May 18 2015

VIA E-mail (director@fasb.org) and U.S. Mail
Susan M. Cosper
Technical Director and Chairman, Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, Income Taxes (Topic 740); Intra-Entity Asset Transfers, File Reference No. 2015-200–I

Dear Ms. Cosper:

On January 22, 2015, the Financial Accounting Standards Board (FASB) released an exposure draft of two proposed accounting standards updates to Income Taxes (Topic 740). The proposed updates pertain to intra-entity asset transfers, File Reference No. 2015-200, and balance sheet classification of deferred taxes, File Reference No. 2015-210. Both updates are part of the FASB's ongoing simplification initiative launched in June 2014 to reduce cost and complexity of complying with U.S. Generally Accepted Accounting Principles (GAAP) while maintaining or improving the usefulness of information provided to users of financial statements. Tax Executives Institute (TEI or the Institute) commends the FASB for undertaking the simplification initiative and is pleased to submit the following comments on the proposed accounting standards update concerning intra-entity asset transfers.

TEI Background

TEI is the preeminent worldwide association of corporate tax executives. Our nearly 7,000 members are accountants, attorneys, and other business professionals employed by approximately 3,000 of the leading companies in North and South America, Europe, and Asia. TEI represents a cross-section of the business community and is dedicated to the development and implementation of sound tax policy and tax accounting principles, as well as to promoting the uniform and equitable enforcement of the tax laws. The Institute is proud of its record of working with congressional committees, government agencies, and other policy-making bodies, including the Securities and Exchange Commission, the Financial Accounting Foundation, and the FASB on tax and tax accounting matters. These efforts inure to the mutual benefit of the government, business taxpayers, preparers and users of financial statements, and ultimately the public at large.

TEI members are responsible for conducting the tax affairs of their companies, ensuring their compliance with the tax laws, and preparing financial disclosures of tax related matters. Most of the companies represented by our members issue financial statements that are governed by the FASB's pronouncements, and, of those, most are SEC registrants. For companies governed by other accounting standards, such as International Financial Reporting Standards, the FASB's work is also critical since FASB pronouncements are often referenced by other accounting standards' boards. In addition, they are subject to scrutiny by the IRS and various other agencies in the United States and foreign jurisdictions on a continual basis.

As a professional association of in-house tax executives, TEI offers a unique perspective. Its members work for companies involved in a wide variety of industries, and thus, their collective perspectives are broad-based and not tied to any particular special interest group. Further, TEI members are responsible for both the tax affairs of their employers and the reporting of tax information in their employers' financial statements. Thus, they are well-versed in the complexities of the tax laws, as well as the financial accounting rules. We believe the diversity, background, and professional training of TEI's members place us in a uniquely qualified position from which to comment on the FASB's proposed accounting standards updates. Along with the government and the investing public, our members have the most at stake in trying to craft a financial reporting system that fairly presents the results of company operations and is as administrable and efficient as possible.

General Views on Proposed Updates to Guidance on Intra-Entity Asset Transfers and Balance Sheet Classification

The accounting standards for income taxes are undoubtedly complex. In many instances, this complexity is a necessary byproduct of complexities in the tax law. Reviewing these standards is an important and expected role of the FASB, and we appreciate the FASB's efforts, in particular, its focus on simplification. We commend the FASB for undertaking a review of existing guidance on the tax effects of intra-entity asset transfers and balance sheet classification of deferred taxes. This is undoubtedly good work for the FASB to be performing. We agree that the FASB's proposal in File Reference 2015-210, Balance Sheet Classification of Deferred Taxes, to disclose all deferred tax items as non-current achieves simplification while retaining relevant disclosures for users of financial statements. We disagree, however, with the FASB's recommendations in File Reference 2015-200, Intra-Entity Asset Transfers. Removing the exception for recognition of tax effects on the intra-entity transfer of assets does not meet the criteria of simplification and, in fact, serves to further complicate the analysis of deferred tax items. Further, the cost of implementation and maintenance is unwarranted, given the absence of simplification for preparers of financial statements or improvement in clarity for users of the financials.

Responses to FASB's Specific Questions for Respondents

Question 1: *Should the current and deferred income tax consequences of an intra-entity asset transfer be recognized when the transfer occurs? If not, why?*

Under existing guidance, ASC 810-10-45-1, intercompany balances and transactions should be eliminated. This includes intercompany open account balances, security holdings, sales and purchases, interest, dividends, etc. Consolidated financial statements represent the financial position and operating results of a single business enterprise, and as such, they should not include gain or loss on transactions among companies in the group. Accordingly, any intercompany profit or loss realized on intra-group sales of assets that remain with the group should be eliminated. Similarly, under ASC 810-10-45-8, no tax impact should be recognized in earnings from a sale of assets between members of a consolidated group.

Under the proposal, the seller of an appreciated asset would recognize current tax expense. The buyer would recognize an increase in tax basis in excess of the consolidated book basis, which would result in a deferred tax asset and deferred tax benefit with no corollary increase in pre-tax consolidated earnings.

From a seller's perspective, the proposal to recognize the current tax consequence of an intra-entity asset transfer when payment is made to a taxing authority may provide some useful linkage between income tax expense, as stated in the statement of earnings, and income tax paid, as stated in the statement of cash flow. The underlying transaction, however, continues to be deferred in consolidation, and as a result, the proposal does not appreciably improve the overall usefulness of information provided to the users of financial statements and is likely to create confusion.

Under current rules from the buyer's perspective, an intra-entity transfer does not impact the buyer's current tax position, and thus, there should be no additional tax accounting related to the initial transfer until the underlying asset is ultimately sold outside the group. The proposal would require the buyer to establish a deferred tax asset reflecting the profit element of the intra-entity transfer, which adds complexity as the buyer may not be aware of the amount of the basis difference. Further, buyers would be required to track the deferred tax asset, subsequently remeasure the deferred tax asset for changes in the buyer's tax rate, and evaluate it for realizability in the buyer's valuation allowance analysis. This accounting would continue until the property is sold outside the group, adding complexity to the accounting standard, contrary to the objectives of the FASB's simplification initiative.

Further, recognition of a deferred tax asset when an intra-entity asset transfer occurs could increase the risk of earnings management or manipulation. For instance, if a low tax jurisdiction entity sells appreciated assets to a U.S. entity (or an entity in another high-tax jurisdiction), the entity in the higher tax jurisdiction would record a deferred tax asset that would serve to offset income tax expense. Pre-tax income arising from the sale would be eliminated, but recognition of the deferred tax asset would decrease tax expense and reduce the overall effective tax rate. This accounting treatment could result in unnatural end-of-year adjustments to execute cross-border transactions for no other reason than to achieve a tax benefit on the financial statements.

As explained above, the proposed change from tracking a prepaid asset (under the existing standard) to tracking a deferred tax asset (under the proposed update) achieves no simplification and in fact injects more complexity and volatility into the tax accounting for intra-entity transfers because a deferred tax account must be measured and evaluated for realizability. This is a significant change that would require far more time and resources than the existing procedures and would also open the door for manipulation. Accordingly, TEI urges the FASB not to adopt the proposed standard update, but instead to provide more guidance for applying the existing standard.

The recognition requirements for intra-entity asset transfers are frequently applied to intercompany sales of inventory (i.e., routine transactions), but may also cover non-routine intra-group transfers of assets, such as intellectual property or stock of a subsidiary. It is these non-routine transactions that more often give rise to complexity and potential variations in application of the current guidance. For instance, there is a lack of guidance and divergence in practice with respect to the following areas:

- Whether ASC 810-10-45-8 applies to transfers of subsidiary stock;
- Whether an arrangement to migrate intellectual property is an intra-entity transfer or merely a license to use the asset;
- Measurement of the amount of tax paid by the seller on the intercompany profit; and
- Determination of the appropriate period over which the deferred tax effects should be recognized in the financial statements.

Given the divergence in treatment for these transactions, we believe it would be more helpful to provide additional guidance under the current pronouncement on the scope of qualifying transactions and when the income tax consequences are recognized for these other types of transfers rather than adopting a new accounting method that may not result in the convergence in practice that the FASB desires. We understand the FASB considered and subsequently rejected this option, stating that additional guidance on an already complex issue would not reduce complexity and that the new pronouncement would provide more useful information. *See* FASB Exposure Draft, Two Proposed Accounting Standards Updates, Income Taxes (Topic 740) (Jan. 22, 2015) at p. 14, BC9. We urge the FASB to reconsider this option and consider our view that the proposed standard updates are themselves complex, would continue to result in divergence, and would likely require future guidance.

Question 2: *If the income tax consequences should not be recognized when the transfer occurs, should the income taxes payable or paid upon transfer be expensed as incurred? If not, how should income taxes payable or paid be recognized?*

The income tax treatment of intra-entity asset transfers varies widely among countries, and the amount of gain or loss recognized for tax purposes may not be the same as that recognized for book purposes. However, if both the financial statement component (gain or loss) and the tax component are eliminated, there is at least symmetry in the treatment of the tax and financial accounting aspects of the underlying transaction. The proposed guidance would potentially put financial statement income/loss recognition on a different timeline than tax recognition. This disparity conflicts with the general matching principle within GAAP. Accordingly, the benefits of maintaining the symmetry of current guidance (i.e., reporting the amount of tax actually paid as a prepaid tax asset and deferring tax effects until the underlying asset leaves the consolidated group) exceeds the potential benefits of adopting the proposed update. As expressed above, we believe adoption of the proposed guidance would cause confusion and provide opportunities to distort effective tax rates. We therefore see no compelling reason to adopt the proposed standard and believe the current guidance is the preferred approach.

Question 3*: Should the proposed guidance be applied on a modified retrospective basis? Are the transition disclosures appropriate?*

As discussed above, TEI is not in favor of adopting the proposed guidance update on intra-entity asset transfers. We do, however, recommend that the FASB provide additional guidance on the scope of qualifying transactions included in the current exception and when the income tax consequences are recognized for certain types of transfers. (See response to Question 1, above.) We agree with the FASB that any changes in guidance that are ultimately adopted should be applied on a modified retrospective basis as proposed in the exposure draft.

Question 4*: Should the amendments in this proposed Update be effective for:*

a. *Public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2016;*
b. *All other entities for annual periods beginning after December 15, 2017, and interim periods in annual periods beginning after December 15, 2018, with early adoption permitted, but not before the effective date for public business entities?*

We agree with the FASB that any changes in guidance that are ultimately adopted should follow the effective dates proposed in the exposure draft.

Question 5: *What would be the expected transition costs of adopting the guidance in the proposed Update? What would be the expected recurring costs of applying the proposed guidance compared with the costs of applying current GAAP?*

During the transition period, all prior transactions would have to be reviewed and adjusted through retained earnings, even though for book purposes the gain or loss on intercompany sales would continue to be unrecognized. The review and adjustment process would create additional costs for preparers of financial statements, yet would not yield any appreciable benefit to users of financial statements.

Under existing and proposed guidance, preparers of financial statements would be required to track the underlying transfer of assets. Compliance with the proposed guidance would also require the additional steps of measuring the deferred tax asset attributable to basis differences and changes in jurisdictional tax rate changes and evaluating the ability to realize the asset, which would likely increase the complexity and cost of complying with the proposed standard.

Conclusion

TEI appreciates the opportunity to provide these comments on the FASB's exposure draft on simplified accounting for income taxes. While the Institute does not agree with the standard updates proposed for intra-entity asset transfers, it does agree with the proposal for simplified balance sheet classification and disclosure, and its members fully support the FASB's efforts to simplify the tax accounting standards embodied in ASC 740. We look forward to commenting on future proposals.

These comments were prepared under the aegis of TEI's Financial Reporting Committee whose chair is Eric Johnson. Should you have any questions about the comments, please do not hesitate to contact Mr. Johnson at (925) 965-4536 or eric.johnson@ros.com or Patrick Evans of the Institute's legal staff at (202) 638-5601 or pevans@tei.org.

Respectfully submitted,
TAX EXECUTIVES INSTITUTE, INC.

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