

MINUTES



**To:** Board Members  
**From:** Cowan (ext. 233)  
**Subject:** Minutes of the May 10, 2006, Board Meeting—Uncertain Tax Positions: Disclosure and Sweep Issues  
**Date:** May 16, 2006  
**cc:** Smith, Bielstein, MacDonald, Leisenring, Project Team, Allen, Sutay, Beswick, Geary, Gabriele, Carney, Polley, Petrone, FASB Intranet, McGeachin (IASB), Upton (IASB)

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Topic: Uncertain Tax Positions: Disclosure and Sweep Issues

Basis for Discussion: Board Memorandum Nos. 19 and 20, dated April 20, 2006  
Board Memorandum No. 21, dated May 5, 2006

Length of Discussion: 9:00 a.m. to 10:30 a.m.

Attendance:

Board members present: Herz, Trott, Crooch, Schipper, Batavick, Seidman, and Young

Board members absent: None

Staff in charge of topic: Thomas

Other staff at Board table: Smith and Cowan

Outside participants: None

## Summary of Decisions Reached:

At today's meeting, the Board decided:

1. To use the administrative practices and precedents concept in the final Interpretation. Administrative practices and precedents apply where there is broad understanding among taxpayers, tax practitioners, and taxing authorities that the authority will not take issue with a position, presuming the taxing authority has access to all the relevant facts.
2. That the term *tax position* also includes a decision to exclude reporting income in a tax return or the decision to classify a transaction, entity, or other position in a tax return as tax exempt.
3. To remove the recognition and measurement guidance relating to uncertainties in income taxes that predate or result from a purchase business combination from Question 17 of the FASB Special Report, *A Guide to Implementation of Statement 109 on Accounting for Income Taxes*, and to nullify the guidance in EITF Issue No. 93-7, "Uncertainties Related to Income Taxes in a Purchase Business Combination," relating to uncertainties in income taxes that predate or result from a purchase business combination.
4. Not to address classification and presentation issues that are currently addressed in Issue 93-7 regarding uncertainties in income taxes that predate or result from a purchase business combination in the final Interpretation. Those issues will be addressed in the Board's joint project with the IASB on business combinations.
5. Not to provide any differential recognition and measurement, disclosure (other than that which currently exists in Statement 109), or transition guidance for nonpublic enterprises, including not-for-profit entities.
6. To amend FASB Statement No. 5, *Accounting for Contingencies*, to exclude contingencies relating to income taxes, and require the following disclosures as part of the final Interpretation:
  - a. A tabular reconciliation of the beginning and ending balances of unrecognized tax benefits in a manner similar to that prescribed in other recent guidance that addresses estimates with significant uncertainty
  - b. For items in which it is reasonably possible that the estimate of the realized tax benefit (an increase in the unrecognized tax benefit liability) for the tax uncertainty will significantly change in the next 12 months:
    - (1) The nature of the uncertainty
    - (2) The nature of the event that could occur in the next 12 months that would cause the change
    - (3) An estimate of the range of the reasonably possible change or a statement that an estimate of the change cannot be made.
  - c. A description of open tax years by major tax jurisdictions.
7. To require the following transition disclosures:
  - a. The nature of the change in accounting principle

- b. The cumulative effect of the change on retained earnings in the statement of financial position as of the date of adoption.
8. The Board directed the staff to proceed to a draft of a final Interpretation for vote by written ballot.

Objective of Meeting:

The meeting's objective was for the Board to address disclosure and sweep issues. The objective for the meeting was met.

Matters Discussed and Decisions Reached:

**Disclosure**

1. The Board agreed unanimously with the staff's recommendation for the following base disclosures:
  - a. For items for which it is reasonably possible that the estimate of the realized tax benefit (an increase in the unrecognized tax benefit liability) for the tax uncertainty will significantly change in the next 12 months:
    - (1) The nature of the uncertainty
    - (2) The nature of the event that could occur in the next 12 months that would cause the change
    - (3) An estimate of the range of the reasonably possible change or a statement that an estimate of the change cannot be made.
  - b. A description of open tax years by major tax jurisdictions
2. Mr. Thomas explained that the staff did not agree with arguments that the proposed disclosures would provide too much information to taxing authorities or competitors. Mr. Thomas indicated that he did not believe the Board would give credence to arguments that derivatives disclosure would provide too much information to federal banking regulators. He indicated he believed that taxing authorities are regulators who are legally endowed with the duty to regulate compliance with self-reporting income tax systems.

3. Mr. Smith explained that the staff was recommending disclosures that would provide relevant information to users that they do not currently have access to, but not detailed information (due to the level of aggregation) that would provide taxing authorities or competitors with an advantage or “roadmap,” thus balancing the conflicting views of users and preparers that were considered by the staff in developing a recommendation on disclosure provisions. Additionally, in discussions with preparers the staff learned that the information for such disclosures would be available without any significant incremental costs. Mr. Smith also stated that it is important to note that uncertainty of potential outcomes is one of the fundamental considerations of the disclosure requirements of FASB Statement No. 5, *Accounting for Contingencies*. He stated that the staff believes that the tabular reconciliation combined with the requirement to address reasonably possible changes in the estimate of the realized tax benefit within the next 12 months provide useful information to financial statement users about uncertainties inherent in the recording of tax benefits associated with uncertain tax positions, while not providing a roadmap to taxing authorities related to the details of the filing positions.
4. Ms. Schipper confirmed with Mr. Thomas that the IRS has a far more detailed and effective “roadmap” in its schedule M-3 than it would be provided by any disclosures in the final Interpretation. She also confirmed that the disclosures would provide new and useful information to users, which they currently are unable to attain. Ms. Schipper also observed that many foreign jurisdictions do not have disclosure similar to the schedule M-3 because their tax regimes are very different (e.g., use or value added taxes).
5. The Board decided by a vote of four (RHH, KAS, EWT, GMC) to two to require a tabular reconciliation of the beginning and ending balances of the unrecognized tax benefits including certain required line items in the reconciliation relating to the changes in the balance of the unrecognized tax benefits, which will be determined in the drafting of the final Interpretation. Mr. Young abstained from the vote and agreed in principle with the tabular reconciliation, but wanted more information about whether or not disclosures

similar to the schedule M-3 are required in foreign jurisdictions. In addition to the minimum required disclosure of the reasons for the change in the balance of the unrecognized tax benefits, companies may also include other line items in the tabular reconciliation as well as narrative to further clarify the reconciliation.

6. Some Board members who voted in favor of the tabular reconciliation indicated they believed that certain required minimum line items are necessary to explain the change in the balance of unrecognized tax benefits. They indicated that not requiring a minimum requirement for certain line items in the reconciliation might lead to boilerplate disclosures that would not be meaningful.
7. Ms. Seidman disagreed with requiring certain minimum line items in the reconciliation. She explained that she preferred to give preparers flexibility to describe the changes in the balance of unrecognized tax benefits. She expressed specific concerns about the ability to capture information relating to
  - a. Advance deposits that may relate to several (unspecified) tax positions, both recognized and unrecognized
  - b. Changes in judgment that relate primarily to timing, which may cause only a reclassification from an uncertain tax position to a deferred tax liability, not an earnings effect
  - c. Settlements, since a settlement often relates to several items, which, similar to advance deposits, can relate to several tax positions, both recognized and unrecognized.
8. Ms. Seidman also expressed a preference for internal consistency within Statement 109, which does not require extensive disclosures for valuation allowances relating to deferred tax assets, which she believes are subject to the same recognition threshold and involve subjective estimates of tax planning strategies and future income.
9. Mr. Batavick disagreed with the tabular reconciliation in general. He stated that he preferred being less prescriptive and allowing preparers to provide the beginning and ending balance of the unrecognized tax benefits and a qualitative description of the reason(s) for the change in the balance. He

further stated that he was not persuaded by users' arguments for a tabular reconciliation. Mr. Batavick explained that disclosures are already very time consuming and complex. He believed that adding another reconciliation would add to the burden and complexity without providing significant incremental information compared to a qualitative description of the reason(s) for the change in the balance of unrecognized tax benefits.

10. Mr. Young expressed his concern that recently the Board had received information that the reconciliation could provide a roadmap to taxing authorities. While he acknowledged that the benefit of the information to users is clear, the possible increase in taxes paid by companies could also hurt those same users. Mr. Young agreed that the information may not provide any incremental information to the IRS; however, he believed that it may provide incremental information to other taxing authorities, for example, other foreign countries.
11. Mr. Thomas stated that currently the Internal Revenue Service is empowered to ask for the total amount of the liability for unrecognized tax benefits. However, based on discussions with preparers, tax practitioners, and even the IRS, the evidence seems clear that the number is meaningless for companies with permanent establishment or nexus in a variety of jurisdictions. Additionally, Mr. Thomas reiterated Ms. Schipper's comments about the IRS's development of the schedule M-3. He stated that he understands several states are currently exploring enhanced disclosures like the schedule M-3.

*Transition Disclosure*

12. The Board unanimously agreed with the staff's recommendation for transition disclosures similar to those contained in the recent FASB Staff Position FTB 85-4-1, "Accounting for Life Settlement Contracts by Third-Party Investors," which requires the following disclosures:
  - a. The nature of and reason for the change in accounting principle
  - b. The cumulative effect of the change on retained earnings in the statement of financial position as of the date of adoption.

13. The final Interpretation will not require disclosure of the reason for the change in accounting principle, since the reason will be the adoption of the final Interpretation.

## **Sweep Issues**

### *Administrative Practices and Precedents*

14. Mr. Cowan presented the administrative practices concept for the Board's discussion. Mr. Thomas indicated that in the staff's work on administrative practices, even representatives of a taxing authority that the staff spoke with acknowledged a particular administrative practice. Mr. Thomas indicated that a particular administrative practice would be widely understood by taxpayers, tax practitioners, and the taxing authority. He also clarified that a change in administrative practices and precedents (for example, when a new commissioner is appointed) would be considered a change in estimate, not an error. The Board unanimously agreed to use the administrative practices and precedents concept developed by the staff. The concept is intended to deal with a limited number of tax positions that are technical violations of the tax law for which it is broadly understood that the taxing authorities, with access to all relevant facts, would not object.

### *Decisions That Reduce Taxable Income*

15. Mr. Cowan stated that the term *tax position* also includes a decision to exclude reporting income in a tax return or the decision to classify a transaction, entity, or other position in a tax return as tax exempt.

16. The Board unanimously agreed that the decision to exclude reportable income on a tax return or a decision to classify a transaction, entity, or other position in a tax return as tax exempt is also a tax position and is within the scope of the final interpretation. Mr. Trott asserted that it is critical to include these items as tax positions in the final Interpretation, especially given the importance of characterizing an entity as nontaxable. In some industries, for example, REITs, mutual funds, and not-for-profit enterprises, the position that the entity is nontaxable could be the most important tax position that the entity takes.

### *Business Combinations*

17. The Board agreed unanimously that recognition and measurement provisions of the final Interpretation should apply to all tax positions including those acquired or taken in a business combination. The Board also agreed unanimously to address the classification and presentation of tax positions acquired or taken in a business combination in its joint project with the IASB rather than amend the guidance in Issue 93-7.

### *Application to Nonpublic Enterprises*

18. Mr. Trott explained that a major constituent group representing nonpublic enterprises expressed two primary concerns about the application of the proposed Interpretation to nonpublic enterprises in its comment letter: (a) that the transition should be prospective and (b) that there should be a different effective date. Mr. Trott said that he explained in a recent discussion with members of this constituent group the changes and decisions that the Board had made in redeliberations. After hearing his update, the constituent group stated that their concerns had been effectively alleviated.

19. Mr. Herz indicated that initially he did not support the staff's recommendation. However, upon hearing that a major constituent group representing nonpublic enterprises did not believe differential transition requirements were necessary, he was persuaded to support the staff's recommendation.

20. The Board agreed to the staff's recommendation not to have differential accounting guidance for nonpublic enterprises by a vote of six to one (DMY). Mr. Young stated that he believed that the change in practice for smaller private companies would be substantial because they very rarely are audited by the taxing authorities and yet the final Interpretation will require them to consider their tax positions as if they were audited. This substantial change would necessitate a longer period to implement the changes and evaluate their tax positions. Mr. Thomas explained that smaller companies would likely have far fewer tax positions and less complex tax positions to evaluate and therefore should not have too much difficulty in applying the final Interpretation. Mr. Trott also asserted that the final Interpretation would provide valuable information on the liquidity of the companies to users and

that a delayed effective date is not warranted, since most companies will have ample time to implement the changes.

21. The Board agreed unanimously to proceed to a draft of the final Interpretation for vote by written ballot.

Follow-Up Items:

Drafting issues related to the format of the tabular reconciliation disclosure.

General Announcements:

None