Tax Reform Considerations for Fiscal Year-End Companies

President Donald Trump's December 22, 2017, enactment of the first major tax reform in more than 30 years has raised numerous implementation and reporting issues for all companies. The enactment date triggers the remeasurement of an entity's deferred tax assets and liabilities using the new rates, while other provisions are only effective for taxable years beginning after December 31, 2017. Companies on a noncalendar, year-end reporting basis face some additional challenges in reporting the effects of the *Tax Cuts and Jobs Act*. Existing—but long forgotten—guidance in Internal Revenue Code Section 15 addresses the application of tax law changes for fiscal year-end companies. The IRS requires the use of a blended rate for interim and annual reporting. Determining the blended rate is a simple mathematical exercise based on calendar days.

The enactment date triggers the remeasurement of an entity's deferred tax assets and liabilities using the new rates. The Financial Accounting Standards Board (FASB) recently developed some relief for companies with deferred tax items initially reported in other comprehensive income and provided clarity on several other financial reporting issues (see BKD's article, FASB Addresses 2017 Tax Act Issues).

Blended Effective Tax Rate

The revenue code requires 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 year's taxable income. 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 the effective date. 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.

Example: Blended Rate for a Company with a June 30 Fiscal Year-End				
Period	Days	Proportion	Tax Rate	Proportional Rate
July 1 – December 31, 2017 (prior to the effective date)	184	50.41%	35%	17.65%
January 1 – June 30, 2018 (after the effective date)	181	49.59%	21%	10.41%
Estimated Annual Effective Rate				28.06%

The following table lists the blended rates based on each 2018 month-end date. Companies with periods ending on dates other than the month-end will need to determine their blended tax rate based on their specific fiscal year-end.

Blended Tax Rates			
Fiscal Year Ending On	Blended Rate	Fiscal Year Ending On	Blended Rate
January 31, 2018	33.81%	July 31, 2018	26.87%
February 28, 2018	32.74%	August 31, 2018	25.68%
March 31, 2018	31.55%	September 30, 2018	24.53%
April 30, 2018	30.40%	October 31, 2018	23.34%
May 31, 2018	29.21%	November 30, 2018	22.19%
June 30, 2018	28.06%	December 31, 2018	21.00%

*Companies, primarily retail, that operate on a 52- to 53-week taxable year would **not** have to apply a blended rate if their year ends within six days of the January 1, 2018, effective date.*

Blending only applies to the corporate tax rate and not to other deductions or credits that changed in the new tax law. For example, the limitation on interest expense deductions for fiscal-year taxpayers will kick in on their first taxable year that begins after January 1, 2018. For a company with a tax year ending June 30, 2018, the interest limitation will not apply until July 1.

Interim Reporting

Noncalendar year-end companies also need to consider the tax rate change's effects on interim reporting if the enactment date is in an interim period. Under Accounting Standards Codification (ASC) 740, 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 estimated annual effective tax rate beginning no earlier than the first interim period that includes the enactment date of the new legislation. ASC 740 does **not** permit the effect of a tax law change to be apportioned among quarters, so an entity should recognize the entire effect in the first-quarter financial statements. This may result in a large variation from expectations in the relationship between income tax expense and pretax accounting income. These variances can result from discrete items, such as adjusting deferred taxes during the period that includes the enactment date, and other adjustments that are necessary to appropriately reflect the new tax legislation's effect on the current period. The guidance requires entities to disclose the reasons behind such variances in their interim-period financial statements if such differences are not readily apparent from the financial statements themselves or from the nature of the entity's business.

Deferred Tax Assets & Liabilities

Although the tax reform did not go into effect until 2018, ASC 740 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. For entities that prepare interim financial statements, estimating the law's effect using the most recent quarter-end, adjusted for known material transactions between the previous quarter-end and date of enactment, December 22, 2017, can be sufficient. Any activity that could have an effect on deferred tax positions during that brief period should be appropriately reflected in the deferred tax remeasurement calculations, *e.g.*, business combinations, purchases of new assets with accelerated depreciation, issuances of share-based compensation or other transactions that result in future taxable or deductible differences. Fiscal year-end companies also will need to consider the effect of reversals of beginning deferred tax balances for the period through the enactment date, as well as the deferred tax effects of temporary differences that originated prior to the enactment date. Guidance in ASC 740 indicates the following applicable tax rates for deferred tax balances:

- For balances expected to reverse after the enactment date and within the current fiscal year, the applicable rate is the "blended tax rate," which will be effective for the fiscal year.
- For balances not expected to reverse within the current fiscal year, the applicable rate is the new statutory tax rate of 21 percent, which will be effective for the first fiscal year beginning after January 1, 2018.

Subsequent Event Reporting

Entities with fiscal years ending before the enactment date that have not issued the financial statements as of the enactment date should follow guidance in ASC 855, *Subsequent Events*. These entities should not reflect the tax reform effects in their annual financial statements because the enactment date is after the end of their fiscal year, but they should consider note disclosure of the anticipated effects to prevent misleading financial statements. If required, entities should include information about the nature of the nonrecognized subsequent event and either an estimate of its financial effect or a statement indicating the effect cannot be estimated.

Internal Controls

Entities should review whether their existing internal controls related to income taxes are properly designed to accommodate the new tax provisions. In addition to controls over income tax accounting, entities also should assess the need for new or modified internal controls related to new income tax disclosures, including any disclosures related to applying the new tax requirements.

For more information, contact your BKD advisor.

Contributor

Anne Coughlan
Director
317.383.4000
acoughlan@bkd.com