September 12, 2005

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Subject: Comments Regarding the Exposure Draft of 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

Dear Technical Director:

I am writing on behalf of the Equipment Leasing Association ("ELA") to provide comments to the Financial Accounting Standards Board ("Board") regarding the Exposure Draft ("ED") of 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. We welcome the opportunity to provide both information and commentary in response to the Board's request for comments on the ED.

A central part of the mission of the ELA and its Financial Accounting Committee is to provide educational information to the public as well as standards setters like the Board relative to data and analyses of leasing industry products, practices, and trends. Organized in 1931, the ELA is a non-profit association that represents companies involved in the dynamic equipment leasing and finance industry to the business community, government and media. ELA's diverse membership consists of independent leasing companies, banks, captive financial services corporations, brokers/agents and investment banks, as well as service providers like accountants, consultants, equipment managers, executive recruiters, insurance companies, lawyers, publishers, and software providers. ELA protects the leasing industry as a major source of funds for capital investment in the U.S. and other countries. Headquartered in Arlington, Virginia, ELA is a national organization with 800 member companies and a staff of 26 professionals. In 2004, the equipment leasing and finance business was estimated to be a $220 billion industry.
Summary of Comments

The ELA supports the goal of the proposed FSP to clarify under what circumstances the earnings pattern in a leveraged lease should be recalculated. A summary of our comments follows:

- We agree with the conclusions regarding recalculating the earnings pattern when cash flow assumptions change.
- We do not support the position that a change in anticipated tax benefits in a lease should trigger a possible change in lease classification of a leveraged lease.
- We disagree with the introduction of “probable” concept related to recognition of tax benefits.
- We believe that the FSP should provide more detailed guidance in the practical issues in dealing with the IRS on audit settlements.
- We believe that the timing of this FSP will put an undue burden on preparers to complete the analysis that is required to comply and implement the new rules by year-end 2005.
- We have to object to the process surrounding this issue. It is not a new issue and the FASB staff gave guidance in 1999 when LILOs experienced changes in cash flow assumptions but no change in after tax income. Lessors used this guidance in their decision-making process in considering settlement with the IRS.

Specific Areas of Concern

We have specific concerns about the broader implications of the proposed change in guidance on lease classification and scheduling under the 'probable' concept. We also have concerns about the proposed guidance on interest paid or to be paid (discussed below) as well as the absence of guidance on existing interest accruals and pre-settlement advance payments made to the IRS (discussed under Issue 3).

Lease classification – We feel that FAS 13 is clear in requiring that lease classification is done only at inception or if there is a change in the lease agreement. The FASB bases its conclusion to retest on the basis that the FAS 13 paragraph 7-9 criteria are for leases other than leveraged leases. Paragraph 42 of FAS 13 that deals with classification of leveraged leases does not mention inception but in our opinion it is implied. Paragraph 42a, for example, requires that the lease meet the definition of a direct finance lease. Thus, the classification requirements in paragraph 42 are directly linked to the classification requirements in paragraphs 7-9. We also note that FIN 21, Accounting for
Leases in a Business Combination, explicitly applies to all acquired leases (including leveraged leases) and frames its interpretative guidance based on whether or not the "provisions of the lease are modified in a way that would require the revised agreement to be considered a new agreement under paragraph 9 of FASB Statement No. 13." To assert that the leveraged lease classification must be reassessed, while that reassessment does not "update" the direct finance lease assessment, seems inconsistent and arbitrary.

In addition, the FASB's proposed changes may also alter long-standing practice that leverage added to a direct finance lease after inception precludes leveraged lease classification. That is, if leveraged lease classification is reassessed upon significant changes and leveraged lease classification could be lost subsequent to inception, it would only be consistent that leveraged lease classification could be obtained subsequent to inception as well. This is simply inconsistent with interpretations of Statement 13 by lessors and auditors for years.

We do not believe that a change in estimated residual value should potentially trigger a possible change in the classification of a lease. We note that the guidance in Statement 13 with respect to a reduction in the residual value of a leveraged lease, to include the illustration at Schedule 7, calls for a cumulative catch-up adjustment and does not call lease classification into question. Further, long-standing practice has consistently followed this accounting treatment. We do not understand the logic of requiring lease classification retesting when a reduction in residual value is associated with a leveraged lease but not when it is associated with a non-leveraged lease. More significantly, we believe that, by creating a discrepancy in lease classification retesting relating to a reduction in estimated residual value, this FSP would be significantly broadened beyond its original scope. We recommend that the guidance of this FSP should relate back to its originally defined narrow scope, i.e., changes in income tax cash flows associated with leveraged leases.

If the decision is to include the reclassification language, we suggest changing the wording in the FSP as below. The underscored text should be replaced by the bracketed bold text. This would make it clear that phasing is the issue that would trigger reclassification.

"b. 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 (other than a change in estimated residual value) changes the characteristics of the lease as defined in paragraphs 42b-d. 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] the lessor shall reclassify the leveraged lease as a direct
financing lease on a prospective basis as of the date the change in assumption occurs. The lessee shall report separately on its balance sheet, as if the lease had been classified as a direct financing lease since lease inception. (a) its investment in the direct financing lease, (b) the nonrecourse debt, and (c) the deferred taxes related to the direct financing lease. The difference between those balances and the balance of the net investment in the leveraged lease prior to the recalculation shall be recognized as a gain or loss in the period in which the assumption changes. The gain or loss recognized shall be included in income from continuing operations before income taxes in the income statement of the lessee.”

“Probable” concept - We believe that introducing the “probable” concept with respect to recognition of tax benefits is inappropriate and not within the scope of the FSP. The otherwise narrow issue being addressed in this project has potentially far reaching ramifications. With the inclusion of a new concept in accounting literature -- namely the introduction of a “probable” concept related to recognition of tax benefits. We believe that this concept is appropriately introduced in the proposed Interpretation on Uncertain Tax Positions and that the guidance in the proposed interpretation should be evaluated separately from and independent of this FSP. We also note that the guidance in the Interpretation, in its final form, will apply to the FSP regardless of direct reference in the FSP to the concepts introduced in the Interpretation. We suggest removing any reference in the FSP to the “probable” concept and propose that the current practice of determining tax benefits based on an enterprise’s best estimate of the benefit is both a more conceptually pure and representational faithful concept than the concept presented in the proposed Interpretation.

We also note that the FSP defines a tax opinion as a third party opinion, in footnote 4 of paragraph 9. We believe that tax opinions should not be limited to third party opinions, specifically; lessors should be free to use internal resources that are also qualified to render tax opinions.

Treatment of interest paid to the IRS - We believe that interest paid to be paid on the agreed adjustment should be presumed to be directly related to the lease; however, the FSP should allow the presumption to be rebutted based on an overall review of the facts and circumstances of a settlement involving compromises of multiple transactions. From a practical perspective, the FSP should allow for any reasonable allocation method to be used in determining the amount of interest to be allocated to a leveraged lease that has been settled with the IRS. The actual interest paid to the IRS for a tax year is often related to the net effect of compromises of multiple transactions that are contended by the IRS and the taxpayer, including a settled in merger lease as well as other offsets (e.g., carryforwards, carrybacks, suspended tax credits that become allowable),
Comments on Issues Presented in the Notice for Recipients

**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?

**ELA Comments:** We believe the scope should be limited to leveraged leases and leases that were leveraged leases but where their classification was changed due to a change in assumptions. First, the scope should be limited since the Board said at its meetings they chose an FSP as the means to amend Statement 13 because they thought that the issue was a very narrow one. We believe the scope should be narrow, as to do otherwise should call for a much more extensive deliberation and due process. We do not believe that lessors who do not invest in leveraged leases are fully apprised of, or even aware of, the potential impacts of the guidance provided in this FSP. We do not believe that lease classification for leases other than leveraged lease should be impacted by this FSP. On the other hand it seems to make sense that if one changes the classification of a leveraged lease based on a change in future expected cash flows and the future expected event is different to such an extent that the change in classification was incorrect, a lease that was once classified as a leveraged lease should be within the scope.

**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?

**ELA Comments:** Regarding the change in cash flows being an important assumption that should be accounted for under paragraph 46, we agree. A change in cash flows changes the MISF yield that is used to recognize leveraged lease revenue. Although Statement 13 does not currently permit such a change to be considered, it seems theoretically correct to recalculate the earnings pattern if the changes result in a significant change in the economics of the lease.
Regarding reclassification, our opinion is that reclassification is done once, at lease inception, unless there is a change in the lease agreement. Changes in assumptions are not changes in the lease agreement.

**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?

**F&I Comments:** We agree. We believe that only actual cash flows up to and including an IRS settlement or expected settlement and estimated cash flows thereafter should be used since these amounts most faithfully represent the economics of the lease. The MISP yield calculation is central to leveraged lease accounting and should represent the actual yield on the transaction. To use anything but actual cash flows would create a yield that is not economically representative of the actual yield to date and an earnings pattern that does not cause earnings to be recognized in periods where there is a positive investment that causes the lessor to incur a cost to carry the investment. The intent of the MISP yield amortization is to recognize earnings directly proportional to the incurring of a cost to carry the investment. Since penalties paid to the IRS result in a cash outflow are related to the lease, we would agree to include them in the calculation of leveraged lease earnings. Since interest paid to the IRS is related to the lease and relates to prior periods, we would agree to include it in the calculation of leveraged lease earnings.

In the interest of consistency in transition, we request that the FSP address the treatment of any existing interest accruals at the time of adoption.

We also request that the FSP provide guidance on how to treat an advance payment of tax and interest in computing the Statement 13 cumulative adjustment. An enterprise may make an advance payment as part of its settlement strategy. An advance payment is allowed by statute and will stop the running of any interest, reduce or eliminate exposure to penalties, and allow the enterprise to sue for a refund. It is returnable at the will of the taxpayer with interest. It has no other tax purpose. An advance payment can be made for a particular tax year. Tax procedure does not permit an advance payment for a specific issue.
The ELA thanks the FASB and its staff for the opportunity to be part of the process in developing this FSP. We repeat our commitment to provide you with information and resources so that the rules you develop meet your objectives, are based in fact, and can be effectively implemented by preparers.

Sincerely,

Michael Fleming

Michael Fleming, CAE
President
Equipment Leasing Association