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SEC Staff Provides Guidance on the Tax Accounting Implications of the Tax Cuts and Jobs Act

On December 22, 2017, the Securities and Exchange Commission (SEC) – specifically, the Office of the Chief Accountant and the Division of Corporation Finance – announced new staff guidance on the accounting impacts of the Tax Cuts and Jobs Act (Tax Act), issuing the following interpretations:

- **Staff Accounting Bulletin (SAB) No. 118**: Recognizing that the Tax Act may give rise to certain challenges and constraints for publicly traded companies when complying with the requirements of FASB Accounting Standards Codification Topic 740, Income Taxes (ASC Topic 740), SAB 118 provides a "measurement period" for companies to evaluate the impacts of the Tax Act on their financial statements.
- **Compliance and Disclosure Interpretation 110.02**: C&DI 110.02 under Exchange Act Form 8-K confirms that the accounting implications of the Tax Act generally will not trigger an impairment disclosure obligation under Item 2.06 of Form 8-K.

Staff Accounting Bulletin (SAB) No. 118

ASC Topic 740 provides guidance on accounting for income taxes under generally accepted accounting principles (U.S. GAAP). Specifically, ASC Topic 740 addresses the recognition of taxes payable or refundable for the current year and the recognition of deferred tax liabilities and deferred tax assets for the future tax consequences of events that have been recognized in a company's financial statements or tax returns.

SAB 118 addresses situations where a company is not able to complete its assessment under ASC Topic 740 of some or all of the income tax effects of the Tax Act by the time the company issues its financial statements for the reporting period that includes December 22, 2017, the date on which the Tax Act was signed into law. In such situations, SAB 118 provides that:

- Where the company can determine a "reasonable estimate" of the effect on its financial statements, the company would reflect that estimate in its financial statements as a "provisional amount."
- Where the company cannot determine a reasonable estimate of the effect on its financial statements, it would continue to apply ASC Topic 740 based on the tax laws that were in effect immediately prior to the enactment of the Tax Act. Additionally, the company would be required to report provisional amounts in the first reporting period in which a reasonable estimate can be determined.

- Where the company's assessment under ASC 740 of the income tax effect is complete, the company must reflect that in its financial statements.

According to SAB 118, under no circumstances should the "measurement period" (which ends when a company has obtained, prepared, and analyzed the information needed to complete the accounting requirements under ASC Topic 740) extend beyond December 22, 2018.

Importantly, SAB 118 notes that if a company accounts for certain income tax effects of the Tax Act under a measurement period approach, the staff believes that supplemental disclosures should accompany such financial statements, including:

1. Qualitative disclosures of the income tax effects for which the accounting is incomplete;
2. Disclosures of items reported as provisional amounts;
3. Disclosures of existing current or deferred tax amounts for which the income tax effects have not been completed;
4. The reason why the initial accounting is incomplete;
5. The additional information that is needed to be obtained, prepared, or analyzed in order to complete the accounting requirements under ASC Topic 740;
6. The nature and amount of any measurement period adjustments recognized during the reporting period;
7. The effect of measurement period adjustments on the effective tax rate; and
8. When the accounting for the income tax effects has been completed.

Companies should be aware of how accounting for the income tax effects of the Tax Act in their financial statements could generate new non-GAAP financial measures. For example, if a company accounts for such effects in certain measures provided in its financial statements but then also provides the same measures excluding those effects, the latter would be a non-GAAP financial measure requiring compliance with the non-GAAP presentation and reconciliation rules.

SEC Staff Compliance and Disclosure Interpretation (C&DI) 110.02

C&DI 110.02 confirms that the re-measurement of a deferred tax asset to incorporate the effects of newly enacted tax rates or other provisions of the Tax Act is not an impairment under ASC Topic 740 and thus does not trigger an obligation to file under Item 2.06 of Form 8-K.

C&DI 110.02 also clarifies that, if companies employing the "measurement period" approach conclude that an impairment has occurred due to changes resulting from the enactment of the Tax Act, then such companies 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 (e.g., Form 10-K or Form 10-Q) instead of filing a Form 8-K.

Looking Forward

The Tax Act will have wide-ranging implications for the tax accounting and financial statement disclosures of public companies. Many of these issues will be addressed during measurement periods over the coming months.

In its press release, the staff encourages publicly traded companies, auditors, and others to consult with it for interpretative assistance with SEC rules, forms, or U.S. GAAP. Consultation guidance is available from the Division of Corporation Finance at https://www.sec.gov/forms/corp_fin_interpretive and from the Office of the Chief Accountant at https://www.sec.gov/info/accountants/ocasubguidance.htm.

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