



2121 41st Avenue
Suite 301
Capitola, CA 95010
PHONE 831.465.8204
FACSIMILE 831.465.9384

May 29, 2015

www.svtdg.org
info@svtdg.org

Ms. Susan Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

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

Dear Ms. Cospers:

The Silicon Valley Tax Directors Group¹ appreciates the opportunity to comment on the FASB's proposed guidance on income tax accounting for intra-entity asset transfers. The input provided within this comment letter is based on our collective experience as preparers of financial statements, responsible for administering accounting for income taxes in an increasingly complex global tax and business environment.

The proposed guidance would require recognition, at the time of the intra-entity asset transfer, of current income taxes in the seller (for the seller's tax consequences on the deferred intercompany profit) and the recordation of deferred income taxes in the buyer (for the difference between the buyer's tax basis of the asset and the cost of the asset reported in the consolidated financial statements).

While we support the Board's Simplification Initiative to identify areas where the cost and complexity in financial reporting can be reduced while maintaining or enhancing decision-useful information for investors, we do not believe this is such an area. We recommend that the proposed guidance not be adopted and that the existing accounting be retained. We further recommend the Board consider issuing clarifying guidance on the existing accounting to reduce diversity of practice.

We believe the proposed guidance's approach—to require the comprehensive recognition of current and deferred income taxes for intra-entity asset transfers—is inconsistent with tax accounting principles and will significantly increase costs and complexity for preparers, while reducing the usefulness of the information provided to users of the financial statements.

¹ The Silicon Valley Tax Directors Group ("SVTDG") is a group of 81 high technology companies with significant presence in the Silicon Valley (California). The SVTDG includes public and private companies, from smaller start-up companies to large multinational companies, with sales ranging from \$100m/yr to over \$180b/yr. The SVTDG supports sound tax and accounting policies that allow the U.S. high tech technology industry to continue to innovate and be competitive in the global marketplace.

The proposed guidance is inconsistent with tax accounting principles

Deferred Income Taxes

We believe the proposed guidance's requirement to record deferred income taxes in the buyer is fundamentally inconsistent with the longstanding foundational objectives and principles of ASC 740. A foundational objective of ASC 740, *Accounting for Income Taxes*, is to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an enterprise's financial statements or tax returns. While the consolidated basis difference that results from an intra-entity asset transfer technically meets the definition of a temporary difference, it is not a basis difference that results in deductible amounts in future years when the asset is recovered or settled, and as such, is not a temporary difference for which a deferred tax asset may be recognized.

The only tax consequences resulting from an intra-entity asset transfer are in the seller. There are no tax consequences to the buyer of property.² Companies maintain their books and records of each legal entity on a stand-alone U.S. GAAP basis in order to facilitate meeting tax and other regulatory reporting obligations. When an intra-entity transfer of property occurs, the buyer obtains basis for both tax and standalone U.S. GAAP reporting in the purchased property equal to the amount paid. As such, the buyer has no temporary difference that will result in taxable or deductible amounts in future years in the buyer's standalone U.S. GAAP financial statements or its tax returns. Accordingly, the stand-alone U.S. GAAP books and records of the buyer will not reflect a deferred tax asset related to its purchase of property.

When a buyer is a member of a consolidated financial statement, ASC 810 would apply to defer the recognition of the intercompany profit on an intra-entity asset transfer. As a result, the buyer's tax basis of the asset would exceed the cost of the asset reported in the consolidated financial statements. The accounting conceptual question is whether this basis difference should be treated as giving rise to a deferred tax asset or not. We think not. The proposed guidance approach would, in effect, require that the buyer be treated as if it purchased the asset for less than it actually paid for the asset in the amount of the deferred intercompany profit. This is inconsistent with what the buyer actually paid. We believe the basis difference in question arises in consolidation/elimination, not with respect to the buyer. We think it is instructive that the proposed guidance's required deferred income tax asset for the consolidated basis difference does not reverse through the buyer's current income tax provision or current payable. We believe this demonstrates that the consolidated basis difference does not give rise to future tax consequences in the buyer and as such is not a basis difference for which a deferred tax asset should be recognized.

We believe the proposed guidance errs by requiring the buyer to recognize a deferred tax asset in its jurisdiction for deferred intercompany profit earned by the seller.

² The buyer obtains basis in the property equal to the amount it paid for the property.

The proposed guidance would represent to readers that a future tax benefit would arise in the buyer in its jurisdiction at its tax rate, when no such future tax benefit would arise in the buyer because the buyer obtains basis for both GAAP and tax purposes in the property equal to what it paid for the property. As such, the proposed guidance would misstate the provision for income taxes, deferred tax benefits, and deferred tax assets.

Current Income Taxes

The proposed guidance’s requirement to recognize, at the time of the intra-entity asset transfer, current income taxes in the seller (for the seller’s tax consequences on the deferred intercompany profit) would overstate the current tax expense for certain intra-entity transfers of intangibles and other long-lived assets. Such transfers are commonly structured and/or agreed with governments to result in tax consequences to the seller over a period of years. For such intra-entity asset transfers, the proposed guidance is inconsistent with the ASC 740 objective to recognize currently incurred tax expense.

The proposed guidance will lead to results that are not representationally faithful, and will reduce comparability and usefulness of financial statements

A comparison of the existing accounting and the proposed guidance is shown in the table below.

	Seller	Buyer	Elimination ³	Consolidated
Existing Accounting	Seller’s tax consequences are deferred	–	–	Deferred recognition (initially). When recognized, tax consequences will be at the seller’s tax rate.
Proposed Accounting	Seller’s tax consequences are recognized in full	–	Deferred tax asset is recorded at <u>buyer’s tax rate</u> based on seller’s deferred intercompany profit.	Deferred recognition (initially), albeit with distortions. ⁴ When recognized, tax consequences will be at the seller’s tax rate, as modified by any <i>changes</i> in buyer’s tax rate and any <i>f/x</i> impacts on buyer’s DTA.

The proposed guidance will lead to provisions for income taxes that are not representationally faithful to the extent there is disparity in income tax rates applicable to

³ Companies maintain their books and records on a standalone U.S. GAAP basis to meet their tax and other regulatory reporting obligations. As such, all effects of the proposed guidance would need to be managed in the eliminations entity (where i/co profit is eliminated).

⁴ Distortions would result to extent seller’s current tax expense at the seller’s tax rate does not equal deferred tax benefit at the buyer’s tax rate, and due to any foreign exchange translation gains/losses on the deferred tax asset.

buyers and sellers within the group, or where different currencies are involved. This result would occur because the seller would recognize current tax expense at the seller's tax rate, while the buyer would recognize deferred tax benefit at the buyer's tax rate and currency (each on the seller's profit on the intra-entity asset that was retained within the group). As a result, the provision for income taxes would no longer reflect the representative effective tax rate of the group because the proposed guidance's required seller's current tax expense and buyer's deferred tax benefit are not correlated with pre-tax income.

We do not believe the proposed guidance's recognition of a consolidated income statement benefit when an asset is transferred intra-entity from a lower tax rate jurisdiction to a higher tax rate jurisdiction is appropriate. We believe that result could be misinterpreted by users of financial statements and could lead to unintended consequences, including having an impact on legitimate tax planning.

Importantly, if the proposed guidance were adopted, it would be very difficult to estimate the required forecast for the annual effective tax rate for the consolidated group. This difficulty is due to the fact the proposed guidance's unique deferred tax assets for the consolidated basis difference always impact the provision for income taxes (i.e., they are not reversed through current income tax provision or current payable). There is no easy way to estimate the impact of this deferred tax asset accounting which would require an annual forecast of intercompany profits recognized on assets that would remain in the group (including current year intra-entity asset transfers), by asset, measured at each buyer's tax rate and currency. The difficulty faced in estimating the effective tax rates is likely to manifest in large swings in the quarterly tax rate.

The proposed guidance will significantly increase cost and complexity in financial reporting

The existing accounting is well understood and companies have well-established processes and procedures that enable companies to implement it on a cost-effective basis. Under the existing accounting, all the tax consequences arise in the seller entity. Buyer tax rates and currency are not relevant to the existing tax accounting, and are generally not tracked.

Accounting for and tracking the proposed guidance's deferred tax assets will require data and processes not presently in existence or relevant for any other purpose. As discussed above, companies maintain their books and records for their legal entities on a stand-alone U.S. GAAP basis in order to facilitate meeting tax and other regulatory reporting obligations. Companies' transactional systems for intercompany asset transfers record the purchase of property at cost. A buyer in an intra-entity transfer obtains basis for both tax and standalone U.S. GAAP reporting in the property purchased equal to the amount paid, hence no basis difference or deferred tax asset exists in the buyer.

The proposed guidance would impose complex new tracking, tracing, and quantification burdens and costs on preparers. The proposed guidance would create a unique type of deferred tax asset that: i) would not exist on the separate U.S. GAAP financial statements of any entity, but would only be recorded in consolidation in the elimination entity, and ii) would always be recorded through the income statement (with no current income tax payable/provision offset). Tracking and tracing these deferred tax assets, testing them for impairment, and providing valuation allowances if appropriate, will result in incremental costs and complexity. Further, preparers would need to track and quantify foreign exchange translation amounts for these deferred tax assets by each buyer jurisdiction, and determine classification (income statement/OCI).⁵

Conclusion

While we are very supportive of the FASB in its ongoing efforts to identify areas where simplification can be achieved while maintaining or enhancing decision-useful information for investors, as stated above, we do not believe this is such an area.

We believe that the proposed guidance is not an improvement in financial reporting. We believe the proposed guidance is fundamentally inconsistent with the objectives and principles of ASC 740 and that it will reduce the usefulness of information reported to investors while increasing cost and complexity in financial reporting. Accordingly, we recommend that the Board not adopt the proposed guidance with respect to the tax consequences of intra-entity asset transfers and instead consider issuing clarifying guidance on the existing accounting to reduce diversity of practice.

The SVTDG's answers to the Board's questions for respondents are shown in the attached Appendix.

We very much appreciate the Board's consideration of our comments. We would be pleased to meet with the Board or Staff at your convenience to answer any questions you might have.

Sincerely,



Jeffrey K. Bergmann
Co-Chair, Silicon Valley Tax Director's Group

⁵ FASB previously considered the proposed accounting and rejected it recognizing that the proposed accounting would result in "complex cross-currency deferred tax computations for most enterprises". FAS109, Accounting for Income Taxes, Basis for Conclusions, Paragraph 124.

APPENDIX

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?*

No. We believe the existing accounting should be retained. The only tax consequences with respect to an intra-entity asset transfer are the tax consequences of the seller; as the buyer obtains basis in the property equal to the amount it paid for the property. Because the seller's intercompany profit from the intra-entity asset transfer has been deferred from recognition in the consolidated financial statements pursuant to ASC 810, the seller's tax consequences should similarly be deferred and recognized as the cost of the asset is recovered—as the asset is sold (or otherwise disposed of) outside the group, or as the asset is amortized, depreciated, abandoned, or impaired. The existing accounting's consolidated provision for income taxes aligns to pre-tax consolidated accounting profit, thereby providing useful information to the reader with respect to the enterprise's tax provision and representative effective tax rate.

Importantly, the proposed guidance requirement to record a deferred tax asset in the buyer violates foundational objectives and principles of ASC 740. Under ASC 740, a deferred tax asset is only permitted if a basis difference gives rise to future tax deductible amounts. The buyer's purchase of property does not result in a basis difference that would result in future tax deductions in the buyer because the buyer gets basis equal to what it paid to acquire the property. Accordingly, under ASC 740, a deferred tax asset may not be recognized by the buyer in an intra-entity asset transfer. In addition, the proposed guidance's requirement to recognize all the seller's tax consequences at the time of the intra-entity asset transfer belies the fact that many intra-entity asset transfers (e.g., intangible property transfers) are structured and/or agreed with governments to result in taxable income to the seller and taxes payable by the seller over a period of years.

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 only tax consequences with respect to an intra-entity asset transfer are the tax consequences of the seller. We believe that the seller's tax consequences should not be recognized when the transfer occurs because the seller's intercompany profit from the intra-entity asset transfer has been deferred from recognition in the consolidated financial statements pursuant to ASC 810. The seller's tax consequences should be deferred and recognized as the cost of the asset is recovered—as the asset is sold (or otherwise disposed of) outside the group, or as the asset is amortized, depreciated, abandoned, or impaired. This is the long-standing existing accounting. We believe the Board should consider issuing additional guidance to reduce diversity in practice and ensure that a seller's tax consequences will be recognized eventually and may not be deferred indefinitely.

Consistent with the existing accounting, we believe the income tax payable should reflect the full amount of the seller's tax consequences and all tax payments made. We do not believe the income taxes payable or paid should be expensed as incurred. We believe the income taxes payable or paid should, consistent with existing accounting, be taken into account as the seller's tax consequences are recognized in the income statement. This is consistent with ASC 810's deferral of the intercompany profit. This is also in recognition of the fact that there are many common intra-entity asset transfers (e.g., transfers of intangibles) where the tax consequences are economically and legally taken into account over time (and so the recognition of the seller's tax consequences over time is appropriate).

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

No. We believe the guidance should not be applied on a modified retrospective basis. We recommend that the Board not adopt the amendments in this proposed guidance. If, however, the Board decides to adopt the proposed guidance, we recommend that the transition rules should permit prospective adoption to avoid imposing significant burdens and complexity on preparers to determine a cumulative effect adjustment. Many taxpayers will not have the records to track historic basis differences (amount of deferred intercompany profit remaining) by buyer entity, jurisdiction, tax rates, and currency. For those who do have records, it will impose a significant burden. We would note further that adoption on other than a prospective adoption basis would require preparers to determine deferred tax asset valuation allowances for prior periods, which could lead to inappropriate use of hindsight. We also believe there is limited utility to users of recording a cumulative effect adjustment. We believe prospective adoption (for transactions arising in the first year following the date of adoption) would enable preparers the necessary time to adopt necessary IT systems and processes.

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 recommend that the Board not adopt the proposed guidance. If, however, the Board decides to adopt the proposed guidance, we recommend the effective date for public business entities be moved out one year (i.e., be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2017). This additional year would provide additional time for preparers to develop the necessary processes, systems, and controls to comply.

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 existing GAAP?*

The transition costs of adopting the proposed guidance will be significant given the volume of intra-asset transfers (inventory, assets for leasing, assets for provision of services, assets for provision of maintenance obligations, intangibles, acquisition integration, etc.), the number of sellers, and the number of buyers in a typical preparer (each with their own tax rate and other relevant information). Many taxpayers do not have the records to track historic basis differences (amount of deferred intercompany profit remaining) by buyer entity, jurisdiction, tax rates, and foreign exchange. For those who do have records, it will impose a significant burden.

We believe the expected recurring costs of applying the proposed guidance will be much greater than the recurring costs of applying the long-standing existing GAAP. The existing accounting is well understood and companies have well-established processes and procedures that enable companies to implement it on a cost-effective basis. Because the proposed update fundamentally changes the relevant accounting to record deferred income tax assets in the buyer, the proposed update will require a great deal of new information to be identified, gathered, tracked and traced, and accounted for, in consolidation (elimination entity). Preparers will need to invest significant resources to develop new systems, processes, and controls to comply.