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May 26, 2015

Via email to director@fasb.org

Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
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Re: Proposed Accounting Standards Update, Income Taxes (Topic 740) (File Reference No. 2015-200 – I and File Reference No. 2015-2010 – II)

Dear Ms. Cosper:

We are pleased to have the opportunity to provide comments related to the Board's two proposed income tax accounting changes regarding: (I) intra-entity asset transfers and (II) balance sheet classification of deferred taxes.

BDO supports the Board's initiative to reduce or eliminate unnecessary complexity from the current accounting guidance, while maintaining the quality and relevance of financial reporting information. However, we believe the Board's simplification initiative should focus on areas of Topic 740 which have broader implications to more businesses. The accounting for income taxes has historically been challenging, resulting in financial reporting misstatements. There are several reasons including: (1) Topic 740 is a complex standard with several exceptions, special rules, and difficult concepts which require expertise in tax and financial reporting, (2) income tax laws globally have become increasingly complex and unique, and (3) accounting for income taxes is often performed outside of the main financial reporting system on various platforms including spreadsheet-based models which have to be imported into the main financial reporting system.

While the current proposals aim to reduce some of this complexity, the proposals may have limited applicability, or may not represent the most significantly complex areas of application by a majority of reporting entities. For instance, complex accounting issues related to intra-entity asset transfers do not arise as frequently as issues related to accounting for valuation allowances, uncertain tax positions, or intraperiod allocation. In addition, the balance sheet classification of deferred taxes is not frequently cited as a source of complexity in practice.

We acknowledge there are mechanical and conceptual accounting challenges in working through the adjustments needed as a result of intra-entity asset transfers. Also, separating deferred income tax assets and liabilities into current and noncurrent classification in the statement of financial position to align with the classification of the respective assets and liabilities may present some accounting system and process challenges. However, as noted, we do not consider these the most extensive challenges with Topic 740.

For example, accounting for a valuation allowance, including the balance sheet allocation of that allowance[1], continues to present significant challenges to many reporting entities. While we appreciate there are risks with providing “bright lines,” there are also opportunities to improve and simplify the current model for valuation allowances. Similarly, the measurement of uncertain tax positions (or “step 2”) and the intraperiod allocation rules could both be simplified, which would have greater impact on all reporting entities. Income tax accounting for share-based payments is one of the more complex accounting areas and we support the Board’s intention to issue a separate proposal related to share-based income tax effects.

Consequently, we encourage the Board to expand its approach to simplify Topic 740. We believe additional outreach that includes mid-market companies (public and private) which may have more limited resources to manage increasingly complex and fast-changing business, regulatory, tax, and standard setting environments, would be beneficial in identifying the areas of potential simplification in Topic 740 for a wider array of reporting entities.

Our responses to the Board’s specific questions are provided in the appendix to this letter.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Yosef Barbut at (212) 888-8292 or Patricia Bottomly at (310) 557-8538.

Very truly yours,

BDO USA, LLP

BDO USA, LLP

[1] The current pro rata allocation requirement can result in a counterintuitive presentation when a valuation allowance is required for only specific, but not all, deferred tax assets.

Appendix

I. Intra-Entity Asset Transfers, File Reference No. 2015-200

Question 1: Should the current and deferred income tax consequences of an intra-entity asset transfer be recognized when the transfer occurs?

While we generally have a neutral view of this proposal, we believe it may result in unintended consequences such as creating a disincentive to legitimate tax planning, or conversely promoting tax planning for the principal benefit of recognizing a net tax benefit due to an intra-entity asset transfer. The latter scenario could occur, for example, when an intra-entity asset transfer does not trigger a tax to the selling entity, while the buying entity receives a tax basis step-up. Also, recognizing the income tax expense prior to recognition of the expected pretax income distorts net income in the period an intra-entity asset transfer occurs and in the periods in which the pretax income is recognized. For example, under current U.S. tax law, the amount and timing of the tax expense from the transfer of intangible assets outside the U.S. is contingent on the future productivity and use of the intangible assets and must be "commensurate with future income" that the intangible assets would generate (the "default" rule).[2] However, current U.S. tax law also allows an election out of the default rule to instead make a lump sum payment of the U.S. tax in the period of transfer (recognize a gain). Under the proposed guidance, utilizing this exception would result in tax expense being recognized in earnings prior to the associated income.

However, we also acknowledge that the adjustments required to account for these types of transactions are not always intuitive. Additionally, there have been practice issues with applying this guidance. There are divergent views on the proper accounting treatment, and varied interpretive guidance exists. For example, the transfer of an indefinite-lived intangible asset requires making a decision as to the amortization period of the deferred tax. Furthermore, an intra-entity asset transfer could trigger a valuation allowance release leading to the question as to whether the valuation allowance release should also be deferred. The Board could choose to address these differing opinions in a separate project if it eventually decides to retain the current accounting. We would not object to this approach.

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

We do not see a significant benefit from bifurcating the current and deferred tax accounting, and also do not believe this would achieve the Board's key objective which is reducing complexity and improving the relevance of reported income tax information. The accounting in the selling entity and the accounting in the buying entity represent two sides of the same coin in the context of an intra-entity asset transfer and should be accounted for consistently.

Furthermore, many intra-entity asset transfers are done for the purpose of achieving a tax rate arbitrage from the recovery of the asset's expected economic value. The reporting entity could

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[2] Under IRS Code section 367(d), the default treatment of an intra-entity outbound (i.e., U.S. to foreign) transfer of an intangible asset is to defer immediate recognition of taxable income and instead require inclusion of "deemed royalties" as taxable income in future U.S. tax returns to be filed during the economic useful life of the intangible asset. The "deemed royalties" must be "commensurate with income" generated by the intangible asset during its economic useful life.

theoretically recover (in sale or use) a higher value from the asset than the intra-entity transfer price. Recognition of the current expense, but not the deferred benefit, on the intra-entity transfer would yield a tax rate that is artificially high in the period of transfer and conversely artificially low in the period of recovery.

The accounting should either be immediate recognition of the total expected net tax effect, or deferral and amortization of the total expected net tax effect throughout the remaining economic useful life (the current accounting requirement).

Furthermore, requiring income taxes paid or payable upon transfer to be expensed in the period of transfer does not provide incremental benefit to users of the financial statements in reconciling current income tax expense, or the effective tax rate, to the actual tax liability incurred. We believe further changes, or a new reconciliation, would be required.

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

We believe a prospective[3] basis of adoption is preferable to a modified retrospective basis since recognition of the net unamortized balance (i.e., prepaid asset less unrecorded deferred tax asset) through opening retained earnings would result in recognition of any remaining income from the recovery of the asset without recognition of tax expense.

However, we would not oppose a modified retrospective approach if, upon adoption, the unrecognized income is not expected to be material to the results of future periods, and this election provides greater simplification for preparers. The unamortized deferred tax and the off balance sheet tax basis step-up should be readily available in a reporting entity's tax accounting and compliance systems as of the beginning of the period of adoption.

Question 4: Should the amendments in the proposed Updates be effective for (annual & interim) periods beginning after December 15, 2016 (for public entities) and for annual periods beginning after December 15, 2017 and interim periods beginning after December 31, 2018 (for private entities) (early adoption allowed but not before the effective date for public entities)?

We agree with these proposed dates and understand they are consistent with the Board's intention to provide reporting entities with adequate time to prepare for adoption of an accounting standard update and to allow private entities an additional year.

Question 5: What should 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?

We believe there would be some expected cost to implement the proposed update, including system changes and training. However, we do not expect that preparers and their auditors would

[3] Under a prospective adoption, the net tax effects of intra-entity asset transfers occurring after the first day of the accounting period the change is applicable would be immediately recognized in earnings, while unamortized prepaid assets and off balance sheet deferred tax assets would still be amortized to income tax expense over the asset's remaining recovery period for book or tax.

incur significant transition costs. The unamortized deferred tax and any off balance sheet tax basis step-up should be readily available from the accounting and tax compliance systems.

Also, we would not expect significant recurring cost savings from adopting the proposed accounting. As noted above, more comprehensive revisions would be needed to achieve significant cost savings in complying with the overall requirements of reporting income tax information.

II. Balance Sheet Classification of Deferred Taxes, File Reference No. 2015-210

Question 1: Should all deferred income tax liabilities and assets be presented as noncurrent in a classified statement of financial position? If not, why, and what alternatives should the Board consider, and what is the conceptual basis of the alternatives?

We are in favor of this proposal.

We believe the Board should also consider changing the presentation of deferred income taxes from different tax jurisdictions to a single amount on the face of the statement of financial position rather than requiring separate presentation by jurisdiction. While information regarding different tax jurisdictions is relevant to users, enhanced disclosures within the footnotes could better achieve the objective of providing meaningful information regarding different tax jurisdictions to the users of the financial statements. Similarly, if current classification of deferred income tax assets and liabilities is not considered particularly relevant to users, the Board might consider whether current classification of liabilities for unrecognized tax benefits should also be shown as non-current since the timing for these liabilities can be unpredictable. We believe that the Board’s proposal could potentially be expanded to include these additional items.

Question 2: Should the proposed guidance be applied on a prospective basis?

We support a prospective basis of adoption.

While the information necessary to retrospectively adopt noncurrent classification should exist, a retrospective application may also have indirect implications to performance, compensations, and debt arrangements tied to balance sheet financial ratios. Due to these concerns, we recommend permitting but not requiring retrospective adoption.

Question 3: Should the amendments in this proposed Update be effective for periods beginning after December 15, 2016 (public entities) and after December 15, 2017 (private entities) with early adoption allowed to private entities but no sooner than the effective date for public?

We agree with the same effective dates for this proposal as the effective dates proposed for the intra-entity asset transfer proposal.

Question 4: What should 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 with the costs of applying current GAAP?

We do not expect the cost to be significant. We expect there would be some transition costs for implementation related to training and system and process changes. We are not certain the recurring cost savings would be significant without further modifications as discussed above.