

May 1, 2006

Mr. Lawrence W. Smith
Chairman of Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

RE: 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:

On the behalf of Costco Wholesale Corporation (Costco), I would like to comment on the proposed accounting treatment of sales and similar taxes as discussed in the above referenced document.

COMPANY BACKGROUND

Costco operates in the membership warehouse segment of specialty retailing, operating a chain of cash and carry membership warehouses in over thirty states and in various international markets including Canada, Japan and United Kingdom. We exceeded \$51 billion in sales in our 2005 fiscal year. Costco's operations are based on the concept that offering very low prices on a limited selection of national brand products, over a wide range of merchandise categories, will produce rapid inventory turnover and high sales volume. Costco services both the retail and wholesale markets.

Costco sells a variety of merchandise including food, candy, tobacco, sundries, appliances, electronics, tools, office supplies, furniture, automotive supplies, apparel, linens, jewelry, housewares, books, optical, prescription and over-the-counter medicines. While varying by state, Costco's sales include sales of items commonly exempted from sales taxes such as food or pharmaceuticals. In addition to being a significant collector of sales taxes, Costco is a tobacco wholesaler / distributor and is the primary taxpayer for state and local tobacco excise taxes.

SCOPE OF THE ISSUE

After having an opportunity to review the Draft Abstract and the materials that preceded it, I unfortunately have to conclude the abstract does not provide any financial statement clarity. One of the conclusions in the Abstract is:

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.

The majority of the discussion in the materials from the March 16 meeting is about sales or excise taxes. These discussions cover taxes that may show on a purchaser's receipt or which ultimately become a part of cost of goods. There was no discussion about significant excise taxes that are considered overhead for

which there are no options for "gross" versus "net" treatment. There are many taxes and fees ultimately levied on wholesale or retail sales that the purchaser is not aware of and which are not passed on. For example, many localities levy their licensing fees on gross receipts. Washington State has an excise tax called the Business and Occupation Tax with a tax rate of approximately one half of one percent of gross receipts. These are taxes "directly imposed on a revenue-producing transaction between a seller and a customer" but are neither a sales nor a "gross/net" excise tax. Are the amounts paid for these taxes to be disclosed?

In addition, the Abstract does not discuss the myriad of fees imposed to promote recycling. These fees are only increasing in number. Many share the same characteristics as a fixed fee sales tax due at the time of sale. These fees should be included in EITF's discussions.

DISCLOSURE

The Abstract is not clear in its definition of "excise taxes". The discussion materials appear to conclude that once an excise tax is levied, the tax payment retains its classification as a tax in subsequent levels of commerce especially if shown on a sales invoice. The vast majority of the excise taxes levied on the products Costco sells have been imposed at the manufacturer level prior to their sale to Costco. We are not the taxpayer. Even if the manufacturer chooses to line item their tax payment on their invoices to us, separate itemization on an invoice does not make the itemized amount anything more than part of the cost of our inventory. We are buying and selling an item of tangible personal property, not its individual cost components. Accordingly, the amount of the excise taxes paid by the manufacturers of our inventory is not subject to any form of disclosure by Costco.

Costco is a taxpayer for tobacco taxes levied by the states, counties and cities in which it operates. Echoing the prior discussions about the complexity of analyzing every tax for legal incidence, tobacco excise taxes are not consistent. The majority of the state taxes are imposed at the distributor level. Even though Costco is the taxpayer, the tax is due for the product to be available for sale. The tax is due before any sale. If the inventory is damaged or destroyed, we may be faced with a significant challenge in getting a refund. Our position would be that these excise taxes are not a "tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer" and, as a result, no disclosure is required. Conversely, a number of the tobacco excise taxes levied by counties and cities may be levied at the time of sale. There is no obligation to pay the tax until the product is sold. These taxes would appear to be excise taxes covered by the Abstract, and if material, disclosure of the amount paid would be required.

Costco will have sold a product whose cost includes excise taxes levied by all levels of government from the federal government down to individual cities. These taxes will be included in our inventory costs and costs of goods sold. With only some of these taxes being imposed at the time of sale, there will be a requirement to disclose only a portion of the amounts paid. This results in an apparent disclosure requirement that is not uniform for one product that incurs multiple similar taxes at multiple levels of commerce.

This inconsistency is reinforced when one considers the effects of differing methods of sourcing a product. Using cigarettes again as an example, Costco buys its inventory directly from the manufacturers. We have registered as a distributor and pay the applicable state and local excise taxes. One of our major competitors purchases their cigarettes from third party distributors and is registered not as a distributor but as a wholesaler. While possibly being liable for some local excise taxes, they are not the taxpayer for the state levied taxes. While we are both in the same industry selling the same line of product, distinctions on who is buying "state tax paid" versus being considered the taxpayer may lead to different disclosure requirements.

RECOMMENDATION

As applied to the wholesaling or retailing of merchandise, I am not convinced there needs to be a discussion of the "gross" versus "net" treatment of non-income taxes. The true object of our industry is the sale of an item, not its cost components. We buy and resell refrigerators. We do not buy and resell steel, insulation, condensers, electrical motors etc.

Regardless of the industry, this issue should be limited solely to enhancing disclosure. Within the footnote for significant accounting policies there should be disclosure noting:

- which tax **collections** are treated as liabilities (sales and other "trust" fund taxes),
- which tax **payments** are included in inventory and cost of goods sold or cost of sales, and
- which **payments** are considered General and Administrative and are expensed (or amortized over the periods they cover) as incurred.

However, for the reasons noted above, disclosure of payment of a select few taxes levied at the time of sale does not provide any clarity or meaningful information.

In closing, I feel the Abstract raises more questions than it answers and feel it should be tabled for further discussion. If adopted, please consider this letter a request for clarification on its application to the taxes whose costs have been included in inventory.

I thank you for the opportunity to comment on the Abstract. If you have any questions please do not hesitate to contact me.

Sincerely,

/s/ Richard A. Galanti

Richard A. Galanti
Executive Vice president
Chief Financial Officer
Costco Wholesale Corporation

Cc: Jeff van Burkleo: Costco Wholesale Corp AVP & Tax Director