

EITF ABSTRACTS

Issue No. 86-43

Title: Effect of a Change in Tax Law or Rates on Leveraged Leases

Dates Discussed: December 4, 1986; January 15, 1987

References: FASB Statement No. 13, *Accounting for Leases*
FASB Statement No. 96, *Accounting for Income Taxes*
FASB Statement No. 109, *Accounting for Income Taxes*
FASB Technical Bulletin No. 79-16 (Revised), *Effect of a Change in Income Tax Rate on the Accounting for Leveraged Leases*
Proposed FASB Statement, *Accounting for Income Taxes*, issued September 2, 1986

ISSUE

With the change in corporate tax rates for 1987 and later years in the United States, lessors under leveraged leases will be required to recognize adjustments in their financial statements in the period that the new tax law is enacted because the change in tax rates is a change in an important assumption under paragraph 46 of Statement 13, as interpreted by Technical Bulletin 79-16 (Revised).

The issue is how to calculate and report the adjustments, if any, required by the change in the tax law.

EITF DISCUSSION

The Task Force reached a consensus that Statement 13 and Technical Bulletin 79-16 (Revised) require that all components of a leveraged lease be recalculated from inception of the lease based on the revised after-tax cash flows arising from the change in the tax law, including revised tax rates and repeal of the investment tax credit. The difference between the amounts originally recorded and the recalculated amounts would be included in income of the year in which the tax law is enacted.

The Task Force also observed that the proposed FASB Statement on income taxes would not require an additional adjustment upon adoption of the liability method of accounting for deferred taxes.

The SEC Observer noted that the above accounting may have distortive effects on the ratio of earnings to fixed charges ("the ratio") as calculated. For example, a favorable after-tax effect might consist of an unfavorable adjustment to pretax income that is more than offset by a favorable adjustment to income tax expense. In those circumstances, despite the overall favorable effect, the ratio as calculated pursuant to the applicable instructions to Item 503(d) of Regulation S-K would be affected negatively because the "earnings" component of the ratio is based on pretax income.

The SEC Observer stated that in filings with the Commission the SEC staff will expect the cumulative effect on pretax income and income tax expense, if material, to be reported as separate line items in the income statement.

He stated further that the SEC staff would not object to exclusion of an unfavorable pretax adjustment from the "earnings" component of the ratio, in cases in which the after-tax effect is favorable, provided that (1) such exclusion is adequately identified and explained in connection with all disclosures and discussions relating to the ratio and (2) supplemental disclosure is made of the ratio as calculated in accordance with the applicable instructions.

Several Task Force members asked if the alternative minimum tax (AMT) should be included in the revised calculation. The Task Force Chairman commented that the staff is investigating the effect the AMT would have on leveraged leases, and the issue will be discussed at a later meeting.

STATUS

In December 1987, the FASB issued Statement 96, and in February 1992, the FASB issued Statement 109 which supersedes Statement 96. Neither of these Statements amends the accounting for leveraged leases required by Statement 13.

In Issue No. 87-8, "Tax Reform Act of 1986: Issues Related to the Alternative Minimum Tax," the Task Force reached a consensus that an enterprise should include assumptions regarding the effect of the AMT, considering its consolidated tax position, in leveraged lease computations. Neither Statement 96 nor Statement 109 affects that consensus.

No further EITF discussion is planned.