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SEC Guidance on Reporting for U.S. Tax Reform

SEC Staff Releases Guidance on Form 8-K Reporting for the Re-Measurement of Deferred Tax Assets and on Initial Income Tax Effects of New Tax Legislation

SUMMARY

On December 22, 2017, the Securities and Exchange Commission's Division of Corporation Finance released [Form 8-K Compliance and Disclosure Interpretation 110.02](#) and its Office of the Chief Accountant published [Staff Accounting Bulletin No. 118](#), which provide guidance on reporting accounting impacts of the recently enacted tax reform legislation. The new C&DI clarifies that disclosure under Item 2.06 of Form 8-K (Material Impairments) is not triggered by the re-measurement of deferred tax assets due to a change in tax rates or tax laws. New SAB 118 provides guidance on reporting the income tax effects of U.S. tax reform for issuers that are not able to complete the accounting for certain tax effects by the time financial statements are issued covering the reporting period that includes the date of the enactment of the Tax Cuts and Jobs Act (December 22, 2017).¹

FORM 8-K COMPLIANCE AND DISCLOSURE INTERPRETATION 110.02

The new Compliance and Disclosure Interpretation ("C&DI") clarifies that disclosure of a material impairment of assets under Item 2.06 of Form 8-K is not triggered by the re-measurement of deferred tax assets to reflect the impact of a change in tax rates or tax laws. The new C&DI notes that the required re-measurement is not an impairment under ASC Topic 740 and that the Instruction to Item 2.06² would apply if a company uses the measurement period approach described below and determines that there is an impairment as a result of the Tax Cuts and Jobs Act (the "Tax Act"). In that case, the company may rely on the Instruction and disclose the impairment in its next periodic report required to be filed under the Exchange Act.

STAFF ACCOUNTING BULLETIN NO. 118

ASC Topic 740 provides guidance for the accounting and disclosure of income taxes under U.S. GAAP. In Staff Accounting Bulletin No. 18 (“SAB 118”), the staff notes that reporting companies may be unable to complete the accounting for certain income tax effects of the Tax Act by the time financial statements are issued for the reporting period in which the Tax Act was enacted (the “Enactment Period”). SAB 118 provides guidance for the scenarios in which a company does not have the necessary information available, prepared or analyzed to complete the accounting for certain income tax effects of the Tax Act when it issues financial statements covering the Enactment Period. In those cases, SAB 118 would permit the company to provide “reasonable estimates” for the income tax effects of the Tax Act and to report those effects as “provisional amounts” in its financial statements during a limited “measurement period.” SAB 118 also addresses supplemental disclosures and provides three illustrative examples that a company applying the measurement period approach should review with its accountants and disclosure counsel.

A. Reasonable Estimate of Effects

In the event that a reporting company’s accounting of certain income tax effects of the Tax Act is incomplete but it can make a “reasonable estimate” of those effects, the staff would not object to the inclusion of the estimate in the company’s financial statements. Companies are to include reasonable estimates in their financial statements in the first reporting period in which they are able to make a reasonable estimate, and this estimate would be reported as a provisional amount. SAB 118 notes that provisional amounts would include, among other things, 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.

If the company is unable to make a reasonable estimate, the reporting company should continue to apply ASC Topic 740 in compliance with the tax rules in effect before the Tax Act’s enactment until the company is able to make a reasonable estimate. SAB 118 also notes that it would be inappropriate for a reporting company to exclude a reasonable estimate from its financial statements to the extent it has made such an estimate.

B. Measurement Period

Reporting companies may provide provisional amounts in their financial statements for a limited “measurement period.” The measurement period begins with the Enactment Period and ends when the company has obtained, prepared and analyzed the information necessary to complete the accounting for the income tax effects of the Tax Act. Under SAB 118 the measurement period may not extend beyond one year from enactment of the Tax Act. The staff also notes that it expects companies to act in good faith to complete the accounting under ASC Topic 740 during the measurement period.

C. Changes in Subsequent Reporting Periods, and Reporting Provisional Amounts

SAB 118 notes that reporting companies may need to adjust provisional amounts, or report additional income tax effects, upon obtaining, preparing or analyzing additional information during the measurement period. SAB 118 clarifies that income tax effects unrelated to the Tax Act should not be reported as measurement period adjustments.

Any provisional amount or adjustment to a provisional amount included in a company's financial statements 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.

PRACTICAL IMPLICATIONS

Although the new C&DI confirms that the re-measurement of deferred tax assets as a result of the Tax Act will not trigger an Item 2.06 filing obligation on Form 8-K, reporting companies should consider and evaluate with their disclosure counsel whether the effects of the Tax Act are material and whether disclosure of those effects would be appropriate, which could be made in an Item 7.01 or 8.01 Form 8-K. If the disclosure is made after the end of a fiscal quarter or year, depending on the nature of the disclosure, a filing may be required under another applicable item such as Item 2.02, which requires a Form 8-K to include any publicly announced financial information for a completed fiscal period. In addition, companies with a fiscal quarter or year ending December 31, 2017 should consider whether and how to address the effects of the Tax Act in their upcoming quarterly earnings releases and periodic reports, in particular in light of the possibility that estimates of the effects of the Tax Act may change between the date of the earnings release and the filing of the periodic report. In addition, companies considering offerings (and those engaged in continuous offerings from notes programs or otherwise) of their securities should also consider how best to address the effects of the Tax Act in their offering related disclosures.

Reporting companies that may be unable to complete the accounting for income tax effects of the Tax Act by the time they issue financial statements covering the Enactment Period should consult with their accountants and disclosure counsel to determine how to apply the guidance in SAB 118 and to assess the appropriate disclosure to be made during the measurement period.

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ENDNOTES

- ¹ The tax reform legislation, commonly referred to as the “Tax Cuts and Jobs Act,” is formally titled “an act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.”
- ² The instruction provides that a filing under Item 2.06 is not required if a company concludes that a material impairment is required under U.S. GAAP and the conclusion is made in connection with the preparation, review or audit of financial statements required to be included in the company's next periodic report, the periodic report is timely filed, and the conclusion is disclosed in the report.

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CONTACTING SULLIVAN & CROMWELL LLP

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CONTACTS

New York

Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Robert G. DeLaMater	+1-212-558-4788	delamaterr@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Richard A. Pollack	+1-212-558-3497	pollackr@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com
Marc Trevino	+1-212-558-4239	trevinom@sullcrom.com
Benjamin H. Weiner	+1-212-558-7861	weinerb@sullcrom.com
Frederick Wertheim	+1-212-558-4974	wertheimf@sullcrom.com

Washington, D.C.

Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Dennis C. Sullivan	+1-202-956-7554	sullivand@sullcrom.com

Los Angeles

Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com

SULLIVAN & CROMWELL LLP

Palo Alto

Scott D. Miller	+1-650-461-5620	millersc@sullcrom.com
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com

London

Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
Richard A. Pollack	+44-20-7959-8404	pollackr@sullcrom.com
Stewart M. Robertson	+44-20-7959-8555	robertsons@sullcrom.com
David Rockwell	+44-20-7959-8575	rockwelld@sullcrom.com

Paris

William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
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Frankfurt

Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
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Tokyo

Izumi Akai	+81-3-3213-6145	akaii@sullcrom.com
Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com

Hong Kong

Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
Michael G. DeSombre	+852-2826-8696	desombrem@sullcrom.com
Chun Wei	+852-2826-8666	weic@sullcrom.com

Melbourne

Robert Chu	+61-3-9635-1506	chur@sullcrom.com
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Sydney

Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
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