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Mr. Lawrence W. Smith
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Financial Accounting Standards Board
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Proposed FASB Staff Position No. FAS 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 Mr. Smith:

Deloitte & Touche LLP is pleased to comment on the proposed FASB Staff Position No. FAS 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" ("proposed FSP"). As discussed below, we support the issuance of the proposed FSP as a final FASB Staff Position. However, we believe there are aspects of the proposed FSP requiring further clarification and revision before issuance as a final FASB Staff Position ("final FSP"). Those aspects are set out below as part of our responses to the specific issues raised in the "Notice for Recipients" section of the proposed FSP.

In addition, the proposed FSP requires tax positions in a lessor's leveraged lease calculation to follow the provisions of the FASB's July 14, 2005, proposed Interpretation, Accounting for Uncertain Tax Positions — an interpretation of FASB Statement No. 109. Deloitte & Touche LLP's comment letter (not attached herein) on the proposed Interpretation expresses concerns that an asset model, in which a tax position must be probable of being sustained for a benefit to be recognized in the financial statements, may not be operational and may not produce comparable and relevant income tax information for financial reporting purposes. Further, we do not believe the effective date in the proposed Interpretation (i.e., end of the first fiscal year ending after December 15, 2005) provides entities with sufficient time to analyze the effects of the proposed Interpretation and correctly apply its provisions.

Because we believe that the guidance, including the date the guidance becomes effective, in the proposed Interpretation and in this proposed FSP should be consistent, we urge the FASB to consider our comment letter on the proposed Interpretation in connection with this comment letter, and to modify the proposed FSP as warranted. This includes a modified effective date for the proposed FSP (as well as for the proposed Interpretation) of no sooner than for periods beginning six months after the proposed Interpretation is issued as final.

Responses to Issues Raised in the "Notice for Recipients" Section of the Proposed FSP

Issue 1: 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 agree with the scope of the proposed FSP, and believe that its provisions should apply to all leveraged lease transactions, as changes in the timing of income tax cash flows are not limited to specific types of leveraged lease transactions.

We are not clear as to what the FASB may have in mind with respect to whether the proposed FSP should be expanded to include all leases under FASB Statement No. 13, Accounting for Leases ("Statement 13"). If the FASB is soliciting views on whether leases that are not leveraged leases at inception can subsequently qualify as leveraged leases (e.g., due to a change in the timing of income tax cash flows), we agree that the scope of the final FSP should not be expanded. That is, a lease transaction's classification over its term can change from that of a leveraged lease to a direct financing lease, but not from that of a direct financing lease to a leveraged lease. However, the FASB should explicitly state this one-directional reclassification concept in the final FSP.

Issue 2: This proposed FSP concludes 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 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 with the proposed amendment to paragraph 46 of Statement 13 in that the timing of the income tax cash flows generated by a leveraged lease should be reviewed on a periodic basis (no longer than annually), and if the expected timing of the income tax cash flows is revised, a recalculation of the rate of return and allocation of income pertaining to the lease should be performed using the revised assumptions. We also agree that whenever a recalculation is required to be performed for a leveraged lease, the lessor should reassess the classification of the lease as a leveraged lease.

Currently, Statement 13 does not require a recalculation of the rate of return and allocation of income to positive investment years of a leveraged lease for a change in timing of income tax cash flows, since such a timing change alone does not affect the estimate of total net income. However, such a timing change impacts the periodic income recognized on the lease, and

indeed may cause the nature of the lease transaction to change such that it no longer qualifies for leveraged lease classification under paragraph 42 of Statement 13.

However, the proposed FSP does not provide guidance as to whether a leveraged lease recalculation involves updating <u>only</u> the specific assumption change(s) that triggered the recalculation <u>or all</u> leveraged lease assumptions included in the recalculation.

This point can be illustrated using the alternative minimum tax guidance included in the proposed FSP. Paragraph 10 of the proposed FSP states, in part:

[A] change in timing as a result of an alternative minimum tax (AMT) credit...would not require recalculation of a leveraged lease because that change is not directly related to that lease (unless there was an indication that the original assumptions regarding total after-tax net income from the lease were no longer valid). This is consistent with Issue 10 of EITF Issue No. 87-8, "Tax Reform Act of 1986: Issues Related to the Alternative Minimum Tax."

The lessor's income tax rate, which generally includes assumptions regarding AMT status, is one of many assumptions involved in leveraged lease accounting. While the proposed FSP provides guidance on AMT considerations in assessing the need for recalculation, it does not address how AMT status should be considered (or reconsidered) in the recalculation itself. The fact that Issue 10 of EITF Issue No. 87-8 requires consideration of assumptions regarding the effect of AMT in an original leveraged lease calculation further clouds the issue.

As such, the final FSP should provide specific guidance on whether to update AMT and other assumptions contemplated at lease inception (e.g., early buy-out assessments, etc.) when performing the recalculation. An example illustrating the required treatment would also be helpful, and we encourage the FASB to include such an example in the final FSP.

In addition, we have interpreted the leveraged lease classification reassessment requirement of the proposed FSP to be a classification reassessment under paragraph 42 of Statement 13 only. That is, the classification reassessment does not involve a reassessment of lease classification pursuant to paragraphs 7 and 8 of Statement 13. However, the final FSP should clarify this concept.

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 the 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 up to the point of the recalculation and estimated cash flows thereafter. Further, any interest and penalties assessed or expected to be assessed by a taxing authority related to the leveraged lease transaction are

inextricably linked to the transaction's actual or estimated cash flows, and are most appropriately reflected as part of the recalculation.

However, we suggest a revision of certain wording in the proposed FSP. Paragraph 9 of the proposed FSP states, in part:

The recalculation shall include actual cash flows that occurred up to and including the point of the actual settlement or expected settlement and the estimated cash flows thereafter.

Since a change to the expected timing of income tax cash flows can occur for reasons other than a settlement with a taxing authority or other party, we believe this sentence should be modified as follows:

The recalculation shall include actual cash flows that occurred up to and including the point of the <u>recalculation</u> actual settlement or expected to be assessed settlement and the estimated cash flows thereafter.

Additionally, the final FSP should address the accounting for interest and penalties upon initial adoption in a situation where an entity has reached a settlement with a taxing authority prior to adoption of the final FSP and has accrued interest and penalties in its financial statements related to the settlement. Upon initial adoption (as a cumulative effect of a change in accounting), paragraph 9 of the proposed FSP requires that interest and penalties be included in the recalculation and recognition of any resulting gain or loss on the change in the net investment in the lease. Therefore, the entity would be required to reverse the previously accrued interest and penalties as part of the initial adoption in order to avoid double-counting the interest and penalty amounts. The final FSP should address this scenario specifically, and should indicate whether the reversal should become part of the cumulative effect adjustment in the statement of operations.

We appreciate the opportunity to comment on the proposed FSP. If you have any questions concerning our comments, please contact Bob Uhl at (203) 761-3705.

Yours truly,

Deloitte & Touche LLP