Tax Cuts and Jobs Act: Accounting and Financial Reporting

Course #2151A

Accounting

2 Credit Hours

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TAX CUTS AND JOBS ACT: ACCOUNTING AND FINANCIAL REPORTING

The objective of this course is to inform the reader of impacts the changes made by the Tax Cuts and Jobs Act have on GAAP and financial reporting. Topics include an analysis of adjustments required to be made to deferred income tax assets and liabilities, including those assets related to net operating losses, the newly issued ASU 2018-02 related to the tax effect of accumulated other comprehensive income, accounting for the change from an S to a C corporation, the impact of the elimination of like-kind exchanges, GAAP accounting for bonus and Section 179 depreciation, new limitations on the interest deduction, SEC SAB 118 transition rules, presenting the tax benefit of an NOL carryover, and more.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

Tax Cuts and Jobs Act: Accounting and Financial Reporting

Study the course materials from pages 1 to 74

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- Recognize how an entity should account for deferred tax accounts under the *Tax Cuts and Jobs Act.*
- Identify how the ASU 2018-02 election is made to reclassify the tax effect on accumulated other comprehensive income.
- Recall the adjustment that is made when an entity converts from S to C corporation status.
- Recognize the type of like-kind exchange that qualifies for nonrecognition of gain or loss under GAAP.
- Identify a way in which an entity can account for bonus depreciation under GAAP.
- Recall the overall impact that the reduction in the corporate tax rate is having on SEC companies.
- Recognize whether SEC companies are permitted to discount tax liabilities pertaining to repatriated income.
- Recall when an entity is required to disclose the tax years open for examination.

NOTICE

This course is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional advice and assumes no liability whatsoever in connection with its use. Since laws are constantly changing, and are subject to differing interpretations, we urge you to do additional research and consult appropriate experts before relying on the information contained in this course to render professional advice.

This course and test have been adapted from supplemental material and uses the materials entitled *The Impact of the Tax Cuts and Jobs Act on GAAP and Financial Reporting* and is a component of *Annual Accounting and Auditing Update & Review © 2020 and 2019 Fustolo Publishing LLC*. Displayed by permission of the author. All rights reserved.

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TABLE OF CONTENTS

IMPACT OF TAX CUTS AND JOBS ACT ON ACCOUNTING AND FINANCIAL REPORTING

Course Objectives

After completing this course, you should be able to:

- Recognize how an entity should account for deferred tax accounts under the *Tax Cuts and Jobs Act.*
- Identify how the ASU 2018-02 election is made to reclassify the tax effect on accumulated other comprehensive income.
- Recall the adjustment that is made when an entity converts from S to C corporation status.
- Recognize the type of like-kind exchange that qualifies for nonrecognition of gain or loss under GAAP.
- Identify a way in which an entity can account for bonus depreciation under GAAP.
- Recall the overall impact that the reduction in the corporate tax rate is having on SEC companies.
- Recognize whether SEC companies are permitted to discount tax liabilities pertaining to repatriated income.
- Recall when an entity is required to disclose the tax years open for examination.

General

On December 22, 2017, President Trump signed the *Tax Cuts and Jobs Act* (the Act) into law. Under this Act, effective January 1, 2018, significant changes are made to the corporate tax rate and other business transactions, some of which directly affect financial statement transactions, disclosures and reporting.

Some of the changes applied in 2017, while others are effective in 2018 and beyond.

The purpose of this course is to address some of the key changes made to business and corporate taxation by the *Tax Cuts and Jobs Act*, and explain how those changes impact GAAP and financial reporting. The chapter also deals with the accounting for other tax-related issues.

The course is segregated into the following topics:

I. GAAP Impact of Tax Changes Made by the *Tax Cuts and Jobs Act*

A. Tax Rate Change Impact on Deferred Income Taxes

B. ASU 2018-02: Income Statement- Reporting Comprehensive Income (Topic 220) Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income

C. Revaluing Deferred Tax Assets Related to NOLs

D. Impact of Indefinite NOL Carryover Period on Deferred Tax Asset Valuation Accounts

E. Accounting for the Change from an S to a C Corporation

F. New Limitation on Interest Deduction

G. Elimination of Like-Kind Exchanges on Personal Property

H. Accounting for Bonus and Section 179 Depreciation in GAAP Financial Statements

I. Overall Impact of Reduction in Tax Rates on SEC Companies

J. SEC Staff Accounting Bulletin (SAB) No. 118

K. FASB Staff Q&A: Topic 740, No. 2: Whether to Discount the Tax Liability on the Deemed Repatriation of Profits

II. Other Tax-Related Issues Affecting GAAP

A. Deferred Tax Assets Recorded on Other Carryovers

B. Presentation of Tax Benefit of NOL Carryover

C. Presenting Deferred Tax Assets and Liabilities on the Balance Sheet- FASB's ASU 2015-17

D. Fixing the Disclosures in Uncertain Tax Positions for Nonpublic Entities

Each of these issues is discussed below.

I. GAAP IMPACT OF TAX CHANGES MADE BY THE TAX CUTS AND JOBS ACT

A. TAX RATE CHANGE IMPACT ON DEFERRED INCOME TAXES

The *Tax Cuts and Jobs Act* decreases the corporate tax rate from 35% to 21% commencing in 2018. The Act also eliminates other corporate tax rates, including the 15% and 25% surtax rates, and the 34% and 39% graduated tax rates.

For companies that are C corporations and have recorded federal deferred tax assets and liabilities using a 34% or 35% rate, those deferred tax assets and liabilities are overstated. The reason is because those deferred tax assets and liabilities will no longer reverse at 34% or 35% and instead, will reverse in future years at 21% based on the new tax law.

Consequently, deferred tax assets and liabilities had to be adjusted to 21% in the year of enactment which was 2017, and not wait until 2018 to make the adjustment. This rule also applies to fiscal year 2018 entities in which the tax year straddles 2017 and 2018, such as a September 30, 2018 year end. Such a fiscal year includes the December 22, 2017 enactment date in it.

Consider the following GAAP authority that addresses this issue:

1. ASC 740-10-30-8 states that a deferred tax liability or asset is recorded *using the enacted tax rate(s) expected to apply to taxable income* in the periods in which the deferred tax liability or asset is expected to be settled or realized.

2. ASC 740-10-45-15 states that when deferred tax accounts are adjusted for the effect of a change in tax laws or rates, the effect shall be *included in income from continuing operations* for the *period that includes the enactment date*.

Therefore, in 2017, entities were required to adjust their deferred tax assets and liabilities using the new 21% tax rate and to record the adjustment as part of income from continuing operations (most likely as part of income tax expense).

The current income tax accrual provision for 2017 continued to be computed using the previous statutory rate of 34% or 35%. Starting in 2018, the current income tax accrual provision is computed using the new 21% rate.

Example: Company X, a C corporation, has a deferred tax liability of $350,000 at December 31, 2016, based on a $1,000,000 temporary difference related to accumulated depreciation, and applying the statutory tax rate in effect for that year of 35% ($1,000,000 x 35%.) There are no state income taxes.

On December 22, 2017 (the enactment date), the *Tax Cuts and Jobs Act* is passed that changes the corporate rate to 21% effective January 1, 2018.

The Company issues annual financial statements for year ended December 31, 2017.

Although the deferred tax liability should be recomputed at 21% at the date of enactment, December 22, 2017, X decides to recompute it at December 31, 2017, arguing that the difference is not material.

Continuing with the example, assume at December 31, 2017, the temporary difference is $1,200,000.

Conclusion: The Company recomputes its deferred tax liability at December 31, 2017 using the 21% rate, which is the new rate that is expected to be in effect in the years in which the deferred tax liability reverses. The adjustment is made in 2017 (not 2018) because 2017 includes the date of enactment (the date the law was signed), December 22, 2017.

The computation requires two steps:

Step 1: Compute the December 31, 2017 deferred tax liability using the existing rate of 35%.[1]

Step 2: Recompute the December 31, 2017 deferred tax liability using the new 21% rate with the adjustment made to income from continuing operations (a separate component of income tax expense).

1. In this example and others within this course, the author uses 35% as the previous statutory rate (pre 2018) when, in fact, many companies had marginal tax rates of 15%, 25%, 39%, or 34% depending on the level of corporate taxable income.