

THE TCJA AND BANK OF AMERICA (BAC): HOW CAN SOMETHING SO GOOD HURT SO BAD?

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On December 22, 2017, the Tax Cuts and Jobs Act (TCJA) became Law. The Law created good news for most corporations; their income tax rate became a flat 21%. As a result, corporations were expected to save \$130.5 billion in 2020 (Auerbach, 2018). Bank of America (BAC), immediately recorded an extremely large expense when the TCJA was passed, in 2017, – even though the Act did not go into effect until 2018. For BAC, this expense was \$2.9 billion. How could BAC's CFO, Paul Donofrio, explain to the CEO, the Board of Directors, investors, creditors, employees – indeed, explain to all stakeholders – that such a marvelous tax break resulted in such a large additional cost?

INTRODUCTION

The Tax Cuts and Jobs Act of 2017 (TCJA), became law December 22, 2017 (H R 1). It created a new flat tax rate for corporations. Large corporations, such as Bank of America (BAC), had been subject to a 35% marginal income tax rate. Now, thanks to the TCJA, the rate became 21%, beginning in 2018. This could save BAC billions of dollars, fuel the pattern of growth the company had established, and increase the wealth of the company for shareholders. This was wonderful! Yet when the law was passed, BAC immediately **expensed** \$2.9 billion. How could BAC's Chairman and CEO, Brian Moynihan, and CFO, Paul Donofrio, explain to the Board of Directors, the investors, and the employees – indeed to all of BAC's stakeholders – that such a marvelous tax break resulted in such a large instantaneous **reduction** in net income?

OVERVIEW OF BANK OF AMERICA

With assets of more than \$2 trillion (BAC, 2017), BAC was the second largest bank in the United States (Federal Reserve). The bank had 4,269 branches. Headquartered in Charlotte, NC, BAC employed more than 200,000 employees (MacroTrends, 2020), and as noted below, in *Fortune* magazine, it had become a dominant player in optimizing sustainability:

Green bonds, which the [Bank of America] all but invented, have raised \$442 billion worldwide since 2013, helping borrowers both

tiny (the Antioch, Calif., Unified School District) and enormous (trillion-dollar Apple), pay for renewable-energy innovations.
(Heimer, 2018)

With the new, lower, tax rate, BAC seemed poised to easily achieve its goal of increasing investment in the environment by \$125 billion by 2025.

WHAT HAPPENED, AND HOW DID BAC HANDLE THE LOSS?

For BAC, the benefits of the TCJA focused solely on the rate change, and the 21% flat rate was permanent. In short, the TCJA provided nothing but good news for BAC. BAC's problem stemmed from the standards that entities must follow for financial-accounting purposes. The standard that so harshly affected BAC is *ASC 740: Income Taxes* (FASB, 1992). *ASC 740*, created by the Financial Accounting Standards Board and fully supported by the Securities and Exchange Commission, codified the rules for accounting for the differences between taxable income and financial-accounting income. Some of these differences were permanent (non-temporary), and some were temporary differences. BAC handled permanent differences when they occurred and then essentially dismissed them. Temporary differences resulted from timing differences, and for BAC, they were more problematic. Temporary differences resulted in deferred tax assets and deferred tax liabilities. The TCJA forced BAC to revalue all its U. S. federal deferred tax assets and deferred tax liabilities.

These revaluations generally had little effect on publicly-traded companies, as the revaluations of deferred tax assets offset the revaluations of deferred tax liabilities. These offsets were not exact; some companies incurred small decreases in net income, while others companies incurred small increases in net income. However, the offsets were not at all favorable for BAC. The adjustments to the Bank's deferred tax assets and deferred tax liabilities reduced net income by \$2.3 billion (BAC, 2017). Why the big difference? Bank of America had a deferred tax asset of approximately \$8.5 billion in 2017 for net-operating-loss carryforwards (BAC, 2017). This amount was far larger than any other deferred tax amounts. Thus, deferred tax assets heavily outweighed deferred tax liabilities, and a large expense was recorded at the end of 2017. The detrimental effect on income was made worse by a similar write-down of \$0.943 billion on energy tax credits BAC had derived from its prowess in financing sustainability projects. Net, then, the financial-accounting rules that BAC had to apply regarding the reduction of the tax rate from 35% to 21% (TCJA) cost the Bank approximately \$2.9 billion of net income. BAC reported EPS of \$1.63 for 2017 (BAC, 2017); the amount would have been approximately \$1.90 without applying *ASC 740* (Motley Fool).

But the entry that changed the values of the deferred tax assets and deferred tax liabilities had no effect on cash – not even on the cash paid in 2017 for income taxes. Thus, when BAC presented the results for the year 2017, they often set the \$2.9 billion cost aside. On January 20, 2018, three BAC executives participated in a conference call with 12 analysts to present results for 2017. Chairman and CEO Brian Moynihan made three presentations with the \$2.9 billion excluded, including the following:

So, let me highlight a little [of] our progress. For the year we reported \$18 billion in after-tax net income. Excluding the tax act impact of \$2.9 billion, we would have reported net income of \$21 billion which is up 18% over [Inaudible] 2016. This represents the highest earnings run rate for the company in its history. Paul will discuss the tax act impact in a little more detail later. (Motley Fool, 2018)

Indeed, CFO Paul Donofrio provided more detail:

Late in the [fourth] quarter, we informed investors through our 8K filing that we expect an impact of approximately \$3 billion from the tax act. Our estimated impact came in just shy of \$2.9, lowering EPS by \$0.27. Remember, the tax act is complex, with several novel provisions. (Motley Fool, 2018)

Paul Donofrio made additional presentations that excluded the \$2.9 expense. Each time, he clearly stated that the results he presented were excluding the amount. At the end of the presentation, the twelve analysts asked many detailed specific questions. However, not one of the questions addressed or considered the \$2.9 billion.

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