May 29, 2015

Technical Director
File Reference Nos. 2015-200 and 2015-210
FASB
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Subject: Two Proposed Accounting Standards Updates (ASU), *Income Taxes (Topic 740): I. Intra-Entity Asset Transfers* and *II. Balance Sheet Classification of Deferred Taxes*

Dear Technical Director:

Pfizer Inc. is a research-based, global biopharmaceutical company headquartered in New York. We discover, develop, manufacture and market leading medicines and vaccines, as well as many of the world's best-known consumer healthcare products. In 2014, we reported revenues of $49.6 billion and total assets of $169 billion. In the normal course of business each year and at each period end, as applicable, intra-entity asset transfers (particularly inventory) and current deferred tax accounts are significant.

Pfizer supports the intent underlying the Board's broad Simplification Initiative; that is, to reduce the cost and complexity in financial reporting, while maintaining or improving the usefulness of the information provided to users of financial statements. However, as more fully explained below, we do not believe that these proposed ASUs achieve that worthy goal.

I. Intra-Entity Asset Transfers

With respect to the proposed ASU on intra-entity asset transfers, we believe (i) that the proposed guidance will likely decrease the decision-usefulness of the information provided, as the results in a particular period could distort an entity's consolidated effective tax rate in a meaningful manner (see also "Decreasing Decision-Useful Information" below) and (ii) that the proposed guidance would introduce greater complexity into the process of accounting for inventory movement (as well as other asset transfers), which did not exist before, by requiring a preparer to track all movements in the supply chain and to forecast these changes in the computation of the expected annual effective tax rate (see also "Introducing Greater Complexity" below).

For convenience, we have provided an example in Appendix B that we believe illustrates our concerns.

<u>Decreasing Decision-Useful Information</u>

As demonstrated by U.S. GAAP disclosure requirements and as we have observed in practice, a reporting entity's **ultimate effective tax rate** on the profit generated from the sale of products is an important financial metric for users of financial statements.

But, as illustrated in our example in Appendix B, neither the tax rate reflected in the period of the intra-entity transfer (when the inventory is still in the supply chain, but moving from one tax jurisdiction to another) nor the tax rate reflected in the period of the third-party sale is representative of the ultimate effective tax rate for the reporting entity on the sale of the product.

We view this outcome as materially decreasing the decision-usefulness of financial statements where the **effective tax rate reflected in the income statement does not represent the ultimate effective tax rate incurred by the reporting entity on the profit generated from the sale of the product**.

In our example in Appendix B, a reporting entity generates a profit of $100 with a tax cost of $25, which represents a 25% effective tax rate on its profits. However, in our example, we observe that this tax rate will not be reflected in the financial statements in either period (if the third party sale occurs in a different period from the intra-entity transfer). Furthermore, as illustrated in Appendix B, the results can be even more distortive when a tax **benefit** is generated in one period (with no associated pre-tax income or loss) while a higher, compensating tax cost is reflected in the next period when the inventory is sold to a third party.

Moreover, considering the above, as the timing of intra-entity asset transfers is within the control of the reporting entity, there is a risk that preparers may seek to drive certain reporting outcomes. For example, a reporting entity may choose to defer or accelerate the timing of the transfer of inventory from one tax jurisdiction to another in order to achieve certain current period results or to smooth earnings (e.g., an entity wanting to decrease its reported tax cost for a certain year could choose to move more inventory from a low tax jurisdiction to a higher tax jurisdiction and thus create a tax benefit in its financial statements to reduce its reported overall tax cost for that period).

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In the basis for conclusions in paragraph BC5, the Board notes that an intra-entity sale of inventory involves two unrelated third parties – the selling entity's taxing authority and the buying entity's taxing authority. We acknowledge that the intra-entity sale involves the selling entity's taxing authority; however, we do not believe that this intra-entity sale involves the buying entity's taxing authority when the asset is still being held by the buying entity - - it has not yet created any receivable or payable or transaction with the taxing authority. In fact, the proposed guidance requires an entity to record a deferred tax asset, which is <u>not</u> the same as a contractual receivable (i.e., no money is owed to the entity by the buyer's taxing authority as a result of the intra-entity transfer). Rather, a deferred tax asset is an asset required to be recorded under U.S. GAAP in order to achieve "matching" between a reporting entity's recorded tax expense and the pre-tax book profit reported in the period (by creating a deferred cost/ credit for differences between the book profit and tax profit that will ultimately reverse). However, in an intra-entity sale, this deferred tax asset does not achieve the aforementioned purpose for which deferred tax assets are created. In fact, as illustrated in our example in Appendix B, since this deferred tax asset does not originate from a current income tax cost that has to be deferred until the related pre-tax profit is recorded (or the related pre-tax cost becomes tax deductible), the proposed guidance actually distorts the tax rate and tax cost of the reporting entity, as compared to the pre-tax profit.

In the specific instance of intra-entity sales, in order to achieve the matching between the book pre-tax profit and the income tax expense in the income statement, it would be necessary to defer the income taxes payable or paid to the seller' s taxing authority until the sale of the asset to a third party outside the entity occurs. Further, rather than creating a deferred tax asset and reversing it the following period/s (when the sale to third parties occurs) and thus creating tax expenses for a given period which we believe are distortive and not reflective of the real tax cost to the entity, we believe that it is necessary and useful to continue to match the recognition of income tax effects to the income reported on a consolidated basis. This approach would provide financial statement users with an effective income tax rate for the consolidated entity that is representationally faithful and 'connected' to the consolidated pretax results.

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We also note that during the "SFAS 109" deliberations, the FASB concluded that, when in conflict, the principles of consolidation accounting should take precedence over the principles of income tax accounting. We agreed with that view then and we continue to believe that the primacy of consolidation principles is essential to the production of decision-useful information.

Also, as illustrated in our example in Appendix B, the consolidated effective income tax rate will now be subject to a level of volatility that would decrease the quality and predictability of the information provided to users for decision-making. While volatility is not inherently undesirable, it should "tell a story" to the users of the financial statements; in this case, we see that the potential volatility not only serves no purpose, but also detracts from the overall story. (For completeness, we note that the "cash flow story" is neither diminished nor enhanced by the proposed changes.)

In summary, from our perspective, the goal of maintaining or improving the usefulness of the information provided to users of financial statements will <u>not</u> be achieved by the proposed guidance.

<u>Introducing Greater Complexity</u>

As the current guidance is long-standing and as intra-entity sales of assets (inventory, in particular) are common, the preparer community long ago established the policies, procedures and internal controls necessary to defer the income taxes paid by the selling entity to the taxing authority in its jurisdiction and to comply with the existing guidance. But, the new guidance doesn't simply permit these processes and procedures to be dismantled; in fact, it will require a totally new infrastructure to be put into place.

As illustrated in our example in Appendix B, in order to comply with the requirements of the proposed ASU, preparers will now have to put into place policies, procedures and enhanced internal controls necessary to track the inventory throughout the supply chain to ensure the proper determination of the tax impact of the excess of the buyer's tax basis over the cost of the transferred asset that is still in the reporting entity's supply chain. This would involve <u>greater</u> complexity than current practice. Rather than simply tracking that an asset (that was subject to an intra-entity transfer) has not yet been sold to external parties, a preparer would now be required to track the tax jurisdiction of the entity holding the asset as of the end of each reporting period.

Furthermore, when preparing the effective tax rate analysis required to be disclosed under U.S. GAAP and in order to provide a meaningful fluctuation analysis between periods for the users of the financial statements, preparers will be required to compare volumes of intra-entity sales in the different tax jurisdictions in the supply chain to explain an entity's effective tax rate and how it fluctuated between periods since, as illustrated in our example in Appendix B, the rate reflected in an entity's financial statements will not necessarily reflect the ultimate effective tax rate on profits generated from product sales, but rather the rate will be affected by supply chain mechanics - - how much inventory is in what tax jurisdiction and how did it get there (was it the subject of an intra-entity transfer?). This is especially onerous from a systems perspective when products have components that can be sourced from different jurisdictions with different tax rates.

Further, an additional complexity will be introduced when measuring tax expense in interim periods since preparers are required to forecast the tax rate for the full year and apply such tax rate to the interim periods. We believe it will be very complex to calculate and forecast the effective tax rate, as the tax rate of the entity can be highly affected by the location and amount of inventory (that was subject to an intra-entity transfer) at each reporting date. We envision the need for what could be complex system changes to enable us to apply the proposed rules as well as more complexity in applying the proposed rules.

In summary, from our perspective, the goal of simplification will <u>not</u> be achieved by the proposed guidance.

<u>Other Comments</u>

In the proposed ASU, the Board asks if income taxes payable or paid should be expensed as incurred if the Board decides to keep the existing prohibition against recognizing the current and deferred income tax consequences of an intra-entity asset transfer. Conceptually, expensing the income tax payable or paid when incurred appears to achieve simplification, but, we believe that doing so before the item is sold to an external party would have the same undesirable effect on consolidated financial statements as the proposed guidance. That is, a disconnect would exist between the recognition of income taxes and the recognition of income upon which those taxes are based for the consolidated entity.

In summary, in this instance, we do not support simplification at the expense of decision-useful information.

<u>II. Balance Sheet Classification of Deferred Taxes</u>

With respect to the balance sheet classification of deferred taxes, we note that the current requirements (i) to classify deferred tax liabilities and assets for temporary differences on the basis of the classification of the related assets or liabilities and (ii) to allocate a valuation allowance between current and noncurrent deferred tax assets on a pro rata basis were originally issued as simplification guidance.

At the time that the existing guidance was developed, the FASB viewed these requirements as practical expedients that would likely be a reasonable proxy for a more complex process. We still believe that in the majority of the cases these practical expedients would result in current deferred income tax assets or liabilities reversing in the following 12 months after the balance sheet date. In addition, the FASB also concluded, at that time, that requiring all deferred taxes be classified as noncurrent would create an inappropriate current ratio.

We note also that the current guidance requires that deferred tax liabilities or assets that are not related to an asset or liability be classified according to the expected reversal date of the temporary difference. This specific requirement requires forecasting how much of the temporary difference will reverse in the next 12 months. However, we do not view this requirement as being complex or onerous, as it only requires forecasting for the next 12 months and is an inherent requirement for many other types of assets or liabilities when an entity presents a classified balance sheet.

We note that in paragraph BC4 to the exposure draft, the Board noted that under current U.S. GAAP, the current and non-current classification generally does not reflect when a temporary difference will reverse and become a taxable or deductible item. We do not share this view since (i) deferred tax liabilities or assets that are not related to an asset or liability are required to be classified according to the expected reversal date of the temporary difference and (ii) deferred tax liabilities and assets for temporary differences that relate to current asset and liabilities, in the majority of the cases are likely to reverse in the next 12 months as the asset or liability will be settled/ disposed of in the next

12 months and then the temporary difference will cease to exist (e.g. deferred taxes related to current accruals and current pre-paid expenses).

We also note that in BC5 board members observed that the reversal of a temporary difference does not necessarily equate to a cash inflow or outflow at the time of reversal; for example, the reversal might result in the recognition of a different deferred tax asset (e.g., a net operating loss carryforward) or an income tax receivable. However, we note that deferred tax assets and liabilities inherently do not represent in-substance assets or liabilities that are converted into cash – rather they represent deferred tax costs or deferred tax credits for pre-tax amounts when the timing of recognition for tax purposes does not match the timing for financial reporting purposes. Therefore, we do not think that it would be representationally faithful to disregard the timing of reversal for classification. We do not see the classification of deferred tax assets and liabilities as different, in substance, than the classification of deferred revenue or pre-paid expense, where the classification is based on timing of reversal and the reversal does not equate to a cash inflow or outflow at the time of reversal.

Given the choice between different practical expedients that are not complex to implement, we would generally prefer the practical expedients that would produce the more representationally faithful outcome. We do not view the current requirements as complex or time-consuming and we believe that the current outcome is materially superior to the proposed alternative.

In summary, from our perspective, we do not support the proposed guidance as we believe (i) that the current guidance is not overly complex, (ii) that the current practical expedients, in the majority of the cases, do provide a representationally faithful result and (iii) that although the practical expedient included in the proposed guidance would achieve increased simplification, the proposed approach would materially decrease the decision-usefulness of the information provided in a classified balance sheet.

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We appreciate the Board's consideration of our comments and would be pleased to discuss any of these matters further.

/s/ Loretta V. Cangialosi

Loretta V. Cangialosi
Senior Vice President and Controller

Attachments

cc: Frank D'Amelio
Executive Vice President and Chief Financial Officer

Appendix A

Questions for Respondents

Proposed ASU I– Intra-Entity Transfers

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?

No. Please see also our comments in the body of our accompanying letter. We believe that the current and deferred income tax consequences of an intra-entity asset transfer should not be recognized until the asset is sold or otherwise disposed of outside the consolidated group of entities. As detailed in our response, we believe the proposed approach of recognizing the current and deferred income tax consequences of an intra-entity asset transfer when the transfer occurs will likely decrease the decision-usefulness of the financial statements and is contrary to the Board's goal of reducing complexity in U.S. GAAP while maintaining or improving the usefulness of the information provided.

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?

No. Please see also our comments in the body of our accompanying letter. As detailed and explained in our response above, we believe that the income taxes payable or paid upon transfer should not be recognized until the asset is sold or otherwise disposed of outside the consolidated group of entities. While simplification may be achieved, a disconnect would exist between the recognition of income taxes and the recognition of income upon which those taxes are based for the consolidated entity, thus decreasing considerably the decision-usefulness of a reporting entity's results. We continue to support the primacy of consolidation principles (when in conflict with other concepts), and, in this instance, we do not support simplification at the expense of decision-useful information.

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

Pfizer strongly recommends that the Board not adopt the proposed Update. However, if the Board proceeds, we would not object to the modified retrospective approach described in the exposure draft.

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?**

Pfizer strongly recommends that the Board not adopt the proposed Update. However, if the Board proceeds, we would recommend extending the effective date at least one year to provide companies sufficient time to develop and implement the systems, policies, procedures and enhanced internal controls that may be necessary to track inventory movement along the supply chain. We base this recommendation on the fact that the proposed Update would most likely have a significant impact on multinational companies (based on the fact that they operate in numerous tax jurisdictions with varying tax rates and may have a more complex supply chain), and they may have to develop systems for tracking inventory along the supply chain in many parts of the world.

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 the current GAAP?

We have not yet analyzed the cost of implementation or any potential cost differences on an ongoing basis. However, we do anticipate the implementation costs could be significant.

<u>**Proposed ASU II – Balance Sheet Classification**</u>

Question 1: Should all deferred income tax liabilities and assets be presented as noncurrent in a classified statement of financial position? If not, why, and what alternatives should the Board consider, and what is the conceptual basis for the alternatives?

No. The existing guidance includes practical expedients that provide for an approximation of amounts that should be classified as current and noncurrent on the balance sheet. We do not view the current requirements as complex and we believe the outcome of such requirements is materially superior to the proposed guidance. Therefore, we believe that the current guidance should be maintained. See our detailed response above.

Question 2: Should the proposed guidance be applied on a prospective basis?

Pfizer strongly recommends that the Board not adopt the proposed Update. However, if the Board proceeds, since the proposed guidance is not overly complex, in order to improve comparability between periods, we propose to reclassify comparative periods to align with the proposed guidance.

Question 3: 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?**

Pfizer strongly recommends that the Board not adopt the proposed Update. However, if the Board proceeds, we would recommend making the effective date consistent with that of the exposure draft related to intra-entity asset transfers.

Question 4: 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?

We have not yet analyzed the cost of implementation or any potential cost differences on an ongoing basis. However, we do not believe we would incur significant implementation costs.

Appendix B – Illustrative Example

The following example is provided to help illustrate some comments and concepts provided in our accompanying letter.

Assumptions					
	Amount	Diff	Profit	Entity A	Entity B
Manufacturing Cost	$10				
Interco Sales Price	$60	+ $50			
Third Party Sales Price	$110	+ $50	+ $100		
Tax Rate				20%	30%
Reported Effective Tax Rate					
Total reported profit of consolidated entity			100		
Tax cost - Entity A ($50 * 20%)			10		
Tax cost - Entity B ($50 * 30%)			15		
Total tax cost			25		
Effective tax rate of consolidated entity			25%		

	Current Accounting Outcome				Proposed Accounting Outcome			
Transaction 1 - **Year 1**	Entity A	Entity B	Topside	Reported	Entity A	Entity B	Topside	Reported
Interco Sale of Inventory								
Sales - Interco	(60)		60	0	(60)		60	0
AR/AP - Interco	60	(60)		0	60	(60)		0
Sales - Third Party				0				0
AR/AP - Third Party				0				0
Inventory	(10)	60	(50)	0	(10)	60	(50)	0
COS - Interco	10		(10)	0	10		(10)	0
COS				0				0
Tax Expense/(Benefit)	10		(10)	0	10		(15)	(5)
Taxes Payable	(10)			(10)	(10)			(10)
Deferred Tax Asset/(Liability)							15	15
Deferred Charge			10	10				0
Effective Tax Rate				NA			% NM, but a benefit	
Transaction 2 - **Year 2**	Entity A	Entity B	Topside	Reported	Entity A	Entity B	Topside	Reported
Third Party Sale of Inventory								
Sales - Interco				0				0
AR/AP - Interco				0				0
Sales - Third Party		(110)		(110)		(110)		(110)
AR/AP - Third Party		110		110		110		110
Inventory		(60)	50	(10)		(60)	50	(10)
COS - Interco				0				0
COS		60	(50)	10		60	(50)	10
Tax Expense/(Benefit)		15	10	25		15	15	30
Taxes Payable		(15)		(15)		(15)		(15)
Deferred Tax Asset/(Liability)				0			(15)	(15)
Deferred Charge			(10)	(10)				0
Effective Tax Rate				25%				30%
Cumulative Transactions - **CUM IMPACT**	Entity A	Entity B	Topside	Reported	Entity A	Entity B	Topside	Reported
Third Party Sale of Inventory								
Sales - Interco	(60)		60	0	(60)		60	0
AR/AP - Interco	60	(60)		0	60	(60)		0
Sales - Third Party		(110)	0	(110)		(110)		(110)
AR/AP - Third Party		110	0	110		110		110
Inventory	(10)		0	(10)	(10)			(10)
COS - Interco	10		(10)	0	10		(10)	0
COS		60	(50)	10		60	(50)	10
			0					
Tax Expense/(Benefit)	10	15	0	25	10	15	0	25
Taxes Payable	(10)	(15)	0	(25)	(10)	(15)		(25)
Deferred Tax Asset/(Liability)			0	0			0	0
Deferred Charge			0	0				0
Effective Tax Rate				25%				25%