of the annual assessment date and should consider market participant assumptions at that date. If the annual goodwill assessment date occurred prior to the 22 December 2017 date of enactment, the fair value analysis would include market participant assumptions related to income taxes that existed as of that date. The valuation would consider the uncertainty that existed on the annual testing date about whether tax reform would be enacted and should not factor in the hindsight of ultimate enactment.

When an event occurs or circumstances change between annual tests that indicate it is more likely than not that the fair value of a reporting unit is below its carrying amount, companies are required to perform an interim goodwill impairment test. Ernst & Young LLP believes the enactment of the new tax law is an event that companies should consider when determining whether an interim goodwill impairment test is necessary (i.e., it may be an impairment indicator). Companies should evaluate the effects of the Act on the carrying amount and fair value of a reporting unit to determine whether it is more likely than not that the fair value of a reporting unit is below its carrying amount. For example, the carrying amount of a reporting unit may change when a company remeasures its deferred tax assets and liabilities under the Act. Similarly, the fair value of a reporting unit may change, depending on whether the assumptions used to measure fair value change as a result of the Act. Judgment will be required to determine whether an interim goodwill impairment test should be performed.

10.6 After-tax hedging of foreign currency risk (updated 31 January 2018)

Companies that designate hedges of foreign currency risk on an after-tax basis will need to consider whether the Act affects the hedging arrangement. For example, for companies that assert indefinite reinvestment of a net investment in a foreign subsidiary under ASC 740 and enter into net investment hedges, it is common to designate the hedging instrument on an after-tax basis in order to compensate for the nontaxable nature of the translation gain or loss that results from the net investment.

In these situations, companies will need to consider how the change in tax rates will affect the hedging relationship, including whether the hedge remains highly effective or whether any ineffectiveness after the enactment date needs to be recorded in earnings if the company has not yet adopted ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*.

Ernst & Young LLP understands that the SEC staff would not object to a registrant concluding that the enactment of the Act on 22 December 2017 does not cause these hedging relationships to no longer be highly effective in the period of enactment. However, Ernst & Young LLP also understands that the SEC staff would expect registrants that did not yet adopt ASU 2017-12 to recognize in earnings any material ineffectiveness related to these hedging relationships that resulted from the Act for the period from 22 December 2017 to 31 December 2017. Ernst & Young LLP also understands that the SEC staff would not expect registrants to apply these views to reporting periods after the one that includes the enactment date or to hedging relationships designated or redesignated on or after 22 December 2017.

Given that the provisions in the Act can affect both the amount of a foreign net investment eligible to be hedged and the tax-effected gains and losses on the hedging instrument, companies should assess their original hedging relationships to determine whether to dedesignate and redesignate new hedging relationships in the first assessment period after the enactment date. Companies need to consider not only the reduction in US corporate income tax rates but how the BEAT and GILTI provisions of the Act may affect their effective tax rates when redesignating or entering into new net investment hedges. The shift to a territorial tax system may also affect a company's ongoing use of after-tax hedging strategies.

10.7 Annual pension and other postretirement benefit plans

Companies that have defined pension and other postretirement benefit plans need to consider the effects of the new corporate tax rates on deferred tax balances related to these plans. Companies that are performing their annual measurement of pension and other postretirement benefits as of 31 December 2017 should first calculate the tax effect of enactment on their pension and postretirement benefit deferred tax balances on the enactment date. The tax effect of a remeasurement of existing deferred taxes should be recorded in income tax expense.

The tax effect of a change in the benefit obligation resulting from a company's annual remeasurement or any remeasurement performed after the enactment date that is recorded in OCI would also be recorded in OCI (using the new 21% rate). If the change in benefit obligation resulting from a remeasurement is recorded in income, the tax effect would also be recorded in income.

10.8 Share-based payments (updated 16 January 2018)

10.8.1 Accounting considerations for withholding taxes

The IRS requires employers to withhold and remit tax on income generated when an employee exercises a nonqualified stock option or when stock awards vest. Companies often repurchase shares equal in value to the tax owed and remit the cash on behalf of the employee to satisfy the tax withholding requirements. ASU 2016-09,¹² which was effective for PBEs for fiscal years beginning after 15 December 2016, amended ASC 718 to allow entities to withhold up to the maximum statutory tax rate in the employee's jurisdiction, instead of the minimum tax rate required by the IRS, without causing liability classification of the award.

Because the Act reduces the maximum federal statutory tax rate to 37% from 39.6% and the minimum federal statutory rate to 22% from 25%, companies should reduce the applicable tax withholding rates to continue to avoid liability classification for the related awards. Companies should verify that they are withholding amounts in accordance with the 2018 IRS income tax withholding tables that were issued on 11 January 2018, regardless of whether they outsource their payroll and related tax responsibilities to third-party service providers or perform these processes in-house.

10.8.2 Accounting considerations for performance conditions based on after-tax metrics

Companies that have issued awards with performance conditions based on after-tax metrics (e.g., earnings per share, net income) should consider the effect of the Act on the probability that the performance condition will be met. For example, vesting in an award with a performance condition may have been assessed as improbable prior to the enactment of the Act. However, as a result of the reduced corporate income tax rate, the vesting may be probable. The effect of the change in estimate of an award's probability of vesting should be accounted for in the period of change by recording a cumulative catch-up adjustment to compensation cost to retroactively apply the new estimate.

¹² ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*.

Companies may modify the terms and conditions of awards with performance conditions based on after-tax metrics to remove the effects of the Act, as they often do for unanticipated events. Companies that make this type of change will apply the modification accounting guidance in ASC 718-20 for adjustments to awards resulting from the application of the Act.

See section 5.2.6, *Broker-assisted cashless exercises and statutory withholding requirements*, section 4.4.2.3, *Changes in estimate of the probability of achievement of the performance condition*, and section 8.4, *Modifications of vesting conditions*, in the FRD publication, *Share-based payment*, for more guidance on these topics.

10.9 Non pro-rata profit and loss allocations among investors (updated 8 February 2018)

Investees or subsidiaries may have contractual profit-sharing arrangements that allocate earnings or losses among the investors (e.g., an equity method investor) in amounts that differ from the investors' pro-rata ownership interests. When these arrangements are substantive, the profit-sharing provisions should be used to allocate earnings and losses to investors.

One approach applied in practice to account for substantive profit-sharing arrangements is the hypothetical-liquidation-at-book-value (HLBV) method. The use of this approach is appropriate when the terms of the substantive profit-sharing arrangement are consistent with the HLBV calculation. See section 6.7, *Equity method investments and joint ventures*, of the FRD publication, and section 16.1.1, *Consolidation*, of the FRD for more guidance on assessing whether a profit-sharing arrangement is substantive and the HLBV method.

The substantive profit-sharing arrangement may refer to a target internal rate of return (IRR) or preferential return to allocate earnings or losses. If the IRR or preferential return is stated on an after-tax basis, generally the terms of the arrangement will specify the tax rate to be applied. When determining equity method income or losses, or allocating income or losses to the non-controlling interest, it is important to obtain an understanding of the terms and conditions of the specific arrangement.

When the terms of the arrangement refer to the tax rate in effect when the benefits are delivered, Ernst & Young LLP believes the tax rate in effect at the date HLBV is applied should be used. For example, an investor that applies HLBV to a calendar year-end investee to determine its share of the investee's earnings or losses for the period ending 31 December 2017 would use the tax rate in effect on that date because the investor would assume the investee was liquidated on that date (rather than the rate in effect as of 1 January 2018). If the terms of the arrangement require a fixed tax rate to be used (e.g., 35%), the fixed tax rate would be used in an investor's application of HLBV to determine its share of an investee's earnings or losses.

A company that uses HLBV to allocate profits and losses of a subsidiary to a noncontrolling interest or to measure its equity method earnings in an investee may be required by the agreement to use the new tax rate in the HLBV calculation covering the periods in which the new rate is effective (i.e., 1 January 2018). If using the new corporate tax rate is expected to materially change the allocation as compared to prior periods and could change the company's results in the future, it should consider disclosing the nature of the event and an estimate of its financial effect, or disclose that such an estimate cannot be made, in accordance with ASC 855.¹³

¹³ ASC 855, *Subsequent Events*.

10.10 Fair value measurements (updated 16 January 2018)

The Act may have immediate and long-term implications for valuations of businesses, equity interests and other assets and liabilities (e.g., intangible assets). Companies should review their fair value estimates and consider whether and, if so, how the Act has affected a market participant's view of fair value.

The implications may go beyond the change in the assumed tax rate. Changes in the calculation of taxable income, which may be affected by the industry and location of a company's operations, should also be considered. For this reason, companies that use an income approach will need to carefully model and appropriately support the changes in taxable income due to the Act. It might also be appropriate for a company to use a market approach, such as using a market multiple based on public company stock prices for comparable companies (e.g., a price to earnings ratio), because these prices should reflect a market participant view of fair value as of the measurement date. While the tax rate for most companies is expected to drop, how a company is affected will depend on its facts and circumstances.

Companies should make a good faith effort to estimate fair value based on the market participant view using available information that is known or knowable to a market participant as of the measurement date. The overall objective of a fair value measurement is to reflect the price a market participant would pay for the asset or receive to assume the liability on the measurement date, assuming customary and normal due diligence. As such, it is possible that the market participant assumptions will evolve in subsequent periods when the market has had more time to fully assess the effects of the Act.

10.11 Equity method impairment considerations (updated 18 January 2018)

An equity method investor should evaluate whether the effects of tax reform indicate that its investment is impaired in accordance with ASC 323-10-35-31 through 35-32A. Investors should evaluate whether the effects of tax reform have reduced the fair value of its investment below its carrying amount. The determination of fair value should consider all facts and circumstances at the measurement date, including market participants' assumptions about enacted tax rates and other effects of tax reform. If the fair value is less than the carrying amount of the equity method investment, the investor evaluates whether the impairment is other than temporary. An investor's determination of whether any indicated impairment is other than temporary will depend on the facts and circumstances. See section 6.8 of the FRD on equity method investments and joint ventures for guidance on assessing other-than-temporary impairment of an equity method investment.

10.12 Treasury regulations (updated 8 February 2018)

Ernst & Young LLP expects the US Treasury Department and the IRS to issue notices and regulations clarifying provisions of the Act. When a company is applying the provisions of SAB 118, they will likely only finalize the recognition of the effects of specific aspects of the Act when they are able to apply a reasonable interpretation of the law. Adjustments to provisional amounts will occur during the measurement period as a company gains a better understanding of how the law operates, and, in some cases, that clarification may come through the issuance of tax notices or regulations. However, adjustments identified due to clarifications of tax law from notices or regulations issued after the measurement period ends or when a company has completed its enactment date accounting for the related provisions of the Act would be evaluated under the guidance for accounting for uncertainty in income taxes in ASC 740 or a change in tax law depending on the type of regulation that is issued. In other words, once the accounting is final, a company will no longer be able to adjust its provisional amounts and will need to evaluate the effects of any Treasury Department actions on its existing tax positions. Companies should continue to monitor regulatory developments.

10.12.1 *US Treasury Department and IRS notices*

The US Treasury Department and the IRS have begun issuing tax guidance on some of the provisions enacted on 22 December 2017, including Notice 2018-07 (29 December 2017) and Notice 2018-13 (19 January 2018), which provide additional guidance on computing the transition tax under the Act.

Notice 2018-07 clarifies the tax treatment of distributions made during the inclusion year as well as how to apply the rules when foreign corporations do not have tax years that conform with those of the US shareholder. It further describes how future regulations will adjust post-1986 E&P to account for amounts paid between foreign corporations during the period between 2 November 2017 and 31 December 2017 (the E&P measurement dates) to avoid double counting of E&P. It also provides that any foreign exchange gain or loss recognized in the future from the distribution of amounts subject to the mandatory inclusion will be subject to the lower effective tax rate (i.e., 15.5% or 8%).

Both notices clarify the definition of cash for purposes of measuring amounts of E&P deemed to be cash, and Notice 2018-13 indicates the appropriate foreign exchange rates to use when translating E&P and cash amounts on the measurement dates. While the notices provide guidance related to other aspects of the transition tax, neither notice addresses whether a taxpayer can elect not to use losses generated in the inclusion year to offset the mandatory E&P inclusion.

If a notice or regulation is released after the date a company closed its books but before its financial statements are issued, Ernst & Young LLP does not believe a company that has accounted for the related provisions of the Act as provisional under SAB 118 would be required to adjust the provisional amounts in its current financial statements. However, a company should consider disclosing the effect of significant adjustments related to any guidance issued but not yet reflected in the company's financial statements. See section 9.1, *SAB 118 and subsequent event considerations*, above.

10.13 **Other considerations**

Companies also need to consider:

- ▶ The effect of the tax law change on previously recorded federal, state and foreign unrecognized tax benefits and assessment of uncertain tax positions as well as related recognition, measurement and disclosure requirements
- ▶ Any effects related to existing deferred state tax amounts
- ▶ Assessment of any deferred tax assets for realizability
- ▶ The potential effect on other accounting assumptions that incorporate a company's US tax rate

11 Disclosures (updated 8 February 2018)

ASC 740 requires companies to disclose the effect of adjustments to deferred tax amounts for enacted changes in tax laws or rates. Companies also need to carefully consider how other aspects of the Act, such as the one-time transition tax, may affect each of the income tax disclosures required under ASC 740. Companies also need to consider whether their accounting policy to account for the effects of the GILTI provisions of the Act is significant and disclose it if it is. ASC 235¹⁴ requires entities to disclose accounting policies that materially affect the determination of their financial position, cash flows or results of operations.

In addition to the disclosures required by ASC 740, SAB 118 requires companies to disclose information about the material financial reporting effects of the Act for which the accounting under ASC 740 is incomplete, including:

- ▶ Qualitative information about the income tax effects of the Act for which the accounting is incomplete
- ▶ The items reported as provisional amounts
- ▶ Existing current or deferred tax amounts for which the income tax effects of the Act have not been completed
- ▶ The reason the initial accounting is incomplete
- ▶ The additional information that needs to be obtained, prepared or analyzed to complete the accounting requirements under ASC 740
- ▶ The nature and amount of any measurement period adjustments recognized during the reporting period

SAB 118 also requires companies to disclose the following information about material financial reporting effects of the Act, which companies will likely disclose in financial reporting periods after the period in which the Act was enacted:

- ▶ The effect of measurement period adjustments on the effective tax rate
- ▶ Disclosures of when the accounting for the income tax effects of the Act has been completed

The following illustration highlights disclosure that the enactment date accounting is incomplete for certain items at the financial statement reporting date. The actual disclosure a company will need to make may be different from this illustration depending on the specific items for which a company's enactment date accounting is incomplete. See Appendix A for additional items a company may need to consider when evaluating the disclosures required by SAB 118.

Illustration 13 – Disclosures a calendar year-end company might make in the period of enactment about incomplete accounting

A calendar year-end company that has not yet completed its accounting might make the following disclosures in the notes to its financial statements for the period ended 31 December 2017.

¹⁴ ASC 235-10-50-3, *Notes to Financial Statements – Disclosure – What to Disclose*.

This is a simple example that addresses only federal income tax effects and does not reflect other disclosures required by ASC 740. Depending on its facts and circumstances, a company will need to provide more information. Disclosures should be sufficiently detailed for a reader to understand the status of a company's accounting for the tax effects of the Act (i.e., effects for which the accounting is complete, effects for which the accounting is incomplete but a reasonable estimate can be made, and effects for which the accounting is incomplete and no provisional amounts have been recorded) and the additional information needed to complete the accounting under ASC 740. In many cases, a company's calculation will be subject to further refinement as additional analysis is completed and as the company gains a more thorough understanding of the tax law, and this possibility should be disclosed.

Example disclosure:

The Tax Cuts and Jobs Act was enacted on 22 December 2017. The Act reduces the US federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. At 31 December 2017, we have not completed our accounting for the tax effects of enactment of the Act; however, in certain cases, as described below, we have made a reasonable estimate of the effects on our existing deferred tax balances and the one-time transition tax. In other cases, we have not been able to make a reasonable estimate and continue to account for those items based on our existing accounting under ASC 740, *Income Taxes*, and the provisions of the tax laws that were in effect immediately prior to enactment. For the items for which we were able to determine a reasonable estimate, we recognized a provisional amount of \$XXXX, which is included as a component of income tax expense from continuing operations. In all cases, we will continue to make and refine our calculations as additional analysis is completed. In addition, our estimates may also be affected as we gain a more thorough understanding of the tax law.

Provisional amounts

Deferred tax assets and liabilities: We remeasured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%. However, we are still analyzing certain aspects of the Act and refining our calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. The provisional amount recorded related to the remeasurement of our deferred tax balance was \$XXX.

Foreign tax effects

One-time transition tax: The one-time transition tax is based on our total post-1986 earnings and profits (E&P) that we previously deferred from US income taxes. We recorded a provisional amount for our one-time transition tax liability for XX of our foreign subsidiaries, resulting in an increase in income tax expense of \$XXX. We have not yet completed our calculation of the total post-1986 E&P for these foreign subsidiaries. Further, the transition tax is based in part on the amount of those earnings held in cash and other specified assets. This amount may change when we finalize the calculation of post-1986 foreign E&P previously deferred from US federal taxation and finalize the amounts held in cash or other specified assets. No additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax, or any additional outside basis difference inherent in these entities, as these amounts continue to be indefinitely reinvested in foreign operations. Determining the amount of unrecognized deferred tax liability related to any remaining undistributed foreign earnings not subject to the transition tax and additional outside basis difference in these entities (i.e., basis difference in excess of that subject to the one-time transition tax) is not practicable, but the related cumulative temporary difference as of 31 December 2017 was \$XX.

We have not made sufficient progress on the E&P analysis for the remaining XX of our foreign subsidiaries to reasonably estimate the effects of the one-time transition tax and, therefore, have not recorded provisional amounts. We continued to apply ASC 740 based on the provisions of the tax laws that were in effect immediately prior to the Act being enacted. Because we had previously determined these amounts were indefinitely reinvested, no deferred taxes have been recorded. It is impracticable to determine unrecognized deferred tax liabilities related to these entities, but the cumulative temporary difference as of 31 December 2017 was \$XX.

Global intangible low-taxed income:

A company that has not determined its GILTI accounting policy

The Act subjects a US shareholder to tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740, No. 5, *Accounting for Global Intangible Low-Taxed Income*, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred. Given the complexity of the GILTI provisions, we are still evaluating the effects of the GILTI provisions and have not yet determined our accounting policy. At 31 December 2017, because we are still evaluating the GILTI provisions and our analysis of future taxable income that is subject to GILTI, we are unable to make a reasonable estimate and have not reflected any adjustments related to GILTI in our financial statements.

A company that has determined its GILTI accounting policy and recorded a material deferred tax liability

The Act subjects a US shareholder to current tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740, No. 5, *Accounting for Global Intangible Low-Taxed Income*, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred. We have elected to recognize deferred taxes for temporary differences expected to reverse as GILTI in future years. However, given the complexity of the GILTI provisions, we have not finalized our analysis of GILTI. We were able to make a reasonable estimate of the deferred taxes on the temporary differences expected to reverse in the future and provided a provisional deferred tax liability of \$XXX at 31 December 2017.

Disclosure of the methodology used for measuring deferred taxes associated with GILTI:

The provisional amount is based on the evaluation of certain temporary differences inside each of our foreign subsidiaries that are expected to reverse as GILTI. However, as we continue to evaluate the Act's GILTI provisions during the measurement period, we may revise the methodology used for determining the deferred tax liability associated with GILTI.

Or

The provisional amount is based on the evaluation of the outside basis difference of our foreign subsidiaries that are expected to reverse as GILTI. However, as we continue to evaluate the Act's GILTI provisions during the measurement period, we may revise the methodology used for determining the deferred tax liability associated with GILTI.

A company that has determined that its accounting policy will be to record GILTI in the period the tax is incurred

The Act subjects a US shareholder to current tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740 No. 5, *Accounting for Global Intangible Low-Taxed Income*, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred. We have elected to recognize the tax on GILTI as a period expense in the period the tax is incurred.

11.1 Additional SEC disclosure considerations (updated 18 January 2018)

When the effects of the tax law changes are or will be material to a registrant, the registrant should consider the disclosure implications in preparing its management's discussion and analysis (MD&A) under Item 303 of Regulation S-K, including its discussion of results of operations and liquidity and capital resources.

The remeasurement of deferred tax assets and liabilities, recording the one-time transition tax and any reassessment of the realizability of deferred tax assets may have a material effect on many registrants' tax provisions.

In addition, the Act will likely result in changes to a registrant's effective tax rates in future periods. When disclosing results of operations, registrants should disclose and explain the effect of the new tax law on the 2017 tax provision as well as the expected effects on the effective tax rate in future years.

Registrants' MD&A must consider any material liquidity implications of paying the required one-time transition tax. Registrants should also include their one-time transition tax liability in the table of contractual obligations based on the estimated installments and describe any related uncertainties.

The SEC staff has historically requested that registrants disclose the amount of cash held overseas that is unavailable for use domestically if the registrant has asserted it will indefinitely reinvest foreign earnings. Registrants may revisit their permanently reinvested assertions about foreign earnings in light of the tax law changes and should update liquidity and capital resources disclosures in MD&A, taking into account the additional funds that would be available to meet the needs of domestic operations net of transition tax payments.

Additionally, the SEC expects registrants to tell investors in MD&A about critical accounting policies, which are the most important methods, assumptions and estimates underlying the financial statements and those that require the most difficult, subjective and complex judgments. Registrants should consider whether their accounting policy to account for the effects of the GILTI provisions of the Act should be included in the critical accounting policy discussion in MD&A.

11.2 Form 8-K reporting considerations

The SEC staff issued Compliance and Disclosure Interpretation (C&DI) 110.02 in response to questions it has received from companies regarding whether the remeasurement of a deferred tax asset (DTA) to reflect the new tax rates or other provisions of the Act would trigger an obligation to file a Form 8-K under Item 2.06, Material Impairments. The C&DI states that the remeasurement of a DTA to reflect the effect of a change in tax rate or tax laws is not an impairment under ASC 740 and would not trigger the reporting requirement. However, the enactment of new tax rates or tax laws could have financial reporting implications, including whether it is more likely than not that the DTA will be realized.

In the C&DI, the SEC staff also noted that registrants employing the measurement period approach described in SAB 118 and concluding that an impairment has occurred (e.g., a valuation allowance) for the period that includes the enactment date due to changes resulting from the enactment of the Act may rely on the Instruction to Item 2.06, which exempts registrants from filing a Form 8-K if the conclusion is made in connection with the preparation, review or audit of financial statements to be included in the next periodic report to be filed. In those situations, registrants must disclose the impairment, or a provisional amount with respect to that possible impairment, in that next timely filed report.

Excerpt from C&DI

Question 110.02

Question: Does the re-measurement of a deferred tax asset (“DTA”) to incorporate the effects of newly enacted tax rates or other provisions of the Tax Cuts and Jobs Act (“Act”) trigger an obligation to file under Item 2.06 of Form 8-K?

Answer: No, the re-measurement of a DTA to reflect the impact of a change in tax rate or tax laws is not an impairment under ASC Topic 740. However, the enactment of new tax rates or tax laws could have implications for a registrant’s financial statements, including whether it is more likely than not that the DTA will be realized. As discussed in Staff Accounting Bulletin No. 118 (Dec. 22, 2017), a registrant that has not yet completed its accounting for certain income tax effects of the Act by the time the registrant issues its financial statements for the period that includes December 22, 2017 (the date of the Act’s enactment) may apply a “measurement period” approach to complying with ASC Topic 740. Registrants employing the “measurement period” approach as contemplated by SAB 118 that conclude that an impairment has occurred due to changes resulting from the enactment of the Act may rely on the Instruction to Item 2.06 and disclose the impairment, or a provisional amount with respect to that possible impairment, in its next periodic report. [December 22, 2017]

How Ernst & Young LLP sees it

While the C&DI clarifies Item 2.06 of Form 8-K, companies should continue to discuss with their securities counsel whether they are required to report any effects of the Act on Form 8-K.

12 Internal control considerations (updated 8 February 2018)

Companies need to evaluate whether changes to their existing processes and controls are necessary to account for the effects of the Act and comply with the provisions of SAB 118. That is, companies need effective internal controls to make sure that the accounting implications of the transition and future tax provision calculations are accurately recorded in their financial statements.

Key areas where changes to existing or new controls may be needed include the processes for estimating and finalizing provisional amounts, calculating the one-time transition tax, tracking outside basis differences after enactment, determining the timing of the reversal of temporary differences, assessing the realizability of deferred tax assets and carryforwards, calculating any minimum taxes and making disclosures.

Additionally, companies need to evaluate whether they need any new information to account for the effects of the tax law changes and whether they will use any new information in their internal controls. If new information will be used in internal controls, companies need to consider the effectiveness of their controls over the completeness and accuracy of that new information.

During the measurement period, controls need to be designed to make sure the company complies with the disclosure requirements of SAB 118. The SAB requirements include disclosure of qualitative information about the status of the accounting and a description of the additional information that needs to be obtained, prepared or analyzed for the company to complete the accounting requirements under ASC 740.

A company that does not make appropriate disclosures about its use of the SAB 118 measurement period is effectively telling users of the financial statements that it has completed its accounting for the enactment-date effects of the Act. Controls on amounts that are finalized need to be designed and operated with a level of precision to prevent material subsequent changes. Those changes made after an amount is finalized will need to be analyzed to determine whether there was an error.

13 What companies need to do now

Personnel in a company's finance, treasury and tax departments need to work together to execute a plan to respond to items such as the new corporate tax rate, the one-time transition tax, an immediate write-off of certain assets, any changes to existing tax attributes and any changes to internal controls that might be required.

Steps companies should take include:

- ▶ **Calculate changes to federal deferred tax balances** – Companies need to measure their deferred tax balances using the new tax rates in the period the tax law was enacted. Companies with fiscal years that don't end on 31 December need to estimate and schedule their temporary differences in the interim period that includes enactment to account for the effects of the tax law change.
- ▶ **Calculate the one-time transition tax on previously deferred foreign earnings and its accounting implications** – Companies should validate US tax attributes such as current and accumulated E&P, previously taxed income and foreign tax credit pools. Further, companies need to identify the amount of accumulated E&P that is held in cash and other specified assets or in illiquid assets for purposes of measuring the transition tax. Companies should consider whether earnings subject to the transition tax are expected to be remitted and any additional tax consequences.
- ▶ **Evaluate whether NOL and foreign tax credits are available to offset the transition tax and whether any remaining carryforwards are realizable** – Companies should determine whether there are excess carryforwards and credits that will remain and whether these carryforwards and credits are more likely than not to be realized.
- ▶ **Estimate which outside basis differences related to foreign subsidiaries exist after considering any one-time transition tax** – Companies should evaluate whether any of the exceptions to recording deferred taxes are available for those basis differences. For any remaining outside basis differences that do not meet any of the exceptions in ASC 740, companies need to determine the appropriate tax rate to measure related deferred tax amounts. Companies should keep in mind that capital gains are not exempted.
- ▶ **Evaluate whether AMT credit carryforwards are realizable** – Companies need to evaluate whether a deferred tax asset is currently recognized in connection with an AMT credit carryforward, the realizability of AMT credit carryforwards and whether amounts should be reclassified to a current or long-term receivable at the enactment date.
- ▶ **Evaluate which assets qualify for immediate expensing** – Companies need to finalize their inventory of qualified depreciable assets purchased since 27 September 2017.
- ▶ **Evaluate compensation plans** – Companies should determine whether their existing plans are subject to the grandfather provisions and whether any adjustments are needed to recorded deferred tax assets in the period of enactment.

14 Preparing for reporting after the effective date

Steps companies should take to prepare for the ongoing effects of the new tax law include:

- ▶ **Evaluate the effect of the GILTI inclusion, FDI and BEAT provisions** – Companies should evaluate what effect these provisions may have on their existing systems and processes to comply with these potential new tax laws.
- ▶ **Evaluate the effect on the estimated annual effective tax rates** – Companies should evaluate the Act's effects on their effective tax rate, including the effects of the new tax rates, GILTI and BEAT provisions.
- ▶ **Evaluate compensation plans** – Companies should determine whether additional employees are considered covered persons who are subject to existing deductibility limits.
- ▶ **Evaluate the effects of limiting deductions related to other expenses (e.g., meals and entertainment expenses)** – Companies need to consider the effect on their estimated effective tax rates if this change is significant.

15 Interim reporting (updated 16 March 2018)

For calendar year-end companies, the new corporate tax rate and many of the Act's other provisions were effective on 1 January 2018. For non-calendar year-end companies, the tax rate was administratively effective under ASC 740 at the beginning of the current fiscal year, but many of the other provisions are effective the first day of the taxable year beginning after 31 December 2017 (e.g., for a company with a 30 September tax year end, many of these provisions are effective on 1 October 2018).

ASC 740-270 provides guidance on accounting for income taxes in interim periods, including a requirement to use an EAETR to compute income tax expense (or benefit) related to ordinary income. Companies that apply SAB 118 need to consider the effects of changes to provisional amounts during the SAB 118 measurement period in calculating tax expense in the interim period.

15.1 Estimated annual effective tax rate reminders

At the end of each interim reporting period, a company is required to make its best estimate of the annual effective tax rate for the full fiscal year. That rate is then used to recognize income taxes on a current year-to-date basis. The estimated effective tax rate should be based on a company's best estimate and reflect enacted federal, state and local income tax rates, foreign tax rates and credits, percentage depletion, capital gains rates, other taxes and credits and available tax-planning alternatives. Additionally, the tax effect of a valuation allowance expected to be necessary at the end of the year for deferred tax assets related to deductible temporary differences and carryforwards originating during the year should be included in the effective tax rate.

Other provisions of the Act besides the new 21% federal corporate tax rate may affect a company's EAETR. Careful consideration of the Act's provisions on a company's EAETR will be necessary.

Additionally, a company that was unable to complete the accounting for the effects of the Act in the period that included the enactment date, could apply SAB 118 and record provisional amounts, if a reasonable estimate of those effects could be determined, or it could continue to apply the tax law that was in effect immediately before enactment if a reasonable estimate could not be determined. SAB 118 provides a measurement period of up to one year for companies to make adjustments to enactment date provisional amounts or record provisional amounts if no reasonable estimate could be made previously. Provisional amounts may relate to both the enactment date and subsequent accounting effects of the Act throughout the measurement period.

Adjustments to enactment-date provisional amounts should be recorded discretely in the interim period. This would also include the effects of adjustments to provisional amounts attributable to post-enactment date prior year activity. Adjustments to provisional amounts related to current year tax effects of ordinary income would be included in the EAETR. See section 9 and section 11 for additional discussion of SAB 118 and its disclosure requirements.

15.2 Key provisions of the Act that could affect the EAETR

15.2.1 *Change to the income tax rate*

Under ASC 740-270-25-5, the tax effect of a change in tax laws or rates on taxes currently payable or refundable for the current year must be recorded after the effective dates prescribed in the statutes and reflected in the EAETR beginning no earlier than the first interim period that includes the enactment date of the new legislation. In addition, the

implementation guidance in ASC 740-270-55-49 and 50 states that the effect of new legislation would not be reflected until it is effective or administratively effective.

For a calendar year-end company the effective date of the new corporate tax rate is 1 January 2018. Therefore, a calendar year-end company must use the new 21% rate in its calculation of the EAETR during the first quarter of 2018. Additionally, the corporate AMT was repealed and should therefore no longer be considered as an alternative tax system when calculating the EAETR.

Non-calendar year-end companies are required to use a blended rate during the fiscal year that includes the enactment date. See section 8, *Special considerations for non-calendar year-end companies*.

15.2.2 Restrictions or eliminations of exclusions, deductions and credits

The Act eliminates or reduces certain deductions that could affect a company's EAETR. For example, it increases the restriction on deductibility of meals and entertainment expenses, reduces the allowable dividend received deduction and repeals the Section 199 domestic production deduction. Section 7.7, *Restriction or elimination of exclusions, deductions and credits*, discusses these provisions.

Further, the Act expands the number of individuals whose compensation is subject to the \$1 million deductibility cap under Section 162(m), and compensation subject to the cap now includes performance-based compensation. See section 7.5 of this publication.

The Act limits the deduction for net interest expense that exceeds 30% of the certain taxpayer's adjusted taxable income. A company whose interest deduction is already limited may not be able to realize the benefits of amounts carried forward. This is because the annual limitation on deductions for interest expense will also apply in future years, and it applies to not only the interest expense incurred in those future years but also to the utilization of any amounts carried forward (i.e., the total interest deduction attributable to the aggregation of current year and carryforward interest deduction is limited to 30% of the taxpayer's adjusted taxable income). Accordingly, a company may determine that a valuation allowance is necessary for the deferred tax asset related to the disallowed interest deduction originating in the current year.

The EAETR should reflect anticipated deductions, limitations and exclusions under the current tax law. Companies will need to carefully evaluate deductions, limitations, exclusions or credits that were historically considered in previous periods' EAETR (i.e., under the prior tax law) and only reflect the currently available provisions when estimating their full fiscal year effective tax rate. Companies also will need to consider the potential effect of the new limitations on interest expense deductions and whether related originating deductible temporary differences are realizable. See section 7.3 of this publication.

15.2.3 Anti-deferral and anti-base erosion provisions

15.2.3.1 GILTI

As discussed in section 6, *Anti-deferral and anti-base erosion provisions*, the Act subjects a US shareholder to current tax on GILTI of its controlled foreign corporations. A company can make a policy election to account for tax on GILTI as a period cost only or to also recognize deferred tax assets and liabilities when basis differences exist that are expected to affect the amount of GILTI inclusion upon reversal. Companies that elect to include tax on GILTI as a period cost only will need to factor the anticipated current-year additional US tax (net of anticipated special deductions and FTCs) into their EAETR. Companies that elect to account

for tax on GILTI in their deferred tax balances are required to also project the deferred tax effects of expected year-end temporary differences in their EAETR.

As mentioned in section 6.1.2.1, *GILTI policy election during interim periods following the enactment date*, companies that have disclosed that they have not selected a GILTI accounting policy will need to be mindful of how they consider GILTI in establishing the EAETR in interim periods. Ernst & Young LLP believes that a company subject to GILTI will need to include an estimate of the current-year tax on GILTI when determining its EAETR, even if it has not yet finalized its accounting policy election. A company that has not yet finalized its accounting policy for GILTI (i.e., determined whether to treat it as a period cost or accrue deferred taxes) should not compute its EAETR with GILTI as part of its deferred taxes. Ernst & Young LLP believes a company that calculates its EAETR including a significant effect from deferred tax balances triggered by GILTI has effectively elected an accounting policy to treat GILTI as part of its deferred taxes. Ernst & Young LLP believes including an estimate of GILTI as a period cost in EAETR does not establish an accounting policy as long as the company has not disclosed its accounting policy.

15.2.3.2 *BEAT*

For companies that meet certain thresholds, the Act creates additional tax on net income by effectively excluding deductions on certain payments (i.e., base erosion payments) to foreign related entities. As discussed in more detail in section 6.3.1, the FASB staff believes that a company should account for the effect of BEAT in the year the BEAT is incurred. A company that expects to be subject to BEAT should estimate the BEAT in its EAETR.

15.2.4 *New territorial system and dividend exemption*

Under the dividend-exemption provisions of the Act, 100% of the foreign sourced portion of dividends paid by certain foreign corporations to a US corporate shareholder are exempt from US taxation (see section 5, *The new territorial system*). Companies need to carefully assess the effect the new territorial tax system may have on their EAETR, including changes to indefinite reinvestment assertions.

Ernst & Young LLP believes that if a company is unable to estimate the effects of the new territorial system, the company should make disclosures describing what part of the Act the company did not consider in calculating its tax expense as required by SAB 118. This would be the case if a company is not able to estimate the effect of the one-time transition tax and continues to assert indefinite reinvestment on foreign earnings based on the prior tax law, for example. If a company ultimately changes its indefinite reinvestment assertion once it is able to make a reasonable estimate of the effect of moving to the new territorial system, the effect of changing its assertion on its prior-year deferred taxes should be recorded as a discrete charge in the period, including the effect on earnings that are not subject to the one-time transition tax.

However, as a reminder, if a company also changes its assertion about current-year earnings (i.e., 2018 earnings for calendar year-end companies) the effects of changing the assertion should be recognized as an adjustment to the EAETR in the period in which the change in assertion occurs. For example, if a company changes its assertion in the second quarter of 2018 and will no longer assert indefinite reinvestment of 2018 earnings, it may need to accrue additional taxes for state and local taxes and, if applicable, foreign withholding taxes on those earnings. The tax effects of changing the indefinite reinvestment assertion for current-year earnings should be recognized as an adjustment to the EAETR in the period in which the change in assertion occurs.

15.2.5 Changes to state income taxes

Most state income tax laws use federal taxable income as a starting point for determining state income tax. As a result, state income taxes could rise as the federal tax base expands. While some states automatically adopt federal tax law changes, other states conform their laws with federal law on specific dates. States also may choose to decouple from new federal tax provisions and continue to apply current law.

The estimated effective tax rate should reflect not only the enacted federal income tax law but also the enacted state income tax law. Therefore, companies should understand the conformity rules in the states in which they operate and monitor any change in state tax law so they can appropriately account for the effects of changes in tax law separate and apart from their EAETR.

Companies need to consider how to respond to the following situations involving the state conformity:

- ▶ If a state automatically adopts federal tax changes, Ernst & Young LLP believes that a company could apply the guidance in SAB 118 if it has not yet completed its analysis of the effects of the state law change on the period that included the Act's enactment date.
- ▶ If the state automatically adopts federal tax changes but subsequently enacts a new tax law to decouple from them, Ernst & Young LLP believes a company should account for the decoupling tax law as a tax law change in the period of enactment.
- ▶ If the state does not automatically adopt federal tax changes and subsequently enacts new legislation to conform with them, Ernst & Young LLP believes a company should account for the enactment of the law as a change in tax law in the period of enactment.

15.3 Ability to estimate the annual effective tax rate

ASC 740-270-25-3 states, "If an entity is unable to estimate a part of its ordinary income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported." ASC 740-270-30-18 goes on to state, "If a reliable estimate of the annual effective tax rate cannot be made, the actual effective tax rate for the year to date may be the best estimate of the annual effective tax rate." In some cases, minor changes in estimated ordinary income can have a significant effect on the EAETR. This can occur when a company is estimating that its operating results will be at or about breakeven or when temporary differences without tax consequences (i.e., permanent differences) are significant compared to estimated income.

Ernst & Young LLP generally does not believe the Act (including any provisions for which the company is not able to make a reasonable estimate under SAB 118) would affect a company's ability to make a reliable estimate for its annual effective tax rate.

15.4 Changes to provisional amounts under SAB 118

SAB 118 does not address the accounting effects of the Act in interim periods. This section discusses Ernst & Young LLP's views on how changes in provisional amounts recorded under SAB 118 affect a company's EAETR.

15.4.1 Changes to enactment date provisional amounts in the subsequent annual period

Ernst & Young LLP believes the effects of making adjustments to provisional amounts related to the effects of the Act on the period that contains the enactment date (e.g., changes in a subsequent interim period in 2018 to provisional amounts originally recorded by a calendar year-end company in the period ended 31 December 2017), if significant, should be recognized as a discrete event similar to the accounting for tax law changes in the period of enactment. Accordingly, companies should not allocate the effect of changes in the

enactment period provisional amounts to subsequent interim periods in the succeeding year by adjusting the EAETR.

15.4.2 Changes to provisional amounts effecting the EAETR

A company may still be analyzing the effects of certain of the Act's provision at the time it is preparing interim financial statements and determining its EAETR. Ernst & Young LLP believes that a company should include its estimate of the income tax effects of these provisions when estimating its EAETR. If a company is still evaluating the effects of the Act, Ernst & Young LLP believes it should disclose which provisions it is still evaluating and that the EAETR may change in subsequent interim periods.

15.4.3 Changes to enactment-date provisional valuation allowances

Changes in valuation allowances as a result of a change in a SAB 118 enactment-date provisional amount will require careful consideration.

ASC 740-270-25-7 states, "The effect of a change in the beginning-of-the-year balance of a valuation allowance as a result of a change in judgment about the realizability of the related deferred tax asset in future years shall not be apportioned among interim periods through an adjustment of the effective tax rate but shall be recognized in the interim period in which the change occurs."

Ernst & Young LLP believes this guidance also applies when a company makes an adjustment during the measurement period to a SAB 118 provisional amount that affects a prior-year valuation allowance or the adjustments recorded to a beginning-of-the-year valuation allowance that was provisional under SAB 118. That is, both the change in prior-year provisional amounts and the change in the beginning-of-the-year valuation allowance should be recorded as discrete events.

Companies will need to distinguish between items that should be reflected as an adjustment to the EAETR (e.g., the effect of finalizing its GILTI accounting policy election) and those that should be recognized as discrete items in the interim period in which they occur.

15.5 Interim reporting disclosure

Companies will need to make disclosures about the specific items for which their accounting is incomplete at the interim financial statement reporting date. As a reminder, disclosures need to be sufficiently detailed for a reader to understand the status of a company's accounting for the tax effects of the Act (i.e., effects for which the accounting is complete, effects for which the accounting is incomplete but a reasonable estimate can be made and effects for which the accounting is incomplete and no provisional amounts have been recorded) and the additional information needed to complete the accounting under ASC 740. In many cases, a company's calculation will be subject to further refinement as additional analysis is completed and as the company gains a more thorough understanding of the tax law. This possibility should also be disclosed. See section 11.1 for SEC disclosure considerations and *Appendix A* for additional items a company may need to consider when evaluating the disclosures required by SAB 118.

SAB 118 indicates an entity should include financial statement disclosures to provide information about the material financial reporting effects of the Act for which the accounting under ASC Topic 740 is incomplete. Therefore, companies should fully disclose all matters for which their accounting is incomplete.

The following illustration provides an example of disclosures a company may make in an interim period about its accounting for income taxes and its incomplete accounting for the effects of the Act under SAB 118.

Illustration 14 – Interim disclosure for a calendar year-end company with incomplete accounting – income taxes footnote

A calendar year-end company that has not yet completed its accounting might make the following disclosures in the notes to its interim financial statements for periods after the period that includes the enactment date.

This is a simple example that addresses only federal income tax effects. Depending on its facts and circumstances, a company will need to provide more or different information.

Note X Income Taxes

The Company's provision for income taxes for the three months ended 31 March 2018 and 2017 is based on the estimated annual effective tax rate, plus discrete items.

The following table presents the provision for income taxes and the effective tax rates for the three months ended 31 March 2018 and 2017:

<i>(in millions)</i>	Three Months Ended March 31	
	2018	2017
Income (loss) before income taxes	\$ xxx	\$ XXX
Income tax expense (benefit)	\$ xx	\$ XX
Effective tax rate	XX%	XX%

The difference between the Company's effective tax rates for the three months ended 31 March 2018 and 2017 and the US statutory tax rates of 21% and 35%, respectively, primarily relates to changes in the valuation allowances against deferred tax assets, non-deductible expenses, state income taxes (net of federal income tax benefit), the effect of taxes on foreign earnings, and changes to provisional amounts recorded for certain aspects of the Act. The changes to provisional amounts increased the effective tax rate by X%. The effective tax rate may vary significantly due to fluctuations in the amount and source, including both foreign and domestic, of pretax income and changes in amounts of non-deductible expenses and other items that could impact the effective tax rate.

Provisional amounts in effective rate

The Tax Cuts and Jobs Act was enacted on 22 December 2017. The Act reduces the US federal corporate income tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. We are applying the guidance in SAB 118 when accounting for the enactment-date effects of the Act. At 31 March 2018, we have not completed our accounting for all of the tax effects of the Act; however, in certain cases, as described below, aspects of our accounting are complete. Additionally, we have made a reasonable estimate of other effects. In other cases, we have not been able to make a reasonable estimate and continue to account for those items based on our existing accounting under ASC 740, *Income Taxes*, and the provisions of the tax laws that were in effect immediately prior to enactment. As further discussed below, during the three month period ended 31 March 2018, we recognized adjustments of \$XXX to the provisional amounts recorded at 31 December 2017 and included these adjustments as a component of income tax expense from continuing operations. In all cases, we will continue to make and refine our calculations as additional analysis is completed. Our estimates may also be affected as we gain a more thorough understanding of the tax law. These changes could be material to income tax expense.

Deferred tax assets and liabilities: We remeasured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%. We recorded a provisional amount of \$XXX as of 31 December 2017 related to the remeasurement of certain deferred tax balances. Upon further analyses of certain aspects of the Act and refinement of our calculations during the three months ended 31 March 2018, we adjusted our provisional amount by \$XXX, which is included as a component of income tax expense from continuing operations. Due to the continued refinement of our transition tax calculation, discussed further below, and the effect it may have on the measurement of NOLs and other carryforwards, we will continue to analyze and refine our calculations related to the measurement of these balances. We consider the enactment-date remeasurement of all other deferred tax assets and liabilities to be complete.

Foreign tax effects

One-time transition tax: The one-time transition tax is based on our total post-1986 earnings and profits (E&P) which we had deferred from US income taxes under previous US law. We originally recorded a provisional amount for our one-time transition tax liability for XX of our foreign subsidiaries, resulting in a transition tax liability of \$XXX being recorded at 31 December 2017. At 31 December 2017, we were unable to make a reasonable estimate of the transition tax liability related to YY of our foreign subsidiaries.

Upon further analyses of certain aspects of the Act and refinement of our calculations for these XX foreign subsidiaries during the three months ended 31 March 2018, we increased our provisional amount by \$XXX, which is included as a component of income tax expense from continuing operations. As of 31 March 2018, XX of our foreign subsidiaries have provisional amounts recorded for the one-time tax liability. During the three months ended 31 March 2018, we made sufficient progress in the E&P analysis for the remaining YY of our foreign subsidiaries to reasonably estimate the effects of the one-time transition tax and, therefore, have recorded an initial provisional amount of \$XXX. For XX of our subsidiaries we are still unable to make a reasonable estimate of the transition tax liability as of 31 March 2018. As we continue to refine our E&P analysis, we will refine our calculations of the one-time transition tax, which could affect the measurement of this liability. No additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax, or any additional outside basis difference inherent in these entities, as these amounts continue to be indefinitely reinvested in foreign operations.

Global intangible low-taxed income (GILTI):

A company that has not determined its GILTI accounting policy

The Act subjects a US shareholder to tax on GILTI earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740, No. 5, *Accounting for Global Intangible Low-Taxed Income*, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred as a period expense only. Given the complexity of the GILTI provisions, we are still evaluating the effects of the GILTI provisions and have not yet determined our accounting policy. At 31 March 2018, because we are still evaluating the GILTI provisions and our analysis of future taxable income that is subject to GILTI, we have included GILTI related to current-year operations only in our EAETR and have not provided additional GILTI on deferred items.

A company that has determined that its accounting policy will be to record GILTI as a period cost only in the period it is incurred and can reasonably estimate a provisional amount

The Act subjects a US shareholder to current tax on GILTI earned by certain foreign subsidiaries. The FASB Staff Q&A, Topic 740 No. 5, *Accounting for Global Intangible Low-Taxed Income*, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI resulting from those items in the year the tax is incurred. We have elected to recognize the resulting tax on GILTI as a period expense in the period the tax is incurred and expect to incur tax for the year ended 31 December 2018. We have made sufficient progress in our calculations to reasonably estimate the effect on our estimated annual effective tax rate. This adjustment increased our effective tax rate by XX%. We will continue to refine our calculations, which may result in changes to this amount.

A company that establishes its accounting policy for GILTI during an interim period needs to disclose that policy. Further, a company that elects to early adopt ASU 2018-02 in an interim period also needs to disclose its accounting policy for releasing the income tax effects from AOCI, as required by that standard (see section 3.1.2, *Reclassification of certain tax effects from accumulated other comprehensive income*) The following are examples of disclosures a company may make in these situations if they are significant to that company's financial statements.

Illustration 15 – Disclosure for a company that has adopted accounting policies for GILTI or the early adoption of ASU 2018-02

A company that makes changes to a significant accounting policy in an interim period should disclose that change in the period in which the change is made. Additional disclosures are required for a company that adopts ASU 2018-02. See Illustration 17 for an example of the additional disclosures.

Note X Summary of Significant Accounting Policies

Accounting for income taxes on GILTI

We recognize the tax on GILTI as a period expense in the period the tax is incurred. Under this policy, we have not provided deferred taxes related to temporary differences that upon their reversal will affect the amount of income subject to GILTI in the period.

Accounting for the release of income tax effects from accumulated other comprehensive income

We use a portfolio approach to release the income tax effects in AOCI related to our available-for-sale debt securities. Under this approach, the income tax effects are released from AOCI upon the sale of an available-for-sale debt security based on the enacted tax rate at the date of sale. Any tax effects remaining in AOCI are released only when the entire portfolio of the available-for-sale debt securities is liquidated, sold or extinguished.

If a company has other items in AOCI, it will need to disclose its accounting policy for releasing income tax effects from AOCI for each of those items.

Companies should also consider the effect of the FASB's new guidance on reclassifying certain tax effects of the Act from AOCI. The following illustrations highlight disclosure that companies may make related to the adoption of this new guidance. See section 3.1.2 for further discussion on the guidance and disclosure requirements.

Illustration 16 – Disclosure for a company that has not adopted ASU 2018-02*Income Taxes*

In January 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, which gives entities the option to reclassify to retained earnings the tax effects resulting from the Act related to items in AOCI that the FASB refers to as having been stranded in AOCI.

The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized in the period of adoption. The Company must adopt this guidance for fiscal years beginning after 15 December 2018 and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including the period the Act was enacted. The guidance, when adopted, will require new disclosures regarding a company's accounting policy for releasing the tax effects in AOCI and permit the company the option to reclassify to retained earnings the tax effects resulting from the Act that are stranded in AOCI. The Company is currently evaluating how to apply the new guidance and has not determined whether it will elect to reclassify stranded amounts. The adoption of ASU 2018-02 is not expected to have a material effect on its consolidated financial statements.

Illustration 17 – Disclosure for a company that has early adopted ASU 2018-02*Income Taxes*

In January 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*, which gives entities the option to reclassify to retained earnings tax effects resulting from the Act related to items in AOCI that the FASB refers to as having been stranded in AOCI.

The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized or in the period of adoption. The Company must adopt this guidance for fiscal years beginning after 15 December 2018 and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including the period the Act was enacted. We elected to early adopt ASU 2018-02. As a result of adopting this standard, we reclassified \$XXX from AOCI to retained earnings.

Or, if the amount reclassified relates to deferred tax amounts that are provisional under SAB 118

The new guidance may be applied retrospectively to each period in which the effect of the Act is recognized or in the period of adoption. The Company must adopt this guidance for fiscal years beginning after 15 December 2018 and interim periods within those fiscal years. Early adoption is permitted for periods for which financial statements have not yet been issued or made available for issuance, including the period the Act was enacted. We elected to early adopt ASU 2018-02. As a result of adopting this standard, we reclassified \$XXX from AOCI to retained earnings. The effect of the Act on temporary differences related to amounts initially recorded in AOCI are provisional (see footnote X for additional discussion). As we finalize the accounting for tax effects of the Act on the related temporary differences, additional reclassification adjustments may be recorded in future periods.

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Appendix A What companies should consider in evaluating whether their accounting for the enactment-date effects of the Act is final (updated 24 January 2018)

Given the complexities involved and the fact that the US Treasury Department may clarify how to apply certain provisions of the Act, companies should not underestimate the effort needed to appropriately interpret and apply all the provisions of the Act prior to concluding that their accounting for the enactment-date effects of the Act is complete.

The following are some of the considerations a company should evaluate before determining that its accounting for the enactment-date effects of the Act is complete, along with questions management should ask itself. This listing is not intended to be all-inclusive and the applicability of the items on this listing will vary by entity.

General considerations

- ▶ **Evaluation of tax law and all underlying provisions** – The Act is the most significant and complex change to the US tax code in more than 30 years and requires the combined effort of companies' finance, treasury and tax departments.

Has the company assessed all parts of the Act, identified all instances where the Act applies and appropriately evaluated all instances where the Act has accounting effects upon enactments?

Has the company been able to reasonably interpret each provision of the Act based on currently available rules and regulations with sufficient precision to consider the accounting for the effects as of the enactment date to be complete?

Has the company considered whether additional clarifications or interpretations of the Act (Treasury Notices, etc.) may affect its analysis and computations?

Does the company plan to engage specialists to assist in analysis of any components of the Act?

Will the company be performing additional analysis and computations before finalizing amounts for inclusion in the related tax returns?

Has the company obtained all documentation and support for all matters addressed in the Act or has the company relied on summary schedules and data for purposes of its accounting?

Effects on deferred tax assets and liabilities

- ▶ **Effects of change in corporate income tax rate on temporary differences and tax loss carryforwards and credits as of enactment date** – Calendar year-end companies may need to make adjustments for material unusual or infrequent transactions that occurred between the enactment date and year end. Estimating temporary differences as of the enactment date for non-calendar year-end companies presents even more challenges.

Have all temporary differences and tax loss carryforwards and credits at the enactment date been appropriately identified and calculated with sufficient precision to consider the measurement of the change in rate upon enactment to be complete?

- ▶ **Immediate expensing** – Under the Act, companies are able to claim bonus depreciation to accelerate the expensing of the cost of certain qualified property acquired and placed in service after 27 September 2017.

Have all assets purchased since 27 September 2017 that qualify for immediate expensing (and that will be treated as such in the company's tax return) been identified?

For those assets acquired after 27 September 2017 for which the company is claiming immediate expense in the year including enactment, have they been confirmed to have been placed in service by the end of the year or will there be more work done to confirm placed in service dates for the tax return?

- ▶ **Valuation allowance reassessment** – Numerous provisions of the Act could increase or decrease a company's need for valuation allowances. Examples of those provisions include the one-time transition tax, interest expense deduction limits, GILTI, FDII, immediate expensing of qualified assets, changes to NOL rules, repeal of the domestic manufacturing deduction, repeal of the corporate alternative minimum tax and limits on employee remuneration.

Have all of the provisions in the Act been appropriately identified and considered in the evaluation of the realizability of deferred tax assets?

Have all qualifying dividends from foreign subsidiaries been eliminated as a source of foreign source income to support the realizability of foreign tax credits or other deferred tax assets?

Have the effects of GILTI and FDII provisions been appropriately considered in projections of future taxable income?

Repeal of the corporate alternative minimum tax

- ▶ **Classification of AMT credits** – Ernst & Young LLP believes it would be appropriate for a company to either continue to classify AMT credits along with its other deferred tax balances or reclassify credits that are expected to be refundable in future periods to an income tax receivable.

Has the company determined the refundable component of its AMT credits and finalized its determination of the appropriate classification of AMT credits?

One-time transition tax

- ▶ **Calculating E&P subject to the one-time transition tax** – Identifying post-1986 E&P of each foreign subsidiary that has not been previously subject to US tax could be a complex and time-consuming process that companies should carefully execute and review.

Has all necessary information to calculate E&P amounts to determine the one-time transition tax payable been obtained?

Has the company obtained the appropriate support for all E&P amounts or will additional work be performed to gather support for the underlying amounts?

Has the company assessed the adequacy of its final support for sustaining its E&P determination with the tax authority?

Have all uncertainties the company identified as reasons to record provisional amounts been resolved?

- ▶ **Calculating and supporting foreign tax credits available to offset the one-time transition tax** – Identifying and supporting foreign taxes generated with the mandatory Subpart F inclusion could be a complex and time-consuming process that companies should carefully execute and review.

Has all necessary information to calculate tax pools to determine the foreign tax credits been obtained?

Has the company obtained the appropriate support for all foreign tax amounts or will additional work be performed to gather support for the underlying amounts?

Has the company assessed the adequacy of its final support for sustaining its foreign tax credits with the tax authority?

Have all uncertainties the company identified as reasons to record provisional amounts been resolved?

- ▶ **Utilization of available tax attributes to offset the one-time mandatory Subpart F inclusion** – Companies may utilize certain tax attributes to offset the mandatory inclusion. Elections are available to forego the utilization of certain attributes to allow other attributes.

Has the company completed its evaluation of the optimal source of attributes to utilize to offset the one-time mandatory Subpart F inclusion?

- ▶ **Calculating the aggregate foreign cash position of the US shareholder** – Cash and other specified assets are defined in the Act and effectively taxed at different rates. Identifying assets that qualify for the lower effective rate could be complex. Non-calendar year-end companies might face additional challenges in determining the amount of cash and other specified assets subject to the one-time transition tax because one of the tax years on which the measurement is based may not have closed yet (i.e., the last taxable year beginning before 1 December 2017).

Have all cash and other specified assets, as defined in the Act, been appropriately identified and measured at each proscribed date?

Move to a territorial system

- ▶ **Determining outside basis differences for each foreign subsidiary after taking into consideration the one-time transition tax** – Companies still need to determine the outside basis differences for each of their foreign subsidiaries after taking into consideration the transition tax. Companies will need to finish their evaluation of any remaining outside basis differences and determine whether they can assert indefinite reinvestment on the related foreign earnings. Companies that are not asserting indefinite reinvestment will need to finalize their calculation and measurement of any remaining deferred tax balances, considering the appropriate tax rate to apply, the effects of state and local income taxes, foreign withholding taxes, other applicable foreign taxes and other attributes that could affect those amounts.

Have outside basis differences for each foreign subsidiary been recalculated after considering the incremental US tax basis created as a result of the one-time transition tax?

Has the evaluation of the remaining outside basis differences been finalized to assess if any residual tax would be due on recovery of the book investment?

Has the evaluation been completed related to the determination of whether the company can assert indefinite reinvestment on the related foreign earnings?

Has the company evaluated whether its indefinite reinvestment assertion, including that on the earnings subject to the transition tax, is consistent with treasury and other expectations of repatriating cash to the US?

Has the company evaluated withholding taxes, other foreign taxes and/or state and local taxes that may apply?

Is the company in any states for which the treatment of the transition tax and/or dividends received deduction is undetermined at this time?

Other international provisions

- ▶ **Global intangible low-taxed income** – Companies need to select an accounting policy to determine whether to account for the tax effects of GILTI as period costs or provide deferred taxes. A company that selects a policy of providing deferred taxes will need to finalize the calculation of the related deferred tax balances, which may require significant judgment. A company that selects an accounting policy of recording GILTI taxes as period costs should have considered the effects on its EAETR.

Has the company completed its analysis of the tax effects of the GILTI provisions?

Has an accounting policy been selected on how to account for the tax effects of GILTI?

Have the effects of the selected accounting policy been fully considered and computed?

- ▶ **Base erosion and anti-deferral provisions** – For companies that meet certain thresholds, the base erosion provision of the Act creates additional tax on net income by effectively excluding deductions on certain payments to foreign related entities. This incremental tax should be included in a company's EAETR.

In the periods after enactment (e.g., 2018 for calendar year-end companies), has the company considered whether it will be subject to BEAT, and has an estimate of this additional tax been included in its EAETR?

Has the company completed its analysis of the tax effect of the BEAT provisions?

- ▶ **Compensation plans** – The Act expanded the number of individuals whose compensation is subject to a \$1 million cap on deductibility under Section 162(m), and the calculation now includes performance-based compensation such as stock options and stock appreciation rights. The provision generally applies to taxable years beginning after 31 December 2017 and provides a transition for compensation paid pursuant to a written binding contract that was in effect on 2 November 2017. Companies will need to carefully review the terms of their compensation plans and agreements to assess whether they are considered to be written binding contracts in effect on 2 November 2017.

Have all the compensation plans in which the covered individuals participate been identified?

Have all compensation plans in which covered individuals participate been evaluated to determine whether they are grandfathered under the Act?

Have the deferred tax consequences associated with the perpetual status as a covered employee been considered in the evaluation of the deferred tax assets associated with plans in which covered individuals participate?

State and local taxes

- ▶ **Determining the effects of the Act on state and local taxes** – Companies need to understand the conformity rules in each state in which they operate so they can appropriately account for the effects on their state income taxes. Companies should consider the tax effects of state and local income taxes in finalizing their income tax provision calculation.

Have the tax effects of state and local income taxes been appropriately considered?

Has the evaluation of the state income tax effects of the transition tax been completed for each state in which the company operates?

Has the evaluation of the state income tax conformity with the US Internal Revenue Code been completed for each material position in each state in which the company operates?

Have the state income tax effects of changes in US tax law been incorporated into the determination of the estimated deferred state income tax rate?

Has the evaluation of the realization of state income tax deferred tax assets been revised to consider changes in US tax treatment and revised projections of state taxable income?

Appendix B Full content of FASB Staff Q&A: Whether private companies and not-for-profit entities can apply SAB 118 (updated 16 January 2018)

Background

The staff of the Division of Corporation Finance and the Office of the Chief Accountant of the Securities and Exchange Commission (SEC staff), from time to time, issue statements in staff accounting bulletins (SABs) that express a view on the application of the Financial Accounting Standards Board (FASB) Accounting Standards Codification® and/or other disclosure requirements. The statements in SABs are not rules or interpretations of the Commission, nor are they published as bearing the Commission's official approval. They represent interpretations and practices followed by the SEC Staff in administering the disclosure requirements of the federal securities laws.

The views and interpretations of the SEC staff are not directly applicable to private companies and not-for-profit entities (as defined in the FASB Codification Master Glossary). However, in the past some private companies and not-for-profit entities have voluntarily applied the guidance in SABs.

The SEC staff recently issued SAB 118 on the application of Topic 740 on income taxes in the reporting period that includes the date on which the 2017 Tax Cuts and Jobs Act (Act) was signed into law.

Question

Given the longstanding practice of private companies electing to apply SABs, would the FASB staff object to private companies and not-for-profit entities applying SAB 118?

Response

Based upon the longstanding practice of private companies electing to apply SABs, the FASB staff would not object to private companies and not-for-profit entities applying SAB 118. If a private company or not-for-profit entity applies SAB 118, they would be in compliance with GAAP.

The FASB staff believes, however, that if a private company or a not-for-profit entity applies SAB 118, it should apply all relevant aspects of the SAB in its entirety. This would include the disclosures listed in SAB 118. The FASB staff also believes that a private company or a not-for-profit entity that applies SAB 118 should disclose its accounting policy of applying SAB 118 in accordance with paragraphs 235-10-50-1 through 50-3 of the Accounting Standards Codification.

Appendix C Full content of FASB Staff Q&A documents on implementation questions (updated 24 January 2018)

FASB Staff Q&A: Whether to discount the tax liability on the deemed repatriation

Background

The Tax Cuts and Jobs Act (Act) imposes a tax on undistributed and previously untaxed post-1986 foreign earnings and profits. The Act permits a company to pay the one-time transition tax over eight years on an interest free basis. The earnings are reported on the 2017¹⁵ tax return and the tax is generally due in annual installments of 8% per year for the first five years, 15% in year 6, 20% in year 7, and 25% in year 8, if properly elected. The payments are due without regard to whether a company has future taxable income or losses.

Question

Does the FASB staff believe that the tax liability on the deemed repatriation of earnings should be discounted?

Response

The FASB staff believes that the tax liability on the deemed repatriation of earnings should not be discounted. The FASB staff notes that paragraph 740-10-30-8 prohibits the discounting of deferred tax amounts. Due to the unique nature of the tax on the deemed repatriation of foreign earnings, the staff believes that the guidance in paragraph 740-10-30-8 should be applied by analogy to the payable recognized for this tax.

Further, the FASB staff does not believe that Subtopic 835-30 on the imputation of interest applies to the unique circumstances related to this tax liability. The guidance in Subtopic 835-30 addresses the accounting for business transactions that often involve the exchange of cash or property, goods, or services for a note or similar instrument. Subtopic 835-30 is premised on the fact that when a note is exchanged for property, goods, or services in a bargained transaction entered into at arm's length, the interest rate should represent fair and adequate compensation to the supplier. The FASB staff believes that the transition tax liability is not the result of a bargained transaction and that the scope exception in paragraph 835-30-15-3(e) for transactions where interest rates are affected by tax attributes or legal restrictions prescribed by a governmental agency (such as, income tax settlements) would apply.

The FASB staff also notes that the tax liability may not be a fixed obligation because it may be subject to estimation and future resolution of uncertain tax positions (for example, amount of earnings and profits from foreign subsidiaries, amount of earnings held in cash and cash equivalents, reduction of the tax for foreign tax credits). Any recognized uncertain tax position related to the deemed repatriation of foreign earnings would not be discounted, and the staff does not believe it is appropriate to have a discounted tax liability when the uncertain tax position is undiscounted.

¹⁵ In some cases, amounts are reported on the 2018 tax return (for example, when a calendar-year-end company has a controlled foreign corporation with a November 30 year-end).

FASB Staff Q&A: Accounting for global intangible low-taxed income

Background

The Tax Cuts and Jobs Act requires a US shareholder of a foreign corporation to include in income its global intangible low-taxed income (GILTI). In general, GILTI is described as the excess of a US shareholder's total net foreign income over a deemed return on tangible assets, which is defined as 10% of its foreign qualified business asset investment reduced by certain interest expense amounts. There is no loss carryforward mechanism to allow GILTI losses in one year to offset GILTI income in another year.

The Tax Cuts and Jobs Act allows a deduction of 50%¹⁶ of GILTI, but this deduction is limited by the taxpayer's taxable income. An entity also is allowed a deemed paid foreign tax credit of up to 80% of foreign taxes attributable to the underlying foreign corporation. Unused foreign tax credits associated with GILTI cannot be carried forward or back or used against other foreign source income. A US shareholder would increase its tax basis in the foreign corporation for the GILTI inclusion.

Question

Does the FASB staff believe that an entity should recognize deferred taxes for temporary basis differences expected to reverse as global intangible low-taxed income (GILTI) in future years or should the tax on GILTI be included in tax expense in the year it is incurred?

Response

The FASB staff does not believe that Topic 740 is clear as to the treatment of GILTI.

Some stakeholders believe it would not be appropriate to provide deferred taxes on individual inside basis differences or the outside basis difference (or portion thereof) because a taxpayer's GILTI is based on its aggregate income from all foreign corporations. Because the computation is done at an aggregate level, the unit of account is not the taxpayer's investment in an individual foreign corporation or that corporation's assets and liabilities. These stakeholders believe that the guidance on deferred tax accounting in Topic 740 using the asset and liability approach does not address taxes on aggregated income because basis differences of a foreign corporation in one jurisdiction may be offset by basis differences in a foreign corporation in another jurisdiction and ultimately may never be taxed. Further, these stakeholders believe that the GILTI computation is dependent on contingent or future events (for example, future foreign income versus loss, the amount of foreign qualified business asset investment in a given year, future foreign tax credits, future taxable income), which suggests that taxes on GILTI should be accounted for as period costs similar to special deductions.

Other stakeholders believe that the current tax imposed on GILTI is similar to the tax imposed on existing Subpart F income. Deferred taxes generally are provided under Topic 740 for basis differences that are expected to result in Subpart F income upon reversal. Because GILTI is included in the US shareholder's taxable income when earned by the foreign corporations, similar to Subpart F income, these stakeholders believe that a US shareholder should recognize deferred tax assets and liabilities when basis differences exist that are expected to affect the amount of GILTI inclusion upon reversal.

Based on the different views provided, the FASB staff believes that Topic 740 is not clear as it relates to the accounting for GILTI, and an entity may apply either interpretation of Topic 740. The staff believes that an entity must disclose its accounting policy related to GILTI inclusions in accordance with paragraphs 235-10-50-1 through 50-3.

¹⁶ The deduction is reduced to 37.5% for tax years beginning after December 31, 2025.

The staff plans to monitor how entities that pay tax on GILTI are accounting for and disclosing its effects by reviewing annual or quarterly reports issued over the next few quarters. Following this review, the staff will provide an update to the Board so it can consider whether improvements may be needed for the accounting or disclosures for the tax on GILTI.

FASB Staff Q&A: Accounting for the base erosion anti-abuse tax

Background

Under the Tax Cuts and Jobs Act, an entity must pay a Base Erosion Anti-Abuse Tax (BEAT) if the BEAT is greater than its regular tax liability. The BEAT calculation eliminates the deduction of certain payments made to foreign affiliates (referred to as base erosion payments) but applies a lower tax rate on the resulting BEAT income.

Question

Does the FASB staff believe that deferred tax assets and liabilities should be measured at the statutory tax rate of the regular tax system or the lower BEAT tax rate if the taxpayer expects to be subject to BEAT?

Response

The FASB staff believes that the BEAT is similar to the alternative minimum tax (AMT) under prior tax law. The AMT was a parallel tax system that resulted in a minimum level of corporate taxation in situations in which regular taxable income was lower than the alternative minimum taxable income due to “preference items” that were not deductible for AMT purposes. An entity that paid the AMT received a tax credit for the tax paid in excess of the amount computed on the basis of the regular tax system. An entity subject to the BEAT does not receive a tax credit for the tax paid in excess of the amount computed on the basis of the regular tax system, but the FASB staff believes that the BEAT is similar to the AMT in that it is designed to be an incremental tax in which an entity can never pay less, and may pay more, than their regular tax liability.

Paragraphs 740-10-30-11 and 740-10-55-32 address the AMT and require an entity to measure deferred taxes using the statutory tax rate under the regular tax system. Paragraph 740-10-30-11 states:

“... [I]t would be counterintuitive if the addition of alternative minimum tax provisions to the tax law were to have the effect of reducing the amount of an entity’s income tax expense for financial reporting, given that the provisions of alternative minimum tax may be either neutral or adverse but never beneficial to an entity.”

Therefore, the FASB staff believes that an entity that is subject to BEAT should measure deferred tax assets and liabilities using the statutory tax rate under the regular tax system. The FASB staff believes that measuring a deferred tax liability at the lower BEAT rate would not reflect the amount an entity would ultimately pay because the BEAT would exceed the tax under the regular tax system using the 21 percent statutory tax rate.

Although an entity may believe that it expects to be subject to the BEAT for the foreseeable future, paragraph 740-10-30-11 further states that “no one can predict whether an entity will always be an alternative minimum tax taxpayer.” The FASB staff believes that a similar conclusion could be applied to BEAT. In addition, taxpayers may take measures to reduce their BEAT exposure and, therefore, ultimately pay taxes at or close to the 21 percent statutory tax rate.

The FASB staff believes that the guidance in Topic 740 therefore indicates that the incremental effect of BEAT should be recognized in the year the BEAT is incurred. The staff also believes that an entity would not need to evaluate the effect of potentially paying the BEAT in future years on the realization of deferred tax assets recognized under the regular tax system because the realization of the deferred tax asset (for example, a tax credit) would reduce its regular tax liability, even when an incremental BEAT liability would be owed in that period. Regardless of any year-over-year effective tax rate fluctuations, the effective tax rate (excluding other permanent items) under this approach would always be equal to or in excess of the statutory tax rate of 21 percent.

FASB Staff Q&A: Whether to discount alternative minimum tax credits that become refundable

Background

Under prior tax law, an entity paid the corporate alternative minimum tax (AMT) if the amount payable under the AMT system was greater than the amount payable under the regular tax system. An entity that paid the AMT received a tax credit (AMT credit carryforward) for the tax paid in excess of the amount owed under the regular tax system. This AMT credit carryforward has no expiration date.

The AMT tax regime is repealed under the Tax Cuts and Jobs Act. Any existing AMT credit carryforward can be used to reduce the regular tax obligation in years 2018 through 2020. Any AMT credit carryforwards that do not reduce regular taxes generally are eligible for a 50% refund in 2018 through 2020 and a 100% refund in 2021. This generally will result in the full realization of any AMT credit carryforwards existing at December 31, 2017, irrespective of future taxable income.

Question

Does the FASB staff believe that AMT credit carryforwards should be discounted at December 31, 2017, because they will be refundable in future years?

Response

The FASB staff notes that paragraph 740-10-30-8 prohibits discounting deferred taxes. Accordingly, any AMT credit carryforwards presented as a deferred tax asset would not be discounted. Likewise, the FASB staff believes that any AMT credit carryforward presented as a receivable should not be discounted because the staff does not believe that Subtopic 835-30 on the imputation of interest applies.

The guidance in Subtopic 835-30 addresses the accounting for business transactions that often involve the exchange of cash or property, goods, or services for a note or similar instrument. Subtopic 835-30 is premised on the fact that when a note is exchanged for property, goods, or services in a bargained transaction entered into at arm's length, the interest rate should represent fair and adequate compensation to the supplier. The FASB staff believes that the AMT credit carryforward is not the result of a bargained transaction and that the scope exception in paragraph 835-30-15-3(e) for transactions where interest rates are affected by tax attributes or legal restrictions prescribed by a governmental agency (such as, income tax settlements) would apply.

The FASB staff notes that paragraph 740-10-50-3 requires an entity to disclose the amounts of tax credit carryforwards for tax purposes. The staff believes this disclosure would apply whether an entity presents the AMT credit carryforward as a deferred tax asset or a receivable and would provide useful information to investors in evaluating the amount that is to be utilized or refunded.