

Disclosure Implications of the Tax Cuts and Jobs Act

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As companies prepare their Form 10-K and proxy statement disclosures, they will be challenged with disclosing the impact of the Tax Cuts and Jobs Act on performance results for the purposes of financial reporting as well as for compensation measurement. Here is a short list of issues to be aware of.

Form 10-K Disclosure Implications of Tax Reform:

Sections in the MD&A likely to be affected by tax reform include the discussion of operating results and financial condition and discussion of critical accounting estimates. Companies also are adding or modifying their risk factors to acknowledge the impact of the Tax Cuts and Jobs Act.

In the MD&A, companies are required to describe any “known trends or uncertainties that have had or that the company reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.” There are comparable requirements for known trends or uncertainties impacting liquidity and capital resources.

Companies should be prepared to assess the potential impact of tax reforms including:

- Reduction of top corporate tax rate from 35% to 21% beginning in 2018
- Capital expenditure deductions: Expensing of new and qualified property placed in service after September 27, 2017, through 2022
- Limit on net interest deductions to 30% of EBITDA
- Net operating loss (NOL) deduction limited to 80% of taxable income with indefinite carryforward; carrybacks generally eliminated
- R&D expenditures paid or incurred after 2021 must be capitalized and amortized over a five-year period
- Adoption of a territorial tax regime: foreign source portion of a qualified dividend received by a 10% U.S. corporate shareholder is exempt from U.S. tax
- Deemed repatriation: 15.5% tax on post-1986 foreign earnings held in cash and an

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8% rate on all other post-1986 earnings

To the extent that companies use reasonable estimates of the tax reform impact in their disclosure in accordance with SAB 118, they may want to caution readers that they are in the process of determining the actual impact, and that their reasonable estimates are based on provisional amounts that may be adjusted upon obtaining, preparing, or analyzing additional information.

Proxy Disclosure Implications of Tax Reform:

Changes to Internal Revenue Code Section 162(m) will eliminate deductibility of compensation for “covered employees” (including now the CFO) over \$1 million, even for qualified, performance-based compensation. However, arrangements in place before November 3, 2017, and that are not materially modified will be grandfathered; IRS guidance is forthcoming.

Disclosure and governance considerations include:

- CD&A Disclosure: 162(m) deductibility will still be a relevant discussion for past awards and grandfathered awards and for distinguishing what’s deductible vs not deductible.
- CD&A Disclosure: Discuss tax reform impact on performance results, and whether those results are adjusted to exclude the impact of tax reform for compensation purposes (e.g., revaluation of deferred tax asset or deferred tax liability based on new corporate tax rate may result in a big non-cash gain or loss in Q4 of 2017).
- CD&A Disclosure: Elimination of 162(m) deductibility is a significant change for compensation programs going forward and may impact compensation design.
- D&O questionnaires: Continue to confirm that compensation committee members qualify as “outside” directors for purposes of certifying grandfathered awards and for certifying vesting of grandfathered performance awards.
- Covered employees: A “covered employee” will now be anyone who has ever been the CEO, CFO, or one of the three most highest compensated officers in any fiscal year beginning after December 31, 2016. Thus, the new rule is essentially “once a covered employee, always a covered employee.” If possible, employers should not structure one-off payments that would cause an individual to become one of the three highest compensated officers in a particular year, when he or she typically would not be one in other years. In addition, employers should track “covered employees” and their compensation arrangements.