28 June 2019

Mr. Shayne Kuhaneck
Acting Technical Director
File Reference No. 2019-700
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
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Dear Mr. Kuhaneck:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update (ASU), Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (the Proposed Standard), from the Financial Accounting Standards Board (FASB or Board).

We support the FASB’s objective in its simplification initiative to reduce the cost and complexity of financial reporting while maintaining or improving the usefulness of the information provided to financial statement users. We believe that the proposal to simplify the accounting for income taxes by removing certain exceptions to the general principles in Accounting Standards Codification (ASC or Codification) 740, Income Taxes, and by clarifying and amending other aspects of the guidance meets that objective, while acknowledging that there is a cost associated with any change.

We generally support the proposal and commend the FASB for responding to concerns raised by stakeholders by proposing guidance that would simplify the accounting for intra-period tax allocations and ownership changes in foreign investments, among other things. However, we recommend that the FASB make certain changes to clarify aspects of the proposed guidance to promote consistency in practice and further simplify the accounting for preparers.

For example, we support the Board’s proposal to amend ASC 740-10-30-27 to clarify that an entity is not required to allocate the consolidated amount of current and deferred tax expense to legal entities that are not subject to tax when those entities are preparing standalone financial statements. However, we believe that giving an entity the option to allocate a portion of the consolidated amount of income tax expense to the separate financial statements of certain legal entities that are not subject to tax creates complexity – particularly if an entity were to make this election when there are multiple owners with potentially different tax attributes. Therefore, we recommend that the Board consider not including the option for an entity to allocate income tax expense to certain entities not subject to income tax in any final guidance. If the Board decides to move forward with this provision, we believe it should clarify to which types of legal entities these amounts may be allocated and how the amount of income tax expense allocated would be determined when the entities are not wholly owned by a single entity.
We have concerns about the proposed transition guidance that would require entities to apply the provisions on franchise taxes (or similar taxes) that are partially based on income on a retrospective basis for all periods presented in the financial statements. We believe that this might present operational challenges for certain entities and recommend that the FASB consider allowing entities to apply this guidance to franchise taxes that are partially based on income on either a retrospective basis or a modified retrospective basis as described in the proposed guidance.

We also have concerns about the proposal to eliminate in its entirety the illustration in ASC 323-740-55-8 and ASC 323-740-55-9. We understand that entities use the guidance in this illustration as a basis to measure an identified impairment and recommend that the Board correct the illustration rather than eliminate the example from the Codification.

In addition, we recommend that the FASB consider using this simplification effort as an opportunity to clarify the wording and requirements related to the exceptions in ASC 740 to recognize deferred tax liabilities and assets related to outside basis differences. While changes in tax law resulting from the Tax Cuts and Jobs Act (TCJA) may reduce some of the challenges of accounting for tax consequences of an entity’s investments in foreign subsidiaries (e.g., accounting for the tax effects of undistributed earnings), it also created new complexities (e.g., global intangible low-taxed income).

We believe the FASB’s simplification project also provides an opportunity to clarify the wording and requirements for applying indefinite reinvestment. The guidance in ASC 740 is inconsistent because it is derived from standards that had different underlying principles (APB 23 vs. FAS 109), and there are inconsistencies in wording and concepts that complicate the accounting for indefinitely reinvested earnings and lead to differing interpretations. For example, ASC 740 provides exceptions to the basic principles for recording a deferred tax asset or liability and uses differing terminology, such as essentially permanent in duration, indefinite reinvestment criteria, indefinite postponement of remittance and reverse in the foreseeable future, among other things.

Finally, we encourage the Board to continue to monitor the effects of the TCJA and determine whether other changes to ASC 740 are needed. In addition, we encourage the Board to continue its research project on ASC 740’s prohibition on backwards tracing to determine whether changes should be made to that guidance.

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Our responses to the questions posed in the Proposed Standard are set out in the Appendix to this letter. We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst & Young LLP
Appendix — Responses to questions raised in the Proposed Accounting Standards Update, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes

Question 1: Do you agree that the amendments in this proposed Update would simplify the accounting for income taxes? If not, please explain which proposed amendment(s) you disagree with and why.

We believe that the proposed amendments generally would simplify the accounting for income taxes. However, as noted in this Appendix, we recommend that the Board consider revising certain aspects of the proposal to improve the operability of any final guidance and promote consistency in practice.

Question 2: Do the proposed amendments maintain or improve the usefulness of information provided to users? Alternatively, would the proposed amendments result in the elimination of decision-useful information? Please explain why or why not.

We believe that the proposed amendments generally would maintain or improve the usefulness of the information provided to users. We also believe removing certain exceptions to the general principles in ASC 740 would simplify the accounting for income taxes and improve the comparability of information provided to users.

For example, the exception to the general principle of intra-period tax allocation is often challenging for companies to apply, and the results of this computation are often counterintuitive. Therefore, we believe eliminating this exception to the general principle of intra-period tax allocation would simplify the accounting for preparers and improve the usefulness of information provided to users.

We note, and agree, that eliminating the current exceptions to the general principles for recognizing or derecognizing deferred tax liabilities for outside basis differences when an investor loses or gains control of foreign subsidiaries or investees accounted for using the equity method would simplify the accounting for preparers and improve the comparability of financial information since outside basis differences would be accounted for in a similar manner, regardless of how the investment was obtained.

While we support the FASB’s proposal to clarify that an entity is not required to allocate its consolidated current and deferred tax expense to the separate financial statements of legal entities not subject to tax, we believe that giving the entity the option to allocate a tax provision to certain legal entities not subject to tax (e.g., single-member limited liability companies) may lead to diversity in practice and reduce comparability of the separate financial statements of these entities. We recommend that the Board not provide this election in any final guidance. If the Board moves ahead with this aspect of the proposal, we recommend that the FASB clarify to which types of entities this election could be applied and how an entity would allocate the income tax expense to these entities when there are multiple owners with potentially different tax attributes. See additional discussion in Question 3.
Question 3: Are the proposed amendments operable and auditable? If not, which aspects pose operability or auditability issues and why? Would any of the proposed amendments impose significant incremental costs? If so, please describe the nature and extent of the additional costs.

We believe that many entities already have in place systems, processes and controls to generate the information they would need to comply with the proposal. Therefore, we believe that entities generally would not incur significant costs. However, we defer to preparers as to whether any of the proposed amendments would impose significant incremental costs.

We have the following recommendations to improve the operability of certain of the proposed amendments:

**Step up in the tax basis of goodwill**

We support the FASB’s proposal to clarify the guidance on determining when a step up in the tax basis of goodwill relates to a separate transaction or a business combination. However, to promote consistency in practice, we recommend removing the word “must” from factor (e) because the factors in the list are clearly described as indicators rather than requirements for a transaction to be considered a separate transaction. Therefore, we recommend the following edit to this factor:

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e. The entity must incur a cash tax cost or sacrifice existing tax attributes to achieve the step up in tax basis.
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We believe that the types of transactions that result in a step up in the tax basis of goodwill are not limited to those directly between a taxpayer and a government. As such, we recommend that the FASB add a title before ASC 740-10-25-54 to clarify that this paragraph relates to Transactions that result in a step up in the tax basis of goodwill, so that a preparer does not interpret the guidance to be limited to Transactions directly between a taxpayer and government, as the current section heading would imply. If the Board does not follow our recommendation, we recommend that it clarify what transactions directly with a government are. For example, it is not clear from the proposal whether this guidance would apply only when an entity has a separate agreement with a government or whether it would also apply when an entity applies a provision under the existing tax law.

**Separate financial statements of legal entities not subject to tax**

We support the Board’s proposal to amend the guidance in ASC 740-10-30-27 to clarify that an entity is not required to allocate the consolidated amount of current and deferred tax expense in the separate entity financial statements of legal entities that are not subject to tax. However, we believe giving the entity the option to allocate a portion of the consolidated amount of income tax expense to the separate financial statements of certain legal entities not subject to tax may lead to diversity in practice and how an entity would allocate income tax expense to these entities when there are multiple owners may vary. Therefore, we recommend that the Board amend any final guidance in ASC 740-10-30-7 to state:

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An entity is not required to shall not allocate the consolidated amount of current and deferred tax expense to legal entities that are not subject to tax (for example, certain partnerships and disregarded entities, such as single-member limited liability companies).
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If the Board does not follow our recommendation to prohibit the allocation of a tax provision to entities not subject to tax, we believe the FASB should clarify to which types of legal entities these amounts may be allocated so that it may be better understood and applied consistently. For example, if the FASB’s intent is to not allow an entity to allocate a tax provision to the separate financial statements of partnerships or multi-member limited liability companies, it should state that fact in the guidance or provide additional guidance or examples clarifying the definition of a disregarded entity. Further, we believe guidance would be needed as to how an entity would allocate a provision to legal entities that are not subject to tax and that are not wholly owned by a single owner or entity.

We recommend that the guidance in ASC 740-10-30-27 be clarified as follows (if allocation is permitted to entities not subject to tax):

However, an entity may elect to allocate the consolidated amount of current and deferred tax expense to legal entities that are not subject to tax and are wholly owned by a single entity (e.g., single-member limited liability companies). An entity may not make this election for legal entities that are partnerships or other legal entities that are not subject to tax and are not wholly owned by the entity. An entity may make this election on an entity-by-entity basis that are disregarded by the taxing authority.

Further, to improve the operability of the proposed changes, we suggest that the proposed amendments in ASC 740-10-30-27 be moved to a separate paragraph (i.e., ASC 740-10-30-27A). The current language in ASC 740-10-30-27 refers to a group that files a consolidated tax return and members of that group. This may confuse the intent of the proposed amendments, which relate to the allocation of consolidated amounts of current and deferred tax expense to certain legal entities.

‘Hybrid’ tax regimes

We support the FASB’s proposal to clarify the guidance on accounting for a franchise tax (or similar tax) that is based on the greater of two calculations, one that is based on income and one that is based on items other than income (a “hybrid” tax regime) in ASC 740-10-15-4(a). In general, we believe that the proposal would reduce the complexity of accounting for income taxes in hybrid tax regimes by requiring entities to account for the portion of the tax based on income (including deferred tax expense or benefit) under the hybrid tax regime in accordance with ASC 740, with any incremental tax amount in excess of the current tax amount being recorded as non-income-based tax expense.

However, we recommend that the Board clarify in any final guidance that the tax rate used to measure the deferred tax assets or liabilities in hybrid tax regimes should be based on the income tax rate component used in the computation of the franchise tax. We also recommend that the FASB clarify any final guidance to state that an entity should not consider whether the temporary difference would reverse in a period at a rate other than the income tax rate used in the computation of the franchise tax when measuring deferred taxes.

We acknowledge that ASC 740-10-55-142 (example 17) indicates that the deferred taxes are required to be recognized based on the tax rate to be applied to a corporation’s net taxable earned surplus, and BC8 of the exposure draft indicates that an entity would not need to consider whether a temporary difference would reverse in a period at a rate other than the income tax rate used in the computation...
of the franchise tax when measuring deferred taxes. However, we believe that incorporating this
guidance into ASC 740-10-15-4(a) would promote consistency in application and provide guidance in
situations when the temporary difference might reverse at a different rate, such as when an entity is
not able to benefit from the taxable losses under the tax law (e.g., when the hybrid tax regime does
not allow a loss carryback or carryforward). We suggest the following changes to ASC 740-10-15-4(a):

The guidance in this Topic does not apply to the following transactions and activities:

a. A franchise tax (or similar tax) to the extent it is based on capital and there is no portion of the
tax based on income. If a franchise tax is partially based on income (for example, an entity pays
the greater of an income-based tax or and a non-income-based tax), deferred tax assets and
liabilities shall be recognized and accounted for in accordance with this Topic. Deferred tax
assets and liabilities shall be measured based on the income tax rate component used in the
computation to determine the portion of the franchise tax based on income. An entity should
not consider whether a temporary difference would reverse in years when the tax is based on
the amount other than income. The amount of current tax expense that is based on income
shall be accounted for in accordance with this Topic, with any incremental amount incurred
accounted for as a non-income-based tax.

Further, we recommend that the Board clarify that a franchise tax that is only based on capital and any
incremental non-income-based amount of a franchise tax determined based on the proposed updates
in ASC 740-10-15-4(a) are not in the scope of ASC 740 and should not be included as a component of
income tax expense. As such, we recommend adding the following sentence to ASC 740-10-15-4(a):

A franchise tax (or similar tax) that is only based on capital and any incremental non-income-based
amount of a franchise tax should not be included as a component of income tax expense.

We also would support the FASB considering a model that would allow the total hybrid tax to be
allocated entirely to either income tax expense or to non-income-based tax expense based on
predominance. We recognize that this would require the FASB to define predominance and provide
additional guidance on how an entity would measure deferred taxes in situations when an entity would
allocate the tax entirely to income tax expense.

Enacted changes in tax laws in interim periods

We support the proposed amendments to require an entity to reflect the effects of enacted changes in
tax law in the annual effective tax rate computation in the first interim period that includes the
enactment date (ASC 740-270-25-5). However, we believe the FASB should clarify that this guidance
would apply only when the effective date of the change in the tax law is within the same fiscal year as
the date of enactment.
Illustration updates

We believe the Board should consider updating the examples it is proposing to change in ASC 740 to reflect current tax laws and situations entities encounter today. We believe that this would increase the operability of the proposed amendments. We believe the FASB should consider updating the following illustrations:

Example 2: Allocation of income taxes to continuing operations and one other item (Cases A and A1)

The Board should consider amending the implementation guidance in ASC 740-20-55-10 through 55-12C to align the tax rates with the current tax law. Under current US Federal tax law, the current income tax and capital gain tax rates are the same. Updating this example for the current tax law would increase the operability of these examples because they would represent fact patterns that exist in practice today.

Example 6: Effect of new tax legislation

Case A: Legislation effective in a future interim period

We believe that most tax law changes that this example would apply to would be related to changes in an income tax rate that is effective in a future period rather than a change in available tax credits. The Board should consider whether the implementation guidance in ASC 740-270-55-45 through 55-49 would increase operability and consistency if it were to include a change in the tax rate instead of a change in tax credits.

Other

We recommend that the FASB consider updating other illustrations in ASC 740 to reflect changes in tax rates and other provisions that differ from the current tax law. This would increase the operability of these examples because they would represent fact patterns that exist in practice today.

Qualified affordable housing project investments

We have concerns about the Board’s proposal to eliminate the example in ASC 323-740-55-8 and ASC 323-740-55-9 because it contains an error in when the impairment should have occurred for an investment in a qualified affordable housing project accounted for using the equity method. We recommend that the FASB correct the error because we understand that entities use the guidance included in this illustration to measure an identified impairment.

However, if the Board moves ahead with this proposed change, we recommend that the Board clarify whether the method for measuring impairment described in footnote (a) of ASC 323-740-55-8 continues to be acceptable. We understand that companies use the guidance for measuring an impairment of these investments. If it is the Board’s intent to no longer allow entities to use this method of measuring impairment, we recommend that the Board provide transition guidance allowing entities that recorded an impairment in a period prior to adoption of a final ASU to adopt this provision on a retrospective or modified retrospective basis (as described in the proposed update). For example, because the current
Illustration measures an impairment on an undiscounted basis, an entity that measured an impairment based on the current guidance might need to record an additional impairment charge upon adoption of any final standard.

**Question 4:** Are the transition requirements and transition disclosures for the proposed amendments appropriate? If not, what transition approach or transition requirements would be more appropriate and why?

We believe that the transition requirements and transition disclosures for the proposed amendments generally are appropriate. However, we have concerns about the transition approach and transition requirement for hybrid tax regimes.

The proposed transition guidance would require entities to apply the pending content related to franchise taxes in ASC 740-10-15-4 that are partially based on income on a retrospective basis for all periods presented in the financial statements. We believe that the transition method might present operational challenges for certain entities, depending on how they currently account for these taxes. For example, because under today’s guidance the amount considered an income tax expense is the amount of tax in excess of the tax that is based on capital, entities may not have measured deferred taxes using the tax rate used in the computation of the hybrid tax. As a result, an entity adopting the proposed amendment may expend additional time and incur additional costs to recompute income tax expense (including deferred taxes) for prior periods presented. We recommend that the FASB consider allowing entities to apply the proposed guidance either on a retrospective basis or a modified retrospective basis, as described in the proposal. In addition, we believe it may take some entities additional time to inventory all the hybrid tax regimes to which they are subject in the jurisdictions in which they operate and recompute their income tax expense based on the proposed guidance. Therefore, we recommend that the Board consider the effort that may be required to adopt this guidance when determining an effective date.

**Question 5:** How much time would be needed to adopt the proposed amendments? Should early adoption be permitted? Should entities other than public business entities be provided with an additional year to implement the proposed amendments? Why or why not?

We defer to preparers because they are in a better position to respond to this question. See our response to Question 4 for considerations related to hybrid tax regimes.

We believe that early adoption of the proposal should be permitted for all entities.

We believe that entities that are not public business entities should have additional time to implement the proposed amendments.