



December 3, 2008

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LETTER OF COMMENT NO. 13

Re: November 3, 2008 Proposed FASB Staff Position (FSP) FIN 48-c, *Effective Date of FASB Interpretation (FIN) No. 48 for Certain Nonpublic Enterprises*

Dear Mr. Golden:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Proposed FSP and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC supports and appreciates the issuance of the Proposed FSP to defer the effective date of FIN 48 for certain nonpublic entities so that the Board may develop much-needed guidance for pass-through entities and reconsider certain disclosure requirements. These two issues have been the focus of TIC's feedback to the Board in prior comment letters and in our September 15, 2008 and October 5, 2007 liaison meetings with selected FASB members.

Pass-through entity guidance

The confusion surrounding the application of FIN 48 to pass-through entities has prevented third-party vendors and CPE providers from publishing relevant nonauthoritative guidance. TIC believes the Board's issuance of this guidance is critical to the consistent application of FIN 48 by pass-through entities. The new guidance should take into account the environment surrounding these entities and the interests of financial statements users, which are very different from the environment surrounding public companies and the needs of their





users. Accruing FIN 48 liabilities for nonpublic entities entails a much more subjective estimation process than for public companies because of the ambiguity surrounding pass-through entity tax positions and the infrequent occurrence of IRS and state tax audits compared to public companies.

The planned FSP for pass-through entities should include comprehensive guidance to address the applicability of SFAS No. 109, *Accounting for Income Taxes*, and FIN 48, *Accounting for Uncertainty in Income Taxes*, to not-for-profit organizations, Subchapter S corporations, real estate investment trusts and limited liability companies and partnerships. The guidance should include a combination of general principles applicable to pass-through entities accompanied by implementation examples in question and answer (Q&A) format.

TIC suggests the Board convene a panel of pass-through entity experts to assist in the development of the guidance. TIC would be happy to offer its assistance to the Board in whatever capacity would be most helpful. Many TIC members have pass-through entity clients and are therefore in an ideal position to review the proposed guidance on a pre-issuance basis to assess whether it is clear and operational.

Disclosure issues for nonpublic entities

TIC also encourages the Board's efforts to amend FIN 48 to provide disclosure relief for nonpublic entities. The disclosures in paragraphs 21(a) and 21(b) are not used in lending decisions by users of nonpublic entity financial statements, especially since FIN 48 accruals generally will be non-cash events for nonpublic entities over time. Therefore, the disclosures are not providing a benefit that exceeds their costs, since the information does not contribute to a lower cost of debt or capital for nonpublic entities. The needs of users should be a key factor in the reconsideration of the disclosure provisions. If the disclosures are not useful, they should be eliminated or modified appropriately for nonpublic entities.

SPECIFIC COMMENTS ON PASS-THROUGH ENTITY ISSUES

Pass-through entity taxation issues are numerous and complex and can be costly to research. The discussion below sets out questions that have arisen surrounding the key conceptual issues and detailed practice problems that TIC members have faced as they attempted to understand how FIN 48 would apply to pass-through entities. TIC recommends that the following issues be addressed in the guidance planned for a future proposed FSP:

Applicability of FIN 48 to pass-through entities and other nontaxable business enterprises

SFAS 109 never provided guidance on accounting for income taxes of pass-through entities beyond accounting rules for the deferred tax effect of a change in an entity's tax status.





However, FIN 48 states that all of its provisions apply to not-for-profit organizations, pass-through entities and certain other entities (such as real estate investment trusts and registered investment companies). Confusion therefore arose as to when and how FIN 48 applies to these entities, which have not previously applied SFAS 109. Guidance is therefore needed on two fundamental questions:

- What is the definition of a pass-through entity?
- What transactions or characteristics of not-for-profits and pass-through entities trigger uncertain tax positions that should be evaluated under FIN 48? For example,
 - Is FIN 48 limited to uncertain tax positions concerning an entity's status as taxable v. nontaxable? That is, if an entity hasn't taken any positions that would jeopardize its election as a pass-through/nontaxable entity, is it outside the scope of FIN 48?
 - If FIN 48 is intended to have broader application, what tax positions are scoped in (e.g., a decision not to file a tax return in a jurisdiction) and at what levels (federal v. state levels and entity level v. shareholder level)?

The following guidance would be needed if the Board decides to extend the applicability of FIN 48 beyond the tax election issue discussed above:

The complexities of state nexus issues for pass-through and not-for-profit entities

Nexus issues arise due to lack of clarity in the state laws regarding the nature of taxes imposed, the level at which income tax may be imposed and when and where they should be recorded. The issue of state nexus is particularly troublesome for pass-through entities as there is no nationally accepted definition of when an entity is subject to a state's income tax. Additionally, if a determination is made that the entity is more likely than not to be subject to a particular state's tax, it is difficult, if not impossible, to determine the statutory limits. State administrative practices are also much less transparent than those of the Internal Revenue Service.

Specific guidance in these areas is critical given the potential high cost involved in conducting nexus studies. TIC therefore requests that implementation guidance be provided on the following issues:

- Most states have the legal authority to attach nexus onto the pass-through entity doing business in the state but not the individual shareholder of the pass-through entity. As a result, many states have set up withholding requirements for the pass-through entity for tax to be paid at the individual level. When a pass-through entity has an uncertain tax position regarding tax to be paid at the individual level, many questions arise about the



appropriate accounting treatment.

- Are uncertain tax positions pertaining to a state's withholding requirements within the scope of FIN 48?
- If so, should the corresponding debit for such withholdings be to income tax expense or equity?
- Assuming that the debit for the uncertain tax position should be in equity, is this recorded on the accrual basis (i.e., when the distribution is declared or when the potential need for a distribution due to an uncertain position is identified) or the cash basis?
- Is the Company's prior history of providing tax distributions relevant?
- Are agreements with the members, shareholders or partners of pass-through entities relevant when the provisions require or aspire to provide tax distributions sufficient to cover shareholder tax liabilities?
- When should entities follow the administrative practice rules in FIN 48?
- Are there circumstances when accrual of penalties and interest could be waived?
- Also, even if the questions above are resolved, the distinction between an entity-level tax and an individual-level tax is not always clear. For example, the Commonwealth of Kentucky has an entity-level Limited Liability Entity ("LLE") tax. The owners of the entity subject to the LLE tax receive a nonrefundable credit for LLE tax paid at the individual level. As a result, confusion exists as to whether this tax is the responsibility of the entity or the owner. As States continue to engineer different tax regimes, more of these types of questions will arise.
 - How should entities apply FIN 48 when state law or regulation is unclear as to the distinction between entity-level and individual-level taxes?

Types of taxes that fall within the scope of FIN 48

Since FIN 48 in an interpretation of FASB Statement No. 109, the scope of the interpretation is limited to income taxes. However, entities often cannot definitively determine whether a particular tax or required tax withholding is an income tax, excise tax or franchise tax. A need has emerged for improved guidance on what qualifies as an income tax. In addition, implementation guidance is needed to allow entities to assess whether such uncertainty means that FIN 48 would not apply or whether uncertainty regarding the nature of a tax is itself an uncertain tax position. For example, a number of states have developed new forms of taxation that are subject to interpretation as to whether they are taxes based on income. In particular, the states of California, Massachusetts and New York (among others) have imposed on Subchapter S corporations a minimum tax that may or may not meet the definition of an income tax. This tax may be individually immaterial at the state level, but could become material to a smaller entity that operates in a number of states.





FIN 48 accounting for composite returns

When entities are permitted to prepare composite returns and remit taxes on behalf of their shareholders, are uncertain tax positions related to those returns required to be considered? If so, once again there is the question of where the debit is recorded—in equity or as an expense?

Unique FIN 48 issues facing not-for-profit organizations

While it is apparent that an entity's FIN 48 assessment should consider whether or not it has a valid tax exempt status and the impact of tax positions in reporting unrelated business income, it is not apparent what the entity should do to assess its exposure to loss of tax exempt status or how the potential for intermediate sanctions (which are IRS penalties imposed on the entity for egregious behavior) should be handled.

ILLUSTRATIVE EXAMPLES

The examples that follow are meant to illustrate some of the specific practice problems that TIC members have encountered based on the various issues described above:

- An LLC has a filing requirement in a particular state solely because one of the shareholders is a state resident. The entity must withhold income taxes for its out-of-state shareholder and remit them to the taxing authority. If the entity decides not to file a partnership return in the state, is this an uncertain tax position that must be accrued? This raises the issue of the importance of a decision to file a tax return even though no entity-level income tax is due.
- A C-Corp owns 5% of an LLC, and accounts for the investment on the equity method. The other members of the LLC are unrelated individuals. Because the LLC is a pass-through entity, it does not consider shareholder taxes in its FIN 48 analysis. However, the C-Corp would be directly impacted by any tax assessments imposed on the LLC. What duty does the C-Corp have to analyze the LLC tax positions, particularly in the case where the C-Corp may not have full access rights to the underlying books and records?
- For many pass-through entities, the shareholders take distributions to cover their tax liability. At the same time, many times the bank loans will have covenants that restrict the amount (usually stated as a percentage of income) that can be distributed for this purpose. If the corporation has a tax audit and it is determined that they understated taxable income, the individual shareholder would need to file an amended return and pay additional taxes. Because the bank covenants allow distributions and the company would cover it, should the uncertain tax position have been booked at the entity level? And if so, is it an expense or a distribution of equity when the liability is recorded?
- A university has a valid determination letter from the IRS as a 501(c)(3) organization.





However, the university may have “Unrelated Business Taxes” that could cause a tax liability in the future should the entity be audited. In addition, unknown to the Board of Trustees, an unreasonably high compensation package may have been approved for the university president that could result in substantial excise taxes against the university, its president and the trustees. TIC believes these entities are no different than for-profit entities when they prepare their returns and take certain positions on gray areas in the tax laws. Implementation guidance is necessary to ensure that not-for-profit organizations are aware of the nature and extent to which FIN 48 is applicable.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen Bodine, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committee

