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SEC Provides Guidance for Disclosure and Accounting Implications of Tax Cuts and Jobs Act

On December 22, 2017, the Securities and Exchange Commission (the "SEC") published new guidance for SEC reporting companies, auditors and others to help ensure timely public disclosures of the accounting impacts of the Tax Cuts and Jobs Act (the "Act"), which was signed into law the same day. The staffs of the Office of the Chief Accountant and of the Division of Corporation Finance issued the following two interpretations:

- Compliance and Disclosure Interpretation ("C&DI") 110.02 (available here), which provides guidance on how to comply with obligations under Item 2.06 of Form 8-K with respect to reporting the impact of a change in tax rate or tax laws pursuant to the Act, and clarifies that the accounting consequences of the Act generally will not trigger this reporting obligation, and

- Staff Accounting Bulletin ("SAB") No. 118 (available here), which provides guidance regarding the application of U.S. generally accepted accounting principles ("U.S. GAAP") when preparing an initial accounting of the income tax effects of the Act and provides an accommodation for companies unable to assess the full effects of the Act during a financial reporting period.

This guidance is consistent with statements made by members of the SEC staff at the 2017 AICPA Conference on PCAOB and SEC Current Developments at which they acknowledged the potential operational and accounting challenges companies could face if U.S. tax reforms were enacted before the end of the year.

Compliance and Disclosure Interpretation 110.02

Item 2.06 of Form 8-K requires disclosure of material charges for impairment of one or more of a registrant's assets, *e.g.*, a deferred tax asset. C&DI 110.02 clarifies that the re-measurement of a deferred tax asset to incorporate the effects of newly enacted tax rates or other provisions of the Act is not an impairment under Accounting Standards Codification ("ASC") Topic 740 and therefore does not trigger an obligation to report under Item 2.06 of Form 8-K. A registrant employing the "measurement period" approach as contemplated by SAB 118 (discussed below) that concludes that an impairment has occurred due to changes resulting from the enactment of the Act may rely on the instruction to Item 2.06 and disclose the impairment, or a provisional amount with respect to that possible impairment, in its next periodic report.

Staff Accounting Bulletin No. 118

As noted by the SEC, the Act could have significant domestic and international tax consequences for a number of companies primarily due to the Act's effect on U.S. corporate tax rates and business-related exclusions, as well as deductions and credits. ASC Topic 740 provides guidance regarding accounting for income taxes under U.S. GAAP, including accounting upon changes in tax laws or rates. The income tax accounting effect of changes in tax laws, such as those introduced by the Act, could include, for example, adjusting (or re-measuring) deferred tax liabilities and deferred tax assets, as well as evaluating whether a valuation allowance is needed for deferred tax assets.

In SAB 118, the SEC staff noted that ASC Topic 740 does not address certain circumstances that may arise for companies when accounting for the income tax effects of the Act. More specifically, the changes in the Act may give rise to operational challenges for companies when complying with the requirements under ASC Topic 740 in connection with their preparation of financial statements for the reporting period containing December 22, 2017 (calendar year-end companies would need to include full financial statements for 2017 in their annual report on Form 10-K due in early 2018).

To assist companies in addressing these issues, the SEC staff outlined in SAB 118 the following three approaches to the application of ASC Topic 740, depending on a company's assessment of the income tax effect of a provision of the Act on its financial statements:

- If a company has completed its assessment of the income tax effect of a provision of the Act on its financial statements, the company must reflect the income tax effect in its financial statements for the fiscal period that includes December 22, 2017.

- If a company has not completed its assessment of the income tax effect of a provision of the Act on its financial statements (because it does not have the necessary information available, prepared or analyzed in reasonable detail to complete accounting under ASC Topic 740), but can determine a reasonable estimate of the effect on its financial statements, the company should reflect the reasonable estimate in its financial statements in the first reporting period in which the company was able to determine that reasonable estimate. The reasonable estimate would be reported as a provisional amount during a "measurement period."

  For purposes of applying the guidance in SAB 118, the "measurement period" begins in the reporting period that includes December 22, 2017 and ends when a company has obtained, prepared and analyzed the information that was needed in order to complete the accounting requirements under ASC Topic 740 (which, in any case, should be no later than December 22, 2018). For each fiscal period during the measurement period, a company should perform the analysis described above and, if necessary, reflect adjustments to its provisional amounts or report additional tax effects based on obtaining, preparing or analyzing additional information about facts and circumstances that existed as of the enactment date that was not initially reported as provisional amounts.

- If a company cannot determine a reasonable estimate of specific income tax effects of the Act on its financial statements, the company should continue to apply the provisions of the tax laws that were in effect immediately prior to enactment of the Act.

The SEC staff's guidance also describes supplemental disclosures that should accompany any provisional amounts reported, including:

- qualitative disclosures of the income tax effects of the Act for which the accounting is incomplete;
- disclosures of items reported as provisional amounts;
- disclosures of existing current or deferred tax amounts for which the income tax effects of the Act have not been completed;
- the reason why the initial accounting is incomplete;
- the additional information that is needed to be obtained, prepared or analyzed in order to complete the accounting requirements under ASC Topic 740;
- the nature and amount of any measurement period adjustments recognized during the reporting period;
- the effect of measurement period adjustments on the effective tax rate; and
- when the accounting for the income tax effects of the Act has been completed.

The SEC staff also indicated that it would not object to foreign private issuers using a measurement period approach to report the effects of the Act on their financial statements using International Financial Reporting Standards.

Additional Considerations

MD&A. At the 2017 AICPA conference, the SEC staff reminded companies to disclose any material effects of tax reform on their results of operations in their MD&A regardless of the enactment date. Conference panelists noted that once any tax reform is enacted, companies would be expected to include robust disclosures about the impact of the tax reform on cash balances held offshore. Companies should also consider providing disclosures with respect to changes in their deferred tax assets and address the Act's impact on future periods as a known trend or uncertainty.

Non-GAAP Financial Measures. Some companies may choose to present supplemental financial information without giving effect to the tax effects of the Act in order to facilitate period-to-period comparison. To the extent these constitute non-GAAP financial measures, care should be taken to comply with the requirements of Regulation G and Item 10(e) of Regulation S-K, which require presentation of the most comparable GAAP financial measure together with a reconciliation of the differences between the measures.

Other Disclosures. Regulation FD prohibits the selective disclosure by domestic reporting companies of material, non-public information to market participants (*e.g.*, analysts and institutional investors), unless it is also disclosed to the general public. Unless filed under Item 8.01, registrants may elect to disclose information pursuant to Regulation FD under Item 7.01 of Form 8-K. Given the likely focus by the investment community, during earnings calls, speeches and other presentations, on the financial effects of the Act, domestic reporting companies that anticipate discussing these effects should ensure compliance with the requirements of Regulation FD when disclosing any material, non-public information and consider reporting the material effects of the Act in advance under Item 7.01 or 8.01 of Form 8-K.

In addition, a registrant making informal public disclosure of the effect of the Act on its financial statements for a completed fiscal period could also trigger a requirement to disclose this information under Item 2.02 of Form 8-K, which generally requires that a Form 8-K be furnished if a company makes a public announcement or release disclosing material non-public information regarding the company's results of operations or financial condition for a completed quarterly or annual fiscal period.

Finally, companies should consider whether the income tax changes introduced by the Act may require a review of internal control over financial reporting processes to identify and assess changes necessary to implement effective controls and to remedy potential deficiencies in their risk assessments arising in connection with these changes.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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