Private Company & NFP Relief on Reporting Tax Act Effects

The Financial Accounting Standards Board (FASB) recently expanded to private companies and not-for-profit (NFP) organizations relief offered by the U.S. Securities and Exchange Commission (SEC) to public companies in reporting the effects of the recently enacted *Tax Cuts and Jobs Act* (Tax Act). Although the tax reform did not go into effect until 2018, current accounting guidance in Accounting Standards Codification (ASC) 740, *Income Taxes*, requires companies to account for the effects of changes in income tax rates and deferred tax balances in the period when the legislation is enacted. Since President Donald Trump signed the Tax Act on December 22, 2017, the impact reporting must be reflected in 2017's year-end and fourth-quarter financial statements.

FASB has clarified several other reporting issues related to the Tax Act (see BKD article, FASB Addresses 2017 Tax Act Issues).

SAB 118

In December, the SEC issued Staff Accounting Bulletin (SAB) No. 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act*, which provides timing relief in accounting for the tax reform changes. These SEC interpretations are not directly applicable to private companies and NFPs. However, in the past some private companies and NFPs have voluntarily applied the guidance in SABs. This staff guidance only applies to the application of ASC 740 in connection with the Tax Act and should not be relied upon when applying ASC 740 to other tax law changes.

FASB concluded that due to the long-standing practice of nonregistrants voluntarily applying SAB guidance, private companies and NFPs may choose (but are not required) to apply the Tax Act relief provided by SAB 118. Financial statements of nonregistrants electing this relief would be in compliance with generally accepted accounting principles. If a private company or NFP applies SAB 118, it should disclose this policy election in the financial statements.

Due to the magnitude of the tax changes and the urgency of quarter-end and year-end filing deadlines, the SEC recognizes that a registrant may not have the necessary information available, prepared or analyzed to complete the required accounting. SAB 118 creates a measurement period—up to a year from the Tax Act's signing on December 22, 2017—to give companies sufficient time to finalize their accounting for the tax law changes. During the measurement period, the SEC expects that entities will act in good faith to complete the accounting under ASC 740. The guidance highlights three possible scenarios, which are noted below. An entity may need to apply all three scenarios in finalizing its accounting for the Tax Act based on its available information.

- **Measurement of certain income tax effects is complete.** Registrants must reflect the tax effects of the Tax Act for which accounting is complete. These amounts are final and **not** provisional.
- **Measurement of certain income tax effects can be reasonably estimated.** Registrants must report provisional amounts for tax effects with incomplete accounting when they can determine a reasonable estimate. The provisional amount should be included in the financial statements in the first reporting period it was determined to be a reasonable estimate.
- **Measurement of certain income tax effects cannot be reasonably estimated.** An entity should **not** adjust its current or deferred taxes until a reasonable estimate can be determined. In this case, an entity would continue to apply ASC 740 based on the tax laws in effect immediately prior to the Tax Act's enactment.

During the measurement period, an entity may adjust provisional amounts or report additional tax effects for items not initially provisioned for based upon 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. These changes should be included in income from continuing operations as an adjustment to tax expense in the reporting period the amounts are determined. Any income tax effects of events unrelated to the Tax Act should **not** be reported as measurement period adjustments.

The following disclosures are required:

- Qualitative disclosures of the Tax Act's income tax effects for which the accounting is incomplete
- Disclosures of items reported as provisional amounts
- Disclosures of existing current or deferred tax amounts for which the Tax Act's income tax effects have not been completed
- The reason why the initial accounting is incomplete
- The additional information that is needed 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
- The effect of measurement period adjustments on the effective tax rate
- When the accounting for the Tax Act's income tax effects has been completed

BKD will continue to follow developments on this topic. For more information on how the new tax law could affect your organization, contact your BKD advisor.

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Appendix – Examples from SAB 118

Example 1

Prior to the reporting period in which the Tax 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. Upon enactment, the Tax 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, *i.e.*, 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 Tax Act will affect 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 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.

Example 1a

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.

Example 2

Company Z has deferred tax assets (assume Company Z was able to comply with ASC 740 and remeasure 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 the Act was enacted, no amount for the recognition (or release) of a valuation allowance would be reported. 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 to determine that no valuation allowance needed to be recognized (or released) to complete the accounting under ASC 740.