Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

Interagency Statement on Accounting and Reporting Implications of the New Tax Law

January 18, 2018

Purpose

The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (hereafter, the agencies) are providing supervised institutions with guidance on the accounting implications of the new tax law, which was enacted on December 22, 2017 (the Act),[1] and certain related matters.

The accounting guidance in this interagency statement is based on the application of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740, "Income Taxes," and does not represent new rules or regulations of the agencies. Changes as a result of the Act are immediately relevant to December 31, 2017, financial statements and regulatory reports, such as the Consolidated Reports of Condition and Income (Call Report) and the Consolidated Financial Statements for Holding Companies (FR Y-9C Report).[2]

Overview

ASC 740 requires that the effect of changes in tax laws or rates be recognized in the period in which the legislation is enacted.[3] As the Act was enacted prior to December 31, 2017, institutions would record the effects of the Act in their December 31, 2017, regulatory reports. Changes in deferred tax assets (DTAs) and deferred tax liabilities (DTLs) resulting from the Act's lower corporate income tax rate and other applicable provisions of the Act would be reflected in the institution's income tax expense in the period of enactment.[4]

Impact on Deferred Tax Assets and Liabilities

ASC 740 requires DTAs and DTLs to be measured at the enacted tax rates expected to apply when these assets and liabilities are expected to be realized or settled.[5] As a result of the change

[1] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, P.L. 115-97 (originally introduced as the Tax Cuts and Jobs Act).

[2] Holding companies should also report the effects of the Act in other relevant December 31, 2017, regulatory reports filed with the Board of Governors of the Federal Reserve System.

[3] See ASC 740-10-35-4.

[4] See ASC 740-10-45-15.

[5] See ASC 740-10-55-23.

in the federal tax rate effective for tax years beginning on or after January 1, 2018, institutions would remeasure their DTAs and DTLs for purposes of reporting as of December 31, 2017. When remeasuring these accounts, institutions would apply the newly enacted federal tax rate to those temporary differences expected to reverse in tax years beginning on or after January 1, 2018. A reduction in the federal tax rate alone would result in decreased DTAs (and a corresponding increase in income tax expense) and decreased DTLs (and a corresponding decrease in income tax expense). The effects of these changes are to be reported in Schedule RI, Income Statement, item 9, "Applicable income taxes (on item 8)," in Call Reports and in Schedule HI, Consolidated Income Statement, item 9, "Applicable income taxes (foreign and domestic)," in FR Y-9C Reports filed as of December 31, 2017. Under ASC 740, institutions that do not use a calendar year tax year may need to schedule reversals of temporary differences at the various applicable enacted federal income tax rates to remeasure their DTAs and DTLs.[6]

Valuation Allowance

Pursuant to ASC 740, a valuation allowance is recorded against any DTA for which it is more likely than not that the benefit of the DTA will not be realized.[7] In conjunction with the remeasurement of an institution's DTAs, management should exercise judgment when assessing the need for a valuation allowance. Any adjustment to an existing DTA, through the creation of a new, or an adjustment to an existing, valuation allowance, is to be included in Schedule RI, Income Statement, item 9, "Applicable income taxes (on item 8)," in the Call Report and in Schedule HI, Consolidated Income Statement, item 9, "Applicable income taxes (foreign and domestic)," in the FR Y-9C Report in the period the valuation allowance is established or adjusted. Additional guidance is provided in the Glossary entry for "Income Taxes" in the regulatory report instruction books.

Effect on Amounts Recognized in Accumulated Other Comprehensive Income

In accordance with ASC 740, the impact of the remeasurement of the deferred tax effects of items reported in accumulated other comprehensive income (AOCI) is recorded through income tax expense, not through other comprehensive income (OCI) (and, hence, AOCI). This creates a disproportionate tax effect in AOCI as the recorded DTA or DTL related to an item reported in AOCI no longer equals the tax effect included in AOCI for that item.

For example, assume an institution purchased a debt security in July 2017 for $1,000,000 and designated the security as available for sale (AFS). As of September 30, 2017, the AFS debt security had a fair value of $990,000. To record the decline in fair value as of September 30, 2017, the institution decreased the carrying value of the debt security on the balance sheet by $10,000 and, assuming a 35 percent tax rate, recognized a DTA of $3,500 and a net decrease of $6,500 ($10,000 decline in fair value, net of tax effect of $3,500) that flowed through OCI to AOCI.

As a result of the Act, the institution's tax rate changes from 35 percent to 21 percent effective for tax years beginning on or after January 1, 2018. The fair value of the AFS debt security

[6] See ASC 740-10-55-15(c).

[7] See ASC 740-10-30-5(e) and 740-10-30-16 through 740-10-30-25.

remains $990,000 as of December 31, 2017. Therefore, the institution would adjust the DTA associated with the unrealized loss on its AFS debt security by reducing the DTA from $3,500 to $2,100. While the entry to offset the establishment of the DTA as of September 30, 2017, was recorded through OCI to AOCI, ASC 740 requires all effects of changes in tax laws and rates to be recorded through current period income tax expense.[8] Thus, the $1,400 difference between the $3,500 reported as a DTA before it is remeasured, and the $2,100 reported as a DTA after it has been remeasured in accordance with ASC 740 as a result of the Act's change in the tax rate, is reported as income tax expense for the period ending December 31, 2017.

After recording the effect of the change in the tax rate, the amount associated with the unrealized loss on the AFS debt security that is reflected in AOCI as of December 31, 2017, is unchanged at $6,500. This results in a disparity between the tax effect of the unrealized loss on the AFS debt security included in AOCI ($3,500) and the amount recorded as a DTA for the tax effect of this unrealized loss ($2,100). While ASC 740 does not specify how this disproportionate tax effect should be resolved, the FASB approved during its January 10, 2018, meeting issuing an Exposure Draft of a proposed Accounting Standards Update (ASU) that will allow reclassification of the disproportionate tax effect ($1,400 in this example) from AOCI to retained earnings in financial statements that have not yet been issued. The FASB expects the ASU to be finalized in February 2018. Therefore, to maintain consistency between amounts reported in their financial statements and regulatory reports, institutions may incorporate the guidance proposed in the ASU for the various items reported net of deferred tax effect in AOCI when preparing their December 31, 2017, regulatory reports.

Regulatory Capital Effects

Under the agencies' regulatory capital rules, DTAs arising from temporary differences that could be realized through net operating loss (NOL) carrybacks as of the regulatory capital calculation date are not subject to deduction from regulatory capital.[9] In contrast, temporary difference DTAs that could not be realized through NOL carrybacks, i.e., those for which realization depends on future taxable income as of the regulatory capital calculation date, are deducted from common equity tier 1 (CET1) capital if they exceed certain CET1 capital deduction thresholds.

Consistent with the regulatory capital rules, for tax years beginning on or before December 31, 2017, an institution may consider its hypothetical NOL carryback potential when determining the amount of temporary difference DTAs, if any, subject to the deduction thresholds for purposes of calculating and reporting its regulatory capital. Thus, an institution's NOL carryback potential

[8] See ASC 740-10-45-15.

[9] 12 CFR 217.22(d)(1)(i) (Board of Governors of the Federal Reserve System); 12 CFR 324.22(d)(1)(i) (Federal Deposit Insurance Corporation); 12 CFR 3.22(d)(1)(i) (Office of the Comptroller of the Currency).

may be taken into account for regulatory capital purposes in its December 31, 2017, regulatory reports.[10]

However, for tax years beginning on or after January 1, 2018, the Act generally removes the ability to use NOL carrybacks to recover taxes paid in prior tax years. As a result of this change in tax law and its interaction with the agencies' regulatory capital treatment of temporary difference DTAs, when an institution calculates its regulatory capital in tax years beginning on or after January 1, 2018, the realization of all temporary difference DTAs will be dependent on future taxable income. Therefore, all temporary difference DTAs will be subject to the deduction thresholds for regulatory capital purposes in such tax years.

Preparation of Regulatory Reports

Institutions are expected to use all available information to make a good faith effort to reasonably estimate the effects of the Act when preparing their December 31, 2017, regulatory reports. This is consistent with the Securities and Exchange Commission's (SEC) Staff Accounting Bulletin No. 118 (SAB 118), which was issued on December 22, 2017, and with the FASB Staff Q&A on Whether Private Companies and Not-for-Profit Entities Can Apply SAB 118 (FASB Staff Q&A), which was issued on January 11, 2018. The agencies encourage all institutions to review SAB 118 and the FASB Staff Q&A. Institutions may use the measurement period approach described in those documents when preparing regulatory reports as of and for the period ending December 31, 2017, and in subsequent periods. Thus, institutions will be allowed to refine their reasonable estimates as additional information is obtained and will not be required to amend previously filed regulatory reports as these estimates are adjusted. An institution's reasonable estimates may include some amounts that are provisional for up to one year following the enactment date of the Act while the institution gathers necessary information to prepare, analyze, and calculate the effects of the law. Depository institutions and holding companies may disclose significant provisional amounts, information limitations, and measurement period adjustments as of December 31, 2017, and in subsequent periods in Schedule RI-E, Explanations, item 7, "Other explanations," or in the Optional Narrative Statement in the Call Report and in the Notes to the Income Statement-Other or in the Notes to the Balance Sheet-Other in the FR Y-9C Report, respectively. SAB 118 includes suggestions for appropriate disclosures in these regulatory report schedules when using a measurement period approach to accounting for the changes in tax law.

Supervisory Considerations

The agencies understand the Act may result in a decrease in capital and after-tax earnings for institutions in a net DTA position as of and for the period ending December 31, 2017. The agencies view the effect of remeasuring DTAs and DTLs due to the Act as a nonrecurring event that generally will not have a substantial adverse impact on most institutions' core earnings or capital over the long term. Nevertheless, if an institution expects the effects of the Act to lower

[10] An institution with a tax year other than the calendar year may consider its hypothetical NOL carryback potential when calculating and reporting its regulatory capital for regulatory report dates through the end of its last tax year beginning on or before December 31, 2017. For example, an institution with a tax year beginning on July 1, 2017, may consider its NOL carryback potential when calculating and reporting its regulatory capital for regulatory report dates through June 30, 2018.

its prompt corrective action category as of December 31, 2017, or a subsequent quarter-end date, the institution should contact its primary federal regulator.