TAX EXECUTIVES INSTITUTE, INC.

August 14, 2015

<u>VIA E-mail (director@fasb.org) and U.S. Mail</u>
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: File Reference No. 2015-270: Proposed Accounting Standards Update, Compensation—Stock Compensation (Topic 718)

Dear Ms. Cosper:

On June 8, 2015, the Financial Accounting Standards Board (FASB) released an exposure draft of proposed improvements to the employee share-based payment accounting rules—Topic 718 (the Proposed Update). The Proposed Update is 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 while maintaining or improving the usefulness of information provided to users of financial statements. Tax Executives Institute (TEI or the Institute) fully supports the FASB's simplification initiative and is pleased to submit the following comments on the Proposed Update.

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 (SEC), the

Financial Accounting Foundation (FAF), 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 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 Internal Revenue Service 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 highly 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 the Proposed Update

TEI's comments focus on the FASB's proposal to account for excess tax benefits and excess tax deficiencies arising from employee stock compensation directly in earnings (the Earnings Approach). The Institute enthusiastically supports the FASB's overall simplification initiative, particularly efforts to simplify accounting standards associated with accounting for income taxes. Tax accounting for employee share-based excess tax benefits and deficiencies is not a particularly troublesome area for financial statement preparers. Thus, we were surprised to see the proposal to make fundamental changes to these rules. There are other much more complex tax accounting issues where opportunity exists to reduce complexity and simplify the preparation of financial statements without adversely impacting the usefulness of the financial statements for users. TEI outlined a number of these issues in a June 10, 2013 letter to the FAF in connection with its post-implementation review of ASC-740.[1] We would welcome the opportunity to discuss these issues with FASB staff.

[1] We encourage the FASB to undertake simplifying updates to discrete aspects of ASC-740 that are exceptionally complex, yet could be eliminated or simplified without diminishing the value of financial statements standards. Examples presented in the above-mentioned letter and a subsequent telephone conference with FASB staff include: computation of deferred tax assets (DTAs) and deferred tax liabilities (DTLs) generally, intraperiod tax allocations,

As discussed below, the Earnings Approach is inconsistent with the true economic nature of an employee stock award and will be difficult for financial statement users to understand. The approach also fails to achieve the FASB's goal of achieving simplicity through its proposed accounting standard updates. In fact, we believe adoption of the Earnings Approach would have the opposite result of creating more complexity, thereby increasing compliance costs for financial statement preparers and confusion for users.

The Current Method of Accounting for Compensatory Stock Awards as Two Distinct Transactions with the Grant Value Impacting Earnings and the Subsequent Change in the Value of the Stock Award Impacting Equity Is the Correct Theoretical and Practical Answer.

TEI agrees with the long-standing view that stock compensation awards result in essentially two transactions — the grant of the award by the company and the exercise of the award by the employee. These are two discrete transactions that should be accounted for separately. First, the granting of the award is a compensatory transaction resulting in compensation expense reported in the income statement. Second, the recipient's exercise of the stock award results in the issuance of stock, which is an equity transaction, appropriately recognized in equity. The tax implications of changes in value of the stock award should likewise be recognized in additional paid in capital (APIC), regardless of whether the change in value is an increase or a decrease in the tax benefit. Recognizing an excess tax benefit or deficiency in earnings upsets this easily understandable and theoretically correct framework.

The FASB has not provided a rationale to abandon this long-standing view, other than a desire for simplification. While simplification is a worthy goal, the current guidance is not overly complex. Further, the proposed Earnings Approach will cause additional administrative burdens for preparers and fail to provide useful information to the users of the financial statements.

The Earnings Approach Will Distort Financial Results because It Fails to Match Tax Expense with Earnings Before Tax.

The proposed Earnings Approach creates a mismatch between income before tax expense and the tax expense amount. Current rules provide that the increase or decrease in the value of stock after the grant date is not recognized as compensation expense in book income before tax. That approach is consistent with the two-transaction framework discussed above, and TEI believes it is the correct approach. The proposed Earnings Approach, however, requires the tax effect of the increase or decrease in stock value after the grant date to be included in tax expense. Thus, income before tax *excludes* the increase or decrease in value, but tax expense *includes* the tax effect of this increase or decrease in value. Tax expense will be distorted by this item, which

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use of valuation allowances to reduce recognized DTAs, computation of DTLs for indefinitely reinvested foreign earnings, and disclosure of significant portions of deferred taxes.

is excluded from book income, and will no longer have a logical relationship to pre-tax book income. This distortion will likely cause confusion and uncertainty for users of financial statements. Further, to address the mismatch, companies may choose to undertake the additional administrative burden of showing earnings without the impact of the Earnings Approach as a non-GAAP financial measure, creating the added complexity of the non-GAAP disclosure itself, as well as the need to now explain the difference between GAAP and non-GAAP measures.

The Proposed Earnings Approach Would Cause Unwarranted Volatility of the Tax Rate.

The Proposed Earnings Approach would not provide useful information to users of financial statements because of the inherent volatility of the tax rate caused by events unrelated to company operations. Volatility would occur because tax expense could change dramatically quarter over quarter or year over year simply because of differences between the stock price used to determine compensation expense on the date the stock award is granted and the stock price on the date the stock award vests or is exercised. The increase or decrease in stock price currently has no direct impact on the determination of income from continuing operations. The proposed Earnings Approach, however, would cause the tax effect of this one item to distort the tax rate from continuing operations. Users of financial statements typically focus on financial statement changes when comparing data quarter over quarter or year over year. This tax rate volatility may cause confusion and uncertainty for users of the financial statements. We understand volatility alone is not a rationale for or against financial reporting. In this case, however, we do not view this adverse impact as an improvement in clarity or a reduction in complexity of the financial statements.

Setting the Record Straight on Complexity

APIC accounting for issuances of stock received as compensation is generally not a significant administrative burden to financial statement preparers. Under current rules, companies are required to maintain an APIC pool to demonstrate tax deficiencies do not exceed the amount in the APIC pool. While the development of processes at adoption of the current standard was challenging, now that processes are in place the accounting work is not difficult to complete, track, or audit. Since the implementation of FAS 123(R), companies have modified their accounting and payroll systems to efficiently capture the required information. In addition, firms that provide stock plan administrative services have developed systems necessary to provide the APIC pool adjustments. Investment in these systems has enabled efficient processes to maintain the APIC pools and to perform the appropriate accounting and tax tasks. Introducing a new process would result in challenges similar to those faced when companies implemented FAS 123(R). TEI does not view the proposal to eliminate APIC accounting as providing any tangible or visible benefit to users of financial statements that would warrant the complexity, disruption, and extra effort required to implement the proposed rule changes. Further, application of the Earnings Approach in practice would add significant complexity to the already difficult income statement quarterly close.

Although introduced as a simplifying measure, adoption of the Earnings Approach would add complexity to the interim reporting requirements for estimating tax impacts for the full year. Decisions concerning whether to exercise options, when to exercise options, and how many options to exercise are decisions made by the individual employee, not by the company. Companies have limited information to support an estimate of the tax impact of these future events. If the Earnings Approach were adopted, stock compensation activity occurring up to the last day of the quarter would have to be collected and analyzed to determine quarterly earnings. Preparers of financial statements have a short period to close the books after the last day of the quarter, typically 4 to 7 days. It would be challenging, perhaps impossible, to collect the information necessary to account for all excess tax benefits and deficiencies realized during the quarter within the quarterly P&L close. Companies would frequently face the undesirable choice of extending the close period, estimating the end-of-quarter stock activity (which can be quite difficult in the case of stock options), or adopting an approach that does not include the end-of-quarter activity until the following quarter. Implementing any of these options would lead to divergence in how companies estimate such amounts for interim reporting of the financial statements, which would detract from the usefulness of financial statements to users. Adding to the difficulties, the true-up of the estimate to actual may unfairly raise SOX 404 control issues to the extent amounts are material. Retaining the current method does not pose these challenges because balance sheet close processes are typically longer than the income statement processes and companies have already adapted their close schedules to accommodate the APIC accounting entries.

Recommendation

We recommend that the FASB not adopt the proposal to recognize excess tax benefits and tax deficiencies in earnings, but instead make simplifying adjustments to the existing APIC accounting rules. Under current treatment, companies must maintain an APIC pool to demonstrate tax deficiencies do not exceed the amount in the APIC pool. A welcomed simplification would be to eliminate the APIC pool and instead require that all excess tax benefits and deficiencies be recorded in APIC.

Conclusion

TEI appreciates the opportunity to provide these comments on the FASB's proposed improvements to the employee share-based payment accounting rules. While the Institute is firmly against adoption of the Earnings Approach as advanced in the Proposed Update, it does believe the current APIC rules can be simplified without adversely impacting the usefulness of the financial statements for users. In addition, the Institute fully supports the FASB's efforts to simplify the tax accounting standards embodied in ASC-740 and is hopeful future exposure drafts will address some of the more complex and challenging tax accounting rules.

These comments were prepared by 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,
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