March 31, 2015

Ms. Susan Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

**RE: File Reference No. 2015-200—I**

Dear Ms. Cosper:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the Board's recent proposal, *Income Taxes (Topic 740): (I) Intra-Entity Asset Transfers.* We commend the FASB for its ongoing efforts to identify areas in which financial reporting can be simplified while maintaining or enhancing decision-useful information for investors.

We are supportive of the proposal to eliminate the exception to the comprehensive recognition of current and deferred income taxes for intra-entity asset transfers (the "exception"). We believe the improvements to the comparability and transparency of reporting the tax effects of these transactions outweigh any potential incremental costs to implement the change.

As noted in 2008 in the *Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission*, exceptions to broader, fundamental principles otherwise applicable in areas of financial reporting often create complexity and result in diverse reporting for similar types of transactions or events, thereby creating less decision-useful information for users. Not surprisingly, the accounting for intra-entity asset transfers was specifically raised as being operationally challenging for preparers and practitioners in the Financial Accounting Foundation's *Post-Implementation Review Report on FASB Statement No. 109, Accounting for Income Taxes.*

The difficulties presented by the exception have only grown in the 10 years since the Board tentatively decided to eliminate the exception in the context of international convergence. The difficulties have grown as a result of the increased prevalence, complexity, and materiality of business transactions to which the exception *could* apply, particularly with respect to cross-border transfers of intangible and other long-lived property. Given the minimal amount of authoritative guidance for applying the exception, a lengthy list of interpretational issues arise, ranging from the basic question of whether a particular transaction is within the scope of the exception to a series of questions around assumptions and the implications of future changes in circumstances that affect multiple reporting periods.

The elimination of the intra-entity asset transfers exception will reduce diversity in practice and align the accounting for the tax consequences of such transfers with the accounting for other transactions that are eliminated in consolidation but have a tax consequence reported in consolidation. The basis for the original exception was an attempt to match the timing of the recognition of the tax consequence with the timing of recovery of the cost of the asset. However, this meant deferring the recognition of the real economic tax consequences of actions taken by management. The resulting lack of clarity is particularly acute for transactions involving intangible or other long-lived assets that are not ordinarily recovered

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through direct sale to a third party but, rather, through assumed consumption by the enterprise over an extended period of time.

We believe the problems presented by the exception translate into difficulties for all stakeholders, which will be addressed by the proposal. In our view, investors will find it simpler and more meaningful, for instance, to understand that a tax payment resulting from an intra-entity sale of assets will be reported as income tax expense in the period in which the tax has been incurred. Preparers are likely to find it easier to identify and report the tax consequences of intercompany transactions when they occur and maintain a consistent set of deferred tax accounts for each tax-paying component regardless of whether the assets were acquired from an unrelated third party or a member of the consolidated group.

In proposing this change to simplify U.S. GAAP, we also note that the proposed change more closely aligns with the IFRS standard on income taxes, IAS 12. The current proposal will eliminate perhaps the most significant remaining difference between the two tax accounting frameworks. In our experience with IFRS, including many companies that converted from U.S. GAAP to IFRS, the application of IAS 12 to intra-entity asset transfers has not presented significant difficulties.

Although we support the proposal, we recognize the implementation challenges that it might create for enterprises that have developed global supply chains and designed information systems to process transactions pursuant to current GAAP for intercompany transfers of inventory. We also appreciate that the original exception was largely contemplated in the context of recurring intercompany inventory transactions for which the deferral of the tax consequences of intercompany transfers would be relatively short-lived. Thus, we would support a revision to the proposal to provide a practical expedient that would permit companies to continue to apply the exception for intercompany transfers of inventory.

PwC supports the Board's continuing simplification initiative. We believe the Board should continue to focus on those areas that (a) have broad impact, (b) remove exceptions and mechanical rules that lead to complexity while maintaining decision-useful information for investors, and (c) result in harmonization with international standards, if possible.

Our detailed responses to the questions in the Exposure Draft are contained in the appendix to this letter. We have submitted a separate letter in response to the Board's proposal related to the balance sheet classification of deferred taxes.

If you have any questions regarding our comments, please contact Patrick Durbin at (973) 236-5152 or Brett E. Cohen at (973) 236-7201.

Very truly yours,

PricewaterhouseCoopers LLP

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## *Appendix*

***Question 1** – Should the current and deferred income tax consequences of an intra-entity asset transfer be recognized when the transfer occurs? If not, why?*

Yes, we believe that the income tax consequences of intra-entity asset transfers should be recognized at the time of transfer. The tax laws in most jurisdictions respect the independent standing of each legal entity and, importantly, taxing authorities in different jurisdictions operate independently. Thus, by transferring an asset from one jurisdiction to another, management of the consolidated enterprise has taken a course of action that has tax consequences. In most cases, a current tax charge arises in the seller's jurisdiction along with a tax basis increase above the asset's carrying amount in the consolidated financial statements–giving rise to a potential deferred tax asset.

The exception in the current guidance presents several conceptual problems within the application of financial reporting standards. The deferral provisions are inconsistent with the fundamental principle of recognizing currently incurred tax expense. They are also inconsistent with the asset and liability approach of ASC 740 in prohibiting recognition of deferred taxes for differences in the book and tax bases of assets. No similar exception permits or requires the deferral of income taxes resulting from intra-entity transactions that do not involve asset transfers, even though the pre-tax effects of those transactions are also eliminated in consolidation. This includes intra-entity transactions in services, financings, licenses, leasing arrangements, and other transactions. In addition, the exception often masks the economic reality of the transaction by not reporting the current and deferred tax consequences of the transaction in the period in which those costs were incurred; instead, it results in reporting a noncash tax expense over subsequent periods, if at all. The effect of the exception is to disregard the consequences of removing an asset from one jurisdiction and having its future economic benefits subject to tax in another jurisdiction.

Outside of recurring inventory transfers among profitable entities within a consolidated reporting group, the exception, as currently articulated, also creates significant challenges in practice. The exception requires that the tax charge be capitalized and then expensed as the asset is recovered, which poses problems when:

- the transferred asset has an indefinite life;
- the asset transferred is the stock of a subsidiary or a business consisting of a number of assets and liabilities;
- the life of the asset differs for book and tax purposes;
- the transaction is structured as a license agreement and it is not apparent that an "asset" has been transferred, or that "profits" have been eliminated in consolidation;
- the asset transferred is not recognized for accounting purposes but is recognized for tax purposes (such as internally generated intangible assets);
- the asset is "deemed" transferred for tax purposes as a result of a "check-the-box" election, which may cause the change in tax status guidance to be viewed as overriding the exception;
- the tax incurred on the transaction is based partly upon the value of an asset being transferred, but partly upon a measure of future profitability associated with the transfer of business functions;
- the two businesses involved in the transfer are separated via a spin-off transaction before the transferred asset is recovered; or
- the tax effects from the intra-entity transfer give rise to an uncertain tax position.

The above list highlights just a handful of the more significant challenges in applying the exception. We concur with the Board's conclusion, expressed in paragraph BC9, that adding additional implementation guidance to this already complex exception is unlikely to result in the desired simplification of financial reporting.

Recognizing that any change from current GAAP creates some level of complexity and cost (presumably offset by the longer term simplification), we appreciate the implementation challenges that removing the exception might create for enterprises that have developed global supply chains and designed information systems to process transactions pursuant to current GAAP for intercompany transfers of inventory. Thus, we believe there is merit in considering a practical expedient that could be continued for inventory transfers.

The original exception was largely contemplated in the context of recurring intercompany inventory transactions, with an expectation that the deferral of the tax consequences of intercompany transfers would be relatively short-lived. From a conceptual perspective, intra-entity transfers of inventory are generally an integral part of the consolidated cost accumulation or revenue earnings process. Other taxes incurred as a result of intra-entity transfers of inventory, such as excise, VAT, or duties, may be capitalized as part of inventory costing. Inventory transactions typically reflect the progress of the inventory within a production or distribution chain with the amount of costs accumulating until sale to a third party occurs.

Application of the exception in such circumstances may be simpler for some preparers and may not result in significantly different periodic reporting results (due to the typically short-lived nature of inventory). In addition, preparers with complex inventory supply chains may have numerous layers of unrealized profit captured among various separate or jurisdictional tax-paying entities. Allowing the exception to continue to be applied as a practical expedient for intra-entity transfers of inventory may be a constructive approach to accommodate preparer concerns with respect to the systems and process complexities that may result from applying the proposed guidance. Since inventory is a clearly defined term in GAAP, the application of the exception should not present the interpretational difficulties that arise from other types of intercompany transfers. If the Board were to consider such an approach, it should also decide whether such an election would constitute an accounting policy that would need to be applied consistently and whether any additional disclosures are warranted.

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

As explained above, we believe that the income tax consequences of intra-entity asset transfers should be recognized at the point of transfer from one tax-paying component of a consolidated reporting entity to another, consistent with the accounting for third-party transactions. This would include both current and deferred tax consequences, in accordance with the fundamental principles of ASC 740. If the exception continued to be applied as a practical expedient for inventory transactions, we would expect the tax consequences to be postponed until external sales occur.

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

We support the modified retrospective adoption model proposed in the Exposure Draft, but believe that entities should have the option to apply a full retrospective approach. The modified retrospective approach may ease the cost of transition for some entities and is therefore an appropriate option in the context of simplification, but we also believe that entities that want to restate prior periods to enhance comparability should be permitted to do so.

We agree with the Board that grandfathering the current guidance for all historic intra-entity asset transfers would be problematic, causing the effects of the exception to live on for decades until all transferred assets were fully recovered. This would lead to a lack of clarity and consistency in financial reporting.

***Question 4*** – *Should the amendments in this proposed Update be effective for:*

*a. Public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2016*

*b. All other entities for annual periods beginning after December 15, 2017, and interim periods in annual periods beginning after December 15,2018, with early adoption permitted, but not before the effective date for public business entities?*

We agree with the proposed mandatory effective dates, but believe that early adoption should be permitted for all entities. The Board has acknowledged in the Exposure Draft the complexity that exists in applying the exception, and in the interests of simplification and reducing costs we suggest that early adoption be permitted. This will be of particular benefit to entities that have not historically had any intra-entity asset transfers, but encounter some between the date of issuance of the Update and the mandatory effective date. Entities that early adopt the guidance should be required to disclose that decision.

The proposed Update links the date of adoption to the date that an entity first applies the amendment related to the proposed Update on the balance sheet classification of deferred taxes–*Income Taxes (Topic 740): (II) Balance Sheet Classification of Deferred Taxes*. While these two amendments have been combined together into a single Exposure Draft, we do not believe that there is any technical or conceptual reason why they should have to be adopted simultaneously. We believe that the decision to early adopt each amendment should be made independently.

***Question 5*** – *What would 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?*

In our experience in audit engagements, we have found that the accounting for intra-entity asset transfers is subject to interpretation and requires considerable analysis and documentation. In our experience in providing tax accounting advisory services to non-audit clients, we have observed that preparers and our engagement teams incur significant time in considering and applying the existing guidance.

We expect there to be a certain cost associated with transition, but after transition we would expect that the revised guidance would be easier to follow and therefore would likely result in reduced future costs. Under current GAAP, entities must track all assets that have been the subject of an intra-entity transfer to ensure that deferred tax is not recorded and that an appropriate amount of the deferred charge is released each period. (In addition to tracking, there can be other implications as well in periods subsequent to the initial transaction, such as assessing potential impairments and tax uncertainties.) The proposed Update will eliminate the need for this tracking, likely saving time and reducing the risk of errors in the future. As discussed above, by allowing the exception to continue to apply as a practical expedient to inventory transactions, the costs of transition may be further reduced.