

## Private Company Financial Reporting Committee

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JOYCE HODSELL  
Chair

December 3, 2008



LETTER OF COMMENT NO. 124

Mr. Robert Herz  
Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856

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

Dear Mr. Herz:

The Private Company Financial Reporting Committee ("PCFRC") has reviewed the Proposed FSP and provides the following comments.

The PCFRC thanks the FASB for issuing the Proposed FSP, which would extend the deferral of the effective date of FIN No. 48 for certain private companies while the FASB develops guidance on the application of FIN No. 48 to pass-through entities and amends the disclosure requirements of FIN No. 48 for private companies. Previous PCFRC recommendation letters informed the FASB about a number of issues arising from FIN No. 48's applicability to pass-through entities, including emphasizing the significant compliance hurdle pass-through entities would encounter when assessing the implications of FIN No. 48. Providing guidance on the application of FIN No. 48 to pass-through entities is essential to ensure the proper and consistent implementation of FIN No. 48 and to help CPE providers and third-party vendors who develop non-authoritative practice aids. Therefore the PCFRC encourages the FASB to develop guidance that consists of clear general principles and comprehensive implementation examples.

Additionally, previous PCFRC recommendation letters highlighted to the FASB concerns about the usefulness and relevance of the disclosure requirements of FIN No. 48 to private company financial statement users. Extended outreach conducted by the PCFRC and the user panel convened by FASB made clear that private company financial statement users did not find the disclosure requirements of FIN No. 48, particularly paragraphs 21(a) and 21 (b), useful or

relevant to their lending, investing, or bonding decision making. As such, the PCFRC appreciates the FASB's decision to amend the disclosure requirements of FIN No. 48 for nonpublic enterprises.

It is possible that practitioners and preparers perceive the application of FIN No. 48 to pass-through entities as more complicated than the Board may have intended. If the application of FIN No. 48 is limited to uncertain tax positions concerning an entity's status as taxable v. nontaxable, then the Board should provide that clarification. That is, if an entity hasn't taken any positions that would jeopardize its election as a pass-through/nontaxable entity, then it would be outside the scope of FIN No. 48.

If that is not the case then there are issues surrounding pass-through entities that need to be addressed.

### **Specific Examples or Problems that Pass-Through Entities Encounter**

The Proposed FSP requests constituents to provide specific examples of problems that pass-through entities will encounter when applying FIN No. 48. The PCFRC has conducted outreach and held internal discussions to identify issues and problems that pass-through entities might confront when applying FIN No. 48. What became evident is that taxation issues related to pass-through entities can be complicated, obscure, numerous, and very subjective.

The PCFRC finds that the issues and examples contained in the AICPA's Private Companies Practice Section Technical Issues Committee ("TIC") letter regarding the Proposed FSP are similar to the issues and examples identified by the PCFRC. As such the PCFRC agrees with TIC in their request for guidance on those specific examples and refers FASB to TIC's letter.

Furthermore, the PCFRC provides the following issues and examples that require further guidance.

1. There is confusion about whether positions taken on a pass-through entity return itself that might be considered "uncertain" and, if audited, would subject the shareholders/partners to additional tax fall under the scope of FIN No. 48. In such cases the shareholders/partners would sometimes look to the pass-through entity for an additional distribution to cover the tax liability. An example of this might be a research and development credit where tax law is subject to interpretation and the pass-through entity makes a judgment that the research and development credit position does not meet the more-likely-than not threshold. Making the required assumption that the return would be audited, should an accrual be made at the pass-through entity level for distributions to cover the tax to be potentially paid at the shareholder/partner

level? When should this distribution be recorded? As declared? On an accrual basis?

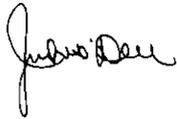
2. Pass-through entities can own non-pass-through subsidiaries (or be required to consolidate non-pass-through variable interest entities), including foreign entities. The tax return for the pass-through entity would not include the subsidiary or the VIE. Guidance is needed on how FIN No. 48 should be applied to these structures.
3. IRS code section 1374 imposes a "built in gains tax" on S corporations if the corporation sold or exchanged an asset acquired from a C corporation. It is defined as any gain recognized during the "recovery period" which is the 10 year period beginning on the first day of the first year for which a C corporation elects S corporation status. Generally speaking, if a C corporation elects S status and sells any of the C corporation assets during the first ten years of its existence, a built in gain tax is imposed at the rate of 35% on unrealized gains computed as of the time of the S election. Two questions arise in connection with FIN 48: (1) is this an "income tax" subject to FASB Statement No. 109?, and (2) if it is an income tax, does the need for a 10 year holding period create an "uncertainty" during the required holding period?
4. Dealing with state nexus issues can be very complex for pass-through entities. In some states a federal S corporation election does not automatically make the corporation an S corporation in that state. Researching each state's administrative policies as is required by FIN No. 48 can be costly and time consuming. The PCFRC requests that this be considered in the FASB's final deliberation.
5. Does FIN No. 48 apply to state income tax required to be withheld or paid on the earnings attributable to non resident shareholder/partners? In some cases it is difficult to determine if this tax is at the entity level or individual level. In the following situations, guidance is needed on when the uncertain tax position should be recorded (as incurred or when a distribution to cover the associated tax is declared) and where the debit should be recorded
  - a. A state requires a pass-through entity with nexus to withhold individual income tax on a nonresident shareholder/partner and non-nexus bearing shareholder/partner. The shareholder/partner files individually to pay additional taxes or receive a refund.
  - b. Same situation as in "a", except the shareholder/partner does not file at the individual level.
  - c. A state requires a pass-through entity with nexus to pay an entity-level tax that is refundable to the shareholder at the individual level when the nonresident shareholder/partner (without nexus in the state) files an individual return.

- d. Same situation as in "c", except the shareholder/partner does not file at the individual level.
- e. A state requires a pass-through entity with nexus to pay an entity-level tax that is nonrefundable to the shareholder at the individual level when the nonresident shareholder/partner (without nexus in the state) files an individual return. The shareholder/partner may use the entity-level tax as a nonrefundable credit for taxes due at the individual level.

The recent user panel that FASB convened to discuss issues related to FIN No. 48 appeared to provide the Board with useful information. The PCFRC recommends that FASB convene a panel of private company pass-through entity experts to assist the Board in writing guidance on these issues.

Please feel free to contact me if you wish to utilize the PCFRC members in helping to clarify issues or review the guidance being developed. Please contact me also if you have any other questions or comments.

Sincerely,



Judith H. O'Dell  
Chair  
Private Company Financial Reporting Committee