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File Reference No. EITF0603

Draft Abstract — EITF Issue 06-3, “How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)”

Dear Mr. Smith:

Deloitte & Touche LLP is pleased to comment on the FASB Emerging Issues Task Force (“EITF”) draft abstract for EITF Issue No. 06-3, “How Taxes Collected From Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)” (the “draft abstract” or “Issue”). While we support the issuance of the draft abstract as a final abstract, we believe its scope requires revision.

Issue 1 of the draft abstract addresses scope. Specifically, paragraph 3 states:

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 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. [Emphasis added]

We do not believe this scope, as drafted, is sufficiently clear to allow for consistent application by preparers across the broad array of taxes assessed by governmental authorities. Specifically, from an operational perspective, we find it difficult to interpret the meaning of “directly imposed.”

The discussions at the March 16, 2006, EITF meeting indicated that the Issue’s scope applied to taxes, including excise taxes, assessed at the point of sale. Those discussions suggest that determining whether a tax is “directly imposed” depends primarily on the **timing** of the tax assessment, as opposed to focusing on the nature of the tax assessment itself. This interpretation leads to difficult substance-over-form considerations for many types of taxes and to potential diversity in practice as to the taxes considered inside and outside of the Issue’s scope.

To illustrate this point, the draft abstract indicates that the consensus would apply to “some excise taxes.” However, it is unclear how an entity would evaluate whether an excise tax would be considered in the scope of this Issue. The following example demonstrates the difficulty in determining whether one common type of excise tax, a cigarette tax stamp, is within the Issue’s scope.

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.

The same scoping difficulty exists for another common type of excise tax, a gasoline excise tax. Gasoline retailers pay excise tax on gasoline purchased for resale. No separate tax stamp is required; rather, the excise tax is subsumed into the cost of the purchased gasoline inventory. While latitude may exist, the excise tax is generally passed on to the customer at the pump, with varying amounts of pricing detail provided to the customer. In at least some jurisdictions, a refund is available to the retailer to the extent the gasoline is not sold to an end customer. Again, opposing views exist as to whether this tax is within the Issue’s scope.

Interestingly, the Issue’s scope seems to clearly include the federal security surcharge assessed on the purchase of an airline ticket (i.e., flat fee per passenger). However, we struggle to identify the conceptual difference between this tax and the cigarette and gasoline excise taxes described above. While a practical difference exists in that the security surcharge is assessed on a service versus an inventoried product sale, in either case, no tax is ultimately incurred without an end-customer sale. As such, the practical difference does not seem to justify a different scoping conclusion.

The difficulty in applying the “directly imposed” aspect of the Issue’s scope is not limited to excise taxes. Similar questions of scope exist with respect to many other types of taxes, including certain types of franchise and gross receipts taxes.

One such example is a cable franchise tax, which is assessed by local municipalities on a cable operator. Our understanding is that, generally, the franchise tax is based on a negotiated percentage of the cable company’s revenues (e.g., 5% of total billed revenues). The operator may, at its discretion, pass on the franchise tax directly to its customers. If so, customers are billed at each invoicing date based on the negotiated percentage.

In this situation, some may conclude that the tax is directly imposed on a revenue-producing transaction as the cable operator generates its revenues from billing customers, thus owing franchise tax to the municipality. Others may conclude that the tax is assessed on the cable operator itself, and therefore is outside the scope of the Issue.

For the reasons articulated above, we recommend that the Task Force revise the Issue’s scope 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.”

As to this revised scope, we believe the phrase “between a seller and a customer” as included in the original scope is redundant (i.e., all revenue-producing transactions are between a seller and customer). Further, each of the four tax examples described above would clearly fall within the revised scope. Based on the nature of these taxes, we believe this is a conceptually-consistent result.

Lastly, specific to excise taxes, current practice provides for an accounting policy decision as to whether those taxes are presented on a gross or net basis, as supported by SEC Regulation S-X, Rule 5-03. We do not believe this Issue will improve financial reporting by requiring an interpretive bifurcation of excise taxes into those inside and outside of the Issue’s scope.

We appreciate the opportunity to comment on the draft abstract. If you have any questions concerning our comments, please contact Jim Kroeker at (203) 761-3726.

Yours truly,

Deloitte & Touche LLP

cc: James Johnson