FASB **EXPOSURE DRAFT**

Proposed Accounting Standards Update

Issued: January 18, 2018
Comments Due: February 2, 2018

Income Statement—Reporting Comprehensive Income (Topic 220)

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 220 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2018-210, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until February 2, 2018. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2018-210
- Sending a letter to "Technical Director, File Reference No. 2018-210, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

On December 22, 2017, the U.S. federal government enacted a tax bill, 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 of 2017). Stakeholders in the banking and insurance industries submitted unsolicited comment letters to the FASB about a narrow-scope financial reporting issue that arose as a consequence of the Tax Cuts and Jobs Act of 2017.

Specifically, stakeholders expressed concerns about the guidance in current generally accepted accounting principles (GAAP) that requires deferred tax liabilities and assets to 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. That guidance is applicable even in situations in which the related income tax effects of items in accumulated other comprehensive income were originally recognized in other comprehensive income (rather than in net income).

Those stakeholders asserted that because the adjustment of deferred taxes due to the reduction of the historical corporate income tax rate to the newly enacted corporate income tax rate of 21 percent is required to be included in income from continuing operations, the tax effects of items within accumulated other comprehensive income (referred to as stranded tax effects for purposes of this proposed Update) do not reflect the appropriate tax rate.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect any entity that is required to apply the provisions of Topic 220, Income Statement—Reporting Comprehensive Income, and has items of other comprehensive income for which the related tax effects are presented in other comprehensive income as required by GAAP.

What Are the Main Provisions and Why Would They Be an Improvement?

The amendments in this proposed Update would require a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate.

Consequently, the amendments in this proposed Update would eliminate the stranded tax effects associated with the change in the federal corporate income tax rate in the Tax Cuts and Jobs Act of 2017 and would improve the usefulness of information reported to financial statement users.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.

Early adoption of the amendments in this proposed Update would be permitted, including adoption in any interim period, for (1) public business entities for reporting periods for which financial statements have not yet been issued and (2) all other entities for reporting periods for which financial statements have not yet been made available for issuance.

An entity would apply the amendments in this proposed Update retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act of 2017 is recognized.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do you agree with the amendments in this proposed Update that would require a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate? If not, why?

Question 2: Are the transition requirements appropriate? If not, what transition approach is more appropriate and why?

Question 3: Do you agree that early adoption should be permitted?

Question 4: Do you agree with the proposed effective date? If not, what effective date is more appropriate and why?

Question 5: GAAP generally prohibits *backwards tracing,* which is the process of recognizing the effects of changes in deferred tax amounts in the current year in the same line item in which the deferred tax amounts were originally recognized (for example, other comprehensive income) in prior years. The Board did not allow backwards tracing as part of this project and is currently researching the merits of a broader project on backwards tracing. Should the Board add a broader project on backwards tracing to its active agenda? If so, why? Additionally, should the following alternatives to backwards tracing be considered in that broader project? If so, why?

a. Accounting for the release of the stranded tax effects from accumulated other comprehensive income
b. Reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects associated with *prior changes* in other tax rates (for example, state and local taxes)
c. Reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects associated with all *future changes* in tax rates.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Codification Section	Description of Changes
Other Presentation Matters (220-10-45)	• Added a paragraph for reclassifying certain income tax effects from accumulated other comprehensive income to retained earnings
Other Presentation Matters (740-10-45)	• Added a paragraph to reference the guidance added in Subtopic 220-10

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–5. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 220-10

3. Add paragraph 220-10-45-12A, with a link to transition paragraph 220-10-65-4, as follows:

Income Statement—Reporting Comprehensive Income—Overall

Other Presentation Matters

> Presentation of Income Tax Effects

220-10-45-12A The Tax Cuts and Jobs Act of 2017 established a 21 percent U.S. federal corporate income tax rate. An entity shall reclassify the effect of remeasuring deferred tax liabilities and assets related to items within accumulated other comprehensive income to retained earnings resulting from the Tax Cuts and Jobs Act of 2017. The amount of that reclassification is the difference between the amount initially charged or credited directly to other comprehensive income at the previously enacted U.S. federal corporate income tax rate that remains in accumulated other comprehensive income and the amount that would have been charged or credited directly to other comprehensive income using the newly enacted 21 percent U.S. federal corporate income tax rate, excluding the effect of any valuation allowance previously charged to income from continuing operations.

Amendments to Subtopic 740-10

4. Amend paragraph 740-10-45-1 and add paragraph 740-10-45-29 and its related heading, with a link to transition paragraph 220-10-65-4, as follows:

Income Taxes—Overall

Other Presentation Matters

740-10-45-1 This Section provides guidance on statement of financial ~~position and~~ position, income statement ~~classification~~and statement of shareholder equity classification, and presentation matters applicable to all ~~of~~ the following:

a. Statement of financial position classification of income tax accounts
b. Income statement presentation of certain measurement changes to income tax accounts
c. Income statement classification of interest and penalties
d. Presentation matters related to investment tax credits under the deferral method.
e. Statement of shareholder equity reclassification of certain income tax effects from accumulated other comprehensive income.

> Statement of Shareholder Equity Reclassification of Certain Income Tax Effects from Accumulated Other Comprehensive Income

740-10-45-29 Paragraph 220-10-45-12A provides guidance on the reclassification of certain income tax effects of items within accumulated other comprehensive income to retained earnings. That guidance results from the Tax Cuts and Jobs Act of 2017.

5. Add paragraph 220-10-65-4 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2018-0X, *Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*

220-10-65-4 The following represents the transition and effective date information related to Accounting Standards Update No. 2018-0X, *Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income:*

a. The pending content that links to this paragraph shall be effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.
b. An entity shall apply the pending content that links to this paragraph retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act of 2017 is recognized.
c. Earlier application of the pending content that links to this paragraph is permitted, including adoption in any interim period for:
    1. Public business entities for reporting periods for which financial statements have not yet been issued
    2. All other entities for reporting periods for which financial statements have not yet been made available for issuance.
d. In the first interim and annual period of adoption, an entity shall disclose the following:
    1. The nature of and reason for the change in accounting principle
    2. A description of the prior-period information that has been retrospectively adjusted
    3. The effect of the change on the affected financial statement line items.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Marsha L. Hunt
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. On December 22, 2017, the U.S. federal government enacted a tax bill, 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 of 2017). Stakeholders in the banking and insurance industries submitted unsolicited comment letters to the FASB about a narrow-scope financial reporting issue that arose as a consequence of the Tax Cuts and Jobs Act of 2017.

Background Information

BC3. In the unsolicited comment letters, stakeholders expressed concerns about the guidance in Topic 740, Income Taxes, that requires deferred tax liabilities and assets to 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. That guidance is applicable even in situations in which the related income tax effects of items in accumulated other comprehensive income (for example, foreign currency translation adjustments and changes in the unrealized holding gains and losses of debt securities classified as available for sale) were originally charged or credited directly to other comprehensive income or to related components of shareholders' equity, as required by GAAP. GAAP generally prohibits backwards tracing, which is the process of recognizing the effects of changes in deferred tax amounts in the current year in the same line item in which deferred taxes originally were recorded.

BC4. Those stakeholders asserted that because the adjustment of deferred taxes due to the reduction of the historical corporate income tax rate to 21 percent is required to be included in income from continuing operations, the tax effects of items within accumulated other comprehensive income (referred to as stranded tax effects for purposes of this proposed Update) do not reflect the appropriate tax rate. Those stakeholders noted that such accounting has the potential to result in outcomes that may be confusing to financial statement users. Additionally, they asserted that recording those tax effects through income from continuing operations, and ultimately retained earnings, may have a negative effect on regulatory capital for some banks. Therefore, those stakeholders requested that the Board allow the effects of the change in the newly enacted corporate income tax rate on deferred taxes that were originally recorded in other comprehensive income to be reflected within other comprehensive income (that is, allow backwards tracing).

BC5. The amendments in this proposed Update do not address the current prohibition in GAAP on backwards tracing because that would necessitate a broader project that could not be completed in sufficient time to resolve stakeholders' immediate concerns. Therefore, because the Board believes that there is a more immediate need for standard setting resulting from the Tax Cuts and Jobs Act of 2017, the proposed amendments focus on a targeted improvement to reclassify stranded tax effects from this tax law change from accumulated other comprehensive income to retained earnings.

Benefits and Costs

BC6. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC7. Overall, the Board concluded that the expected benefits of the amendments in this proposed Update would justify the expected costs. The proposed amendments would result in improved financial reporting. That is, after the reclassification is made for the stranded tax effects from accumulated other comprehensive income to retained earnings, the federal tax effects of items in other comprehensive income would reflect the newly enacted federal corporate income tax rate of 21 percent, resulting in components of equity that would be more accurately stated. Furthermore, the Board does not anticipate that entities would incur significant costs to determine the amount of the stranded tax effects resulting from the enactment of the Tax Cuts and Jobs Act of 2017 and to make the reclassification. Additional discussion about the costs and benefits of the proposed amendments is provided throughout this basis for conclusions.

Reclassification from Accumulated Other Comprehensive Income

BC8. The Board decided to require a reclassification from accumulated other comprehensive income to retained earnings for the stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate and the newly enacted 21 percent corporate income tax rate. The amount of the reclassification would not include any stranded tax effects that resulted from recording a valuation allowance through income from continuing operations on a deferred tax asset related to items within accumulated other comprehensive income.

BC9. The Board noted that a reclassification of the stranded tax effects would be a targeted improvement that is responsive to the immediate concern of stakeholders in the banking and insurance industries (that is, short of considering the broader issue of backwards tracing) and would improve the usefulness of information reported to financial statement users.

BC10. The Board considered but rejected a broader alternative to require reclassification of the stranded tax effects within accumulated other comprehensive income to retained earnings for the change to the newly enacted corporate income tax rate, previous changes to other tax rates such as state and local tax rates, and for all future tax rate changes.

BC11. While that broader alternative would eliminate all stranded tax effects within accumulated other comprehensive income, additional research and outreach would need to be conducted to determine the cost, complexity, and benefit of reclassifying the stranded tax effects associated with prior changes in tax rates and future changes in tax rates. The Board understands the urgency of the need for a change to GAAP, and a broader alternative would not be responsive to the immediate issue identified by stakeholders resulting from the Tax Cuts and Jobs Act of 2017.

Broader Project on Backwards Tracing

BC12. The Board decided to add a broader project to its research agenda related to the issue of backwards tracing. The Board directed the staff to consider the expected cost and expected benefits of backwards tracing from both a preparer perspective and a financial statement user perspective.

Effective Date and Early Adoption

BC13. The Board decided that the amendments in this proposed Update would be effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

BC14. The Board believes that the effective date provides sufficient time for entities and their auditors to analyze the effect of the amendments in this proposed Update. Additionally, the Board noted that the effective date aligns closely with the measurement period in U.S. Securities and Exchange Commission Staff Accounting Bulletin No. 118, *Income Tax Accounting Implications of the Tax Cuts and Jobs Act*. Under SAB 118, if an entity's accounting for certain income tax effects of the Tax Cuts and Jobs Act of 2017 is incomplete by the time the financial statements are issued for the reporting period that includes the enactment date of December 22, 2017, an entity can complete the accounting under Topic 740 within a measurement period that would not extend beyond one year from the enactment date.

BC15. The Board decided to permit early adoption for public business entities for which financial statements have not yet been issued and all other entities for which financial statements have not yet been made available for issuance. The Board noted that early adoption would allow some entities to align the timing of the reclassification of the stranded tax effects of items included within accumulated other comprehensive income to retained earnings with the income statement effect of the adjustment to deferred tax liabilities and assets for the reduced corporate tax rate in their 2017 financial statements.

Transition and Transition Disclosures

BC16. The Board decided that the amendments in this proposed Update would be applied retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act of 2017 is recognized. As such, the reclassification of the stranded tax effects would align with the guidance that requires deferred tax accounts to be adjusted for the effect of the change in tax laws or rates, the effect of which is included in income from continuing operations for the period that includes the enactment date.

BC17. The Board acknowledged that for entities that record provisional amounts under SAB 118 and adjust those provisional amounts upon obtaining, preparing, or analyzing additional information, the reclassification could occur in multiple reporting periods.

BC18. The Board decided to require transition disclosures in the first interim and annual period of the change, including the nature of and reason for the accounting change in accounting principle, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on affected financial statement line items. The Board decided to require those transition disclosures because the changes are limited to few financial statement line items and detailed disclosures are required by Topic 220 that would provide additional quantitative information about the reclassification from accumulated other comprehensive income to retained earnings.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Proposed changes to the Taxonomy are available for public comment through ASU Taxonomy Changes provided at www.fasb.org and will be incorporated in the final Taxonomy after the FASB has completed its deliberations and issued a final Accounting Standards Update.