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Ms. Susan M. Cospers
Emerging Issues Task Force Chairman
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Dear Ms. Cospers:

The general recognition approach in ASC Section 740-270-25 causes entities that have a substantive operating parent that ordinarily does not pay income taxes and one or more taxable subsidiaries to record interim income taxes different than the actual amount of income taxes that have been incurred. This occurs because the proportion of operating parent income (for which no income taxes accrue to the consolidated entity) to consolidated ordinary income is frequently different in interim periods than annual periods. Executives supplement financial statements with schedules and verbal explanations in an attempt to provide clarity.

The enclosed paper provides background information and evaluates three alternatives for dealing with the issue. I believe there is an opportunity to help shareholders, analysts and other users better understand the tax situations of these entities and thank you in advance for your consideration of this matter.

I would welcome the chance to discuss the issue and can be reached at (253) 924-5255.

Very truly yours,

Weyerhaeuser Company

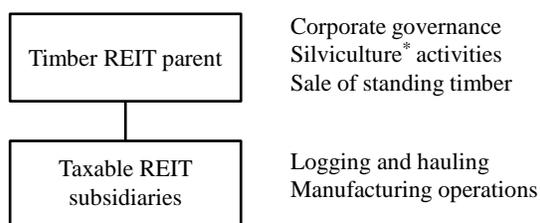
A handwritten signature in blue ink, appearing to read 'Jerald W. Richards', with a long horizontal flourish extending to the right.

Jerald W. Richards
Chief Accounting Officer

Title: Organization Structure Effect on Accounting for Income Taxes in Interim Periods

Background

1. Entities which have an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and include one or more taxable subsidiaries have become more common in practice. For example, changes to the Internal Revenue Code in the late 1990s led to the creation of timber real estate investment trusts (“Timber REITs”). There are also public limited partnerships with substantive non-taxable operations and taxable subsidiaries. These types of structures may not have been contemplated when FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods: an interpretation of APB Opinion No. 28*, was deliberated.
2. Timber REITs serve as the example in the background section of this paper. Other types of entities that have a substantive operating parent, whose income is effectively taxed at the shareholder level, likely face accounting and reporting challenges similar to those described below.
3. A Timber REIT parent is a substantive operating entity that conducts REIT-qualified activities such as owning and managing a timberland portfolio primarily for the production and sale of standing timber. In order to qualify as a REIT under the Internal Revenue Code, at least 75 percent of the Timber REIT parent’s gross income must come from rent and sales of real property, including standing timber on a pay-as-cut basis. In addition, at least 75 percent of the fair market value of a Timber REIT parent’s assets must be qualified assets—primarily timberlands and cash. The fair market value of a Timber REIT parent’s net investment in taxable REIT subsidiaries is limited to 25 percent of the Timber REIT parent’s gross assets. Following is chart that illustrates the typical organization of a Timber REIT:



* Silviculture is the practice of controlling the establishment, growth, composition, health, and quality of forests to meet diverse needs and values.

4. A Timber REIT parent generally distributes its earnings to shareholders without paying corporate level taxes. Timber REIT parents are subject to income taxes on built-in gains on sales of real property, other than standing timber, held by the Timber REIT parents during the first 10 years after a triggering event, such as REIT conversion. Timber REITs seek to minimize sales during the first 10 years and built-in gains taxes actually incurred are generally inconsequential. Timber REITs also include taxable REIT subsidiaries that pay corporate income taxes on their earnings.
5. The relative mix of earnings reported by the Timber REIT parents and taxable REIT subsidiaries fluctuates from quarter to quarter and is frequently different in an interim period than the mix of consolidated earnings expected for the full year. This is due to the difference in the nature of business conducted by Timber REIT parents compared to taxable REIT subsidiaries. The fluctuations in the mix of earnings is significant at times due largely to the fact that demand and prices for individual products fluctuate quickly and significantly and the effect is not directly correlated across entities within a Timber REIT structure. The mix of earnings can also fluctuate significantly depending on the timing and amount of real estate sales and whether the real estate is sold by the Timber REIT parents or taxable REIT subsidiaries.

6. The general recognition approach in ASC Section 740-270-25 requires entities to recognize interim income taxes based on applying a consolidated estimated annual effective tax rate to year-to-date ordinary earnings plus items that are discretely recognized as they occur. Because the proportion of Timber REIT income (for which no income taxes accrue to the consolidated entity) to consolidated ordinary income is different in interim periods than annual periods, the general recognition approach causes Timber REITs to record interim income taxes that are more or less than the actual amount of interim income taxes that have been incurred (based on the operations of the taxable subsidiary through that date).

7. The situation described in paragraphs 5 and 6 results in uninformative information, a lack of clarity, and a lack of transparency regarding Timber REIT interim income tax provisions. Timber REIT executives supplement financial statements with schedules and verbal explanations in an attempt to provide clarity.

8. Currently there is diversity in practice when dealing with this situation. Some entities apply the general recognition approach in ASC Section 740-270-25 in all interim periods. Other entities apply the year-to-date recognition method referred to in ASC paragraph 740-270-30-18 only when the difference between recorded income tax amounts and income tax amounts based on the operations of the taxable subsidiary through the interim date are material, on the basis that the reporting entity is not able to reliably estimate the information needed to determine the annual effective tax rate. Those entities revert to the general recognition approach in all other annual periods. Finally, others apply the year-to-date recognition method in all interim periods and do not ever use the general recognition method, on the basis that the reporting entity is not able to reliably estimate the information needed to determine the annual effective tax rate.

9. The Task Force should address this issue because entities apply different approaches in practice when dealing with the issue described above. The different approaches make it more difficult for shareholders, analysts and other users to understand each entity's tax situation, and to compare performance across entities.

Scope

10. This Issue applies to structures which have an operating entity at the top of the organization structure that ordinarily does not pay corporate income taxes and include one or more taxable subsidiaries. [Alternatively, the staff may wish to describe this as an issue to exclude income that is taxed directly to the shareholders of the operating entity from the estimated effective tax rate.]

Accounting Issue and Alternatives

How an entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries should recognize income taxes in interim periods.

View A: An entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries should recognize interim income taxes in accordance with Subtopic 740-270. Unless some or all of the information needed to determine the annual effective tax rate cannot be reliably estimated, interim income taxes are to be recognized using the general recognition approach in ASC Section 740-270-25.

11. Proponents believe that View A is the method applied by most entities in practice. Proponents believe that an entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries should apply a method consistent with that used by most entities and that providing an additional exception to the general method is not needed.

12. Proponents note that the View B and C methods could result in volatile consolidated effective income tax rates over the course of a year for a reporting entity, even when operations come in as planned over the course of the year. Proponents view this as a process for allocating the results of the year over interim periods in a rational and consistent manner.

13. Opponents believe that View A would cause a reporting entity with an operating entity at the top of its corporate structure that ordinarily does not pay income taxes to recognize interim income taxes in amounts that are higher or lower than the amount of income taxes that the reporting entity has incurred (based on the operations of the taxable subsidiary through that date). While there is some level of difference for all entities, opponents believe that the difference is more significant for an entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries. Opponents look to the definition of a liability under FASB Concepts Statement No. 6, *Elements of Financial Statements*, which states the following in paragraph 36:

A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.

14. Opponents note that the View A approach would also result in the recognition of assets in interim balance sheets that do not meet the definition of an asset under FASB Concepts Statement No. 6, *Elements of Financial Statements*.

View B: An entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries should recognize interim income taxes using the year-to-date recognition method referred to in paragraph 740-270-30-18 plus items that are discretely recognized as they occur for all interim periods.

15. Proponents believe that the amount of income taxes recognized in interim periods under View B would more faithfully represent the amount of income taxes incurred in the interim periods than would be the case under View A. This is because the amount of interim income taxes recognized by an entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries under View B would be based on the actual mix of year-to-date income generated by the operating parent and taxable subsidiaries, not a different mix estimated for the full year. While there is some level of difference for all entities, the difference is more significant for an entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries.

16. Proponents note that the View B approach already exists in Subtopic 740-270.

17. Opponents note that the View B method applies a method that is inconsistent with the method ordinarily required by U.S. GAAP. The View B method serves as an alternative approach under current U.S. GAAP only when a reporting entity is not able to reliably estimate the information needed to determine the annual effective tax rate.

18. Opponents note that in most cases the allocation process in ASC Subtopic 740-270 would not result in a liability or asset consistent with performing calculations on a year-to-date basis for entities with taxable entities at the top of the corporate structure.

View C: Each entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries should recognize interim income taxes separately for the operating parent and its taxable subsidiaries as a group using the general recognition method in paragraph 740-270-25-1. The year-to-date recognition method referred to in ASC paragraph 740-270-30-18 should be applied in periods in which the entity is not able to reliably estimate the information needed to determine the annual effective tax rate for the operating parent or its taxable subsidiaries, as applicable.

19. Proponents believe that the amount of income taxes recognized in interim periods under View C would more faithfully represent the amount of income taxes incurred in the interim periods than would be the case under View A. This is because the amount of income taxes recognized by an entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries under View C would be calculated separately for the operating parent and the taxable subsidiaries as a group, which would effectively eliminate the difference caused when the mix of earnings between the operating parent and taxable subsidiaries is different in an interim period than the mix of earnings estimated for the full year. In addition, the amount of income tax assets and liabilities reported in interim balance sheets would more closely align with the amounts that would be recorded based on the definitions of assets and liabilities under FASB Concepts Statement No. 6, *Elements of Financial Statements*. While there is some level of difference for all entities, proponents believe that the difference is more significant for an entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries.

20. Proponents of this view point to IAS 34, *Interim Financial Reporting*. They note that IFRS provides guidance that addresses this situation, and, therefore, they think IAS 34 may be informative in considering the accounting under U.S. GAAP. Specifically, proponents believe that an entity that has an operating parent at the top of the organization structure that ordinarily does not pay corporate income taxes and that includes one or more taxable subsidiaries should use separate income tax rates to calculate interim income tax provisions for the operating parent and taxable subsidiaries as a group to the extent practicable under IFRS because the effective income tax rates are different (ordinarily zero in the case of the operating parent).

Paragraph 30(c) of IAS 34 states:

Income tax expense is recognised in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year. Amounts accrued for income tax expense in one interim period may have to be adjusted in a subsequent interim period of that financial year if the estimate of the annual income tax rate changes.

Paragraphs B13-14 of IAS 34 state:

This is consistent with the basic concept set out in paragraph 28 that the same accounting recognition and measurement principles shall be applied in an interim financial report as are applied in annual financial statements. Income taxes are assessed on an annual basis. Interim period income tax expense is calculated by applying to an interim period's pre-tax income the tax rate that would be applicable to expected total annual earnings, that is, the estimated average annual effective income tax rate. That estimated average annual rate would reflect a blend of the progressive tax rate structure expected to be applicable to the full year's earnings including enacted or substantively enacted changes in the income tax rates scheduled to take effect later in the financial year. IAS 12 *Income Taxes* provides guidance on substantively enacted changes in tax rates. The estimated average annual income tax rate would be re-estimated on a year-to-date basis, consistent with paragraph 28 of this Standard. Paragraph 16(d) requires disclosure of a significant change in estimate.

To the extent practicable, a separate estimated average annual effective income tax rate is determined for each taxing jurisdiction and applied individually to the interim period pre-tax income of each jurisdiction. ***Similarly, if different income tax rates apply to different categories of income (such as capital gains or***

income earned in particular industries), to the extent practicable a separate rate is applied to each individual category of interim period pre-tax income. While that degree of precision is desirable, it may not be achievable in all cases, and a weighted average of rates across jurisdictions or across categories of income is used if it is a reasonable approximation of the effect of using more specific rates. [emphasis added]

21. Proponents note that the information needed to apply the View C approach should be readily available because reporting entities calculate income taxes by legal entity in order to maintain the integrity of legal entity books for statutory, management reporting and other purposes.

22. Proponents note that the View C method is consistent with the general recognition method ordinarily required by U.S. GAAP. The only difference is that the View C method would be calculated separately for the operating parent and its taxable subsidiaries as a group, as opposed to a consolidated level.

23. Opponents note that in most cases the allocation process in ASC Subtopic 740-270 would not result in a liability or asset consistent with performing calculations on a year-to-date basis for entities with taxable entities at the top of the corporate structure.

24. Opponents of View C note that the question of whether interim income taxes should be computed at a level lower than the consolidated entity was considered and rejected for all but a few instances when FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods: an interpretation of APB Opinion No. 28* was deliberated. Paragraph 83 of FIN 18 states:

Many respondents stated that the intent of Opinion No. 28 was to apply one overall estimated annual effective tax rate to "ordinary" income for the consolidated reporting entity. Several respondents stated that interrelationships between jurisdictions would make the use of separate rates impractical. Paragraph 22 was modified to indicate that one overall estimated annual effective tax rate shall be used with the two exceptions described in that paragraph and discussed further in paragraphs 84 and 85 below.

Recurring Disclosures

25. The following disclosures could be required if View B or View C are adopted:

- a. The components of income (loss) before income tax expense (benefit) should be provided in two separate groups: entities that ordinarily do not pay income taxes and those that do in interim and annual financial statements;
- b. The components of income tax expense (benefit) should be provided in two separate groups: entities that ordinarily do not pay income taxes and those that do in interim and annual financial statements;
- c. The variation in customary income tax relationships required by paragraph 740-270-50-1 should be provided only for the entities that ordinarily pay income taxes as a group in interim financial statements; and
- d. The reconciliation required by paragraph 740-10-50-12 should be provided only for the entities that ordinarily pay income taxes as a group in annual financial statements.

Transition

26. Presented below are two transition alternatives for consideration:

View A: Entities should apply this Issue on a retrospective basis to all comparative interim periods presented. Early adoption is permitted in the first interim period within a fiscal year.

27. Proponents of View A observe that the FASB's conceptual framework describes comparability (including consistency) as one of the qualitative characteristics of accounting information. Those proponents refer to paragraph B7 of the Basis for Conclusions in FASB Statement No. 154, *Accounting Changes and Error Corrections*, which states that:

The Board concluded that retrospective application improves financial reporting because it enhances the consistency of financial information between periods. That improved consistency enhances the usefulness of the financial statements, especially by facilitating analysis and understanding of comparative accounting data.

28. Proponents of View A anticipate that entities should have the information available to retroactively apply the consensus.

View B: Entities should apply this Issue prospectively at the beginning of a fiscal year.

29. Proponents of View B believe that users primarily use interim income taxes to assess current performance and to predict future results. Proponents do not believe that users value interim income taxes for comparative periods, given that interim income taxes include the effect of changes in annual estimates and information for the full prior year is available.

Transition Disclosures

30. The guidance on other presentation matters in Subtopic 250-10, Accounting Changes and Error Corrections—Overall, is applicable for any voluntary change in accounting principle, including a change in the method of applying an accounting principle. The disclosure requirements in ASC paragraphs 250-10-50-1 through 250-10-50-2 (with the exception of 250-10-50-1(b)(3) which is not applicable) could be required for an accounting change required by this Issue.