

April 22, 2013

Technical Director
File Reference No. EITF-13C
FASB
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Submitted via email to director@fasb.org

Re: Proposed Accounting Standards Update — Income Taxes (Topic 740) *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit Carryforward Exists*

Dear Technical Director:

On behalf of the 11,000 members of the Virginia Society of CPAs (VSCPA), we appreciate the opportunity to respond to the “Invitation to Comment” on the Financial Accounting Standards Board’s (FASB) Exposure Draft. The Virginia Society of CPAs’ (VSCPA) Accounting & Auditing Advisory Committee has reviewed and discussed the proposed Accounting Standards Update *Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit Carryforward Exists* and provided the following comments:

Two Illustrations to Provide a Framework for Our Conclusions

To provide a framework for our conclusions, we are presenting two illustrations of the accounting considerations we believe Topic 740 presently requires when there is an uncertain tax position and the entity is in a loss carryforward position.

1. **A comparison of the assumptions underlying the illustrations.** The assumptions underlying the illustrations differ only in when the loss carryforward expires.
 - a. In the first illustration, the loss carryforward will not expire until after the current-year return is no longer open.
 - b. In the second illustration, the loss carryforward will expire in two years but the return will be open for three years.
2. **The assumptions that are the same for both illustrations.** The following assumptions are the same for both illustrations:
 - a. The tax rate is 30 percent.
 - b. At the beginning of the year, the entity had a \$50 loss carryforward and a \$15 deferred tax asset (30 percent of \$50).
 - c. The entity’s tax return for the current year reports a taxable loss of \$10 for the year and a loss carryforward of \$60 at the end of the year (\$50 at the beginning of the year plus \$10 loss reported for the year),
 - d. The \$10 taxable loss reported in the return includes a \$20 deduction that is based on an uncertain tax position.
 - e. Disallowance of the \$20 deduction would amend the \$10 taxable loss reported in the return to \$10 taxable income.

3. **The first illustration.** The accounting considerations we believe Topic 740 requires for the first illustration follow:
 - a. If the taxing authority examined the current-year return and disallowed the \$20 deduction, the entity would have taxable income of \$10 instead of a \$10 taxable loss. However, no tax would be imposed, and therefore no payment would be required, because \$10 of the loss carryforward at the beginning of the year would be offset, reducing the amended taxable income from \$10 to \$0.
 - b. Since no tax would be imposed, no obligation would be recorded for the unrecognized tax benefit of the \$20 deduction that is based on an uncertain tax position and there would be no current provision.
 - c. Since disallowance of the deduction would require using \$10 of the carryforward, the deferred tax asset would be based on \$40 (the \$50 carryforward at the beginning of the year less \$10) and reduced by \$3 from \$15 to \$12 (30 percent of \$40), resulting in a \$3 deferred tax expense.
 - d. The total provision would be \$3, consisting entirely of the deferred tax expense.
 - e. The financial statements would report a \$10 pretax loss and a \$3 tax expense.
 - (1) That differs from the \$3 benefit that would be expected (30 percent of the \$10 pretax loss) by \$6 because no tax benefit was recognized for the \$20 deduction in the return that is based on an uncertain tax position (30 percent of \$20).
 - (2) The \$6 unrecognized tax benefit (30 percent of the \$20 deduction) would therefore be disclosed.

4. **The second illustration.** The accounting considerations we believe Topic 740 requires for the second illustration follow:
 - a. The \$50 loss carryforward at the beginning of the year will expire in two years, but the current-year return will be open for three years. If the return is examined and the deduction disallowed in the third year, all the \$50 loss carryforward would have expired, and the entity would be assessed additional tax of \$3 (\$10 taxable income after disallowing 30 percent of the \$20 deduction).
 - b. The entity would record a \$3 current tax expense and a \$3 obligation for the unrecognized tax benefit of the deduction based on an uncertain tax position. Since the loss carryforward at the beginning of the year is unchanged, no deferred tax would be recognized.
 - c. The financial statements would report a \$10 pretax loss and a \$3 tax expense.
 - (1) That differs from the \$3 benefit that would be expected (\$10 pretax loss X 30%) by \$6 because no tax benefit was recognized for the \$20 deduction based on an uncertain tax position (30 percent of \$20).
The \$6 unrecognized tax benefit (30 percent of the \$20 deduction) would therefore be disclosed.

5. **A comparison of the results.** A comparison of the results follows:
 - a. A \$3 tax expense is reported in each illustration, but in the first illustration the expense consists entirely of deferred tax and in the second illustration the expense consists entirely of current tax.
 - b. An obligation for the unrecognized tax benefit is recognized only in the second illustration. That is because disallowance of the deduction based on an uncertain tax position would require a payment in the second illustration, but it would not require a payment in the first illustration. In the first illustration the unrecognized tax benefit reduces the calculated deferred tax asset similar to the guidance in FASB ASC 740-10-25-17 for temporary differences.
 - c. In both illustrations, the effect of not recognizing the tax benefit of the \$20 deduction is disclosed because it causes the tax provision to differ from the amount that would be obtained by applying the 30 percent tax rate to the pretax loss.

Our Conclusions

We believe the proposed guidance does not change the accounting considerations already required by Topic 740. However, we believe a literal reading of the proposed new paragraph 740-10-45-10A could lead to a different conclusion. Stating that the unrecognized tax benefit “shall be presented in the statement of financial position as a reduction to a deferred tax asset” suggests that in the first illustration an obligation should be recognized and shown as a contra account.

That reading would be consistent with the title of the EITF Issue *Presentation of a **Liability for** [emphasis added] an Unrecognized Tax Benefit When a Net Operating Loss or Tax Credit Carryforward Exists*. We believe that reading is in conflict with Topic 740 and with what is being proposed. As an observation, we note that the title of the proposed ASU, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit Carryforward Exists*, excludes the phrase “a liability for.”

To avoid confusion, we believe the new paragraph 740-10-45-10A should be changed as follows:

An unrecognized tax benefit, or a portion of an unrecognized tax benefit, shall be ~~presented in the statement of financial position~~ accounted for as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward or tax credit carryforward at the reporting date is not available under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position, the unrecognized tax benefit shall be presented in the statement of financial position as a liability.

Because we believe the proposed ASU does not change the requirements of Topic 740, we agree that:

- The guidance should be applied retrospectively,
- No additional time is needed for small and midsize nonpublic entities to implement the guidance
- The effective date should be the same for public and nonpublic entities

Again, the VSCPA appreciates the opportunity to respond to this Exposure Draft. Please direct any questions or concerns to VSCPA Government Affairs Director Emily Walker at ewalker@vscca.com or (804) 612-9428.

Sincerely,



Mike Wagner, CPA, CGFM
Chair

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