

May 30, 2019

Technical Director  
File Reference No. 2019-500,  
FASB, 401 Merritt 7,  
PO Box 5116,  
Norwalk, CT 06856-5116

**Re: File Reference No. 2019-500: Comments on the Revised Exposure Draft for the Proposed Accounting Standards Update to Income Taxes (Topic 740)**

Dear Director Kalanick and Members of the Board,

I am writing to express both my strong support for many of the Financial Accounting Standards Board (FASB) proposed accounting standards updates to the disclosure requirements for income taxes and to articulate ways in which the proposed standards should be further amended. If there is one single area of financial disclosure where there has been a long time consensus in favor of additional disclosure among a wide variety of stakeholders, including investors, accounting firms, academics, companies, public interest groups, and others, it is in the area of income taxes.

The current proposal would certainly result in more effective, decision-useful information about income taxes compared to a relatively opaque status quo. However, the proposal, as it stands now, is insufficient in providing investors and other users of the financial statements many critical and material pieces of information relating to income taxes. It is absolutely crucial that the FASB further amend the proposed standards to ensure that this information is included.

**Experience as a User of Financial Statements**

For over a decade, I have been a very active user of the income tax disclosures of public companies. I have personally reviewed and analyzed 1,000s of income tax notes and related disclosures in companies' 10-K filings to the Securities and Exchange Commission (SEC). I did this work primarily as an analyst at the Institute on Taxation and Economic Policy (ITEP) and continue to do so in my new position working at the U.S. Senate Budget Committee.

The goal of my analysis of companies' income tax information was at its core to answer three basic questions:

1. What is a company's tax rate in the United States and relevant jurisdictions?
2. What is driving the tax rate that the company is paying?
3. Is the tax rate the company is paying sustainable or how might it change substantially moving forward?

Given that tax payments represent a substantial portion of a company's profits and cash flow, being able to answer these basic questions is more than material to any financial statement user to understanding the basic financial position of a company.

What is absolutely clear from my decade spent carefully reading and analyzing income tax disclosures is that the current standards are woefully inadequate in allowing investors or other users of the financial statements to answer even these basic questions at a high level. The FASB correctly recognized the lack of decision-useful information when it decided to pursue a series of updates to these standards.

### **How the Proposal Fills in Some Gaps**

The most useful proposed update is the requirement that companies' disaggregate their income taxes paid and income tax expense between federal, state and foreign taxes, rather than simply reporting this information on a worldwide basis. This proposal would allow users of financial statements to get a clearer picture of the company's overall tax status, with only negligible additional compliance costs to companies.

Some stakeholders have raised concerns that both federal tax expense and income taxes paid could provide a misleading picture of the general state of a company's tax status. There are several reasons why these concerns are insufficient to justify holding back on the expansion of disclosure. First, if anything, the ways in which these two measures of a company's tax rate are inadequate should justify more context and disclosure in other areas, not less overall disclosure. Because tax information is so critical to understanding a company's financial situation, it absolutely needs to be included in a decision-useful way, rather than being excluded or included in an unhelpful way as some stakeholders advocate. Second, it does not take a particularly sophisticated user of financial statements to understand that the longer term trends in a company's tax status are more important than year to year fluctuations. In other words, by looking at several years of data, financial statement users can overcome concerns that potentially misleading year to year fluctuations could cause. If the concern with income tax cash paid is that it might create a misleading view of a companies' taxes on its current year income, the FASB could require that income taxes paid be additionally disaggregated by taxes paid for the current and prior tax years. Finally, by requiring both the disclosure of income tax expense and income tax paid, the standards allow users two different and complimentary views of a company's tax status. For example, income tax paid obviously gives clearer picture of the cash flowing out of a company due to taxes, while income tax expense provides a better picture of what future income taxes will be paid out in the future. Given this, the inadequacies in each measure are made up for to some extent by comparing them to each other.

Disaggregation of income tax expense and income tax paid by federal, state and foreign is imperative because it provides users of financial statements the most basic breakdown for understanding what is driving the overall effective tax rate of the company. Without such a breakdown, it would be unclear where a change in the tax rate is being driven, whether in the United States, a foreign country, or even changes in state tax codes overall. Similarly, there would be no way to understand and estimate the risk for future changes in the company's tax rate or to even explain changes already happening.

It is worth noting here that disaggregation of domestic taxes into the federal and state level represents a significant improvement over the previous exposure draft. Because total state level

income taxation can be significant and material in its own right, it is important that users of financial statements be able to distinguish whether a change in the effective tax rate is being driven at the federal or state level. It would be more ideal to require disclosure of state by state corporate income taxes, but certainly requiring total state taxes in the aggregate is a cost effective and decision-useful improvement over the status quo requirements.

### **The Importance of Further Disaggregation by Country**

The most concerning change between the previous exposure draft and the new one is the removal of any further disaggregation of foreign tax and related information by country. The bulk of this letter deals with this issue and the related question 5 in the current exposure draft. The FASB received comments from a wide spectrum of sources arguing in favor of going much further than the standard proposed in terms of disaggregation by country, including numerous investor groups and major individual investors, academics, members of Congress, religious groups, and corporate transparency groups. This has also been an especially important issue to the FASB's own Investor Advisory Committee, which has brought concerns about this issue up in numerous previous advisory meetings.

The disaggregation of country by country information advocated by a variety of groups would go well beyond income and tax information. Most groups advocating for additional disclosure have looked to the recent standard set by the Organisation for Economic Co-operation and Development (OECD) for disclosure, which called for the disaggregation of total revenues, profit, income tax paid, tax cash expense, stated capital, accumulated earnings, number of employees on a full-time basis, and book value of tangible assets on a country-by-country basis. Many companies already have to file country-by-country reports to the Internal Revenue Service (IRS) in the coming years, meaning that providing this information in financial statements would represent little to no additional cost.

Even if there is a considerable cost to companies in preparing this information as part of the financial statement, it is worth the cost in providing investors the decision-useful information they need to invest. If an investor does not know essential pieces of information such as where the company is reporting income or paying taxes, it is not possible to accurately gauge the risk of an investment in the company given the importance of this financial decisions by the company. It is also information that companies themselves should be or are already calculating as part of the normal management of their global operations.

Another concern about disaggregation of financial and specifically tax information on a country by country basis is that in some jurisdictions the relevant information may not have been required to be calculated until after the financial disclosure is due in a given year. The FASB should further study the issue of whether or not estimates would be more than adequate to deal with this issue. Companies have proven more than capable in making such calculations in other tax disclosures and there's no reason that this would not be the case here. If the FASB determines that it is the case, there is no reason that the board could not simply require these disclosures on a delayed basis. As discussed throughout this comment letter, the annual tax

information is most useful as part of looking at the general trends of a company's taxes, so having the information on a delayed basis would still be invaluable.

The most disconcerting reasoning by the FASB for its decision to reject country level disaggregation is noted in BC25 of the exposure draft, where it notes that many stakeholders are concerned that such disclosure could lead to higher taxes for those companies. Such an impact is well outside the consideration and responsibility of the FASB and should be not even be considered in the discussions of what accounting standards it should be setting. It is not the job of the FASB to help companies for which it sets accounting standards to lower or raise their tax rates. If this is going to be a consideration for the FASB, it is worth noting that the existing disclosures are already being used in debates and discussion over tax rates and broadening the disclosure standards would simply ensure that these debates are taking place with more accurate, rather than often misleading information.

In rejecting the OECD approach, the FASB is setting itself in contrast to the global trend toward the standardization of private and public disclosure of this basic country by country tax and financial information. Given the global trend, by not moving forward with substantial additional disaggregation now, the FASB will likely be forced to revisit its standard in the not too distant future.

### **Intermediate Disaggregation Proposals**

While embracing the OECD standard as part of financial reporting would be ideal, the FASB may not be prepared for a variety of reasons to make such a move at this time. In this context, it is worth noting that many aspects of the OECD standard less directly relevant to taxes could make sense as part of updating standards on segment reporting.

There are also more intermediate and cost effective ways to disaggregate decision-useful disclosures without requiring the full OECD disclosures. The FASB proposed in its previous exposure draft one such method. In the draft, the FASB proposed to require companies to disaggregate foreign tax expense by significant country. This information would be a substantial improvement on the current proposal by providing the key material information on foreign taxes. Such a standard would have been improved by the requirement that companies disaggregate their foreign income by significant country and provide the amount in taxes in those countries with significant income. In other words, a forward looking and cost effective standard would be to require companies to disaggregate their foreign income by significant country and to require that they disclose the taxes they owe in those countries.

Additionally, when issues with the significant country by tax proposal came up, issues which were outweighed against the value of disclosure by the board, the FASB considered an even more cost effective approach that would have required companies to disclose their income tax cash paid by significant country. This approach would cost companies very little and would provide investors with invaluable information. Critics of this standard argue that such information would not be decision-useful. Their critique misunderstands that while income tax paid in one year could be misleading, users of financial statements can look at the trends over several years to get decision-useful information from this data. Also, to the extent that this

information would not be decision-useful, it is because it should be supplemented with additional information, such as the disaggregated income number to make it more useful.

### **Addressing Specific Questions**

While my main concern about the new exposure draft revolves around the disaggregation of income and tax among foreign tax jurisdictions (as posed in question 5 of the exposure draft and discussed in great detail above), there are a number of other points worth discussing based on my experience working with financial statements.

#### *Reconciliation Standard*

As per question 6, the lowering of the federal corporate tax rate should not result in a raising of the 5 percent threshold for the inclusion of items in the rate reconciliation. The rate reconciliation standard of 5 percent was too high under previous law, with companies taking advantage of the high threshold to obscure the details of rate reductions or increases into large vague categories. Such vague information undermined in many cases the usefulness of the rate reconciliation in determining what was driving a company's tax rate. A more ideal threshold would have been 1 percent under the old tax code and lowering the threshold to 1 or 3 percent should be seriously considered moving forward. At a minimum, the current threshold should be maintained.

#### *The Tax Cuts and Jobs Act and Indefinitely Reinvested Earnings*

As per question 7, the Tax Cuts and Jobs Act (TCJA) had a number of significant effects on the tax code that have significant implications for accounting standards. Previously, financial statement users could use the amount of indefinitely reinvested earnings in foreign subsidiaries and the estimated amount of tax owed if these earnings were repatriated as a rough proxy for estimating the potential risk to increased taxes on offshore earnings. With the changes to the new law, this information is no longer material and the FASB appropriately proposes to remove requirements for its disclosure. However, this removal does mean that users of financial statements are deprived of a proxy, even a rough and potentially fraught one, in trying to estimate understand sustainability of the tax rate on foreign earnings.

One approach to dealing with the loss of this valuable information in the disclosure would be to more comprehensively require the disclosure of income and tax information on a country by country basis as discussed in greater detail earlier in this letter. An alternative more targeted approach would be to require companies to separately disclose their domestic tax expense recorded on their foreign-sourced earnings. Such a requirement would provide investors and users of financial statements the ability, similar to the one provided by the disclosure of indefinitely reinvest earnings, to have a proxy for how aggressively companies are using risky offshore tax avoidance methods. For example, if a company is paying close to a 10.5 percent domestic tax rate on its foreign source earnings, this would highly indicative of a company that is unsustainably shifting much of its offshore income into low or zero tax jurisdictions. Similarly, if a company is paying close to nothing in domestic taxes on its offshore earnings, this would be indicative of a company already paying higher and sustainable rates offshore.

One added advantage of requiring companies to disclose their domestic tax expense on foreign sourced earnings is that it would prevent confusion by investors and other financial statement users over whether a company's domestic tax is being driven by issues with its foreign or domestic earnings.

#### *Disaggregating Unrecognized Tax Benefits*

As per BC39-42, the FASB considered many different forms of disaggregation of unrecognized tax benefits as part of the disclosure framework project, but ultimately decided to not make any proposal along these lines. One cost effective and decision-useful additional disclosure would be to require companies to disclose their unrecognized tax benefits by federal, state and foreign jurisdictions. Under the current standard, while it is possible to get some sense of the tax aggressiveness of a company's overall tax positions, it is not possible to match this up in any meaningful way with the taxes the company is paying on the federal, state and foreign levels. Requiring such disaggregation would allow for a better understanding of the interaction of unrecognized tax benefits and the rates being paid.

Disaggregating foreign unrecognized tax benefits could also prove especially valuable in allowing investors to determine whether companies are adequately considering the potential risks of aggressive offshore tax avoidance positions. After years of analyzing the offshore tax positions of hundreds of multinational companies, it has become clear to me that companies did not and continue to not adequately discount the risks of offshore tax avoidance strategies in calculating their unrecognized tax benefits. Requiring disaggregation here could allow investors to get a better sense of how these risks are or are not being priced in and could potentially nudge companies to take a closer look at how they are accounting for riskier foreign tax positions.

#### **Conclusion**

I appreciate all the hard work the FASB and related stakeholders have put into the construction of the proposed income tax disclosure standards update over the past several years. Many of the proposed changes would make disclosure more effective, but even more progress needs to be made to bring our accounting standards up to date with the modern economy and prevailing global trends.

Sincerely,

A handwritten signature in black ink, appearing to read 'Richard Phillips', written in a cursive style.

**Richard Phillips**