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# SAB 118 Implementation Issues

On December 22, 2017, the SEC staff issued SAB 118,[1] which provides guidance on accounting for the impact of the Tax Cuts and Jobs Act (the "Act").[2] Under SAB 118, an entity would use something similar to the measurement period in a business combination. That is, the entity would recognize those matters for which the accounting can be completed, as might be the case for the effect of rate changes on deferred tax assets and deferred tax liabilities ("Bucket 1"). For matters that have not been completed, the entity would either (1) recognize provisional amounts to the extent that they are reasonably estimable and adjust them over time as more information becomes available ("Bucket 2") or (2) for any specific income tax effects of the Act for which a reasonable estimate cannot be determined, continue to apply ASC 740[3] on the basis of the provisions of the tax laws that were in effect immediately before the Act was signed into law (i.e., the entity would not adjust current or deferred taxes for those tax effects of the Act until a reasonable estimate can be determined) ("Bucket 3").

In connection with the implementation of SAB 118, entities have identified several issues related to its scope and application. This alert discusses implementation issues associated with three topics: (1) the global intangible low-tax income (GILTI) policy election, (2) uncertain tax positions (i.e., FIN 48[4]), and (3) indefinite reinvestment assertions (i.e., APB 23[5]).

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[1] SEC Staff Accounting Bulletin No. 118 (codified as SEC Staff Accounting Bulletin Topic 5.EE, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act").

[2] H.R. 1/Public Law 115-97, "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018."

[3] FASB Accounting Standards Codification (ASC) Topic 740, *Income Taxes*.

[4] FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (superseded; codified in ASC 740-10).

[5] APB Opinion No. 23, *Accounting for Income Taxes — Special Areas* (superseded; codified in ASC 740-30-25).

## GILTI Policy Election

The FASB staff noted in Q&A No. 5[6] that ASC 740 is not clear about the appropriate accounting for GILTI and that companies may therefore elect to either (1) treat taxes on GILTI as period costs in a manner similar to special deductions or (2) recognize deferred tax assets and liabilities when basis differences exist that are expected to affect the amount of GILTI inclusion upon reversal (the deferred method).

### Does SAB 118 apply to the selection of an accounting policy for GILTI in such a manner that an entity can use the measurement period of one year to make its selection?

While SAB 118 does not explicitly refer to accounting policy choices, we believe that the following application of its guidance to a company's GILTI policy election would be appropriate:

- A company is not required to adopt an accounting policy for GILTI in the financial statements for the period that includes the enactment date. To create and preserve the flexibility to make that election at some time during the measurement period, however, the company must disclose that it has not yet adopted an accounting policy. This guidance applies even if the company already knows, or has reasonable estimates of, the effect of the two different accounting policies on the financial statements and the difference is material.
- If a company's accounting policy is still "open" during any subsequent quarters within the one-year measurement period, a policy is not established by including the current-year estimated actual tax effects of GILTI as a current-period expense in the company's annual effective tax rate used for calculating its interim tax provision.
- Once a company records deferred taxes with respect to GILTI, and the recognition of such deferred taxes is considered material, the company has elected an accounting policy regardless of whether the amount recorded is considered a provisional amount under SAB 118. Changes made to that policy during or after the measurement period would be subject to ASC 250[7] from that point on.
- Subsequent adjustments of the deferred tax amount recorded for GILTI, including adjustments related to the company's policies used to calculate such amount (e.g., inside basis vs. outside basis), would not be subject to ASC 250 provided that (1) they occur during the one-year measurement period and (2) the amounts recorded in prior periods were marked as provisional.
- Once the deferred tax amount for GILTI is considered final, ASC 250 would apply to any future adjustments related to the company's policies used to calculate such amount.

This application of SAB 118 has been discussed with the SEC staff, and we understand that the staff will not object to it as long as a company provides the disclosures required by the SAB.

## Uncertain Tax Positions (i.e., FIN 48)

The primary focus of SAB 118 is on what to do when "an entity does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting under ASC Topic 740." One view is that the term "information" refers in that context only to the underlying data (e.g., earnings and profits (E&P), outside basis) that needs to be gathered, prepared, and analyzed. For example, to compute its deemed repatriation transition tax, an entity will need to know its E&P for its foreign subsidiaries from as far back as 1986, but such information may not be readily available and sufficiently detailed to allow the entity to complete its computations. A second view, however, is that the term

[6] FASB Staff Q&A Topic 740, No. 5, *Accounting for Global Intangible Low-Taxed Income*.
[7] FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*.

"information" could pertain to items other than just data and hence such items could also be within the scope of SAB 118.

A number of technical questions remain about certain provisions of the Act, and additional definitional and computational guidance is needed. Legislative technical corrections, regulations, notices, and other forms of guidance may ultimately address some of the questions, while answers to others may evolve over time. In the meantime, companies are attempting to interpret the Act and to develop reasonable estimates on the basis of incomplete information.

### How do SAB 118 and the need to record "reasonable estimates" interact with the guidance in ASC 740 regarding uncertain tax positions (i.e., FIN 48) with respect to the Act?

SAB 118 addresses certain practical problems created by the enactment of a vast amount of new and complex legislation only nine days before December 31, 2017 — the end of a reporting period for most entities. The Act was developed over a very condensed timeframe, and preparers and practitioners had little time to analyze its preliminary or final versions. As a consequence, there may be tax technical matters with respect to the Act for which it is not feasible to prepare a complete "more-likely-than-not" assessment during the enactment period or potentially even in subsequent quarters within the measurement period.

Accordingly, we believe that uncertainties about how the Act should be interpreted may be accounted for provisionally under SAB 118. More specifically, during the one-year measurement period, an entity may account for an uncertain tax technical matter with respect to the Act on the basis of a reasonable estimate of how the Act will ultimately be interpreted. As new information becomes available, an entity would then adjust its provisional estimate until it can complete its more-likely-than-not assessment. It would need to complete that assessment, along with appropriate measurement of the resulting positions, by the end of the measurement period. In a manner consistent with SAB 118, an entity should make a good faith effort to develop reasonable estimates until it prepares a complete more-likely-than-not assessment.

Determining whether a tax technical matter is within the scope of SAB 118 during the one-year measurement period will of course depend on the specific facts and circumstances of each individual entity and will require considerable judgment.

## Indefinite Reinvestment Assertions (i.e., APB 23)

ASC 740-30-25-6 notes that a deferred tax liability is not recognized for an excess of the amount for financial reporting over the tax basis of an investment in a foreign subsidiary that meets the criteria in ASC 740-30-25-17.

ASC 740-30-25-17 states, in part:

> The presumption . . . that all undistributed earnings will be transferred to the parent entity may be overcome, and no income taxes shall be accrued by the parent entity, . . . if sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation. A parent entity shall have evidence of specific plans for reinvestment of undistributed earnings of a subsidiary which demonstrate that remittance of the earnings will be postponed indefinitely. These criteria required to overcome the presumption are sometimes referred to as the indefinite reversal criteria. Experience of the entities and definite future programs of operations and remittances are examples of the types of evidence required to substantiate the parent entity's representation of indefinite postponement of remittances from a subsidiary.

While the guidance in ASC 740-30-25-17 addresses unremitted earnings, ASC 740-30-25-6 and ASC 740-30-25-18(a) are clear that the evaluation is not limited to such earnings but rather applies to the entire outside basis difference.

The Act imposes a one-time deemed repatriation transition tax on a U.S. shareholder's pro rata share of certain undistributed and previously untaxed post-1986 foreign E&P of specified foreign corporations in which the shareholder has an investment. The imposition of this tax may eliminate, in part or in whole, the need for U.S. federal deferred taxes on what is often the largest component of a company's overall outside basis difference in its foreign investments (i.e., unremitted earnings). However, it does not eliminate the potential need for deferred taxes related to withholding taxes, states taxes, or other income taxes that might be incurred from the reversal of an entity's overall outside basis difference as described in ASC 740-30-25-6 and ASC 740-30-25-18(a). Accordingly, many entities are reevaluating their previous indefinite reinvestment assertions regarding the excess of the amount for financial reporting over the tax basis of their investments, including unrepatriated earnings.

## How should the SAB 118 guidance be applied to an entity's indefinite reinvestment assertions under ASC 740-30-25-6, ASC 740-30-25-18(a), and ASC 740-30-25-17?

Example 1 in SAB 118 discusses a Bucket 3 fact pattern and states the following:

> Prior to the reporting period in which the Act was enacted, Company X did not recognize a deferred tax liability related to unremitted foreign earnings because it overcame the presumption of the repatriation of foreign earnings. [Footnote omitted] Upon enactment, the Act imposes a tax on certain foreign earnings and profits at various tax rates. Based on Company X's facts and circumstances, it was not able to determine a reasonable estimate of the tax liability for this item for the reporting period in which the Act was enacted by the time that it issues its financial statements for that reporting period; that is, Company X did not have the necessary information available, prepared, or analyzed to develop a reasonable estimate of the tax liability for this item (*or evaluate how the Act will impact Company X's existing accounting position to indefinitely reinvest unremitted foreign earnings*). As a result, Company X would not include a provisional amount for this item in its financial statements that include the reporting period in which the Act was enacted, but would do so in its financial statements issued for subsequent reporting periods that fall within the measurement period, beginning with the first reporting period falling within the measurement period by which the necessary information became available, prepared, or analyzed in order to develop the reasonable estimate, and ending with the first reporting period within the measurement period in which Company X was able to obtain, prepare, and analyze the necessary information to complete the accounting under ASC Topic 740. [Emphasis added]

In addition, SAB 118 indicates that the SEC staff's views were informed by FASB FSP FAS 109-2,[8] which contains similar guidance and states, in part:

> The FASB staff believes that the lack of clarification of certain provisions within the [2004] Act and the timing of the enactment necessitate a practical exception to the Statement 109 [ASC 740] requirement to reflect in the period of enactment the effect of a new tax law. Accordingly, an enterprise is allowed time beyond the financial reporting period of enactment to evaluate the effect of the [2004] Act on its plan for reinvestment or repatriation of foreign earnings for purposes of applying Statement 109 [ASC 740].

Accordingly, we believe that, in a manner similar to the guidance in FSP FAS 109-2, and as specified in Example 1 of SAB 118, an entity should apply ASC 740 as it completes its plans for reinvestment of its outside basis difference, including its plans for reinvestment or repatriation of unremitted foreign earnings. More specifically, to the extent that an entity has finalized its plans and can calculate the resulting tax effects, the entity should disclose those plans and record the associated tax effects (Bucket 1). If an entity has completed all or portions of its assessment (e.g., made the decision to repatriate from all or certain entities) and has the ability to reasonably estimate the effects of that assessment (or portions thereof), it should record provisional amounts for those effects and disclose the status of its efforts (Bucket 2). If an entity has made insufficient progress to reasonably estimate its plans, it should disclose the status of its evaluation and should not adjust its previous indefinite reinvestment assertions for the effects of the Act (Bucket 3).

[8] FASB Staff Position (FSP) FAS 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision Within the American Jobs Act of 2004* (superseded).

An entity should be mindful that its plans for reinvestment or repatriation of unremitted foreign earnings could be affected by matters other than those associated with the Act. For example, if an entity's cash flow needs in the United States change significantly for reasons other than those caused by the Act (e.g., the need for cash in the United States to pay off debt, settle litigation, or fund an acquisition), the entity should evaluate those matters outside the SAB 118 framework to ensure that its prior intent related to reinvestment is still appropriate.

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