

FASB Emerging Issues Task Force

Issue No. 06-3

Title: How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)

Document: Issue Summary No. 1, Supplement No. 1*

Date Prepared: May 15, 2006

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Dates Previously Discussed: March 16, 2006

Previously Distributed EITF Materials: Issue Summary No. 1, dated February 28, 2006

References

FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies* (FAS 19)

SEC Regulation S-X, Rule 5-03 (Rule 5-03 of Regulation S-X)

* The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.

Background

1. At the March 16, 2006 EITF meeting, the Task Force reached a tentative conclusion on this Issue and directed the staff to pursue the issuance of a draft abstract for public comment. The draft abstract was posted to the website on April 4, 2006, for a 30-day comment period that ended May 4, 2006.

2. Comment letters received on the draft abstract have been distributed to members of the Task Force and have been analyzed by the FASB staff. At the June 15, 2006 EITF meeting, the Task Force will have the opportunity to consider those comment letters as it redeliberates the elements of the tentative conclusion in the draft abstract and addresses the issues raised in this Supplement. The Task Force will then be asked to reach a final consensus on this Issue.

Summary of Comment Letters

3. Eight comment letters were received on the draft abstract. Those commenting included three preparers of financial statements, two industry associations, one investment firm, and two accounting firms. Three of the respondents agreed with the tentative conclusions, three other respondents disagreed with the tentative conclusions, and two other respondents asked for clarification on the scope of the draft abstract. The recommendations to the Task Force are based on the staff analysis of the information received, subsequent discussions with the respondents, and whether that information was previously considered in the Task Force's initial deliberations of these issues.

4. Based on the FASB staff's analysis of the comment letters received, the staff recommends that the draft abstract be modified to clarify the scope of the Issue to ensure that its application is consistent with the Task Force's tentative conclusions reached at the March EITF meeting. The FASB staff is proposing the following modification to the draft abstract (additions are underscored and deletions are struck through):

4. The Task Force reached a [consensus] on Issue 1 that the scope of this Issue includes any tax assessed by a governmental authority that is ~~directly~~-imposed concurrent with or subsequent to ~~on~~ a revenue-producing transaction between a

~~seller and a customer, and may include, but are not limited to, sales, use, value added, and some excise taxes.~~

5. Based on the FASB staff's analysis of the comment letters, the staff believes the following comment warrants consideration by the Task Force at the June 15, 2006 EITF meeting.

Comment: The scope of Issue 06-3 should be revised to include any tax assessed by a governmental authority that is incurred as a result of a revenue transaction, either as a percentage of revenue or as a fixed dollar amount on each revenue transaction. (Issue 1)

Accounting Issues and Alternatives

Issue 1: Whether the scope of Issue 06-3 should be revised to include any tax assessed by a governmental authority that is incurred as a result of a revenue transaction, either as a percentage of revenue or as a fixed dollar amount on each revenue transaction.

View A: The scope of Issue 06-3 should be revised to include any tax assessed by a governmental authority that is incurred as a result of a revenue transaction, either as a percentage of revenue or as a fixed dollar amount on each revenue transaction.

6. Proponents of View A believe that the scope of this Issue should be expanded to include all taxes incurred as a result of a revenue producing transaction regardless of the point at which the tax is assessed in the revenue process. Proponents of View A believe that the scope of this Issue, as drafted, focuses primarily on the timing of the tax assessment as opposed to the nature of the tax assessment itself. They believe that upon the application of this issue, taxes that are economically similar will be subject to different disclosure requirements based solely on the timing of the tax is assessment.

7. Proponents of View A believe that it is unclear how an entity would evaluate whether certain taxes (for example, excise taxes) are within the scope of this Issue. To illustrate that point, Comment Letter No. 1, from Deloitte & Touche LLP, provides four examples of what it

believes demonstrates the difficulty in determining what is within the Issue's scope. The following is one of the examples provided in the comment letter:

A seller purchases cigarette packs from a vendor/producer and separately purchases cigarette tax stamps from a taxing authority. The tax stamps must be affixed to the cigarette packs prior to sale to a customer. Generally, the tax stamps are affixed to the cigarette packs early in the seller's distribution chain, and are treated as a separate, inventoried cost. In at least some jurisdictions, the seller is eligible for a tax stamp refund from the taxing authority if the cigarette packs are not sold to a customer.

As drafted, it is unclear whether this type of excise tax is within the scope of the Issue. One view is that this excise tax is assessed on the seller prior to the point-of-sale transaction with a customer. In fact, the seller may have latitude in whether it passes on the cost of the tax stamp, notwithstanding state-minimum pricing and other tobacco-product pricing idiosyncrasies. As such, this excise tax may not be considered directly imposed on a revenue-producing transaction between a seller and a customer, and thus would be outside the scope of the Issue.

An opposing view is that this excise tax is directly imposed on a revenue-producing transaction between a seller and a customer in that the seller cannot, by law, sell the cigarette packs to a customer without first affixing the tax stamp. The timing of when the tax stamps are purchased and affixed to the cigarette packs is not relevant, nor does it matter that the seller may have latitude in passing on the cost of the tax stamp. Rather, the scoping determination would focus on the fact that the cigarette packs cannot be sold without affixing the tax stamp, making the tax directly imposed on a revenue-producing transaction. This view is supported to the extent a refund is available to the seller for unsold cigarette packs.

Proponents of View A believe that under their proposed scope, the types of excise taxes described above would be within the scope of the Issue because the excise tax noted in the example is related to a revenue transaction. That is, the purchased cigarettes will ultimately be sold to a customer.

8. However, opponents to View A believe that the phrase "incurred as a result of a revenue transaction" will be difficult to apply in practice. They believe that in the cigarette tax example, an alternative view is that the tax is assessed on the procurement process and not incurred as a result of a revenue transaction. They also are concerned that preparers will have to track the tax separately in the inventory systems in order to comply with the disclosure requirements.

9. Proponents of View A believe that the scope of the Issue, as currently written, will not improve financial reporting because Rule 5-03 of Regulation S-X provides an accounting policy choice and requires disclosure for all excise taxes if included in revenues and greater than one percent of revenues. Accordingly, for public companies, this Issue could exclude certain excise taxes that are within the scope of Rule 5-03 of Regulation S-X, therefore requiring some entities to disclose separate amounts of excise taxes (that is, one amount (total) under Rule 5-03 and another amount (a subset of the total) under the provisions of this Issue). Proponents of View A believe that this will result in information that is not decision useful to the users of the financial information.

View B: The scope of Issue 06-3 should not be revised.

10. Proponents of View B believe that this Issue should be applied to taxes on revenue producing transactions when the tax is imposed concurrent with or subsequent to a revenue-producing transaction. Proponents of View B believe that determining which taxes are assessed as a result of a revenue producing transaction and which are assessed during the production or procurement process is difficult. These proponents believe that View A will be difficult to implement because an entity would need to analyze the economic and legal characteristics of each tax to determine if it is a result of a revenue producing transaction. This will result in diversity in the application of the consensus. Taxes that are assessed on the purchase of a product for resale would be excluded from View B, but included in View A. Proponents of View B believe that from the customer's perspective, when a tax is assessed by a governmental authority on a revenue producing transaction, the seller is always in substance acting as an agent for the governmental authority, and when taxes are assessed during the production or procurement process, then they are more of a procurement or production cost. Proponents of View B look to severance (lifting) taxes in the oil and gas industry, which are included in the cost of the inventory in accordance with FAS 19, as an example of a production tax that could be interpreted as a tax that is the result of a revenue producing transaction.

11. Proponents of View B also note that if taxes on the production or procurement process are considered within the scope of the Issue, there also exists the potential for diversity in how taxes are disclosed. To illustrate View B proponent's concern, consider the following fact pattern:

Company A is a licensed distributor of cigarettes and purchases cigarettes for resale in its retail stores directly from a manufacturer. When Company A purchases the cigarettes, Company A is required to pay a tax on the cigarettes. Company B, on the other hand, is not a licensed distributor of cigarettes and, therefore, at the time it purchases cigarettes from its distributor, the tax has already been assessed on the cigarettes. Proponents of View B believe that if the scope of the Issue is expanded as proposed in View A, then Company A would be considered within the scope of the Issue while Company B would not be considered within the scope of the Issue even though the same exact amount of tax was paid on the product.

Other Comments

12. The staff considered other comments on the draft abstract that it did not believe warranted specific discussion herein and, as a result, concluded that a change to the draft abstract was not necessary. However, the FASB staff's recommendation for addressing the comment specified in this Supplement for Task Force consideration is reflected in the marked draft abstract included as Exhibit 06-3A.

EITF Abstracts (DRAFT)

Issue No. 06-3

Title: How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)

Dates Discussed: March 16, 2006; June 15, 2006

References: FASB Statement No. 154, *Accounting Changes and Error Corrections* (Statement 154)

APB Opinion No. 22, *Disclosure of Accounting Policies*

EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent"

EITF Issue No. 00-10, "Accounting for Shipping and Handling Fees and Costs"

EITF Issue No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred"

ISSUE

1. Taxes are assessed by various governmental authorities on many different types of transactions. These taxes range from sales taxes that are applied to a broad class of transactions involving a wide range of goods and services to excise taxes that are applied only to specific types of transactions or items. The characteristics of how these different types of taxes are calculated, remitted to the governmental authority, and administered are numerous and varied and, therefore, very difficult to summarize into simple discernible models. Questions have arisen as to the income statement presentation of these types of taxes.

2. The issues are:

Issue 1— Whether the scope of this Issue should include (a) all nondiscretionary amounts assessed by governmental authorities, (b) all nondiscretionary amounts assessed by governmental authorities in connection with a transaction with a customer, or (c) only sales, use, and value added taxes

Issue 2— How taxes assessed by a governmental authority within the scope of the Issue (Issue 1) should be presented in the income statement (that is, gross versus net presentation).

EITF DISCUSSION

3. The Task Force reached a [consensus] on Issue 1 that the scope of this Issue includes any tax assessed by a governmental authority that is ~~directly~~-imposed concurrent with or subsequent

~~to on a revenue-producing transaction between a seller and a customer, and may include, but are not limited to, sales, use, value added, and some excise taxes~~

4. The Task Force reached a [consensus] on Issue 2 that the presentation of taxes within the scope of Issue 1 on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed pursuant to Opinion 22. In addition, for any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. The disclosure of those taxes can be done on an aggregate basis.

5. The [consensuses] reached in this Issue are not intended to readdress the consensuses in Issues No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," No. 00-10, "Accounting for Shipping and Handling Fees and Costs," and No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred."

Transition

6. The Task Force observed that because the [consensus] in this Issue requires only the presentation of additional disclosures, an entity would not be required to reevaluate its existing policies related to taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer. However, a company that chooses to reevaluate its existing policies and elects to change the presentation of taxes within the scope of this Issue must follow the requirements of Statement 154.

Effective Date

7. The [consensuses] in this Issue should be applied to financial reports for interim and annual reporting periods beginning after December 15, 2006. Earlier application is permitted.

Board Ratification

8. At its [June 28, 2006] meeting, the Board ratified the [consensuses] reached by the Task Force in this Issue.

STATUS

9. No further EITF discussion is planned.