Michael Monahan  
Senior Director, Accounting Policy  

May 29, 2015  

Ms. Susan Cosper, Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  
director@fasb.org  


Dear Ms. Cosper:  

The American Council of Life Insurers (ACLI) appreciates the opportunity to comment on the FASB’s Exposure Draft, Income Taxes (Topic 740): Intra-Entity Asset Transfers (the “Exposure Draft”). The update is part of the FASB’s ongoing simplification initiative launched in June 2014 to reduce cost and complexity of complying with U.S. Generally Accepted Accounting Standards (GAAP) while maintaining or improving the usefulness of information provided to users of financial statements. Reviewing this issue is clearly an important and expected role of the FASB, and we appreciate the FASB’s efforts in this focus on simplification.  

Our view is the proposal to remove the exception for recognition of tax effects on the intra-entity transfer of assets does not meet the criteria of simplification. The proposal, in fact, appears to complicate the analysis of deferred tax items. Therefore, the proposed change is not warranted – considering the potential high cost of implementation and maintenance – as there is no real simplification or improvement in clarity for the reader. Please refer to the attached Appendix, which provides responses to the specific Exposure Draft questions for respondents.  

Sincerely,  

Mike Monahan  
Senior Director, Accounting Policy  

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1 The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with 284 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums. Learn more at www.acli.com.
APPENDIX QUESTIONS FOR RESPONDENTS

Question 1 – Should the current and deferred income tax consequences of an intra-entity asset transfer be recognized when the transfer occurs? If not, why?

ACLI Response:
Pursuant to ASC 810-10-45-1, intercompany balances and transactions are eliminated. Gains or losses on transactions among companies in the group are not included, so that consolidated financial statements represent the financial position and operating results of a single business enterprise. Similarly, under ASC 810-10-45-8, no tax impact should be recognized in earnings from a sale of assets between members of a consolidated group.

This proposal will result in a tax impact from an intercompany transaction that is not reflected in pre-tax earnings, which will likely create confusion to the users of financial statements. The seller of an appreciated asset under the proposal would recognize current tax expense. The buyer would recognize a deferred tax asset based on the excess tax basis over the consolidated book basis.

Recognition of a deferred tax asset when an intra-entity asset transfer occurs could increase the risk of earnings management or manipulation. For instance, if a low tax jurisdiction entity sells appreciated assets to a higher tax jurisdiction entity, the higher tax jurisdiction entity will record a deferred tax asset and offset income tax expense. The pre-tax income will be eliminated, but the recognition of the deferred tax asset will decrease tax expense and reduce the overall effective tax rate. This could result in cross-border transactions done for no other reason than to realize a tax benefit on the financial statements.

The proposal could provide a link between the seller’s cash taxes paid to a taxing authority as stated in the statement of cash flow to income tax expense, as stated in the statement of earnings. The underlying transaction, however, continues to be deferred in consolidation and, as a result, the proposal does not appreciably improve the overall usefulness of information provided to the users of financial statements.

The deferred tax accounting will add considerable complexity from the buyer’s perspective, as the buyer may not be aware of the profit element of the intra-entity transfer. This basis difference will need to be tracked until the underlying asset is ultimately sold outside the group. Additionally, the intra-entity transfer again from the buyer’s perspective does not impact the buyer’s current tax position and, thus, there should be no additional tax accounting until the underlying asset is ultimately sold outside the group. The proposal requires a deferred tax asset to be established, re-measured for changes in the buyer’s tax rate, and factored into the buyer’s valuation allowance analysis. Therefore, the proposal adds complexity to the accounting standard, contrary to the objectives of the FASB’s simplification initiative.

The recognition requirements for intra-entity asset transfers are frequently applied to intercompany sales of inventory, but may also cover intra-group transfers of other assets, such as intellectual property or stock of a subsidiary. These latter transactions often give rise to complexity and potential variations in application of the current guidance. For instance, there appears to be a lack of guidance and divergence in practice with respect to the following areas:

- Whether the transfer of stock of a subsidiary is covered under the scope of ASC 810-10-45-8.
- Whether an arrangement to migrate intellectual property is an intra-entity transfer of an asset as opposed to merely a license to use the asset.
- How to measure the amount of tax paid by the seller on the intercompany profit.
• How to determine the appropriate period for which the deferred tax effects should be recognized in the financial statements.

Given the differences in treatment for these transactions, we believe it would be more helpful to provide additional guidance under the current pronouncement on the scope of qualifying transactions and when the income tax consequences are recognized for these other types of transfers, rather than issuing new guidance not likely to create the convergence in practice desired.

Question 2 – If the income tax consequences should not be recognized when the transfer occurs should the income taxes payable or paid upon transfer be expensed as incurred? If not, how should income taxes payable or paid be recognized?

ACLI Response: Taxing jurisdictions vary widely in their laws related to recognizing intra-entity asset transfers, and the amount of the gain or loss recognized for tax purposes may not be the same as what is recognized for book purposes. However, if both the income component (gain or loss) and the tax component are eliminated there is at least symmetry in the treatment of all aspects of the underlying transaction. Therefore, we suggest the current guidance remain and report the amount of tax actually paid as a prepaid tax asset. The tax effects should be deferred until the underlying asset leaves the consolidated group. This approach to recognizing tax consequences aligns with the guidance on recognition of consolidated pre-tax earnings and therefore, in our opinion, is a preferred approach.

Question 3 – Should the proposed guidance be applied on a modified retrospective basis? Are the transition disclosures appropriate?

ACLI Response: Although we suggest the proposal on intra-entity asset transfers should not be adopted, we do agree any change in guidance ultimately adopted should be applied on a modified retrospective basis as proposed in the exposure draft.

Question 4 – Should the amendments in this proposed Update be effective for:
   a. Public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2016;
   b. All other entities for annual periods beginning after December 15, 2017, and interim periods in annual periods beginning after December 15, 2018, with early adoption permitted, but not before the effective date for public business entities?

ACLI Response: Any changes ultimately adopted should follow the effective dates proposed in the exposure draft.

Question 5 – What would be the expected transition costs of adopting the guidance in the proposed Update? What would be the expected recurring costs of applying the proposed guidance compared with the costs of applying current GAAP?

ACLI Response: The transition costs of adopting the proposed update would be significant and would not yield any appreciable benefit to shareholders, because all prior transactions must be reviewed and adjusted
through retained earnings, even though for book purposes the gain or loss on intercompany sales would continue to be unrecognized.

The cost of applying the proposed update would be at least the same as the cost incurred under current GAAP because tracking of the underlying assets is required in either scenario. We assert the added analysis required to now measure the deferred tax asset on basis differences created by the proposed guidance would actually increase the complexity and cost of operating under the proposed standard. In addition, there will be continued cost in reflecting the impact of tax rate changes on this deferred tax asset.