MINUTES

Financial Accounting Standards Board

To:	FASB Board Members
From:	Request for guidance on Interpretation 48. Van Eperen x229
Subject:	Minutes of the April 15, 2009, Board Meeting
Date:	May 13, 2009
cc:	Leisenring, Bielstein, Golden, Bossio, Lott, Klimek, Chookaszian, Posta, Glotzer, C. Smith, Stoklosa, Proestakes, Sutay, Mechanick, Gabriele, Inzano, Van Eperen, FASB Intranet

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topic:	Analysis of comment letters received on the proposed guidance on Interpretation 48.
Basis for Discussion:	Board Memorandum dated April 15, 2009
Length of Discussion:	9:00–9:55 a.m.
Attendance:	
Board members present:	FASB: Herz, Linsmeier, Seidman, Siegel, and L. Smith
Board members absent:	IASB: Leisenring
Staff in charge of topic:	Glotzer (FASB)
Other staff at Board table:	FASB: Golden, Van Eperen

Administrative Issues:

Before the discussion of guidance on Interpretation 48, Mr. Golden explained that the staff had initially planned to discuss the effective date and transition of Statement 140, and FIN 46(R) on April 15, 2009. However, because Statement 140 and FIN 46(R) were currently distributed for external review, Mr. Golden and the staff felt it was more appropriate to discuss after external review comments were received. Mr. Golden explained that the effective date and transition of Statement 140 and FIN 46(R) would be presented to the Board in May, which should not delay the expected issuance of the guidance.

Summary of Decisions Reached:

The Board discussed issues presented in comment letters related to a decision at the December 17, 2008, meeting to proceed with the guidance phase for FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, for pass-through and tax exempt not-for-profit entities. The Board made the following decisions in response to those comment letters and additional feedback.

1. The Board decided to provide guidance in narrative form with examples as needed to clarify the application of the guidance.

2. The Board decided not to provide guidance related to whether a tax is or is not an income tax.

3. The Board decided that attribution of the income tax to the entity or its owners should be based on the laws and regulations of the taxing authority rather than on who is responsible for payment of the income taxes.

4. The Board decided that the proposed guidance would clarify that an entity's status as a pass-through entity or a tax exempt not-for-profit entity is a tax position.

5. The Board decided to provide guidance that explains that a consolidating entity should include uncertain tax positions recorded by its subsidiaries in its consolidated financial statements, regardless of the tax status of the consolidating parent. Additionally, the Board indicated that when referencing consolidation standards, the proposed guidance should make it clear that it is referencing GAAP consolidation standards, not tax consolidation standards.

6. The Board decided that the proposed guidance would be effective upon issuance for entities that currently apply Interpretation 48, and upon adoption of Interpretation 48 for those entities that have deferred the application of that Interpretation. Certain nonpublic entities may defer the effective date of Interpretation 48 to the annual financial statements for fiscal years beginning after December 15, 2008.

The Board directed the staff to proceed to a draft of a proposed FSP for vote by written ballot, with a 30-day comment period.

Objectives of Meeting:

The objective of the meeting was for the staff to discuss with the Board the comment letters received from constituents about the proposed guidance on the applicability of Interpretation 48 for pass-through entities and tax exempt not-for-profit entities. The staff planned to discuss with the Board whether there were any necessary adjustments to the proposed guidance as a result of the comments received and if the proposed FSP should be issued to the public for comment. The objectives were met.

Matters Discussed and Decisions Reached:

1. The following three topics were discussed: (a) the format for the proposed FSP, (b) the content of the proposed FSP, and (c) the effective date and transition.

Issue 1: The Format for the Proposed FSP

2. Mr. Glotzer began the discussion by explaining that at the December 17, 2008, Board meeting, the Board directed the staff to proceed with the guidance phase for FASB Interpretation No. 48, *Accounting for Uncertainly in Income Taxes.* Mr. Glotzer explained that the staff planned to present issues related to the format, guidance, and effective date of the proposed FSP for pass through and tax exempt entities.

3. Mr. Glotzer explained that in the notice for recipients, respondents were asked to provide specific problems pass-through and not-for-profit entities would have in applying Interpretation 48. The comment letters contained many issues constituents feel need clarification in applying Interpretation 48. In addition, during the research phase of this project, the staff read an article published by the Pennsylvania Society of Certified Public Accountants (PICPA) in the *Pennsylvania CPA Journal.* The article discusses the wide variety of tax laws and regulations of

state and local taxing jurisdictions, illustrating the diversity in tax laws that entities may encounter if they operate in multiple jurisdictions.

4. Mr. Glotzer explained that the staff planned to discuss three topics with the Board, including the format for the proposed FSP, the content of the proposed FSP, and the effective date and transition of the FSP.

5. Mr. Glotzer explained that the comment letters proposed two alternatives to provide guidance to pass-through and tax exempt not-for-profit entities. The first was to provide guidance in a question and answer (Q&A) format addressing the specific issues raised in comment letters and other sources. The second was to provide guidance in narrative form with examples as needed to clarify the application of the guidance.

6. Mr. Glotzer explained that those who support Alternative 1 point out that a Q&A format is well suited to answer many of the specific questions raised by constituents. Furthermore, the FASB has issued EITF Abstracts to answer specific tax questions. Mr. Glotzer explained that those who support Alternative 2 believe that a Q&A format is not a practical solution. Because tax laws and regulations change as jurisdictions look for more ways to raise revenue, the specific scenarios mentioned in the comment letters and the PICPA article may change and new scenarios may be created. This could lead to requests for guidance whenever new circumstances arise.

7. **Staff Recommendation:** The staff recommended alternative 2. The staff believed that alternative 1, a Q&A format, may not answer all of the questions, and it would open the door for future requests for guidance.

8. **Board Vote:** All Board members agreed with the staff's recommendation.

Issue 2: The Content of the Proposed FSP

9. Mr. Glotzer explained that after reviewing the comment letters, the staff believed the comments and questions raised by respondents should be addressed by providing guidance to answer the following four questions: (a) is this tax an income tax, (b) whose tax is it, (c) what is a tax position, and (d) how does Interpretation 48 apply for consolidated/combined financial statements?

Issue 2(a): Is this Tax an Income Tax?

10. **Staff Recommendation:** Mr. Glotzer explained that the staff does not believe that it should answer this question because this issue relates to all entities, not only pass-through and not-for-profit entities.

11. Mr. Herz explained that the Board had previously asked the staff to research if current literature exists to help entities answer this question. Mr. Glotzer expressed that the staff had contacted the four largest public accounting firms, and that there is a lot of guidance in the public company world. Ms. Seidman asked if this information was publicly available. Mr. Glotzer explained that he was not aware of whether the type of information held at large public accounting firms is available for smaller companies. Mr. Smith explained that some smaller accounting firms currently deal with this issue because some have public clients.

12. Mr. Leisenring stated that additional clarity will be expressed in a draft of IAS 12. However, Ms. Seidman mentioned that the additional clarity in that draft is not currently available to constituents.

13. Mr. Golden indicated that each time there was a change in income tax law, the large accounting firms meet and are able to establish practice. However, Mr. Linsmeier and Ms. Seidman expressed concern that this information is not available to small companies. Mr. Smith expressed that he believes small companies also meet and are able to establish practice.

14. Mr. Proestakes explained that the staff plans to include, in the background of the draft, an acknowledgement that questions were raised, and point readers to existing literature to help clarify what is an income tax. Mr. Glotzer explained there is some information in the codification which will help users answer specific income tax questions, for example how to account for built in gains tax.

15. **Board Vote:** All Board members agreed with the staff's recommendation.

Issue 2(b): Whose Tax is it?

16. Mr. Glotzer explained that many respondents mentioned the fact that some jurisdictions do not follow the Federal income tax laws regarding the entity's pass-through status. In some jurisdictions, the Federal pass-through status is disregarded and the entity is subject to income taxes at the state, local, or foreign level. Some jurisdictions require the entity to pay taxes on behalf of the owners. Some jurisdictions only require it for nonresident owners. Some

jurisdictions allow the owners to file returns. Others do not. Several respondents asked where to record the debit when taxes are paid by the entity but are being paid on behalf of the owners.

17. Mr. Glotzer explained that the staff initially considered the concept of ultimate responsibility. However, during the research phase, the staff received a letter from a CPA practitioner stating that ultimate responsibility should not be the criterion. The practitioner expressed concern that the ultimate responsibility for payment might fall on the entity but the laws and regulations might indicate that the payment is made on behalf of the owners. The practitioner suggested the concept of assignment. The practitioner suggested that payments on behalf of the owners which have been assigned to the entity should be charged to distributions. If payments are made that exceed the amount assigned to the owners, that excess should be charged to income taxes.

18. Mr. Glotzer explained that the staff also discussed the concept of ultimate responsibility with representatives from the Big 4. Two representatives raised the issue of joint and several liability for the income tax. They said that when the entity and the owners are jointly and severally liable for the income tax, ultimate responsibility could not be determined. One representative suggested the concept of primary responsibility. He said primary responsibility could be used when the laws and regulations indicate that both the entity and the owners have ultimate responsibility for payment. The primary responsible party would be determined by whom the taxing authority would go to first for payment.

19. Mr. Glotzer explained that the staff believes the concept of primary responsibility could have unintended consequences. First, it acknowledges that there are others who also are responsible for the income taxes, those who are secondarily liable. Who is primary and who is secondarily liable can be different for two jurisdictions with identical laws and regulations. One jurisdiction may go after the entity because it has deeper pockets, while another may go after an owner. The staff does not believe it is appropriate to provide guidance that could result in two entities with identical circumstances recognizing different amounts for the same transaction.

20. Mr. Glotzer explained that if primary responsibility is the criterion, in the situation where the entity pays on behalf of the owners making the entity primarily responsible, the entity would have an income tax expense, which is counterintuitive.

21. **Staff Recommendation:** Based on the comments received, the staff believed that the determination of whose tax it is should be based on attribution of the income tax to the entity or

its owners based on the laws and regulations of the taxing authority, rather than on who has ultimate or primary responsibility for paying the tax.

22. Ms. Seidman asked if articulation of this principle will change current practice. Mr. Glotzer said he believed it would not.

23. Mr. Smith said that the staff recommendation is consistent with the way Statement 109 was written, and that he believed the Board should remain consistent. Mr. Smith expressed disagreement with the examples in the drafted FSP. Mr. Glotzer explained that the examples would change based on how the Board votes. Mr. Linsmeier expressed that he does not think examples are necessary. Mr. Herz, Ms. Seidman, Mr. Smith, and Mr. Siegel explained that only examples which are helpful to the reader should be included.

24. Mr. Leisenring explained a situation in which Company A, a public company, owns 50 percent of a partnership which takes very aggressive tax positions. Mr. Leisenring asked if Company A is exempt from this standard if it simply receives a K-1 from a partnership. Mr. Golden explained that the ownership of the partnership by company A will cause Company A to apply Statement 109 and FIN 48. Ms. Seidman explained that the project does not plan to scope out any entities; the project is only meant to provide guidance.

25. **Board Vote:** All Board members agreed with the staff's recommendation.

Issue 2(c): What is a Tax Position?

26. Mr. Glotzer explained that another common theme among the comments and questions was whether certain situations create uncertain tax positions. The questions were often phrased to ask if specific situations were uncertain tax positions.

27. **Staff Recommendation:** Mr. Glotzer explained that the staff believed that issues relating to tax positions can be resolved by referencing the definition of a tax position in paragraph 4 of Interpretation 48. The staff also believed that the guidance should clarify that all tax positions can be uncertain. In other words, the proposed FSP should not define uncertain tax positions. Rather, it should clarify the concept of a tax position. Management should be using professional judgment when evaluating the level of uncertainty in the tax positions taken based on all the facts and circumstances. If necessary, examples would be provided to illustrate the application of the proposed guidance.

28. Mr. Golden explained that the determination of whether an entity is a pass-through entity is a tax position. Mr. Linsmeier explained that paragraph 4 of FIN 48 provides examples of what tax positions are, including tax status, something he believes sufficiently answers the questions above. Ms. Seidman stated that without more clarification, the examples alone do not sufficiently answer the questions.

29. Mr. Glotzer explained that because of the confusion surrounding whether an entity's determination of tax status is a tax position, the staff should provide clear guidance, so it will not be necessary to reconsider the issue at a later date. Mr. Proestakes stated that repeating concepts, such as restating a portion of paragraph 4 of FIN 48 in the FSP, will be dropped from the codification. Ms. Seidman expressed that she would like the language to be clear and simple to apply. Mr. Linsmeier asked if the FSP should include examples, or if modifications of paragraph 4 should be made. Mr. Herz explained that the staff could amend paragraph 4, and include examples if necessary. Mr. Golden agreed and stated that examples will be considered when drafting the FSP.

30. Mr. Leisenring asked if there would be a difference if Company A invested in a tax-paying entity versus a nontax-paying entity. Mr. Herz explained that the investment in a tax-paying entity may have a deferred tax asset or liability, and that the tax attribute under the tax law is different for the entity than for a partner in a partnership.

Issue 2(d): How Does Interpretation 48 Apply to Consolidated/Combined Financial Statements?

31. Mr. Glotzer explained that another area of concern identified in the comments and questions relates to consolidated or combined financial statements. Respondents asked about situations where a pass-through entity has subsidiaries that are taxable entities. The staff believes that the underlying issue in the comments and questions is whether the parent's status as a taxable, pass-through, or tax exempt not-for-profit entity should govern whether Interpretation 48 is applicable. There seems to be confusion about whether the parent's status would override the tax status of any entities included with the consolidated group. The staff believes this question can be answered by referencing consolidation standards that would require that consolidated financial statements present the results of operations and the financial position of a parent and all its subsidiaries as if the consolidated group were a single economic entity.

32. **Staff Recommendation:** The staff believed that for situations in which the reporting entity has consolidated entities some of which apply Interpretation 48 and some that do not, the guidance should indicate that the consolidated financial statements should include tax positions for each entity within the consolidated group that has applied Interpretation 48 or has taxable income assigned to it from a pass-through subsidiary. The staff suggested that the proposed FSP also state that management should apply consolidating standards to determine what needs to be included in the financial statements.

33. Mr. Linsmeier disagreed with addressing the question because the question appeared to state that FIN 48 does not apply to all entities, which as Mr. Herz and Ms. Seidman agree, is not the case.

34. Mr. Smith would characterize the message differently. Mr. Smith clarified, in agreeing with Mr. Linsmeier, that all entities would apply Interpretation 48, but some entities would not have an uncertain tax position.

35. Ms. Seidman stated that guidance should be provided to clarify that consolidated entities should include uncertain tax positions recorded at the separate entity level in the consolidated financial statements, regardless of the status of the consolidating entity.

36. Mr. Leisenring provided an example in which a partnership takes excessive tax depreciation on an asset, and asked if that is an uncertain tax position. Mr. Herz stated that it was. Mr. Golden provided an example in which a subchapter S entity has operations in Washington and a subsidiary in Alaska. Mr. Golden asked if the subchapter S entity has to apply Statement 109 based on the subsidiary's operations in Alaska. Mr. Golden stated that it did.

37. Mr. Herz again clarified that the tax laws and regulations should be a basis for this decision, much as the staff had already explained. Mr. Linsmeier again expressed that an entity's tax status does not exempt it from applying Interpretation 48.

38. To answer a question from Mr. Leisenring, Mr. Golden stated that an entity which consolidates a subsidiary has to account for the income tax positions of that subsidiary.

39. To clarify a comment by Mr. Leisenring, Mr. Smith noted that if an entity has an equity method investment in a partnership and the partnership states it has significant income, when in fact it has a loss, the entity receiving the K-1 must deal with this uncertainty.

40. Mr. Linsmeier asked if the consolidation questions were addressed in question 2(b). Mr. Golden expressed that issue 2(b) would determine who is legally responsible for the tax, but would not explain how the consolidated entity has to account for the uncertainty related to the tax.

41. Ms. Seidman expressed that if individuals would like guidance, it should be provided.

42. Mr. Herz explained that entities must be very clear that the consolidation guidance in Statement 109 and Interpretation 48 is referencing GAAP consolidation standards, not tax law consolidation standards. Mr. Herz made an analogy to confusion about paragraph 9(a) of Statement 140, regarding legal consolidation rules.

43. Mr. Herz stated that the order in which questions are presented in the proposed FSP should change so that the proposed FSP first addresses if a tax is an income tax, then addresses whose tax it is, and then addresses consolidations. All Board members agreed.

44. **Board Vote:** All Board members agreed with the staff recommendation.

<u>Issue 3: Effective Date and Transition:</u>

45. **Staff Recommendation:** The staff recommended that the proposed FSP be effective upon issuance for entities currently applying Interpretation 48. For entities that have deferred the application of Interpretation 48, the staff recommended that this FSP be applied upon initial adoption of Interpretation 48. Mr. Glotzer also recommended a 30-day comment period.

46. In responding to a question, Mr. Glotzer stated the effective date for the proposed guidance would be for periods ending on or after December 15, 2009.

47. Mr. Herz and Mr. Siegel asked if 30 days was sufficient for a comment period. Mr. Smith expressed that this guidance must be aligned with the education cycle for interested constituents. Mr. Proestakes stated that if the guidance is published in June, it would become part of the CPE educational programs. Mr. Herz explained that the staff should ensure that providers of third party practice aids are aware of and can incorporate the guidance into their CPE programs.

48. **Board Vote:** All Board members agreed with the staff's recommendation.

<u>Follow-up Items:</u>

The staff will begin drafting a proposed FSP for ballot.

General Announcements:

None.