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Corporate Income Tax Accounting: 2018 Year-End Wrapup

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Tax accountants had a lot on their plates in 2018. From the lingering fallout of tax reform to the need to assess the potential state income tax implications of the U.S. Supreme Court's decision in *Wayfair* to the adoption of various new accounting standards, many are wondering where the year has gone. Though much work has been accomplished this year, relaxation will have to wait as tax professionals prepare to incorporate these significant developments into their year-end income tax accounting and reporting processes.

Tax reform developments

The *Tax Cuts and Jobs Act* (TCJA), enacted on Dec. 22, 2017, included myriad changes affecting businesses, including lowering corporate tax rates, limiting or eliminating certain deductions, accelerating certain income recognition, changing the use of net operating losses (NOLs), eliminating the alternative minimum tax (AMT), and imposing significant changes on the taxation of foreign operations. These changes had, and will continue to have, a significant impact on the financial accounting and reporting of income taxes. Summarized here are major components of the TCJA that are likely to require considerable income tax accounting consideration during 2018 year-ends and beyond.

Conclusion of the SAB 118 measurement period

Under U.S. GAAP, the effects of changes in tax law on an entity's balance sheet tax positions must be accounted for in the period of enactment. Due to the late-2017 enactment date of the TCJA and the volume and complexity of changes it contained, many tax professionals were scrambling to interpret the law and account for its enactment date effect.

Recognizing this fact, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 118 (SAB 118) to address situations when a registrant did not have the necessary information available, prepared, or analyzed in reasonable detail to complete the required income tax accounting and to provide up to a one-year measurement period for completion.

On Jan. 12, 2018, the Financial Accounting Standards Board (FASB) staff issued FASB Staff Q&A, Topic 740, No. 1, which allowed private and not-for-profit entities the option to apply SAB 118. If applied, all the provisions of SAB 118 would be required, including the relevant disclosures. Additionally, private and not-for-profit companies applying the provisions would disclose this application as an accounting policy. (Note that in March 2018, the FASB issued Accounting Standards Update (ASU) 2018-05 to incorporate the guidance in SAB 118 into Topic 740.)

SAB 118 provided the following measurement model, with related required disclosures, for scenarios in which any entity's measurement of accounting for the TCJA was:

- Complete (in whole or in part): The effects should be recorded in the reporting period.
- Incomplete, but can be reasonably estimated: The provisional effects (or changes in the provisional effects) should be recorded in the reporting period.
- Incomplete and cannot be reasonably estimated: The entity should not record provisional amounts based on the TCJA and should continue to record the effects based on the tax laws that were in effect immediately prior to the TCJA being enacted. For those income tax effects for which an entity is not able to determine a reasonable estimate, the entity should record the effects in the first reporting period in which a reasonable estimate can be determined.

The provisional amount is subject to adjustment during the measurement period until the accounting under ASC 740 is complete; however, the measurement period should not extend beyond one year from the enactment date of the TCJA. Thus, a company's measurement period will end in the financial reporting period that includes Dec. 21, 2018.

Corporate tax rate change

The corporate tax rate was reduced from a graduated system that effectively topped out at flat rates of 34 or 35 percent to a flat 21 percent rate effective Jan. 1, 2018. Fiscal year-end companies must apply the following three-step blended rate concept for their year that includes Jan. 1, 2018:

1. Determine the tax for the entire year under the old graduated system and multiply that tax by the number of days in the fiscal year occurring before Jan. 1, and then divide by 365.
2. Determine the tax for the entire year using a 21 percent rate; multiply that tax by the number of days in the fiscal year occurring after Dec. 31; then divide by 365.
3. Add the result of steps 1 and 2.

Given the lower tax liabilities of a 21 percent tax rate environment, companies might find it taking more time to absorb nonrefundable tax credits. Companies with significant amounts of expiring nonrefundable credits should consider the credits' realizability and continually monitor the need for any valuation allowance against tax credit carryforward deferred tax assets.

Repeal of AMT

The TCJA repealed the AMT for tax years beginning after Dec. 31, 2017. Any AMT credit carryforwards a company has accumulated will offset 100 percent of regular tax liability. Fifty percent of any AMT credit carryforward not used in 2018, 2019, and 2020 will be refunded. One hundred percent of any AMT credit carryforward remaining at the end of 2021 will be refunded. The use and refund of credits subject to IRC Sections 382 and 383 will continue to be limited by those loss corporation provisions.

The IRS has indicated that under the *Balanced Budget and Emergency Deficit Control Act of 1985* (BBEDCA), refunds of AMT credits under the TCJA will be subject to the sequestration reduction percentage in effect for the federal fiscal year in which such refund is processed. Thus, once the sequestration reduction percentage is published for the U.S. government's federal fiscal year in which an AMT credit refund is expected to be processed, companies should reduce the tax asset representing the estimated refund by the sequestration reduction amount.

The BBEDCA requires the Office of Management and Budget to compute and release the reduction percentages for a fiscal year on the same day the president's budget for that year is submitted to Congress. Historically this has occurred in February. Thus, reduction percentages currently are known for the fiscal years ending Sept. 30, 2018 (6.6 percent) and Sept. 30, 2019 (6.2 percent).

AMT credit carryforwards could be classified as either a receivable, a deferred tax asset, or bifurcated between a receivable and a deferred tax asset based on expectations for recovery considering the IRC Section 382 and sequestration limitations. An entity should apply the approach selected consistently with appropriate disclosures in the financial statements.

NOLs

Generally, NOLs originating in tax years ending after Dec. 31, 2017, no longer will be allowed to be carried back, though they will never expire (exceptions exist for nonlife insurance companies and certain farming losses). However, NOL carryforwards originating in years beginning after Dec. 31, 2017, are subject to an annual limitation and can be used only to offset 80 percent of taxable income. (Note that while the effective date is the same for a calendar-year company (2018), these two provisions have different effective dates for a fiscal-year company, with the loss of carryback ability occurring first.)

These new rules will affect the evaluation of the realizability of deferred tax assets in several ways. First, the ability to realize a reversing deductible temporary difference via carryback of any resulting loss to a prior year no longer exists. Next, because NOLs originating after Dec. 31, 2017, will be indefinite-lived, deferred tax liabilities related to indefinite-lived assets might be considered as a source of future taxable income that can absorb reversing deferred tax assets. However, as these new NOLs will be subject to the 80 percent limitation, considerably more scheduling of the reversal of temporary differences and use of tax attribute carryforwards might be required to confirm deferred tax asset realizability.

Executive compensation limit

The TCJA made changes to the IRC Section 162(m) \$1 million deduction limit applied to public companies on compensation paid to covered executives. The changes include eliminating the exceptions for commissions and qualifying performance-based compensation. The changes in total likely will result in more disallowed compensation deductions to more companies, on more employees, and over a longer time period.

Complex transition rules would grandfather pre-TCJA treatment for qualifying amounts paid under written binding contracts in existence on Nov. 2, 2017, and not subsequently materially modified. After taking into account the grandfathering provisions of the new law:

- The changes will put more emphasis on whether differences between accrued but not yet tax-deductible compensation should be permanent or temporary.
- Forecasting will be required to estimate the future tax deductibility of any amounts expensed for financial statement purposes in earlier years.
- When forecasting the timing and amount of stock-based compensation deductions, corporations must consider the expected reversal of the recorded expense. It is not appropriate to consider estimated deficiency or excess benefit amounts (in other words, the potential fair market value-based tax deduction) ahead of the quarter in which the award settles.
- In the year that an otherwise temporary deductible difference is established on a stock-based compensation award to a Section 162(m) covered employee, if it is expected that Section 162(m) would otherwise deny deductibility when settled, the difference should be permanent as opposed to temporary.
- When both cash and stock compensation are present, U.S. GAAP allows a company to choose the order of priority it gives to cash versus stock compensation in applying the Section 162(m) limits – to cash first, to stock first, or pro-rated. Once chosen, the ordering policy should be applied consistently.

In September 2018, the IRS released Notice 2018-18, which provides guidance on the application of IRC Section 162(m), as amended by the TCJA, relative to the grandfathering provisions and the definitions of publicly held corporation, covered employee, and applicable employee remuneration. One item of particular interest is the notice's clear indication that the grandfathering provisions apply only to amounts of compensation that, as of Nov. 2, 2017, a company would be legally obligated to pay. Thus, if a contract existing on that date included a clause giving the company so-called negative discretion to reduce a payment amount that would otherwise be earned, the entire amount subject to such discretion would not be grandfathered, regardless of whether the discretion was fully exercised. The TCJA's amendments to Section 162(m) apply to taxable years beginning on or after Jan. 1, 2018. The U.S. Department of the Treasury and the IRS anticipate that the guidance in this notice will be incorporated into future regulations that, with respect to the issues addressed in the notice, will apply to any taxable year ending on or after Sept. 10, 2018.

Interest expense limitation

The TCJA limits a company's net interest deduction to 30 percent of adjusted taxable income beginning after 2017. Adjusted taxable income is defined as earnings before interest, taxes, depreciation, and amortization (EBITDA). For tax years beginning after Dec. 31, 2021, a company may deduct only its net interest expense up to 30 percent of earnings before interest and taxes. Any disallowed interest expense can be carried forward indefinitely, creating an indefinite-lived deferred tax asset.

Timing of income recognition

The TCJA changes certain revenue recognition rules, as outlined in IRC Section 451, for accrual basis taxpayers with applicable financial statements, such as those filed with the SEC or other federal agencies or audited financial statements used for credit purposes or for reporting to shareholders, partners, other proprietors, or beneficiaries. For these taxpayers, revenue will be recognized for tax purposes no later than it is recognized for financial reporting purposes, although a one-year deferral of recognition for prepaid goods and services still is allowed. Excluded from the new tax rules are income from mortgage servicing contracts and, subject to IRS clarification, most special methods of accounting, such as long-term contract recognition under Section 460. The new rules are effective for tax years beginning after Dec. 31, 2017, or after Dec. 31, 2018, for new rules related to original issue discount.



Corporate-owned life insurance

Tax reform legislation made changes to Section 101 that adversely affect the tax-free nature of death benefits received by a taxpayer who acquires life insurance policies but who, at the time of acquisition, had no substantial family, business, or financial relationship with the person whose life was insured.

Generally, death benefits received under a life insurance contract are federally tax-free under Section 101. However, prior to the TCJA, if a life insurance contract was sold or transferred for valuable consideration, death benefits were taxable to the extent they exceeded the consideration transferred plus subsequent premiums and other amounts paid by the buyer or transferee. This taxable treatment did not apply, however, if 1) the transferee acquired the contract in a carryover tax basis transaction (such as a tax-free reorganization) or 2) if, among other things, the contract was transferred to a corporation in which the insured was a shareholder or officer. The TCJA eliminated these two exceptions to death benefit taxability for “reportable policy sales,” which, beginning Jan. 1, 2018, are any direct or indirect acquisitions of an interest in a life insurance contract if the acquirer has “no substantial family, business, or financial relationship with the insured.” Subject to interpretation, this might occur, for example, in a taxable or nontaxable business combination if the assets acquired from the target included company-owned life insurance contracts and the insured would not become an employee or shareholder of the acquirer. Notice 2018-41 (in which the IRS signaled its intent to issue interpretive guidance) contains more detail, but much is still unclear about the TCJA’s impact on the prior exceptions.

A company acquiring existing life insurance contracts on or after Jan. 1, 2018, must determine if any such acquisitions meet the reportable policy sale definition, thus making a portion of future death benefits taxable. If so, the company must determine whether to carry a deferred tax liability for some or all of the cash surrender value (CSV) at the acquisition date as well as a deferred tax liability for any post-acquisition CSV increases.

In a taxable acquisition (absent a bargain purchase scenario), it is likely that the consideration a buyer transfers to acquire the contract (which should also be the buyer’s tax basis) will equal its acquisition date book value (fair value), and thus no deferred taxes should be recorded at that time.

In a carryover basis acquisition, the acquisition date analysis is less clear. Typically, the carried-over tax basis will be less than the CSV on the target’s books, whereas the consideration transferred to acquire the policy should be some portion of the total consideration transferred in the tax-free acquisition. Absent a bargain purchase, the consideration allocated to the policy for tax purposes might be argued to be the fair value assigned for GAAP purposes, which typically is the policy’s CSV. An acquirer will have to determine which number to use under its interpretation of the new tax law. In other words, in a carryover basis acquisition that includes a reportable policy sale, would it measure that policy’s portion of taxable death benefits against the carried-over basis or against the transferred consideration allocated? The tax law conclusion will drive the tax accounting in determining whether to record a deferred tax liability for any portion of the Day 1 CSV recorded.

Going forward, even if the buyer in a reportable policy sale asserts an intention to hold the policy until death (which previously allowed the recording of no deferred tax liabilities), subsequent CSV increases recorded in excess of subsequent premiums paid will require establishment of a deferred tax liability, because a like amount of future death benefit would be taxable.

GILTI

The TCJA also introduced a new tax on global intangible low-taxed income (GILTI). This tax requires a U.S. shareholder of a foreign corporation to include certain income earned by controlled foreign corporations (CFCs) in the gross income of the U.S. shareholder. GILTI generally is based on the aggregate of all CFCs' income in excess of a 10 percent return on foreign depreciable, tangible property less interest expense not paid to other CFCs. The greatest impact will be on companies with foreign subsidiaries that generate earnings without a large aggregate foreign fixed asset base and whose earnings have been taxed at a low rate, or those that are limited in their ability to use foreign tax credits. The provision is included in Subpart F of the code and generally is treated similarly to traditional Subpart F income.

Per FASB Staff Q&A, Topic 740, No. 5, "Accounting for Global Intangible Low-Taxed Income," 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 thereof) because a taxpayer's GILTI is based on its aggregate income from all foreign corporations. 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.

Based on the different views provided, 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. Following this review, the staff will provide an update to the FASB so it can consider whether improvements are needed for the accounting or disclosure for the tax on GILTI.

Foreign-derived intangible income

The TCJA provides for U.S. companies to receive a benefit for producing goods and services in the U.S. and selling them overseas or for the sale or license of intellectual property for use outside the U.S. by allowing a deduction of 37.5 percent of foreign-derived intangible income (FDII) for tax years beginning after Dec. 31, 2017. That deduction changes to 21.875 percent for tax years beginning after Dec. 31, 2025. FDII generally is calculated as a portion of the foreign-derived income of a U.S. corporation determined by calculating the excess of total income from the transactions described earlier in this paragraph over a 10 percent return on qualified business asset investments (which is effectively the company's basis in domestic tangible depreciable property) used to generate the FDII.

The FDII deduction should be considered a permanent deduction, similar to the pre-TCJA domestic production activities deduction, and not an adjustment to deferred taxes. Because FDII would be considered in the year the deduction is taken, it should therefore reduce a company's effective tax rate.

Base erosion anti-abuse tax

The TCJA established a new minimum tax known as the base erosion anti-abuse tax (BEAT) to be paid for tax years beginning after Dec. 31, 2017, in instances when a company's BEAT is greater than its regular tax liability. BEAT is 10 percent (5 percent for 2018 and increasing to 12.5 percent after 2025) of a U.S. corporation's taxable income adjusted to add deductible payments (excluding cost of goods sold and services charged at cost) made to foreign related parties. BEAT only applies to U.S. operations with gross receipts of more than \$500 million and qualifying payments to related parties greater than 3 percent of all deductible expenses. Unlike AMT, the BEAT tax paid does not reduce future regular income tax liabilities.

Per FASB Staff Q&A, Topic 740, No. 4, "Accounting for the Base Erosion Anti-Abuse Tax," the FASB staff believes that the incremental effect of BEAT should be recognized in the year the BEAT is incurred. As such, the effective tax rate under this approach (excluding permanent items) always would be equal or in excess of the 21 percent statutory rate. 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.

Wide-reaching state and local developments

South Dakota v. Wayfair Inc.

On June 21, 2018, the U.S. Supreme Court reversed a long-standing position and ruled that a physical presence was not required in order for a state to impose a sales and use tax collection obligation on an out-of-state retailer. In *South Dakota v. Wayfair Inc.*, the Court concluded that the physical presence standard it had previously endorsed was "unsound" and an "incorrect interpretation of the Commerce Clause."

Nexus is the degree of business activity or other presence that must exist before a taxing jurisdiction has the right to impose a tax on a business enterprise. If nexus exists, a business enterprise can be required to collect and remit sales and use taxes on sales made to purchasers in that state.

So far, more than 25 states have enacted economic nexus (nexus without a physical presence) models with varying enforcement dates. Other states are issuing guidance suggesting that economic nexus policies soon might be enacted. It is expected that most, if not all, states that impose sales and use tax will adopt some type of economic nexus standard.

While the applicability of *Wayfair* to remote sellers of merchandise is clear, the decision has far-reaching and less obvious implications for other taxpayers. Businesses that provide taxable services or sell products that straddle the line between tangible property and services – software and digital content, for example – also will be significantly affected.

Currently, more than 40 states have an economic nexus standard for income or franchise tax. With the *Wayfair* decision, doubt concerning the validity of economic nexus for all categories of state tax has been removed for the most part. Thus, even though *Wayfair* doesn't specifically address income or franchise tax, the decision is motivating taxpayers to revisit all their state tax nexus positions.

Accounting standards developments

On the accounting front, the FASB issued several new ASUs in 2018, including those addressing nonemployee stock compensation, additional guidance on lease accounting, and various codification improvements. As another calendar year closes, many companies will need to ensure that rule changes with effective dates during 2018 have been considered properly in preparing their income tax computations and disclosures. Other ASUs with later effective dates may be early adopted in 2018. The following list of ASUs is not all-inclusive and the discussions are narrowly focused on those that might have income tax implications. The ASUs are in order of their effective dates for public business entities (PBEs) with calendar years.

ASUs with PBE effective dates starting in 2018 (early application permitted for many)

Revenue recognition

ASU 2014-09, “Revenue From Contracts With Customers (Topic 606),” was issued in May 2014.

The first quarter of 2017 was the earliest time that any entity could adopt the sweeping changes of this new revenue recognition standard. It is intended to substantially enhance the quality and consistency of how revenue is reported while also improving comparability. It replaces previous guidance on revenue recognition in ASC 605 and eliminates industry-specific guidance. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Since its issuance, ASU 2014-09 has spawned multiple clarifying or correcting ASUs, including ASUs 2016-08, 2016-10, 2016-12, 2016-20, and 2017-13.

A company’s income tax accountant will need to pay close attention to whether adoption of this ASU creates, eliminates, or changes any temporary differences in the recognition of revenue for GAAP-versus-tax purposes.

Revenue Procedure 2018-29 provides procedures to obtain automatic consent to change to an otherwise permissible tax accounting method that follows Topic 606 accounting, in the year Topic 606 is adopted. It does not contain guidance on tax reform changes to IRC Section 451(b).

Due to the delay issued by ASU 2015-14, “Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date,” PBEs, certain not-for-profit entities, and certain employee benefit plans (public entities) must apply ASU 2014-09 to annual reporting periods beginning after Dec. 15, 2017, and related interim periods. All other entities must apply the guidance to annual reporting periods beginning after Dec. 15, 2018, and interim periods in the following year. All entities may apply the guidance early, but only as early as annual periods beginning after Dec. 15, 2016.

Financial instruments

ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities,” was issued Jan. 5, 2016. Select changes are discussed in this section.

The ASU changes the accounting for most equity securities and provides new and changed financial statement disclosures. With limited exceptions, equity securities that were accounted for as available for sale, with unrealized gain or loss presented as a contra account to amortized cost and recorded to other comprehensive income, still will be carried at fair value but now will be presented on the balance sheet as one amount, with subsequent changes recorded through the income statement. Tax accountants will need to adjust how they identify and account for the temporary difference associated with changes in value after initial acquisition.

Additionally, the ASU addresses the assessment of valuation allowances on certain deferred tax assets. Under previously accepted practice, deferred tax assets related to unrealized losses on debt securities that are classified as available for sale did not require a source of income test for realization when there is intent and the ability to hold the securities until maturity or value recovery. The ASU now requires realizability of the deferred tax assets to be evaluated in conjunction with other deferred tax assets and with consideration of sources of income.

The ASU is effective for PBEs for fiscal years beginning after Dec. 15, 2017, and for interim periods within. For all other entities, it is effective for fiscal years beginning after Dec. 15, 2018, and for interim periods in the following year. Early adoption is not permitted for the specific topics discussed earlier.

Breakage on certain prepaid stored-value products

ASU 2016-04, “Liabilities – Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products,” was issued in March 2016.

The ASU narrowly addresses breakage (that is, the monetary amount of the card that ultimately is not redeemed by the cardholder) for prepaid stored-value products that are redeemable for monetary values of goods or services but also may be redeemed for cash. It addresses the diversity in practice for recognizing breakage (income) by concluding that all such in-scope products are financial liabilities. Many products are scoped out, but examples of products in scope include prepaid gift cards issued by specific payment networks and redeemable at network-accepting merchant locations, prepaid telecommunications cards, and traveler’s checks. Similar to the revenue recognition ASU, any changes in financial statement recognition timing should be compared to the timing of the item’s recognition for tax purposes.

The ASU is effective for PBEs for fiscal years beginning after Dec. 15, 2017, and for interim periods within. For all other entities, it is effective for fiscal years beginning after Dec. 15, 2018, and for interim periods in the following year. Early application was permitted upon its March 2016 issuance, including adoption in an interim period.

Tax consequences of intra-entity taxable asset transfers

ASU 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory,” was issued in October 2016.

Once an entity adopts this ASU, it will recognize the income tax consequences of an intra-entity transfer of assets other than inventory when the transfer occurs. This situation most commonly occurs when one member of a consolidated financial reporting group transfers assets to another member, when the members file separate tax returns in various jurisdictions, and when some or all of those jurisdictions treat the transfer as a taxable transaction. Under current GAAP, the selling (or transferring) member defers recognizing, for consolidated financial reporting purposes, any resulting income tax expense, including taxes currently payable or paid, while the buying (or receiving) member does not recognize deferred income taxes for any basis difference for the transferred assets. The tracking burden this creates will be simplified or eliminated under the new ASU.

The ASU is effective for PBEs for annual reporting periods beginning after Dec. 15, 2017, including related interim periods. For all other entities, it is effective one year later and for interim periods within the following year. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which interim or annual financial statements have not been issued or made available for issuance. In other words, early adoption should be in the first interim period. Adoption should be on a modified retrospective basis through a cumulative-effect adjustment directly to beginning retained earnings.



Codification improvements

ASU 2018-09, “Codification Improvements,” was issued in July 2018.

The FASB has a standing project on its agenda to address suggestions on the codification received from stakeholders and to make other incremental improvements to GAAP. This perpetual project facilitates codification updates for technical corrections, clarifications, and other minor improvements, and should eliminate the need for periodic agenda requests for narrow and incremental items. These amendments are referred to as codification improvements. Updates in this ASU include, but are not limited to, the following:

- **Amendments to Income Statement – Reporting Comprehensive Income – Overall**

The guidance in paragraph 220-10-45-10B(b) states that taxes not payable in cash are required to be reported as a direct adjustment to paid-in capital. This requirement conflicts with other guidance in Topic 740, “Income Taxes,” Subtopic 805-740, “Business Combinations – Income Taxes,” and Subtopic 852-740, “Reorganizations—Income Taxes,” which generally states that income taxes and adjustments to those accounts upon a business combination or a bankruptcy that is eligible for fresh-start reporting must be recognized in income. The amendment in this update clarifies the guidance in paragraph 220-10-45-10B by removing the generic phrase about taxes not being payable in cash and adding guidance that is specific to certain quasi-reorganizations.

- **Amendments to Compensation – Stock Compensation – Income Taxes**

This update amends paragraph 718-740-35-2 to clarify that an entity should recognize excess tax benefits (that is, the difference in tax benefits between the deduction for tax purposes and the compensation cost recognized for financial statement reporting) in the period in which the amount of the deduction is determined, which generally is the period in which the stock award is settled. This includes deductions that are taken on the entity’s return in a period different from when the event that gives rise to the tax deduction occurs and the uncertainty is resolved about whether the entity will receive a tax deduction and the amount of such tax deduction.

- **Amendments to Business Combinations – Income Taxes**

The three methods for tax allocation described in paragraph 805-740-25-13 do not follow the broad principles of being systematic, rational, and consistent with Topic 740. The amendment removes the allocation methods in paragraph 805-740-25-13 and conforms the guidance in Subtopic 805-740 with the guidance in Topic 740.

The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments in this update do not require transition guidance and were effective upon issuance of the update. However, many of the amendments in the update do have transition guidance with effective dates for annual periods beginning after Dec. 15, 2018, for PBEs.

ASUs with PBE effective dates starting in 2019 (early application permitted)

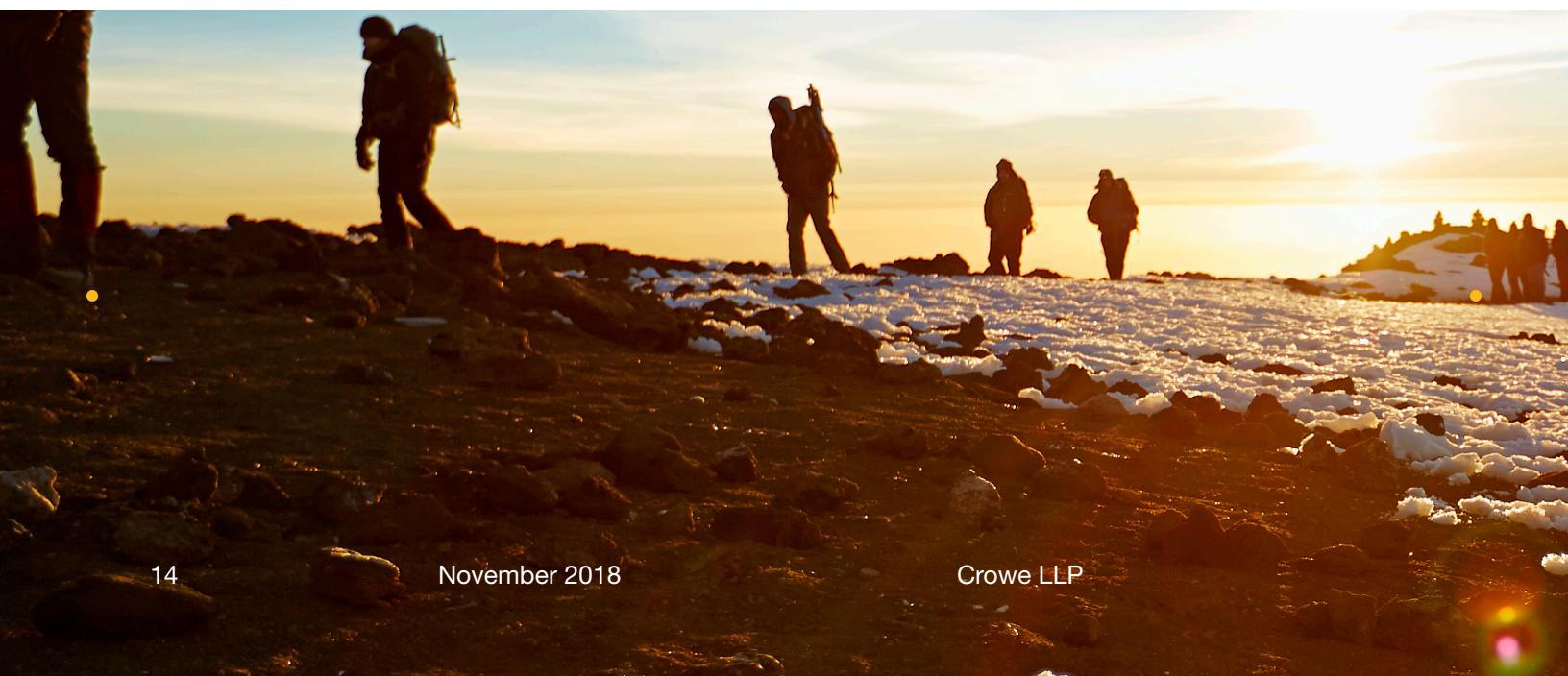
Lease accounting

ASU 2016-02, “Leases (Topic 842) Section A – Leases: Amendments to the FASB Accounting Standards Codification,” was issued in February 2016.

The most significant change in this new standard is that all leases, not just finance leases, will be recorded on the balance sheet unless they meet the short-term lease criteria (essentially, lease terms of 12 months or less with no bargain purchase element). A right-of-use asset, which will be amortized to the income statement, will be recorded to represent the right to use the leased asset, and a liability will be recorded to represent the lease obligation. Amounts still will be recorded to the income statement based on whether the lease is classified as finance or operating. If a lease is classified as a finance lease, both interest expense and amortization expense will be recorded. If it's classified as an operating lease, a single lease expense will be recorded. The pattern of expense typically will be front-loaded for finance leases and straight-line for operating leases. Tax accountants will need to record separate deferred tax assets and deferred tax liabilities for the new balance sheet accounts, determine the new expense accounts or account locations, and otherwise determine what changes this ASU will bring to the tracking of book-versus-tax differences in accounting for leases.

During 2018, two additional ASUs (ASUs 2018-01 and 2018-11) were issued to provide certain practical expedients and an additional adoption transition method that may be employed with the adoption of ASU 2016-02.

For PBEs, the standard is effective for interim and annual periods beginning after Dec. 15, 2018. For all others, it is effective for fiscal years beginning after Dec. 15, 2019, and for interim periods the following year. Early adoption was permitted upon the February 2016 issuance of the ASU.



Bond premium amortization timing

ASU 2017-08, “Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities,” was issued in March 2017.

This ASU changes the amortization period for the acquisition premium on debt securities with explicit noncontingent call features that are callable at fixed prices on preset dates. Premium amortization is shortened to the earliest call date. Previously, amortization was determined over the contractual life of the security. Acquisition discounts still are accreted to maturity.

For U.S. tax purposes, bondholders must compute and compare yields under both scenarios (held-to-maturity or to earliest call) on a bond-by-bond basis. For taxable bonds, tax amortization is required to follow the scenario that produces a higher yield to the holder (tax-exempt bonds must follow the lower-yield scenario). Generally, unless a bond features a significant call premium, the held-to-maturity scenario will produce a higher yield. Thus, for most taxable bonds, amortization timing for U.S. GAAP and tax purposes will diverge when the new ASU is adopted, creating a new temporary difference and tracking requirement.

Adoption is on a modified retrospective basis with cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. Any adoption adjustment also will affect the unrealized gain or loss account for affected available-for-sale securities. Care should be taken to properly tax-effect the adoption adjustments, including any adjustment to deferred taxes on unrealized gain or loss.

The ASU is effective for PBEs for fiscal years beginning after Dec. 15, 2018, and interim periods therein. For all other entities, the ASU is effective for fiscal years beginning after Dec. 15, 2019. Early adoption, which may be desirable for holders of significant positions, is permitted, including adoption in an interim period, in which case, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

Reclassification of certain tax effects from accumulated other comprehensive income

ASU 2018-02, “Income Statement – Reporting Comprehensive Income (Topic 220),” was issued in February 2018.

GAAP requires that deferred tax liabilities and assets be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date. This is so even in situations in which the related income tax effects of items in accumulated other comprehensive income (AOCI) were originally recognized in other comprehensive income, not income from continuing operations. This requirement has the effect of leaving tax amounts stranded in AOCI.

Some stakeholders expressed concern that the remeasurement of deferred taxes for the new 21 percent corporate tax rate had the effect of creating significant stranded tax effects in AOCI, resulting in AOCI not reflecting an appropriate tax rate.

In response, the FASB issued this ASU to allow an optional reclassification from AOCI to retained earnings for stranded tax effects resulting from the TCJA. The reclassification should include the effect of the change in U.S. corporate income tax rate on the gross deferred tax amounts and the related valuation allowances, if any, at the date of enactment of the TCJA related to items remaining in AOCI. The effect of the change in tax rate on any gross valuation allowances that were originally recorded in income from continuing operations shall not be included. A company may also include in its reclassification other income tax effects of the TCJA (not defined in this ASU) on items remaining in AOCI.

Because the amendments only relate to the reclassification of the income tax effects of the TCJA, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected.

All entities are required to adopt the ASU, as it contains disclosure requirements applicable to all, including:

- Entities must provide a description of the accounting policy for releasing income tax effects from AOCI.
- Entities not electing to reclassify must disclose that fact in the period of adoption.
- Entities electing to reclassify must disclose that fact, in the period of adoption, along with a description of any other income tax effects related to the TCJA that are reclassified.

The ASU is effective for all companies for fiscal years beginning after Dec. 15, 2018, and interim periods within those years. Early adoption is permitted for financial statements that have not yet been issued or made available for issuance.

Improvements to nonemployee share-based payment accounting

ASU 2018-07, “Compensation – Stock Compensation (Topic 718),” was issued in June 2018.

The FASB simplified the accounting for nonemployee share-based payments for goods or services to be used in a grantor’s own operations by aligning it with and including it within the scope of Topic 718, which addresses employee share-based compensation.

The following are outside the scope of Topic 718:

- Inputs to an option pricing model and the attribution of cost (that is, the vesting period and pattern of recognition) for nonemployee payments
- Share-based payments to provide financing to the issuer
- Share-based payments to grant awards in conjunction with selling goods or services to customers as part of a contract under Topic 606, “Revenue From Contracts With Customers”

The following changes will apply to nonemployee share-based payment awards:

- Instead of measuring at the fair value of the consideration received or the fair value of the equity instruments issued, the awards will be measured at grant date fair value.
- Instead of measuring at the earlier of when a commitment for performance by the counterparty is reached or the date at which the counterparty’s performance is complete, the awards will be measured at the grant date.
- Instead of measuring awards with performance conditions at the lowest aggregate fair value, the grantor will consider the probability of satisfying performance conditions contained in the awards.
- The classification of equity-classified awards no longer will need to be reassessed upon vesting unless award modifications occur after the award vests and the nonemployee no longer is providing goods or services.

For PBEs, the ASU is effective for fiscal years beginning after Dec. 15, 2018, including interim periods within that year. For all other entities, this ASU is effective for fiscal years beginning after Dec. 15, 2019, and interim periods within fiscal years beginning after Dec. 15, 2020. Early adoption is permitted, including in an interim period, but no earlier than the adoption of Topic 606.

ASUs with PBE effective dates starting in 2020 (early application permitted for many)

Credit losses

ASU 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” was issued in June 2016. The ASU affects entities holding financial assets that are not accounted for at fair value through net income, including loans, debt securities, trade receivables, net investments in leases, and other financial assets not specifically excluded. Tax-relevant changes are discussed in this section.

The ASU changes the manner in which the allowance for credit-related losses is determined – from an incurred loss to an expected loss approach. As such, it could increase the size of a company’s allowance for credit losses. It does not change the manner or criteria for an actual charge-off of a bad debt, and thus should have minimal impact on the related income tax accounting.

The ASU also changes the accounting associated with the acquisition of financial assets in a business combination. For assets whose collectibility has already deteriorated, the nonaccrable yield associated with purchased credit impairment is replaced with a credit loss allowance on purchased credit deterioration. The target’s existing allowance still is written off via Day 1 acquisition method accounting, and a fair value adjustment for reasons other than credit quality still will be recorded. On nondeteriorated (healthy) financial assets, a new allowance for any expected losses is established through the acquirer’s income statement. Tax accountants will need to identify and track any book-to-tax differences in order to adapt to the new terminology and requirements.

With regard to credit impairment of investment securities, under the ASU the direct write-down to the basis of an impaired security for other-than-temporary impairment, with no subsequent reversal should the security improve, is being replaced. Once adopted, any recordable impairment will be isolated within an allowance for credit losses, presented as a contra investment account, which could be reversed in the future should the security’s expected performance improve. This could create new or revised tracking for tax accounting, depending on positions being taken in tax returns regarding these impairments.

This ASU is effective for all of the following:

- PBEs that are SEC filers for annual and interim periods beginning after Dec. 15, 2019
- PBEs that are not SEC filers for fiscal years and interim periods beginning after Dec. 15, 2020
- All other entities for annual periods beginning after Dec. 15, 2021, and interim periods the following year

Early adoption is allowed for annual and interim periods beginning after Dec. 15, 2018.

Summary

The year 2018 was demanding for tax accountants. Tax reform's major overhaul to the tax code has had far-reaching implications. The SEC and the FASB were busy as well, providing accounting guidance for circumstances where uncertainty existed. And, of course, the Supreme Court threw in a game-changing decision in the field of income tax nexus. Many hours were invested to gain a deeper understanding of these developments and to ensure they were appropriately addressed in the preparation of both tax returns and financial statements. There is more work to come as tax accountants prepare to incorporate these many changes into their year-end financial reporting.



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