



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

October 25, 1999

Mr. William T. Yates
Vice President & Controller
Advanced Clearing, Inc.
4211 South 102nd Street
P.O. Box 2226
Omaha, NE 68103-2226

Re: Net Capital Treatment of Deferred Tax Liabilities Directly Related to Prepaid Advertising Expense

Dear Mr. Yates:

This responds to your letter dated March 23, 1999, on behalf of Advanced Clearing, Inc. (the "Firm"), regarding the net capital treatment under Rule 15c3-1 under the Securities Exchange Act of 1934 ("Exchange Act")¹ of its deferred tax liability directly related to prepaid advertising expense.

Based on your letter and conversations with the staff of the Division of Market Regulation ("Division"), I understand the following facts to be pertinent to your request. Paragraph (c)(2)(iv) of Rule 15c3-1 requires a broker-dealer when computing net capital to deduct from its net worth certain illiquid or nonallowable assets. In addition, paragraph (c)(2)(i)(C) of Rule 15c3-1 provides that a broker-dealer may add back to its net worth when computing net capital certain deferred tax liabilities which directly relate to: (1) income derived from nonallowable assets; (2) unrealized gains on assets subject to haircuts under paragraph (c)(2)(vi) and Appendices A and B of Rule 15c3-1 at the applicable tax rates; or (3) unrealized gains on assets otherwise deducted from net worth.

You request that the Firm be allowed to add back to its net worth the amount of its deferred tax liability which relates to prepaid advertising expense.² You state that Generally Accepted Accounting Principles ("GAAP") requires the Firm to recognize its prepaid advertising expense in the period in which the advertising takes place and

¹ 17 C.F.R. § 240.15c3-1 (1999).

² The Firm prepays its advertising expense with a current cash payment.

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that the Internal Revenue Code permits the deduction of prepaid advertising expense in the period in which it is paid. You further state that the Firm accounts for this tax-to-book discrepancy by recognizing a deferred tax liability and a related nonallowable asset entitled "prepaid advertising."

You contend that the net capital treatment of the deferred tax liability should be similar to the treatment under paragraph (c)(2)(i)(C) of Rule 15c3-1 because it is directly related to a nonallowable asset. You further contend that the deferred tax liability does not affect the Firm's cash flows, income tax liability or overall operating risk profile and that the journal entry "merely alters the timing under which advertising costs are recognized in book net income." However, you assert that the accounting treatment for prepaid advertising expense results in an inappropriate double charge to net capital because the asset entitled prepaid advertising is nonallowable and the deferred tax liability also reduces the Firm's net worth.³

Based on the foregoing, the Division will not recommend enforcement action if, when computing net capital, the Firm adds back the amount of its deferred tax liability which directly relates to the nonallowable asset entitled prepaid advertising. You should be aware that this is a staff position with respect to enforcement only and does not purport to express any legal conclusions. This position is based solely on the foregoing description. Factual variations could warrant a different response, and any material change in the facts must be brought to the Division's attention. This position may be withdrawn or modified if the staff determines that such action is necessary for the protection of investors, in the public interest, or otherwise in furtherance of the purposes of the securities laws.

Sincerely,



Michael A. Macchiaroli
Associate Director

cc: Raymond J. Hennessy, NYSE
Thomas R. Cassella, NASD

³ Exchange Act Release No. 18737 (May 13, 1982), 47 FR 23919 (June 2, 1982) specifically requires a broker-dealer to adopt the accrual method of accounting under GAAP for its financial reporting.