Comment letter related to the impact of the new tax bill enacted December 22, 2017 and the effects on Deferred Tax Assets / Deferred Tax Liabilities as related to Accumulated Other Comprehensive Income (AOCI) items, which the proposed Accounting Standards Update issued January 18, 2018, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, attempts to address. Most notably having an income tax impact for this rate change related to unrealized gains or losses on available-for-sale (AFS) securities, which are balance sheet only accounts until final settlement.

The primary reason I am writing this comment letter is due to the various interpretations I have heard from clients and the nature of the accounts related to unrealized gains and losses on AFS securities. Creating a current income tax effect for an item that does not usually have a direct income impact and can move from a gain to a loss simply due to portfolio make-up, market activity and assumptions on future interest rate changes simply does not make sense. As most banks hold AFS securities to help balance the asset/liability mix and intend to hold until full settlement, the unrealized gain/loss amounts will never have a direct bottom line impact.

While adjusting the deferred tax asset (DTA) or deferred tax liability (DTL) without a corresponding adjustment to ending AOCI appears to match all research of the accounting guidance, it seems to lack the elements of logic and common sense, which are generally present in accounting guidance, not to mention the basic mathematical calculation.

The need to address the change in tax rate from the current level of 34% / 35% to the newly enacted rate of 21% is obvious, and I agree that any changes related to previously reported items in the income statement must be reported through income tax expense. (Not reversed against a line item where previously reported, known as backwards tracing.) What appears to be the issue is the impact of the change on items that remain in AOCI at the end of the period, particularly related to unrealized gains and losses on available-for-sale securities. The guidance requires the AOCI for AFS securities to be presented, net of tax.

Therefore, if the deferred tax liability for an unrealized gain (or a deferred tax asset for an unrealized loss) is calculated at the new rate of 21%, then to corresponding item in AOCI would have to be reported at the rate of 79% to properly report as net of tax. If the ending AOCI is calculated net of tax as noted, there would not be “stranded tax effects” and it does not appear there would be a need for any income tax expense effect, or an adjustment to retained earnings.

**Proposed adjustment to the current guidance:** As noted, any adjustments to DTAs and DTLs for typical timing differences (allowances, depreciation, deferred income, etc.) would need to be reported as a component of income tax expense. Any DTAs or DTLs related to unrealized gains or losses on AFS securities would need to be calculated as currently required at the newly enacted tax rate and the related AOCI calculated net of tax, with no P&L impact until future settlement.

Please help add some clarity and consistency on the AOCI portion, and update the proposed ASU as necessary. Please exclude the deferred tax impact of unrealized gains and losses related to AFS securities from the current income tax expense adjustments required with changes in federal tax rates.

Thank you for your consideration on this matter,

Dan

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