Managed Funds Association
The Voice of the Global Alternative Investment Industry
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May 30, 2023

Via Electronic Mail: director@fasb.org

Hillary H. Salo
Technical Director
Financial Accounting Standards Board
801 Main Avenue
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures*; File Reference No. 2023-ED100

Dear Ms. Salo,

Managed Funds Association[1] ("**MFA**") welcomes the opportunity to comment on the Exposure Draft of the proposed Accounting Standards Update (the "**Update**") from the Financial Accounting Standards Board (the "**Board**"), "Income Taxes (Topic 740): Improvements to Income Tax Disclosures." MFA members, including traditional hedge funds, credit funds, and crossover funds, help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns over time. MFA members are investors, lenders, creditors, and other allocators of capital (collectively, "**financial statement users**" or "**investors**") for which providing information that is useful in making rational investment, credit, and similar resource allocation decisions is critical with respect to financial reporting.

We are concerned that the proposed Update neither improves the decision usefulness of income tax information for financial statement users nor meaningfully addresses investors' need for greater transparency in disclosures related to the rate reconciliation. Rather, we believe that the substantial granularity required by the proposed amendments is likely to be misleading and result in significant diversity in practice. Accordingly, we urge the Board to further consider whether the proposed Update is necessary or appropriate in the public interest, particularly in context of the several projects that the Board has undertaken in recent history related to reducing some of the complexity associated with the accounting for income taxes under ASC 740 (*i.e.*, the Simplification Initiative).[2] In doing so, we strongly recommend that the Board withdraw the proposed Update and continue its outreach to stakeholders.

With respect to the proposed amendments to the ***rate reconciliation*** disclosure, we believe that disclosure of certain specific categories of income tax effects is uninformative and dilutive of the value of disclosures that do in fact meaningfully enhance the transparency, comparability, and consistency of

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[1] Managed Funds Association ("**MFA**"), based in Washington, D.C., New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 170 member firms, including traditional hedge funds, credit funds, and crossover funds, that collectively manage nearly $2.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

[2] *See*, *e.g.*, Accounting Standards Update No. 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes* (Dec. 2019).

disclosed information. We urge the Board to reconsider the disclosure of the following specific categories (and other proposed amendments) as they would not provide investors with decision-useful information. Accordingly, we strongly recommend that the Board withdraw the proposed Update.

State and local income tax, net of federal (national) income tax effect. The proposed amendments require that public business entities provide a qualitative description of the state and local jurisdictions that contribute to the *majority of the effect* of the state and local income tax category. The term *majority of the effect* is not defined in the proposed Update nor in other GAAP. The lack of specific guidance could result in significant diversity in practice. If the Board determines to move forward, we encourage it, at a minimum, to provide a clarification of what shall constitute a *majority of the effect* (for example, "greater than 50%" or "simple majority," terms which are generally used in other GAAP). This clarification would allow issuers to consistently apply the standard and result in more comparable financials.

Valuation allowances. The proposed amendments require that public business entities disclose the income tax effect of changes in valuation allowances. Although valuation allowances impact an entity's annual effective tax rate ("**AETR**"), such changes generally have no, or no material, bearing on its cash-tax exposure, cash flows, or capital allocation. As discussed more fully below, if an entity is required to reassess its valuation allowances on existing tax attributes, existing disclosure requirements capture such changes. The Board provides no basis to conclude that a detailed analysis of how an entity manages its valuation allowances would enhance investors' ability to assess income tax information that affects cash flow forecasts and capital allocation decisions and identify potential opportunities to increase future cash flows.

Enactment of new tax laws. The proposed amendments require that public business entities disclose the income tax effect of new tax laws enacted. Although ASC 740 does not explicitly require disclosure of new tax laws, if an entity is required to reassess its valuation allowance on existing tax attributes or make a significant adjustment to its AETR affecting its resulting interim income tax provision in the period of enactment, the entity would comply with the footnote disclosure requirements in ASC-740-270-50-1 in its interim financial statements.[3] The proposed amendments' requirement to disclose the income tax effects of new tax laws enacted would be redundant to existing disclosure requirements. The Board recognizes such existing requirements in its Summary but provides no basis for concluding that new disclosures are additive or otherwise decision-useful.

Effect of cross-border tax laws. The proposed amendments require that public business entities disclose the income tax effect of cross-border tax laws and separately disclose any reconciling item within the cross-border tax laws category whose income tax effect is greater than 5% of the amount computed by multiplying income (or loss) from continuing operations before tax by the applicable statutory federal (national) income tax rate. Much of the information that relates to this category is already disclosed to some extent by U.S. multinational enterprises, albeit in less granular detail. The Tax Cuts and Jobs Act[4] requires reporting entities to consider the projected impact of various provisions—Global Intangible Low Taxed Income ("**GILTI**"), Base Erosion and Anti-Abuse Tax, Foreign Derived Intangible Income—on their AETR, and in certain cases (*e.g.*, GILTI), disclose their accounting policy related to inclusions in accordance with ASC 235-10-50-1 through 50-3. The proposed amendments' additional detail would

[3] Similarly, the Securities and Exchange Commission's ("**SEC's**") Regulation S-K requires disclosure of material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or future financial condition. This includes descriptions and amounts of matters that are reasonably likely based on management's assessment to have a material impact on future operations. *See* 17 C.F.R. § 229.303(a).

[4] Pub. L. No. 115-97, 131 Stat. 2054 (2017).

provide limited, if any, incremental information or benefit to investors and may actually be misleading. Indeed, the disclosure and disaggregation of the income tax effect of cross-border tax laws appears to be presented separately from any related foreign tax credit amounts that may reduce an entity's cash-tax impact from such provisions. As a result, such disclosures may inappropriately inflate the relevance of the income tax effect of cross-border tax laws relative to the entity's overall cash-tax position.

Further disaggregation of reconciling items on the basis of a quantitative threshold. The proposed amendments would conform the existing public business entity rate reconciliation disclosure requirements in GAAP to the existing SEC requirements to disclose rate reconciling items in excess of a quantitative threshold of 5%, described above.[5] However, the proposed amendments go further in principle by requiring disclosures that are neither suitable nor appropriate for the purpose for which they were intended. The SEC has understood its rate reconciliation disclosure requirements to "be primarily of interest to professional analysts…and may not be required in financial disclosure designed for the average investor."[6] The Board fails to consider that separate disclosure of reconciling items whose income tax effect is greater than 1.05% [21% statutory U.S. federal income tax rate x 5%] of income from continuing operations may be inappropriate and unsuitable for the average investor seeking to understand a reporting entity's business opportunities and exposures. This concern for excessive and irrelevant disclosure is more acute where a foreign jurisdiction in total does not meet the 5% threshold, but there are individual reconciling items, which meet the 5% threshold, disclosed for that foreign jurisdiction as contemplated for the U.K. in the illustration in ASC 740-10-55-231. Such disclosures make it more difficult for investors to discern material data points that are suitable for informed investment decisions.

Limited data value. The proposed amendments also go further by requiring disclosures regardless of whether a quantitative threshold or other significance criteria is met.[7] We disagree that such disclosures, unmoored from any standard of income tax effect materiality, would provide investors with decision-useful information. Moreover, there is frequently no consistent methodology or approach used by auditors in calculating and providing disclosures for many of the specific categories in ASC 740-15-50-12A. Accounting may include estimates and assumptions with varying degrees of uncertainty. For example, the standard for when a reporting entity is required to establish and may subsequently release a valuation allowance is highly subjective, and accordingly, accounting firms may apply the standard in different ways, yielding results that are difficult to reconcile across entities. The Board risks entities evaluating immaterial amounts for disclosure and other entities disclosing jurisdictions with cumulatively low coverage with little to no value to investors.

Transition method. The proposed amendments would be applied retrospectively to all prior periods presented. Reporting entities would be required to provide three years of information pursuant to the proposed Update (*i.e.*, current year from year of adoption, plus two prior year comparables). We

[5] 17 C.F.R. § 210.4-08(h)(2).

[6] Accounting Series Release No. 149, "Notice of Adoption of Amendment to Regulation S-X to Provide for Improved Disclosure of Income Tax Expense,' Securities Act Release No. 5441, Exchange Act Release No. 10523, Public Utility Holding Company Act Release No. 18190, Investment Company Act Release No. 8104 (Nov. 28, 1973); *see also* General Revision of Regulation S-X, 45 Fed. Reg. 63660, 63661-62 (Sep. 25, 1980) ("The Commission believes that annual reports to shareholders should not be overburdened with information which, although relevant to meaningful analysis, is of little interest to the majority of users…Clearly, the need to provide registrants with adequate flexibility in order to maintain the annual report to shareholders, and financial statements included therein, as readable and comprehensive documents has been one of the Commission's primary concerns.")

[7] Other than ASC 105-10-05-6 ("The provisions of the Codification need not be applied to immaterial items.") which applies to all Codification guidance. Notwithstanding, the Codification provides little guidance as it relates to assessing materiality and no definition of general applicability of "immaterial" (or "material").

disagree that the information disclosed by this transition method would be decision-useful or readily available (or could be acquired through existing processes or systems). Such dated information holds little current relevance for investors. As described above, there is frequently no consistent methodology or approach used by auditors in calculating and providing the disclosures required by the proposed Update. Such diversity in practice necessarily calls into question the expediency and cost at which such information can be obtained. If the Board determines to move forward, we encourage it, at a minimum, to provide a wholly *prospective* transition in consideration of the complexities associated with the proposed Update.

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We appreciate the opportunity to provide comments to the Board on the proposed Update, and we would be pleased to meet with the Board or its staff to discuss our comments. If the Board or its staff has questions or comments, please do not hesitate to contact Joseph Schwartz, Director & Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Jennifer W. Han

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cc: Richard R. Jones, Chair, Financial Accounting Standards Board
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