(I) JP Morgan Chase

Joseph L. Sclafani

Executive Vice President and Controller

Director, TA&l—FSP Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 Letter of Comment No: File Reference: FSPFAS13-A
Date Received:

Re: Proposed FASB Staff Position 13-a

Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction

Dear Sir/Madam:

J.P. Morgan Chase & Co. ("JPMorgan Chase") appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB") Proposed FASB Staff Position (FSP) 13-a, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction.

Overall, we agree with the Board's recent conclusion that the timing of the cash flows relating to income taxes generated by a leveraged lease is an important assumption that should be accounted for by recalculating the rate of return on the lease and recording a catch-up adjustment, as required for other significant changes in assumptions in Statement of Financial Accounting Standards No. 13, Accounting for Leases. However, we believe that the guidance in the FSP needs to be expanded and clarified, particularly with respect to how the FSP intersects with the proposed FASB Interpretation on Uncertain Tax Positions and FASB Staff Interpretation No. (FIN) 21, Accounting for Leases in a Business Combination.

The attachment contains JPMorgan Chase's specific comments on the FSP. We would be pleased to discuss our comments with you at your convenience. If you have any questions, please do not hesitate to contact Shannon Warren at (212) 648-0906 or me.

Very truly yours,

Joseph L. Sclafani

Attachment

JPMorgan Chase's Comments on the Proposed FASB Staff Position 13-a, Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction

ATTACHMENT

<u>Issue 1</u>: The scope of this proposed FSP would apply to all transactions classified as leveraged leases in accordance with Statement 13. Do you agree that the scope of this proposed FSP should be limited to only leveraged lease transactions or should the scope be expanded to include all leases under Statement 13? Why or why not?

We do not believe that the scope of the proposed FSP should be expanded to include all leases under Statement 13. This FSP primarily addresses recalculation and reclassifications that arise from changes in timing of cash flows relating to income taxes. Only leveraged leases use after-tax cash flows to compute yield and for purposes of determining classification. Therefore, we do not believe that the guidance in the FSP is relevant to other types of leases.

Issue 2: This proposed FSP concludes that the timing of cash flows relating to income taxes generated by a leveraged lease is an important assumption that should be accounted for in accordance with the guidance in paragraph 46 of Statement 13. Additionally, this proposed FSP would require a leveraged lease to be reclassified if, at any time, a revision of an important assumption requires a recalculation of a leveraged lease and changes the characteristics of the lease in a manner that would have resulted in the lease not qualifying as a leveraged lease had the revised assumption been included in the original or most recent leveraged lease computation. Do you agree? Why or why not?

We agree that the timing of cash flows relating to income taxes generated by a leveraged lease is an important assumption that should be accounted for in a similar fashion to other changes in significant assumption in accordance with Statement 13. The timing of tax deductions drives the economics of a leveraged lease; thus, if the timing of such deductions changes, that is a significant event that should be reflected in the accounting.

However, we do not concur with the FSP requirement to reclassify a leveraged lease that has undergone a revision of an important assumption. To date, Statement 13 requires a lease to be classified at its inception, and the classification of the lease is not changed unless (1) both the lessor and lessee agree to a revision that would have resulted in a different classification of the lease had the changed terms been in effect at lease inception or (2) the lease is extended or renewed. Changes in estimates (for example, changes in the residual value of the leased property) or changes in circumstances (for example, default by the lessee) do not give rise to new lease classification. This same rationale is carried forward in FIN 21. Paragraph 8 of FIN 21 states that "The Board views the substance of a business combination that is accounted for under the purchase method to be the purchase of the lessor's or lessee's interest in an existing lease. The original lessor or lessee does not become a party to a new agreement; accordingly, there is no new agreement to be classified, and Statement No. 13 does not permit reclassification of the existing lease unless the provisions of the lease are modified."

Our view is that the current Statement 13/FIN 21 guidance is appropriate because when a lessor and lessee agree to changed provisions, the parties are actively participating in the change and thus are able to evaluate how the change might impact their accounting in deciding whether to modify a

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lease. Other circumstances, such as a decline in the residual value of the equipment or an adverse IRS settlement, are outside of the lessor's control, and we do not believe that the lessor should be penalized by losing the benefits of leveraged lease accounting treatment in those types of situations.

Issue 3: This proposed FSP would require that the recalculation be based on actual cash flows that occurred up to and including the point of actual settlement or expected settlement and the estimated cash flows thereafter. Additionally, this proposed FSP would require that the recalculation include any interest and penalties assessed or expected to be assessed by the taxing authority. Do you agree? Why or why not?

We agree that the recalculation should be based on actual cash flows that occurred up to the point of actual settlement or expected settlement and the estimated cash flows thereafter. Actual cash flows drive the economics of a leveraged lease, and by using actual cash flows, the accounting will reflect the true economic yield on the investment in the lease.

From a theoretical perspective, we agree that it is appropriate to include interest and penalties within the lease runs. However, there is a significant practical implementation issue with including interest assessed or expected to be assessed by the taxing authority in the recalculation of the rate of return on the lease. When a lessor performs a recalculation using an estimated settlement amount and related interest, the lessor will most likely estimate the interest for future periods based on currently published IRS rates. On a quarterly basis, the IRS updates these rates, giving rise to a situation where the lessor might need to recalculate the rate of return and therefore adjust the lease balance on a quarterly basis. For this reason, the FASB should consider excluding interest from the recalculation, recording that tax liability "outside" the lease run. It does not appear that the inclusion of penalties "inside" the lease run would cause a similar implementation issue, as the calculation of penalties does not involve a quarterly rate change, but rather is a more static amount. For this reason, we agree that penalties should be included within the lease runs.

COMMENTS ON OTHER ISSUES

Interaction With Proposed FASB Interpretation on Uncertain Tax Positions

Paragraph 12 of the FSP requires that tax positions shall be reflected in the lessor's calculation based on the guidance in the proposed FASB Interpretation, Accounting for Uncertain Tax Positions—an interpretation of FASB Statement No. 109 ("Interpretation"). The Interpretation requires a two-step process for recognition of the financial statement effects of a tax position. First, a company needs to assess whether a tax position is probable of being sustained on audit, based on the technical merits of that position. We understand that "probable" is being interpreted as at least a 70-75% likelihood. Then, if the probable threshold is met, the company records its best estimate of the tax impact. However, if the probable criterion is not satisfied, then a reserve of 100% must be established.

With respect to LILOs/SILOs, the IRS has established settlement guidelines for these transactions, and is actively engaged in a settlement process with many, if not all, affected taxpayers. We believe that a company engaged in such a settlement process can estimate the settlement it will achieve with

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the IRS with a high degree of probability, and therefore, in such instances, this estimated settlement should be included in the lease recalculation regardless of the probability that the tax position could be sustained on audit. In fact, this is the same approach which is implied by footnote 5 to the Interpretation which states "The recalculation should be based on the settlement amount or estimated settlement amount designated by the Service as attributable to the leveraged lease transaction."

Leveraged Leases Acquired in a Business Combination

We believe that the FSP needs to be expanded to provide guidance with respect to leveraged leases that have been acquired in a business combination, and accordingly, have been fair valued in accordance with FIN 21. If an estimated IRS settlement was included in the lease cash flows that were fair valued at the time of purchase, then the acquiring entity has in fact already applied the guidance in this FSP. The FSP should clarify that in those instances, the only further adjustment necessary is if the assumptions change. As discussed in our response to Issue 2 above, under FIN 21, leases acquired in a business combination are not retested for classification unless lease provisions have been modified. In our response to Issue 2, we expressed the view that the FSP should not change the FIN 21 guidance. However, if the final FSP still requires retesting for classification, then the FSP should clearly indicate which leveraged lease accounting run to use for the retest, either (1) the pre-acquisition lease run from inception of the lease or (2) the post-merger run prepared under FIN 21. Our position is that the pre-acquisition run should be used for reclassification, because it is the better representation of the lease attributes. The post-merger run is by definition "incomplete," since it only includes cash flows from the date of acquisition forward.

Effective Date

We request that the implementation date of the new standard (currently December 31, 2005 for calendar-year companies) be delayed until year-end 2006, along with the implementation date of the Interpretation on uncertain tax positions. A great deal of work and analysis is needed in order to assess tax positions, and retesting and recalculating leveraged leases is a complex and time-consuming process.