Notice for Recipients of This Proposed FASB Staff Position

This proposed FASB Staff Position (FSP) addresses how a change or projected change in the timing of cash flows relating to income taxes generated by a leveraged lease transaction affects the accounting by a lessor for that lease. The guidance in this proposed FSP would amend FASB Statement No. 13, *Accounting for Leases*, and would apply to all transactions classified as leveraged leases in accordance with Statement 13. Tax positions would be reflected in the lessor's calculation based on the guidance in a proposed FASB Interpretation on accounting for uncertain tax positions.

The timing of the cash flows relating to income taxes generated by a leveraged lease is an important assumption that affects the periodic income recognized by the lessor for that lease. Therefore, a change in the timing of cash flows relating to income taxes generated by a leveraged lease would be accounted for in accordance with the guidance in paragraph 46 of Statement 13. That is, the expected timing of income tax cash flows generated by a leveraged lease transaction would be reviewed annually or more frequently if events or changes in circumstances indicate that a change in timing is probable of occurring. If during the lease term, the expected timing of the income tax cash flows generated by a leveraged lease is revised, the rate of return and the allocation of income to positive investment years would be recalculated from the inception of the lease following the method described in paragraph 44 of Statement 13. The recalculation would include 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, the recalculation would include any interest and penalties assessed or expected to be assessed by the taxing authority.

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, the lessor would reclassify the leveraged lease as a direct financing lease. The lessor would report separately on its balance sheet, as if the lease had been classified as a direct financing lease since lease inception, (1) its investment in the direct financing lease, (2) the nonrecourse debt, and (3) the deferred taxes related to the direct financing lease. The difference between these balances and the balance of the net investment in the leveraged lease prior to the recalculation would be recognized as a gain or loss in the period in which the assumption changes. The gain or loss recognized would be included in income from continuing operations before income taxes in the same line item used when leveraged lease income is recognized.

If revision of an important assumption does not change the lease in a manner that would have resulted in the lease not qualifying as a leveraged lease, the accounts constituting the net investment balance would be adjusted to conform to the recalculated balances, and the change in the net investment would be recognized as a gain or loss in the period in which the assumption is changed. The gain or loss recognized would be included in income from continuing operations before income taxes in the same line item used when leveraged lease income is recognized.

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues or specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

Issues

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?

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?

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?

PROPOSED FASB STAFF POSITION

No. FAS 13-a

Title: Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction

Comment Deadline: September 12, 2005

Introduction

1. The Board directed the FASB staff to issue this FASB Staff Position (FSP) to address how a change or projected change in the timing of cash flows relating to income taxes generated by a leveraged lease transaction affects the accounting by a lessor for that lease. The guidance in this FSP amends FASB Statement No. 13, *Accounting for Leases*. Appendix A of this FSP exhibits the amendments to Statement 13.

Background

2. In a typical leveraged lease transaction, the lessor is the owner of the asset for income tax purposes. Consequently, the lessor is allowed to depreciate the asset for income tax purposes and thereby receives accelerated depreciation deductions. In the early years of the lease, accelerated tax depreciation deductions combined with interest expense deductions on the nonrecourse debt typically exceed the rental income from the lease. The combination of nonrecourse financing and the favorable tax cash flow pattern typically enables the lessor to recover its investment in the early years of the lease and thereafter affords the lessor the temporary use of funds (deferred tax balances) from which additional income can be derived, producing a unique economic effect. However, that is only a timing effect because the lessor is typically required to disburse cash in the later periods as (a) the taxable income from the lease is no longer reduced by accelerated tax depreciation and interest expense deductions and (b) the principal on the nonrecourse debt is repaid. The tax timing element (in effect, a "loan" from the taxing authority) of a typical leveraged lease produces a favorable cash flow pattern and provides a significant portion of the lessor's expected return on the transaction from the earnings generated on that loan. In fact, some leveraged leases would yield uneconomic results without this loan.

3. Paragraph 44 of FASB Statement No. 13, *Accounting for Leases*, requires the lessor in a leveraged lease transaction to recognize lease income at a level rate of return on its net investment[1] in the lease in those periods in which the net investment is a positive amount.[2] Therefore, the timing of income tax cash flows generated by a leveraged lease affects the timing of income recognition from that lease. Because tax benefits in a leveraged lease are often realized in the early periods of the lease, disproportionately more income is typically allocated to those early periods.

4. The Internal Revenue Service (Service) has challenged or may challenge both the amount and the ability to accelerate the timing of tax deductions in certain leveraged lease transactions commonly referred to as Lease In–Lease Out (LILO) and Sale In–Lease Out (SILO) transactions. As a result, some lessors in LILO transactions have settled with, or are in the process of settling with, the Service as an alternative to court action, and some lessors in SILO transactions also may settle if and when challenged by the Service. To date, those settlements have resulted in a significant change in the timing of the realization of tax benefits and an assessment of interest and penalties. This change in the timing of the realization of tax benefits has the effect of changing the timing of the estimated after-tax cash flows from the leveraged lease (and therefore the timing of income recognition from the lease) and reducing the overall expected return. However, the change in timing does not change the estimated total net income from the lease.[3]

5. Paragraph 46 of Statement 13 provides the accounting guidance that applies when a revision of an important assumption changes the estimated total net income from the lease. Specifically, paragraph 46 states:

> Any estimated residual value and all other important assumptions affecting estimated total net income from the lease shall be reviewed at least annually. If during the lease term the estimate of the residual value is

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[1]Paragraph 43 of Statement 13 describes the net investment in a leveraged lease.

[2]The accounting requirements for a leveraged lease transaction are based on the ". . .*investment with separate phases method*" as described in paragraph 109(c) of Statement 13.

[3]Although interest and penalties assessed by the Service change the estimated total net income from the lease, in practice, the Board understands that interest and penalties had been excluded from the recalculation prior to the issuance of this FSP.

> determined to be excessive and the decline in the residual value is judged to be other than temporary or if the revision of another important assumption *changes the estimated total net income from the lease,* the rate of return and the allocation of income to positive investment years shall be recalculated from the inception of the lease following the method described in paragraph 44 and using the revised assumption. The accounts constituting the net investment balance shall be adjusted to conform to the recalculated balances, and the change in the net investment shall be recognized as a gain or loss in the year in which the assumption is changed. [Emphasis added.]

6. Although paragraph 46 requires a recalculation of a leveraged lease when a revision of an important assumption changes the estimated total net income from the lease, it does not require a recalculation of a leveraged lease when a revision of an important assumption changes only the timing of the estimated cash flows relating to income taxes generated by that lease.

7. Questions have arisen as to whether a lessor in a leveraged lease transaction should recognize the effects of a change or projected change in the timing of the cash flows relating to income taxes generated by that lease and, if so, how to account for those effects.

FASB Staff Position

8. The guidance in this FSP applies to all transactions classified as leveraged leases in accordance with Statement 13.

9. The timing of the cash flows relating to income taxes generated by a leveraged lease is an important assumption that affects the periodic income recognized by the lessor for that lease. Therefore, a change in the timing of cash flows relating to income taxes generated by a leveraged lease shall be accounted for in accordance with the guidance in paragraph 46 of Statement 13. That is, the expected timing of income tax cash flows generated by a leveraged lease transaction shall be reviewed annually or more frequently if events or

changes in circumstances indicate that a change in timing is probable of occurring.[4] If, during the lease term, the expected timing of the income tax cash flows generated by a leveraged lease is revised, the rate of return and the allocation of income to positive investment years shall be recalculated from the inception of the lease following the method described in paragraph 44 of Statement 13. The recalculation shall include 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, the recalculation shall include any interest and penalties assessed or expected to be assessed by the taxing authority.[5] The accounts constituting the net investment balance shall be adjusted to conform to the recalculated balances, and the change in the net investment shall be recognized as a gain or loss in the period in which the assumption is changed. The gain or loss recognized shall be included in income from continuing operations before income taxes in the same line item used when leveraged lease income is recognized. The guidance in paragraph 11 of this FSP shall be applied when the lease no longer meets the criteria to be classified as a leveraged lease.

10. The guidance in this FSP applies only to changes or projected changes in timing that are directly related to the leveraged lease transaction. For example, a change in timing as a result of (a) an interpretation of the tax law, (b) a change in the lessor's assessment of the likelihood of prevailing a challenge by the taxing authority, or (c) a change in the lessor's intent to settle with the taxing authority that will change the timing or expected timing of the tax benefits generated by a leveraged lease would require a recalculation, since that change in timing is directly related to that lease. However, a change in timing as a result of an alternative minimum tax (AMT) credit or insufficient taxable income of the lessor would not require a recalculation of a leveraged lease because that change is not directly related to that lease (unless there was an indication that the original

[4]A tax opinion is external evidence supporting a management assertion, and the decision to obtain a tax opinion is a matter of judgment to be exercised by management in evaluating the weight of all available evidence and the uncertainties of the applicability of the relevant statutory or case law or of the Service's assertions.

[5]The recalculation should be based on the settlement amount or expected settlement amount designated by the Service as attributable to the leveraged lease transaction.

assumptions regarding total after-tax net income from the lease were no longer valid). This is consistent with Issue 10 of EITF Issue No. 87-8, "Tax Reform Act of 1986: Issues Related to the Alternative Minimum Tax."

11. 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, 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 lessor 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 shall be included in income from continuing operations before income taxes in the same line item used when leveraged lease income is recognized.

12. Tax positions shall be reflected in the lessor's calculation based on the guidance in a proposed FASB Interpretation on accounting for uncertain tax positions.[6] That is, initial probable[7] tax positions shall be reflected in the lessor's calculation at the lessor's best estimate of the amount that ultimately will be sustained upon examination by taxing authorities. A previously recognized tax position that no longer meets the probable criterion should be derecognized in the financial statements in the period in which the enterprise concludes that it is more likely than not that the position will not be sustained. The lessor shall reflect the change of assumption in the period in which there is a change in the lessor's best estimate of the amount that ultimately will be sustained upon examination by taxing authorities. The determination of when a tax position no longer

[6] The proposed FASB Interpretation is expected to be issued in 2005 with the same effective date as this FSP. The guidance in this FSP is subject to change based on changes in the proposed FASB Interpretation.

[7] The term *probable* is used in the proposed FASB Interpretation consistent with its use in FASB Statement No. 5, *Accounting for Contingencies*, to mean: "The future event or events are likely to occur."

meets the recognition criteria is a matter of individual facts and circumstances evaluated in light of all available evidence.

Effective Date and Transition

13. The guidance in this FSP shall be effective as of the end of the first fiscal year ending after December 15, 2005 (December 31, 2005, for calendar-year end enterprises). Earlier application of this guidance is encouraged.

14. All tax position assumptions must meet the probable threshold at the date of adoption of this FSP in order for the benefits of the tax position assumptions to be reflected in the financial statements. If, at the date of adoption, the tax position does not meet the probable threshold, it shall be considered a change of important assumption as of the date of adoption.

15. An entity shall recognize the cumulative effect of initially applying this guidance as a change in accounting principle as described in paragraph 20 of APB Opinion No. 20, *Accounting Changes*.[8] Pro-forma disclosures required by paragraph 21 of Opinion 20 and retrospective restatement of prior interim or annual periods are not permitted. The amount to be reported as a cumulative-effect adjustment in the statement of operations shall be the gain or loss recognized pursuant to the provisions of paragraphs 9 and 11 of this FSP. Leveraged leases shall be reclassified pursuant to paragraph 11 as of the effective date of this FSP.

[8]FASB Statement No. 154, *Accounting Changes and Error Corrections*, shall be effective for fiscal years beginning after December 15, 2005, and does not change the transition provisions of any existing accounting pronouncements. Therefore, that statement is not expected to affect the transition requirements of this FSP.

Appendix A

PROPOSED AMENDMENT TO STATEMENT 13

A1. FASB Statement No. 13, *Accounting for Leases*, is amended as follows: [Added text is underscored and deleted text is ~~struck out~~.]

a. Paragraph 46:

Any estimated residual value and all other important assumptions affecting estimated total net income from the lease shall be reviewed at least annually. Additionally, the expected timing of income tax cash flows generated by the lease is an important assumption and shall be reviewed annually, or more frequently, if events or changes in circumstances indicate that a change in timing is probable of occurring.[26a] If during the lease term the (a) estimate of the residual value is determined to be excessive and the decline in the residual value is judged to be other than temporary, ~~or~~(b) ~~if the~~ revision of another important assumption changes the estimated total net income from the lease, or (c) expected timing of the income tax cash flows is revised, the rate of return and the allocation of income to positive investment years shall be recalculated from the inception of the lease following the method described in paragraph 44 and using the revised assumption. The recalculation shall include 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, the recalculation shall include any interest and penalties assessed or expected to be assessed by the taxing authority. The accounts constituting the net investment balance shall be adjusted to conform to the recalculated balances, and the change in the net investment shall be recognized as a gain or loss in the year in which the assumption is changed. The gain or loss recognized shall be included in income from continuing operations before income taxes in the same line item used when leveraged lease income is recognized. An upward adjustment of the estimated residual value

[26a] A tax opinion is external evidence supporting a management assertion, and the decision to obtain a tax opinion is a matter of judgment to be exercised by management in evaluating the weight of all available evidence and the uncertainties of the applicability of the relevant statutory or case law or of the Service's assertions.

shall not be made. The accounting prescribed in this paragraph is illustrated in Appendix E.

a. A revision of the expected timing of the income tax cash flows applies only to changes or projected changes in timing that are directly related to the leveraged lease transaction. For example, a change in timing as a result of (a) an interpretation of the tax law, (b) a change in the lessor's assessment of the likelihood of prevailing a challenge by the taxing authority, or (c) a change in the lessor's intent to settle with the taxing authority that will change the timing or expected timing of the tax benefits generated by a leveraged lease would require a recalculation, since that change in timing is directly related to that lease. However, a change in the timing as a result of an alternative minimum tax credit or insufficient taxable income by the lessor would not require a recalculation of a leveraged lease, since that change is not directly related to that lease (unless there was an indication that the original assumptions regarding total after-tax net income from the lease were no longer valid).

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, 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 lessor 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 lessor.

c. Tax positions shall be reflected in the lessor's calculation based on the guidance in the proposed FASB Interpretation on accounting for uncertain tax positions.[26b] That is, initial probable[26c] tax positions shall be reflected in the lessor's calculation at the lessor's best estimate of the amount that will ultimately be sustained upon examination by taxing authorities. A previously recognized tax position that no longer meets the probable criterion should be derecognized in the financial statements in the period in which the enterprise concludes that it is more likely than not that the position will not be sustained. The lessor shall reflect the change of assumption in the period in which there is a change in the lessor's best estimate of the amount that ultimately will be sustained upon examination by taxing authorities. The determination of when a tax position no longer meets the recognition criteria is a matter of individual facts and circumstances evaluated in light of all available evidence.

[26b]The proposed FASB Interpretation is expected to be issued in 2005 with the same effective date as this FSP. The guidance in this FSP is subject to change based on changes in the proposed FASB Interpretation.

[26c]The term *probable* is used in the proposed Interpretation consistent with its use in FASB Statement No. 5, *Accounting for Contingencies*, to mean: "The future event or events are likely to occur."

Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

B1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this FSP. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background

B2. The Board became aware of settlements or potential settlements between the Service and lessors for certain types of leveraged lease transactions commonly referred to as LILO and SILO transactions. In those settlements, the Service may disallow the original timing of the tax deductions generated by the lease, thereby changing the estimated timing of cash flows generated by that lease and, therefore, the estimated timing of periodic net income on that lease.

B3. Paragraph 46 of Statement 13 requires a recalculation of a leveraged lease when a revision of an important assumption changes the estimated total net income from the lease but does not specify whether a recalculation is required when a revision of an important assumption changes only the timing of the estimated cash flows from the lease. Therefore, under Statement 13, a lessor would not be required to perform a recalculation upon a change in only the timing of cash flows generated by a leveraged lease.

B4. The Board observed that Statement 13 allowed entities to continue to recognize net income from a leveraged lease on an accelerated basis, even though the timing of income recognition would have been significantly different had the revised timing of cash flows been used to initially record the leasing transaction. Therefore, the Board added a project to its agenda to address the accounting by a lessor when a change in the timing of the realization of tax benefits generated by a leveraged lease occurs.

Objective of This FSP

B5. The objective of this FSP is to amend Statement 13 to require a lessor to perform a recalculation of a leveraged lease when there is a change in the timing of the realization of tax benefits generated by that lease. This FSP also amends Statement 13 to require a lessor to reevaluate lease classification when a recalculation of a leveraged lease is performed.

Scope

B6. The guidance in this FSP applies to all transactions classified as leveraged leases in accordance with Statement 13. When this FSP was deliberated by the Board, LILO and SILO transactions were the transactions expected to be most affected by the guidance in this FSP. However, the Board concluded that the scope should include all leveraged leases, since changes or potential changes in the timing of the realization of tax benefits are not unique to LILO and SILO transactions.

Recalculation of a Leveraged Lease Transaction

B7. Although paragraph 46 of Statement 13 requires a recalculation of a leveraged lease when a revision of an important assumption changes the estimated total net income from the lease, it does not specify whether a recalculation is required when a revision of an important assumption changes the timing of the estimated cash flows but not the estimated total net income from that lease.

B8. Many leveraged leases provide significant tax benefits to the lessor, and leveraged lease accounting is significantly influenced by the cash flows between the lessor and the taxing authority. A change in the timing and (or) amount of those cash flows could change the underlying economics of the transaction. The Board believes that the accounting should coincide with the economics of the transaction and, therefore, such a change should be reflected in the financial statements of the lessor.

B9. This FSP requires that the recalculation of the leveraged lease include any interest and penalties assessed or expected to be assessed by the taxing authority. The Board believes that the recalculation should include cash flows from interest and penalties because those cash flows are directly associated with the leveraged lease and result in a change in the estimated total net income from that lease. The Board believes that including those cash flows that change the estimated total net income from the lease is consistent with the requirements of paragraph 46 of Statement 13.

B10. The Board discussed whether a recalculation of a leveraged lease should be performed in all cases in which there has been a change in the estimated timing of the realization of tax benefits generated by that lease. Some Board members suggested incorporating a threshold into the guidance such that only a change in timing that exceeds an established threshold would require a recalculation. The Board discussed some possible thresholds but decided not to incorporate a threshold in the guidance. Some Board members believe that establishing a threshold would likely not relieve a lessor from the burden of performing a recalculation because a recalculation would likely need to be performed to determine whether the effect from the change in timing exceeded the threshold. These Board members considered the incremental cost of reflecting the results of the recalculation in the financial statements and concluded that the benefit to investors and creditors outweighs that cost. Other Board members believe that establishing a precise threshold is not practicable because determining what will be material to a set of financial statements depends on individual facts and circumstances, including qualitative factors.

B11. The Board discussed circumstances that change the estimated timing of the realization of tax benefits. The Board decided that only changes in timing that are directly related to the leveraged lease transaction should result in a recalculation. For example, a change in timing as a result of AMT status or insufficient taxable income available to the lessor would not result in a recalculation. The Board believes that it would be very difficult to determine what aspects of a lessor’s taxable income (or loss) give rise to the change in timing in those situations. The Board decided that the guidance should be consistent with Issue 10 of Issue 87-8, which states that: “[a]n enterprise whose tax position frequently varies between AMT and regular tax would not be required to recompute each year unless there was an indication that the original assumptions regarding total after-tax net income from the lease were no longer valid.”

Reevaluation of Lease Classification

B12. This FSP requires a lessor to reevaluate the classification of a leveraged lease when a revision of an important assumption requires a recalculation of a leveraged lease. Paragraphs 7–9 of Statement 13 provide criteria for classifying leases and for reevaluating lease classification. However, these paragraphs are applicable to leases "other than leveraged leases." Paragraph 42 of Statement 13 provides criteria for classifying leveraged leases.

B13. The combination of nonrecourse financing and a cash flow pattern that typically enables the lessor to recover its investment in the early years of the lease affords the lessor the temporary use of funds from which additional income can be derived. Statement 13 provides special accounting associated with this unique economic effect of leveraged leases, including (a) the ability of the lessor to offset the nonrecourse debt against the lease receivable and (b) the requirement to recognize income over periods in which the investment in the lease exceeds the related tax benefits, which results in the recognition of most of the net income of a lease during the early years of the lease. The Board believes that because leveraged leases receive this special accounting treatment, a lessor should be required to reevaluate the classification of a leveraged lease when a recalculation of that lease is required to be performed. The requirement to reevaluate lease classification for a leveraged lease is applicable to situations in which a lessor is required to perform a recalculation in accordance with the provisions of Statement 13 or the provisions of this FSP.

Timing of the Recalculation

B14. The Board has added a project to its agenda to clarify the minimum probability threshold that a tax position taken in a tax return must meet for the related tax benefit to be recognized in an entity's financial statements. Under the proposed FASB Interpretation on accounting for uncertain tax positions, initial probable tax positions would be reflected in the lessor's calculation at the lessor's best estimate of the amount that ultimately will be sustained upon examination by taxing authorities. A previously recognized tax position that no longer meets the probable criterion would be derecognized in the financial statements in the period in which the enterprise concludes that it is more likely than not that the position will not be sustained. The lessor shall reflect the change of assumption in the period in which there is a change in the lessor's best estimate of the amount that ultimately will be sustained upon examination by taxing authorities.

B15. The Board believes that the guidance in this FSP should be consistent with the guidance in the proposed FASB Interpretation, which is expected to be issued in 2005 with the same effective date as this FSP. The guidance in this FSP is subject to change based on changes in the proposed Interpretation.

Effective Date and Transition

B16. The Board decided that this FSP should be effective as of the end of the first fiscal year ending after December 15, 2005. The Board considered three alternatives for the effective date of this FSP. The two other alternatives were for (a) the first reporting period beginning after the date the FSP is finalized and (b) fiscal years beginning after December 15, 2005. During its deliberations of the effective date, the Board weighed the need to provide entities with sufficient time to make the necessary calculations with the need to provide investors, creditors, and others with information that is relevant to the assessment of the effects of the calculations. The Board believes that entities will have sufficient time to make the necessary calculations based on the expected completion date of this FSP. However, the effective date of this FSP is subject to change based on its actual issuance date.

B17. The Board decided that an entity should recognize the cumulative effect of initially applying this guidance as a change in accounting principle. The Board considered three alternatives for the transition requirements of this FSP. The two other alternatives were (a) prospective application and (b) retrospective application. The Board believes that prospective application would result in inconsistent treatment for lessors in LILO and SILO transactions because some lessors have negotiated and settled with the Service while others have not. The Board believes that retrospective application would be problematic because a lessor would be required to use hindsight to determine when the change in timing actually occurred.