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Letter of Comment No: 12
File Reference: FSPFAS109

December 1, 2004

Mr. Lawrence W. Smith, Director
Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Proposed FASB Staff Position No. FAS 109-a, “Application of FASB Statement No. 109, *Accounting for Income Taxes*, for the Tax Deduction Provided to U.S. Based Manufacturers by the American Jobs Creation Act of 2004”

Dear Mr. Smith:

We agree with the FASB staff’s observations in paragraph 4 of the proposed FSP that the domestic manufacturing deduction provided by the American Jobs Creation Act of 2004 (the Act) has characteristics that are similar to the special deductions illustrated in paragraph 231 of FASB Statement No. 109, *Accounting for Income Taxes*. Accordingly, we agree with the fundamental conclusion in the FASB staff’s proposal that the domestic manufacturing deduction should be accounted for as a special deduction, and not as a tax rate reduction.

Due to the limited number of situations in which the special domestic manufacturing deduction may impact the determination of the valuation allowance or the measurement of deferred tax assets and liabilities when graduated tax rates are a significant factor, we question the need for the examples provided in Appendix A of the proposed FSP. However, we have the following comments on the examples if the staff concludes that the examples should be retained in the final FSP.

The examples illustrate a simplified graduated tax rate system that is not consistent with that of the U.S. tax law. If a graduated tax rate system is incorporated in the examples, we believe the use of a graduated tax rate system that mirrors the U.S. tax law would be more relevant.

Paragraph 2 of the proposed FSP indicates that the Act provides a tax deduction based on a percentage of the lesser of (a) qualified production activities income or (b) taxable income (after the deduction for the utilization of any net operating loss carryforwards).



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We agree with that description of the provisions of the Act. However, examples 2 and 4 of the proposed FSP illustrate calculations of the domestic manufacturing deduction using taxable income *prior to* the deduction for the utilization of net operating loss carryforwards. As a result, we believe that, based on the facts presented in Examples 2 and 4, the expected domestic manufacturing deduction should be \$27 in Example 2 and \$90 in Example 4.

In Example 2, it is not clear why the enterprise would have used a 35% rate to measure the deferred tax asset for the net operating loss carryforward before the change in tax law because the net operating loss carryforward reduces expected taxable income below \$380 and, therefore, the 30% tax rate would be applicable even before consideration of the domestic manufacturing deduction.

In Example 4, if the domestic manufacturing deduction is \$90 as described above, no valuation allowance would be needed for the deferred tax asset for the net operating loss carryforward because the domestic manufacturing deduction of \$90 would not reduce expected taxable income below the amount of the net operating loss carryforward.

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If you have questions about our comments or wish to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449 or Mark Bielstein at (212) 909-5419.

Sincerely,

KPMG LLP