Dear Ms. Cosper,

Deloitte & Touche LLP is pleased to comment on the FASB’s proposed Accounting Standards Update (ASU), Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income.

We support the Board’s efforts to respond timely to concerns raised by stakeholders that the Tax Cuts and Job Act of 2017 would result in tax effects of items within accumulated other comprehensive income (AOCI) not reflecting the appropriate tax rate. We believe the proposed ASU addresses this concern.

We generally agree with, and support finalizing, the amendments proposed in the ASU. Appendix A contains our responses to the proposed ASU’s questions for respondents as well as additional observations regarding the ASU’s proposed approach. Appendix B contains additional details related to those observations.

We would be happy to share additional perspectives and suggestions with the Board and FASB staff on the matters discussed in our comment letter.

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We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Matt Himmelman at (714) 436-7277, or Peggy Cullen at (312) 486-9139.

Yours truly,

Deloitte & Touche LLP

cc:

Robert Uhl
Matt Himmelman
Peggy Cullen
Appendix A
Deloitte & Touche LLP
Response to Proposed ASU’s Questions to Respondents

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?

Overall, we generally agree with, and support finalizing, the amendments proposed in the ASU to reclassify the stranded tax effects resulting from the newly enacted federal corporate income tax rate from accumulated other comprehensive income to retained earnings. However, given that the proposed ASU may have limited benefits to the users of financial statements of certain entities, (specifically those outside the banking and insurance industries which do not have regulatory capital requirements), we believe adoption of the ASU should be optional, rather than required, to allow those entities that view the benefits as sufficient to justify the time and effort associated with adopting the ASU, while allowing those that do not to avoid such costs.

More specifically, determining the amount that “remains” in AOCI and for which a deferred tax asset or liability was remeasured in accordance with the newly enacted tax rate may be challenging for certain types of transactions. For example, translation adjustments with respect to movements in foreign exchange rates are recorded to other comprehensive income (OCI), along with the corresponding tax effects if an entity does not consider the entire amount of the financial reporting carrying value in excess of the tax basis in its investment in a foreign subsidiary to be indefinitely reinvested. Upon a non-liquidating distribution or divestiture from such foreign investment, the entire amount of tax recorded to OCI in prior periods will still “remain in AOCI” even though only a portion of the related deferred tax asset/liability may have reversed. In fact, in many cases it might take a significant amount of time and effort for an entity to determine the amount of tax that “remains” in AOCI for which there is a corresponding deferred tax asset or liability that was remeasured in accordance with the newly enacted corporate income tax rate as it could potentially go back a number of years.

Furthermore, as presently drafted, it is unclear if the Board intended for the ASU to require a reclassification from AOCI to retained earnings related to “all” amounts initially charged or credited directly to OCI, regardless of whether there is a corresponding deferred tax asset or liability that was remeasured in accordance with the newly enacted corporate income tax rate. For example, an entity may have a tax accounting method that taxes the gain/loss related to available for sale securities on an unrealized basis rather than when realized. In that case, the tax effects remaining in AOCI would represent taxes already paid at the historic tax rate and there would have been no remeasurement of a deferred tax asset or liability in accordance with the newly enacted tax rate. While it may take less time and effort to record a reclassification of all amounts initially charged or credit directly to other comprehensive income rather than bifurcate the amounts of tax initially recorded in OCI and for which a deferred tax asset or liability remains as of the enactment date, we believe a reclassification reducing the tax effects recorded in AOCI for amounts that were, in fact, previously taxed at the historic tax rates would be counterintuitive and not provide useful information to the users of the financial statements.

Irrespective of the Board’s intent with respect to the aforementioned “stranded” foreign currency amounts, in order to improve consistency in application of the ASU, we believe the final ASU should more clearly define (1) what constitutes “the amount initially charged or credited” to OCI, (2) what constitutes an amount that “remains in AOCI,” and (3) what the Board intended when it noted that the
amount should be calculated “excluding the effect of any valuation allowance previously charged to income from continuing operations.” Said differently, we believe the final ASU should better clarify what is meant by “stranded tax effects,” as that term is used in the ASU. Our recommendations are discussed in more detail in Appendix B.

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

Yes. We agree with the transition requirements.

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

Yes. We 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?

Yes. We agree with the proposed effective date.

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.

While we would not be opposed to the Board adding a broader project on backwards tracing to its active agenda or performing additional diligence around the alternatives to backwards tracing noted above, we believe the time and resources of the Board would be more appropriately allocated to other projects.
We believe the process of backwards tracing can be a difficult and time consuming process, as noted in our example in response to Question 1. That view is consistent with paragraph 113 of the Basis for Conclusions to Statement of Financial Accounting Standard No. 109, Accounting for Income Taxes, which stated in part that:

The Board decided that the entire tax effect of a change in enacted tax rates should be allocated to continuing operations in order to avoid the sometimes complex problems of tracing back to events of prior years in conjunction with:

a. Many different types of temporary differences

b. Incremental tax rates (used for intraperiod allocation) that may be different from statutory tax rates

c. Operating loss and tax credit carrybacks and carryforwards

Additionally, we are aware the Board performed outreach in 2016 as part of its year-long agenda consultation to identify major areas of financial reporting for which improvement might be warranted. In response to that outreach, backwards tracing was not identified as an issue. We believe this is evidence that the prohibition on backwards tracing, absent a material change in tax law such as the Act, is not an issue of primary importance to stakeholders.

We are aware that in response to the Tax Cuts and Jobs Act of 2017 (the Act), stakeholders provided comments to the Board regarding the impact the prohibition on backwards tracing would have on their financial statements due to the significant change in rates mandated by the Act. However, we believe the proposed ASU adequately addresses the issue raised by stakeholders through reclassification of the stranded tax effects resulting from the Act remaining in AOCI to retained earnings and obviates the immediate need for the Board to undertake a broader project on backwards tracing.
Clarifications of Wording in ASC 220-10-45-12A

Page 1 of the ASU states the following [emphasis added]:

... 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.

BC8 uses similar language, stating that:

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.

Without additional clarification, however, we believe “stranded tax effects,” in the context of the ASU, could be interpreted to mean one of three things:

1. Items that were originally charged to OCI for which a deferred tax item “remains” and a corresponding current period tax expense or benefit was recognized in continuing operations as a result of the change in enacted tax rates;
2. Items that were originally charged to OCI and for which a deferred tax item “remains” on the balance sheet as of the enhancement date; or
3. Items that were originally charged to OCI which “remain” in AOCI regardless of whether they have been stranded as a result of a change in enacted tax rates or as a result of another matter and regardless of whether or not a corresponding deferred tax amount still exists on the balance sheet as highlighted in our response to Question 1 in Appendix A.

While we believe the Board may have intended to capture only those items in #2 above, the prescriptive guidance in ASC 220-10-45-12A, as currently drafted [emphasis added], does not appear to clearly delineate between the aforementioned interpretations:

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.
rate, excluding the effect of any valuation allowance previously charged to income from continuing operations.

For example, while not explicitly stated, we believe that, if a valuation allowance is initially recorded in the same period as a deferred tax asset, the amount “initially credited to OCI” would be zero. Accordingly, at the date of enactment, the amount “that remains in” AOCI would also be zero and no reclassification would be required under the proposed ASU. If, however, a deferred tax asset is initially credited to OCI and has not since reversed, and a valuation allowance is recorded in a subsequent period through a charge to continuing operations, at the date of enactment, a gross deferred tax asset would remain for which the tax initially recorded would appear to “remain in” AOCI, “excluding the effect of any valuation allowance previously charged to income from continuing operations.” Said differently, we believe that the intent is to ignore the valuation allowance that exists as of the date of enactment, if such valuation allowance was not also charged to OCI. However, the last sentence of BC8, which states that “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” might be read to imply that no entry should be made at all because the stranding occurred prior to the change in tax rate (i.e. the stranded tax effects do not stem from the change in tax rates, but rather as a result of the recording of a valuation allowance in continuing operations).

We also believe the Board’s intent with respect to amounts “initially credited” to OCI in accordance with ASC 740-20-45-7 is not currently addressed within the proposed ASU. For example, assume that in Year 1 an entity has a $100 loss on an AFS security that is charged to OCI, but no tax effect is initially recorded because the entity needs a full valuation allowance. Assume that in Year 2, however, the same security experiences a $20 gain. On the surface, it would appear as if no amount would be “initially charged” (as contemplated by the ASU) to OCI as the reduction in the deferred tax asset would be offset by a reversal of a portion of the valuation allowance. If, however, the entity was in an overall loss position, ASC 740-20-45-7 would require recording an “expense” to OCI related to the current year gain in order to allow a benefit to be recognized in continuing operations with respect to the continuing operations loss. It is unclear as to whether the Board contemplated this situation in drafting the ASU, and should consider adding clarification of how preparers should address this fact pattern in consideration of the amount “initially recognized”.

As such, we would suggest that the wording in ASC 220-10-45-12A be clarified.