

# US Tax Reform—Disclosure Considerations

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On December 22, 2017, tax reform (the “Tax Act”)<sup>1</sup> was signed into law. The Tax Act will have significant implications for companies, including on their accounting and associated disclosure, as discussed below. The SEC’s Office of the Chief Accountant and the Division of Corporation Finance (“Corp Fin”) have each issued guidance to aid companies in their disclosures addressing the accounting impact of the Tax Act.

## Staff Accounting Bulletin 118 (“SAB 118”)<sup>2</sup>

SAB 118 expresses the SEC Staff’s views on how the standard on accounting for income taxes (Financial Accounting Standards Codification Topic 740, Income Taxes (“ASC 740”)) should be applied in the context of the Tax Act. ASC 740 requires companies to reflect the accounting impact of legislative changes in the quarter they are signed into law, even if they go into effect at a future date. SAB 118 acknowledges, however, that accounting for certain income tax effects of the Tax Act may be incomplete by the time financial statements are issued for the reporting period that includes the enactment date of December 22, 2017, and provides guidance on how companies should address certain situations:

### How to Address Tax Effects

#### Incomplete Tax Effects

For those “income tax effects” of the Tax Act that are incomplete (i.e., the company did not have the necessary information available, prepared or analyzed—including computations—in reasonable detail to complete the accounting under ASC 740), a company should report “a provisional amount based on a reasonable estimate (to the extent a reasonable estimate can be determined), which would be subject to adjustment during a ‘measurement period’ until the accounting under ASC 740 is complete.”

#### Some Completed Tax Effects

If some of the income tax effects of the Tax Act have been completed by the time the company issues its financial statements, but some have not, SAB 118 provides that, only with respect to the tax effects that are incomplete, to the extent the company can make a “reasonable estimate” for those effects, such an estimate should be included

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<sup>1</sup> The official title of the Tax Act is “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.” Prior to an amendment, the Tax Act was originally titled the “Tax Cuts and Jobs Act.” The full bill is available [here](#).

<sup>2</sup> SAB 118 is available [here](#).

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and reported as a “provisional amount” during a “measurement period.” Examples of provisional amounts would include “reasonable estimates that give rise to new current or deferred taxes based on certain provisions within the [Tax] Act, as well as adjustments to existing current or deferred taxes that existed prior to the [Tax] Act’s enactment date.”

### No Reasonable Estimate Possible

If the company cannot make a reasonable estimate, it should “continue to apply [ASC 740] (e.g., when recognizing and measuring current and deferred taxes) based on the provisions of the tax laws that were in effect immediately prior to the [Tax] Act being enacted.”

### Measurement Period

The measurement period begins in the reporting period that includes the date of enactment of the Tax Act and “ends when an entity has obtained, prepared, and analyzed the information that was needed in order to complete the accounting requirements under [ASC 740].” Companies are expected to act “in good faith” to complete the accounting treatment under ASC 740, and the measurement period should not extend beyond one year from the enactment date. The company may need to reflect adjustments during the measurement period or to report additional tax effects if it obtains, prepares or analyzes additional information about facts and circumstances that existed as of the enactment date. Any income tax effects of events unrelated to the Tax Act should not be reported as measurement period adjustments. Any provisional amounts or adjustments to provisional amounts included during the measurement period “should be included in income from continuing operations as an adjustment to tax expense or benefit in the reporting period the amounts are determined.” SAB 118 includes examples that apply the guidance in connection with unremitted foreign earnings and deferred tax assets.

### Disclosures

The supplemental disclosures that should be included in the financial statements where the accounting under ASC 740 is incomplete should describe the following: (i) qualitative disclosures of the income tax effects of the Tax Act for which the accounting is incomplete; (ii) disclosures of items reported as provisional amounts; (iii) disclosures of existing current or deferred tax amounts for which the income tax effects of the Tax Act have not been completed; (iv) the reason why the initial accounting is incomplete; (v) the additional information that is needed to be obtained, prepared, or analyzed in order to complete the accounting requirements under ASC 740; (vi) the nature and amount of any measurement period adjustments recognized during the reporting period; (vii) the effect of measurement period adjustments on the effective tax rate; and (viii) when the accounting for the income tax effects of the Tax Act has been completed.

## Item 2.06 of Form 8-K Compliance and Disclosure Interpretation (“C&DI”) 110.02<sup>3</sup>

The Tax Act’s reduced corporate income tax rate may result in a reduction in the value of deferred tax assets. For companies relying on SAB 118, this new C&DI clarifies that the remeasurement of a deferred tax asset to incorporate the effects of the Tax Act is not an impairment under ASC 740 and, therefore, does not trigger an obligation to file under Item 2.06 of Form 8-K<sup>4</sup> with respect to disclosure of a material impairment of an asset. However, “the enactment of new tax rates or tax laws could have implications for a registrant’s financial statements, including whether it is more likely than not that the [deferred tax asset] will be realized.” A company that uses the “measurement-period” approach of SAB 118 that concludes “that an impairment has occurred due to

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<sup>3</sup> C&DI 110.02 is available [here](#).

<sup>4</sup> Form 8-K requires disclosure when a material charge for asset impairment is required under GAAP and an estimate of the charge (unless the company is not able in good faith to estimate the charge, in which case disclosure of the estimate can be delayed until known). No Form 8-K filing is required if the company reaches the conclusion in connection with the preparation of financial statements required to be included in the next Form 10-K or Form 10-Q, and the SEC staff has made clear that a conclusion that “coincides” with the preparation of the financial statements is made “in connection with” their preparation.

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changes resulting from the enactment of the [Tax] 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.” The relevant instruction provides that “[n]o filing is required under [] Item 2.06 if the conclusion [regarding the material charge for the impairment] is made in connection with the preparation, review or audit of financial statements required to be included in the next periodic report due to be filed under the Exchange Act, the periodic report is filed on a timely basis and such conclusion is disclosed in the report.”

## Practical Implications and Additional Disclosure Considerations

### Voluntary Disclosures / Regulation FD

Even if a company concludes that no Form 8-K is required, it should consider the Tax Act’s impact on its 2017 financial results and anticipated results for 2018. Investors and analysts are likely to ask companies about the Tax Act’s impact on a company’s results, and companies should consider whether to provide public disclosure to address these issues; if a company does not provide a public update, answering questions selectively should be considered carefully because of the risk of a violation of Regulation FD.

### Earnings Releases

SAB 118 does not address the financial statements included in a company’s earnings release. Although such financial statements typically do not include the notes that accompany financial statements included in periodic reports, companies should remain mindful of the disclosures called for in SAB 118 and consider the extent to which it is appropriate to include such disclosures in their earnings release. Companies may want to specifically identify amounts that are provisional and include an explanation of the extent to which the impact of the Tax Act is or is not reflected in their earnings release financial statements. Companies should also address both positive and negative tax accounting effects of the Tax Act to the extent that they have completed their ASC 740 assessment of such effects.

### Item 2.02 of Form 8-K

Item 2.02 of Form 8-K is triggered by any public disclosure of material non-public information regarding a company’s results of operations or financial condition for a completed quarterly or annual fiscal period. Any disclosures regarding material tax accounting effects of the Tax Act that relate to, but are made after the end of, the fiscal period that includes December 22, 2017 could trigger a required Item 2.02 Form 8-K.

### Other Disclosure in Periodic Reports

Companies will also need to address the Tax Act in their periodic reports to the extent that it materially affects future results. In particular, companies should update their discussion of known trends and uncertainties in MD&A, as well as any changes in their business or strategy that may result from the impacts of the Tax Act. Companies should also carefully consider the impact that future tax rates and any impairments could have on contractual provisions, such as debt maintenance covenants and executive compensation targets, and update disclosure as necessary.

### Non-GAAP Financial Measures

Companies that have completed or provisionally provided for their assessment of the Tax Act’s tax accounting effects and reflected those effects in their financial statements, but then back out that impact to address period-over-period comparability, should be mindful of the non-GAAP rules. For example, if a company has accounted for the impact of a provision of the Tax Act in its year-end financial results, but then states what its results would have been “excluding the impact of the Tax Act,” this is a non-GAAP financial measure that triggers the presentation and reconciliation requirements of Regulation G and Regulation S-K Item 10(e).

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## Section 162(m)

The Tax Act eliminates Section 162(m)'s exemption for performance-based compensation.<sup>5</sup> Companies submitting compensation plans or agreements for a shareholder vote may need to revise their standard tax discussion to reflect the absence of the deduction. Elimination of the deduction could also be relevant to compensation disclosure and analysis, as the impact of accounting and tax treatments of the particular form of compensation is specifically noted as an example of potentially material information that should be disclosed.<sup>6</sup>

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<sup>5</sup> Compensation is not subject to the new rules if it would have otherwise been deductible under the current Section 162(m) rules when paid and it is payable pursuant to a written binding contract that was in effect on November 2, 2017 and that is not materially modified thereafter. The Joint Explanatory Statement released with the bill provides the following guidance: (i) a plan in effect on November 2, 2017 is not by itself sufficient to qualify for the written binding contract exception; (ii) a written plan may qualify for the grandfather if it meets certain requirements, including that the amounts payable under the plan are not subject to discretion, and that the employer does not have the right to terminate or materially amend the plan (except on a prospective basis for future service periods); and (iii) a written binding contract that is renewed after November 2, 2017 ceases to qualify for the exception.

<sup>6</sup> See Item 402(b)(2)(xii) of Regulation S-K.