PNC

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Mr. Lawrence Smith
Director, Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

VIA EMAIL (director@fasb.org)

Re: Proposed FASB Staff Position 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 Mr. Smith,

The PNC Financial Services Group, Inc. (PNC) is one of the nation's largest financial services companies with over $90 billion in assets as of June 30, 2005. PNC has a diversified business mix, including consumer banking, institutional banking, asset management and global fund processing services. The company's stock is traded on the New York Stock Exchange.

We appreciate the opportunity to comment on the proposed FASB Staff Position FAS 13-a (the "proposed FSP"). We agree with the concept that recalculation of the rate of return and allocation of income to positive investment years should be required as a result of a change in the actual or expected timing of income tax payments. However, we believe there are implementation alternatives which may simplify the accounting and promote more financial reporting consistency. As such, we offer the following comments for consideration:

<u>Summary</u>

- We agree that changes in the timing of tax payments change the underlying economics of these leases and therefore represent a change in a significant assumption that should be reflected in the allocation of income over the leverage lease term in accordance with Statement of Financial Accounting Standards (SFAS) No. 13, "*Accounting for Leases.*"

- We disagree that any resulting interest payments or penalties should be included in the recalculation and subsequent reallocation of income over the lease term. We believe these payments should be treated the same as all other such payments resulting from settlements with the IRS -- they should be included in current income and not part of the cumulative effect adjustment.

- Since few companies have actually settled with the IRS on leveraged lease issues, we believe the implementation guidance requiring the use of estimates to determine the cumulative effect of the change will result in a lack of consistency and comparability in the financial statements of the affected companies. This approach will also create future earnings volatility as estimates are trued up prior to and at the time of settlement. Only those few companies who have actually settled will report the true cumulative effect of the change when the FSP is implemented. An alternative approach we offer for consideration would be to record the estimated change to accumulated other comprehensive income (AOCI) if the issue is not yet settled. Once settlement is achieved, the AOCI balance would be transferred and reflected in net income in that period as a cumulative effect of a change in accounting principle in accordance with the FSP. This approach would ensure consistent application of the guidance among companies while reducing potential earnings volatility in future periods.

- We believe the guidance in the FSP should not be aligned with the proposed interpretation of SFAS No. 109, *"Accounting for Income Taxes."* Based on the settlement history of the leverage lease tax deductions with the IRS, the issue focuses on the timing of the deductions rather than whether the deductions will be allowed. We believe the alignment of the FSP with the SFAS No. 109 proposed interpretation on uncertain tax positions will result in confusion and inconsistency especially regarding evaluating whether the new "probable threshold" has been met.

- We also request clarification in the final FSP as to the treatment of voluntary tax deposit payments made to the IRS prior to settlement of the leverage lease issues. We do not believe these deposits, which are returnable on demand, should be treated as changes in the timing of tax payments requiring recalculation of the leveraged lease cash flows.

- Finally, due to the complexity of the issues included in the FSP, we believe the proposed effective date is very aggressive and may not allow sufficient time for effective implementation of the guidance. Adoption of our AOCI proposal would lessen this concern.

These specific topics are discussed in more detail below.

Interest Payments and Penalties

We believe that interest payments and penalties should not be included in the recalculation of the leveraged lease cash flows and subsequent reallocation of income over the lease term. Interest payments and penalties are not changes to the initial leverage lease assumptions and should be reflected in current earnings the same way such payments are accounted for when settling any other tax issue. These are normal economic transactions with the IRS that are separate and apart from the leveraged lease calculations. To afford cumulative effect treatment to these payments is inconsistent with the treatment of such payments under existing GAAP. In addition, the inclusion in the cash flow analysis of interest paid to the IRS as part of a settlement is inconsistent with the treatment of interest benefits inherent in the initial leveraged lease calculation. Incremental interest income from the positive cash flows in the early years of the lease due to the deferral of tax payments is not included in the initial income allocations. From this perspective, we believe the exclusion of interest on both sides of the analysis provides a

balanced and representationally faithful result. Lastly, the exclusion would also provide more consistency among companies since settlement dates and any related interest payments could differ significantly due to factors including the company's audit cycle, issues to be resolved, and the overall settlement/litigation strategy.

We also suggest reconsideration of the inclusion of actual or estimated penalties in the revised cash flow calculations. In addition to the inconsistency with existing GAAP, penalties are generally assessed when a specified confidence level is not met or a position taken by the company was incorrect. However, penalties are also often negotiated or in some cases waived by the IRS. Penalties also may be assessed for a group of transactions or issues as opposed to a specific transaction when settling an open tax year. The fact a penalty is assessed and agreed to by the company results from an interpretation of tax law and the company's particular facts and circumstances. One company may settle and accept a penalty assessment while another may pursue litigation. These appear to be economic decisions outside the purview of the transaction. In addition, a particular taxpayer may be exempt from the assessment of any penalties if it has an NOL carryforward that can be utilized. The inclusion of penalties by some taxpayers and exclusion by others would impact the comparability of the financial statements among the companies applying the guidance.

IRS Settlements

The recalculation requires the use of actual cash flows through the settlement date and estimated cash flows thereafter. Where no settlement has yet occurred, a company is essentially required to estimate the timing and amount of the settlement. This approach will result in inconsistency in reporting among companies since most companies have not settled with the IRS on the timing of tax deductions for LILO and SILO transactions. Further, the fact that some companies are currently litigating the tax consequences of these types of transactions, further reduces consistency in reporting. It is presumed that these companies will estimate that 100% of the tax benefits will be received based on the filed returns, while those who do not choose to litigate and intend to settle may assume a significant concession as to the timing of deductions.

We believe that the fact a different result will be reported based on whether or not settlement has occurred or the company has opted to litigate provides for a broad area for noncomparability among companies that could result in significant differences in what would be reported in the cumulative effect of the change in accounting principle versus future operating earnings. The recalculation method should be the same for all companies, regardless of the status of settlement or litigation. It would appear that those who have settled the issue would benefit from application of the cumulative effect provision of the proposal. Conversely, for companies who have not yet settled or are litigating the timing issue, any changes from their estimated settlement (i.e., their cumulative effect amount) would be reflected in operating earnings subsequent to adoption of the FSP.

An alternative to reduce the noncomparability among companies applying the FSP would be to record a charge to accumulated other comprehensive income (AOCI) if the issue is not yet settled with the IRS. The charge would be based on the company's recalculation of the leverage

lease income allocation based on its best estimate of cash flows including any tax payments. Any changes to the estimate prior to final settlement would be recognized as adjustments to AOCI. Once settlement is achieved, the AOCI balance would be transferred and reflected in net income in that period as a cumulative effect of an accounting principle in accordance with the FSP. This approach would ensure consistent application of the guidance among companies based on their specific situation while reducing potential volatility in future operating earnings.

Alignment with Proposed Interpretation of SFAS No. 109

In estimating the cash flows from the leveraged lease, the FSP aligns with the exposure draft concerning uncertain tax positions. We believe the linking of the FSP guidance regarding the inclusion of tax benefits in the recalculation and the SFAS 109 proposed threshold is inappropriate. The ED requires that it be probable a position will be sustained by taxing authorities upon audit based on its technical merits. One definition of probable is an unqualified should level of opinion which is generally viewed professionally as a 70-75% probability of prevailing. In the case of LILOs and SILOs, the transaction that precipitated the FSP, many companies have should or even higher level will opinions. However, the IRS has viewed these transactions as abusive tax shelters, and, consequently, we believe there is likely disagreement among accounting firms as to whether the probable threshold has been met. Therefore, we believe there is an inherent issue upon adoption of the guidance included in the FSP as to whether any tax benefit can be anticipated in a cash flow projection. Not recognizing any tax benefit would seem to be an irrational result when it is common knowledge that the IRS will settle LILOs providing a significant deduction for the taxpayer, and it is anticipated settlements related to SILOs would be consistent. Also, it should be added that these settlements represent a change in timing of deductions over the life of the contract and not a disallowance of deductions. However, using a projected settlement that is significant, but less than 70% is likely to constitute contrary evidence for meeting the probable threshold as defined in the ED. Accordingly, we believe the FSP should be de-coupled from the ED and if estimated cash flows are to be used prior to entering into settlements with the IRS, the estimate should be a simple best estimate of what the cash flow from the tax benefit will be.

Potential Clarification

If the final FSP requires recalculation prior to actual settlement or resolution of the controversy, we believe clarification or amplification is required in instances when cash payments are made to the IRS prior to final resolution.

There are at least two situations where a company may make a payment to the taxing authorities outside final resolution of the dispute:

1. A deposit in the amount of tax to stop the accrual of interest on any potential underpayment of tax.
2. A payment of the tax followed by filing a refund claim. This procedure would be elected if the company desired the venue for resolution to be for example in U.S. District Court or Claims Court as opposed to Tax Court.

We do not believe such payments should be treated as changes in timing. A deposit that has been made to stop the accrual of interest is returnable on demand and is not treated as a tax payment under tax law. Accordingly, we believe that a deposit is appropriately not treated as a reduction in the deferred tax liability. Since the deposit does not change deferred tax, the net investment in the lease remains unchanged and therefore no recalculation is required.

A tax payment that is made merely to preserve a company's right to determine the forum in which its dispute with a taxing authority will be adjudicated, we do not believe should require a recalculation.

We believe that the FSP should explicitly address whether payments in these situations are treated as changes in timing within the meaning of paragraphs 9 or 10.

Effective Date

Given the nature and complexity of the issues addressed by the Proposed FSP, we believe the effective date of December 31, 2005 is very aggressive and may not allow sufficient time to evaluate, plan and implement the requirements of the proposal.

PNC appreciates your consideration of our views on this matter. If you have any questions or would like to discuss any points in this letter in more detail, please contact me at 412-762-3900

Sincerely,

Samuel R. Patterson
Controller
The PNC Financial Services Group

Thomas F. Garbe
Assistant Controller and
Director of Accounting Policy
The PNC Financial Services Group