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VIA EMAIL TO: director@FASB.org

Technical Director
File Reference No. 2015-200
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, *Income Taxes (Topic 740) – Intra-Entity Asset Transfers*

To Whom It May Concern:

Our firm, Financial Reporting Advisors, LLC, provides accounting and SEC reporting advisory services, litigation support services, and dispute resolution services. We specialize in applying generally accepted accounting principles to complex business transactions. We appreciate the opportunity to provide comments on the Board's Proposed Accounting Standards Update, *Income Taxes (Topic 740) – Intra-Entity Asset Transfers* (the ED).

As evidenced by the long history of changes in standards or proposed changes in this area over the years, understandably there are strongly-held different points of view on the technical accounting issue and different views about assessing costs and benefits. But, on balance, we support the issuance of the ED as a final standard. We acknowledge there will be costs to preparers to implement the ED guidance. Procedures will need to be changed and, if not already being done, temporary differences in the buying jurisdiction will need to be tracked. However, we believe the benefit from the more representationally faithful financial reporting in the ED and the elimination of practice problems caused by the current guidance outweigh those costs.

In our view, the ED guidance is consistent with the fundamental principles of Topic 740 and better aligns the guidance regarding the income tax consequences of intra-entity transfers with the conceptual framework. Some have argued (as did the Board in issuing FASB Statement No. 109, *Accounting for Income Taxes*) that there is a conflict between the guidance in Topic 740 and the guidance in Topic 810 (originally issued as Accounting Research Bulletin No. 51, *Consolidated Financial Statements*). We believe those arguments focus on the apparent disconnect between (1) deferring the recognition of pretax gains on intra-entity transfers of assets until that gain has been realized in a transaction with a third-party and (2) immediately recognizing the income tax consequences in the selling and buying tax jurisdictions of the intra-entity transfer. However, there is only a disconnect if the tax effects of the intra-entity transfer are viewed as a part of the

transaction, rather than as separate transactions with the relevant taxing authorities. We believe instead, as discussed in paragraph BC5 of the ED, that tax effects are a result of transactions with third parties independent of the buyer and seller in the intra-entity transfer, and therefore their recognition should not be tied to the recognition of the effects of the intra-entity transfer.

Typically, accrual accounting results in a matching of revenue and related costs. Paragraph 145 of FASB Concepts Statement No. 6, *Elements of Financial Statements*, states:

Accrual accounting uses accrual, deferral, and allocation procedures whose goal is to relate revenues, expenses, gains, and losses to periods to reflect an entity's performance during a period instead of merely listing its cash receipts and outlays. Thus, recognition of revenues, expenses, gains, and losses and the related increments or decrements in assets and liabilities—including matching of costs and revenues, allocation, and amortization—is the essence of using accrual accounting to measure performance of entities. The goal of accrual accounting is to account in the periods in which they occur for the effects on an entity of transactions and other events and circumstances, to the extent that those financial effects are recognizable and measurable.

In our view, that paragraph makes two critical points that support the recognition of the income tax consequences of intra-entity transfers in the period those intra-entity transfers occur. First, “the goal of accrual accounting is to account in the periods in which they occur for the effects on an entity of the transactions and other events and circumstances....” Second, the recognition of revenues and costs is tied to “related increments and decrements in assets and liabilities....” In other words, the use of accrual accounting should not result in the recognition of debits or credits in the statement of financial position that do not meet the definition of assets or liabilities. Under current guidance, an asset is recognized for the income tax consequence of the intra-entity transfer in the selling jurisdiction. That “asset” is a deferred cost and does not meet the definition of an asset in the conceptual framework—paragraph 241 of Concepts Statement 6 states that the deferred tax charges and credits prescribed by APB Opinion No. 11, *Accounting for Income Taxes*, do not meet the definitions of assets and liabilities.

We further believe the approach in the ED is intellectually consistent with another area of accounting for intra-entity items—namely, accounting for the foreign currency effects of intercompany receivables and payables that are not of a long-term investment nature. Under current accounting, these foreign currency gains and losses are retained in consolidated net income even though the balance sheet amounts completely eliminate. This accounting respects the parent and subsidiary individual functional currencies and that the intercompany gains and losses (and effects on functional currency cash flows) are just as real as with transactions involving third parties. Similarly, the approach in the ED respects the parent and subsidiary individual tax jurisdictions and that the temporary differences (and effects on functional currency cash flows) are just as real as with transactions involving third parties.

It is also worth noting that the Emerging Issues Task Force (Task Force) addressed a similar situation in EITF Issue No. 93-17, *Recognition of Deferred Tax Assets for a Parent Company's Excess Tax Basis in the Stock of a Subsidiary That is Accounted for as a Discontinued Operation*. Generally Accepted Accounting Principles (GAAP) in effect at that time (APB Opinion No. 30, *Reporting the Results of Operations – Reporting the Effect of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transaction*)

precluded the recognition of a gain at the time a subsidiary meets the conditions for presentation as discontinued operations and required any such gains be recognized in the period the subsidiary is disposed of. Paragraph 34 of Statement 109 (now ASC 740-30-25-9) provided that “a deferred tax asset shall be recognized for an excess of the tax basis over the amount for financial reporting of an investment in a subsidiary or corporate joint venture that is essentially permanent in duration only if it is apparent that the temporary difference will reverse in the foreseeable future.” If an entity’s tax basis in its subsidiary to be disposed of exceeded its financial reporting basis (and there was not a need for a valuation allowance for the resulting deferred tax asset), the guidance in Statement 109 would result in the recognition of a gain (a tax benefit) in a period earlier than allowed by the guidance in Opinion 30. Consistent with the guidance in the ED, the Task Force concluded that Opinion 30 governed the pretax accounting for an investment that met the conditions for presentation as a discontinued operation and that the guidance in Statement 109 governed the accounting for the income tax consequences.

The ED guidance would also eliminate the confusion that currently exists around the scope of the intra-entity exception and conflicts between that exception and other provisions in Topic 740.

The most problematic issue relates to accounting for the income tax consequences of intra-entity arrangements for the right to use intellectual property. Depending on an entity’s business and tax objectives, such arrangements may take a variety of forms. Some forms (such as an outright sale or license for exclusive use for the entire economic life of the intellectual property) are readily identifiable as intra-entity transfers of assets, but there is diversity in determining whether other contractual arrangements that provide rights of use of intellectual property are transfers of assets to which the exception applies. For example, consider a U.S. company that has intellectual property acquired long ago in a business combination that it uses in its worldwide operations. Assume this company issues a perpetual license to use this intellectual property in Europe to its Irish subsidiary in exchange for a one-time, lump sum payment. Some accountants may conclude the license constitutes the intra-entity transfer of an asset—the Irish subsidiary owns the rights to the intellectual property with respect to its use in Europe and the U.S. parent no longer has any direct economic interest in the intellectual property as it relates to its use in Europe. Other accountants view this transaction differently. They would point to the accounting for license revenue in such a transaction between unrelated parties and conclude that, while the Irish subsidiary now owns an asset (the right to use the intellectual property in Europe which is measured at the amount paid for that right), the U.S. parent does not have a “cost of sales” recognized in its income statement in the manner of an inventory transfer. Accordingly, those accountants believe this transaction is not an intra-entity transfer of an asset. Still other accountants may conclude that the answer depends on the U.S. company’s accounting policy with respect to its unit of account for this intellectual property or whether the license is exclusive or non-exclusive. That is, if the U.S. company has treated the worldwide rights to the intellectual property as a single unit of account, then the transaction would not be an intra-entity transfer of an asset. However, if the U.S. parent has treated the European rights as a separate unit of account (for example, if the European rights had been acquired in a transaction separate from the acquisition of the rights for the rest of the world), then the transaction would be an intra-entity transfer of assets. The accounting for the income tax consequences of these arrangements under current GAAP can differ materially depending on whether the arrangement is considered to be an intra-entity transfer of an asset.

There are also situations in which the current guidance on accounting for the income tax consequences of intra-entity transfers of assets conflicts with other guidance in Topic 740. For

example, assume there is an intra-entity transfer of the ownership of a subsidiary and there is an income tax cost in the selling jurisdiction. ASC 740-10-25-3(e) and ASC 810-10-45-8 (the exception for the income tax consequences of intra-entity transfers of assets) provide for recognition of an asset for the income tax consequences incurred in the seller jurisdiction. However, ASC 740-30-25-9 prohibits the recognition of a deferred tax asset related to an excess of tax basis over financial reporting basis in an investment in the stock of a subsidiary unless it is apparent that the temporary difference will reverse in the foreseeable future. Which provision in Topic 740 should cover the accounting for the income tax consequences of that transaction? Another example of a conflict with the guidance on accounting for the income tax consequences of intra-entity transfers of assets relates to the requirement to consider tax-planning strategies when assessing the need for a valuation allowance. Should the taxable income that would be generated by a potential intra-entity transfer of assets be anticipated as part of an entity's assessment of its need for a valuation allowance for deferred tax assets (and thereby be immediately recognized as a reduction of tax expense) or should the incremental change in valuation allowance caused by the intra-entity transfer of assets be considered part of the income tax consequence of the transfer (paragraph 124 in the Basis for Conclusions to Statement 109 states "the income taxes paid by the seller including the tax effect, in the seller's tax jurisdiction, of any reversing temporary differences as a result of that intercompany sale are deferred")? The guidance proposed in the ED would eliminate these practice issues.

In addition to the matters already addressed in the ED, we believe it would be helpful for the final standard to address whether the income tax consequences of intra-entity transfers of assets should be included in the computation of the estimated annual effective tax rate or should be accounted for discretely in the period in which they occur. Without such guidance, we believe that diversity may well develop on this matter.

Once again we appreciate the opportunity to comment on the ED. If there are any questions, please contact Richard R. Petersen at 312-345-9102.

Sincerely,



Financial Reporting Advisors, LLC