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The Tax Cuts and Jobs Act Meets Public Company Reporting

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Accounting for income taxes can be complex and is seldom exciting. Suspense was added, however, by the passage of the Tax Cuts and Jobs Act shortly before year end 2017. Would public companies have enough time to analyze the impact of the new law before their year-end financial reports were due? Even before then, would they need to report an impairment of a deferred tax asset, possibly on a Form 8-K?

Moving quickly, the Staff of the SEC came to the rescue on the same day (December 22, 2017) as the tax legislation was signed into law. The relief package came in two pieces:

(i) Staff Accounting Bulletin No. 118 ("SAB 118"), which provides a limited extension of the period during which the effect of the legislation can be reported; and

(ii) Compliance and Disclosure Interpretation 110.02, which affirms that a material impairment of a deferred tax asset does not occur within the meaning of Item 2.06 of Form 8-K when the asset is re-measured as a result of a change in the applicable tax rate or other provisions of the Tax Cuts and Jobs Act.

Despite this well-crafted relief package, the actual accounting process will remain complex and numerous questions will undoubtedly emerge. In addition, companies will need to assess carefully how their other disclosures are affected by the passage of the Tax Cuts and Jobs Act.

SAB 118 and the "Measurement Period" Allowance

Under Financial Accounting Standards Codification Topic 740, Accounting for Income Taxes, companies generally must address changes in tax laws or tax rates in the financial reporting period that includes the enactment date, in this case December 22, 2017. For calendar year end reporting companies, this would require recognition of the impact of the tax law changes in financial statements for the year ended December 31, 2017. Given the potential complexity of the issues to be analyzed, it could be difficult satisfy this requirement before the due date of the company's Annual Report on Form 10-K.

SAB 118 provides relief by dividing possible disclosures into three categories, with extended time periods built into two of the categories.

(i) For tax effects for which the accounting is complete by the time the company issues its financial statements, the company must provide full disclosure in its financial statements.

(ii) For tax effects for which the accounting is not complete, but a reasonable estimate can be determined, the company must include the estimate as a provisional amount in the financial statements. Once the accounting for this effect was completed, the company would disclose the actual amount through an adjustment made in the reporting period in which the accounting was completed. The accounting process would need to be completed by the end of a "measurement period" of no more than one year from the enactment date.

(iii) For tax effects for which a reasonable estimate cannot be determined by the time the company issues its financial statements, the company would initially disclose that it was unable to make a reasonable estimate and would instead treat the item as if there had been no change in law. Thereafter, the company would make disclosures in subsequent periods, when it could make a reasonable estimate or had completed the accounting. In each case, however, the entire process would need to be completed within the one-year measurement period.

An individual company might have tax effects to disclose in each of the three categories described above. In its initial financial statements and its periodic reports over the measurement period, the company would qualitatively disclose the incomplete or provisional tax effects, the reasons why the accounting was incomplete and the additional information that was needed to be obtained, prepared, or analyzed. The company would also disclose the nature of any adjustments recognized during the reporting period, the impact of the adjustments on the effective tax rate, and when the accounting was completed.

In a footnote, the SEC Staff indicated that it would not object to foreign private issuers using a measurement period approach to report the effect of the Tax Cuts and Jobs Act on their financial statements using International Financial Reporting Standards.

Compliance & Disclosure Interpretation 110.02 and Form 8-K

Under Item 2.06 of Form 8-K, a company must disclose on Form 8-K if it concludes that a material charge for impairment to one or more of its assets is required under GAAP. In Compliance & Disclosure Interpretation 110.02, the SEC Staff indicated that disclosure under this provision of Form 8-K would not be required by the revaluation of a deferred tax asset as a result of a tax rate change or other provision of the Tax Cuts and Jobs Act, so long as the impact was properly disclosed in accordance with SAB 118, as described above.

Other Disclosures

While the accommodations described above can be expected to be very helpful, companies must still take care in analyzing the effects of the law and disclosing the results of this analysis over the course of the measurement period. Companies will want to describe the uncertainties in their earnings release and other informal disclosure. Companies should treat evolving information about the effects of the new tax law as they treat other information that pertains to their financial statements, being mindful to guard against selective disclosure or trading on undisclosed material information. While the information may seem speculative or prospective in nature, it may technically relate to a completed financial period, triggering a requirement to disclose the information under Item 2.02 of Form 8-K if informal public disclosure is made.

Companies should also be mindful of the rules governing non-GAAP financial statement disclosures. Presentations of financial information in accordance with SAB 118 will presumably be treated as having been made in accordance with GAAP. A presentation made as if prior law applied, however, would most likely be a non-GAAP presentation once the company has either completed its accounting for the change in law or has reasonably estimated the effect of the change as described in SAB 118. If prior law numbers are shown in order to facilitate comparisons to prior periods, a reconciliation to the GAAP numbers would be required.

Finally, in preparing their year-end disclosures, companies should also consider the broader impact that the Tax Cuts and Jobs Act might have on their financial results or business strategy, depending on the nature of the company's business and its current tax position. Considerations of this sort might be required in risk factors or in Management's Discussion and Analysis of Financial Condition and the Results of Operations.

About The Author:

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Bonnie J Roe has over thirty years of experience as a corporate lawyer advising publicly and privately held companies and funds. Her practice focuses on general corporate law, securities law, mergers and acquisitions, corporate governance, and private equity. Bonnie regularly advises public companies and their boards of directors on public disclosure, SEC compliance matters, corporate governance, and executive compensation. She has served as counsel for issuers, investors, and placement agents in connection with public and private offerings, including cross-border offerings. She also represents companies and investment funds in early and later stage financing transactions and has significant experience in fund formation and investment. Bonnie has counseled numerous buyers and sellers of publicly and privately held businesses, helping to develop and execute strategies for achieving business goals in an efficient manner. Her clients include both U.S. and internationally-based companies.

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