ROPES & GRAY

ALERT

Securities & Public Companies

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SEC Provides Guidance for Accounting Impacts of Tax Reform Law

On December 22, 2017, the same day that the President signed into law the Tax Cuts and Jobs Act (the "Act"),[1] the SEC's Office of the Chief Accountant and Division of Corporation Finance issued guidance to assist with timely public disclosure of the accounting impact of the Act. The new guidance includes: (i) Staff Accounting Bulletin No. 118 ("SAB 118"), which expresses the staff's views on the application of U.S. GAAP when assessing the accounting impact of the change in tax laws reflected in the Act, and (ii) Exchange Act Form 8-K Compliance and Disclosure Interpretation ("C&DI") 110.02, which expresses the staff's views on the applicability of Item 2.06 of Form 8-K to the re-measurement of deferred tax assets triggered by changes in tax rates pursuant to the Act.

Staff Accounting Bulletin No. 118

The staff issued SAB 118 to address the applicability to the Act of FASB's Accounting Standards Codification Topic 740, *Income Taxes* ("ASC Topic 740"), which provides accounting and disclosure guidance on accounting for income taxes under U.S. GAAP. Specifically, SAB 118 is intended to assist companies in applying ASC Topic 740 in the reporting period in which the Act was enacted, particularly when the accounting for certain income tax effects of the Act is incomplete at the time of the issuance of a company's financial statements for the reporting period. SAB 118 imports "measurement period" concepts that apply in accounting for business combinations under ASC Topic 805, *Business Combinations*, which provides guidance on business combination accounting. The staff guidance makes the following points:

- If a company's accounting under ASC Topic 740 for certain income tax effects of the Act is ***completed*** by the time the company issues its financial statements for the reporting period that includes December 22, 2017, the company's financial statements must reflect those income tax effects.
- If a company's accounting for certain income tax effects of the Act is ***incomplete*** by the time the company issues its financial statements for the reporting period that includes December 22, 2017, the following would apply:
    - The company would report as provisional amounts the specific effect of those items for which the accounting is not complete but for which it can determine a reasonable estimate. These provisional amounts would be subject to adjustment during a "measurement period" until the accounting under ASC Topic 740 is complete.
    - For those items for which the company cannot determine a reasonable estimate, the company would continue to apply ASC Topic 740 to those items based on tax laws in effect immediately prior to the Act. The company would report provisional amounts in the first reporting period in which it can determine a reasonable estimate, which provisional amounts would similarly be subject to a "measurement period."

[1] The official title of the 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 Act was titled the "Tax Cuts and Jobs Act."

The measurement period for provisional amounts would begin in the reporting period that includes December 22, 2017 and would end when an entity has obtained, prepared, and analyzed the information necessary to complete the accounting requirements under ASC Topic 740. During the measurement period, the staff expects that companies will be acting in good faith to complete the accounting under ASC Topic 740, but in no circumstances should the measurement period extend beyond one year from the enactment date.

During the measurement period, the company may need to reflect adjustments to provisional amounts, or include provisional amounts for which an estimate has been determined. Any provisional amounts or adjustments to provisional amounts 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 also provides that companies making use of the measurement period approach should disclose in financial statements the material financial reporting impacts of the Act for which the accounting under ASC Topic 740 is incomplete, including, among other things:

- qualitative disclosures of the income tax effects of the Act;
- the reasons the initial accounting is incomplete;
- the additional information that is needed to be obtained, prepared, or analyzed 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.

Compliance and Disclosure Interpretation 110.02

Along with SAB 118, the staff issued a new C&DI to clarify that (i) the re-measurement of deferred tax assets as a result of changes in tax rates pursuant to the Act is not an impairment under ASC Topic 740 and (ii) companies making use of the measurement period approach in SAB 118 that conclude that an impairment has occurred due to changes resulting from the enactment of the Act need not file under Item 2.06 of Form 8-K. Instead, companies may rely on the instruction to Item 2.06 that specifies that no Form 8-K filing is required if the company reaches the conclusion in connection with the preparation, review or audit of financial statements required to be included in the next periodic report if the periodic report is timely filed and such conclusion is disclosed in the report.

SAB 118 can be found here.

The new C&DI (Question 110.02) can be found here.

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