

Office of the Chief Accountant

123 Front Street, 5th Floor Toronto, Ontario M5J 2M2 Canada

Tel: 416-955-7876 Fax: 416-955-7191

September 12, 2005

Technical Director - File reference: 1215-001 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Dear Sir/Madam:

RBC Financial Group would like to thank the Financial Accounting Standards Board ("Board") for the opportunity to comment on the Exposure Draft: Proposed Interpretation Accounting for Uncertain Tax Positions, an interpretation of FASB Statement No. 109 ("ED").

**Letter of Comment No:** 

**Date Received:** 

File Reference: 1215-001

We support the Board's objective to enhance the overall comparability of financial reporting of income taxes. We also agree that there is a need for further guidance on the criteria for recognition, de-recognition and measurement such that uncertain tax positions would be reported consistently.

While we agree with the overall direction of this ED, we do have concerns regarding the proposed model. Accounting for tax matters will always involve judgement. The proposed dual threshold creates two decision points where significant judgement would be involved to determine first when the outcome of an uncertain tax position would meet the probable threshold for recognition and then again when the outcome has fallen below the more-likely than not threshold for de-recognition. The complexity of the recognition model increases with each added decision point. Consequently, we do not believe the model would necessarily achieve the Board's intention of enhancing the comparability of financial reporting. We are also concerned that the proposed recognition threshold would cause consistent overstatement of liabilities and increased volatility in earnings, thereby not being representative of the true underlying economics of the tax positions. The attached appendix contains a detailed discussion of our concerns.

Should you have any questions regarding the issues discussed in this letter, please do not hesitate to contact me.

Thank you,

Yours very truly,

(Mrs) Linda F. Mezon Chief Accountant **Appendix**: Comments for Proposed Interpretation – Accounting for Uncertain Tax positions, an interpretation of FASB Statement No. 109 ("ED").

#### **Dual threshold**

The ED establishes a recognition threshold at "probable" and a de-recognition threshold at "more-likely than not". The definition of "probable" in this ED is consistent with other GAAP literature which indicates that "probable" is a higher level of likelihood than "more-likely than not". The ED also establishes that "The recognition threshold is a positive assertion that a tax position is valid under the tax law and the enterprise is entitled to the economic benefits associated with that position. Ref: ED: para 6". This probable level is consistent with a perceived level of confidence of an unqualified "should prevail" tax opinion. While this definition is consistent with other GAAP literature, it is a higher threshold than the generally accepted threshold to file an uncertain tax position in tax returns.

In general, the current tax practice is to file a tax benefit when it meets the threshold under applicable tax law where penalties would not be incurred for underpayment of taxes based on "more-likely than not", or at a threshold that is much lower than "probable". Application of the ED's proposal could potentially result in an overstatement of liabilities as the accounting threshold is much greater than the tax threshold and is therefore not a true representation of the economics of the tax positions. This is consistent with the alternative views expressed in the ED (ref: B46). In subsequent periods, the liability plus interest that had been accrued could potentially be reversed when the reporting entity settles with the taxing authority or when the statue of limitation expires with the tax position unchallenged, resulting in income volatility.

We also feel that the dual threshold adds complexity to the recognition model as it establishes two decision points rather than one decision point. As per EITF D-80 Q&A #8, "The Board recognized that application of the term probable in practice requires judgment", consequently, judgement is required to determine what is probable and therefore when to recognize an uncertain tax position. Significant judgement is also involved in subsequent reporting periods to determine what is "more-likely than not" for the purpose of de-recognizing previously recognized position. We do not believe the proposed dual threshold would necessarily achieve the Board's original objective of enhancing "comparability".

We recommend a single recognition/de-recognition threshold that is consistent with the threshold acceptable and practiced under tax laws of applicable jurisdictions. A single threshold would not eliminate professional judgement but could reduce the amount of judgment involved as recognition and de-recognition of uncertain tax position would occur at the same level of likelihood. This alternative would eliminate some of the ambiguity caused by the dual threshold approach.

# Measurement

While we agree with the Board that guidance is required to assist a reporting entity to determine when to recognize and de-recognize uncertain tax positions, we do not agree with the measurement methodology proposed by the ED.

<sup>&</sup>lt;sup>1</sup> Per EITF D-80 Q&A #8, Probable is a higher level of likelihood than "more likely than not".

The ED recommends the measurement of a tax benefit that has met the probable criteria using a "single most likely amount" ref: para 11. This may be a sound definition in theory, but would be difficult to implement in practice. All estimates come within a range of possibilities; some amounts may have equal probability of prevailing. Therefore, significant judgement is still required as individual's opinion would vary. We do not believe the current definitions of measurement would necessarily achieve the Board's objective of improving comparability.

We recommend that measurement of an uncertain tax position using the "most probable amount" that the entity expects to settle the tax position. This will result in a better reflection of the economics of the tax positions and could be based on past history, peer experience and/or a probability analysis of potential outcomes. We feel the most probable measure is a more comparable measure for similar tax positions as the taxing authorities would rule similar matters consistently overtime.

### Complexity

### The proposed ED is difficult to understand

"Unit of Account" is not defined. Per ED paragraph 9, "The appropriate unit of account for a tax position, and whether the probable recognition threshold is met for a tax position, is a matter of the individual facts and circumstances of that position evaluated in light of all available evidence". Footnote 6 provides an example of "unit of account", but fails to provide an exact definition. The following is a quote from footnote 6. "In this example, the unit of account is the research project. The appropriate unit of account may be different based on facts and circumstances." Given that it is an important concept in this ED, we recommend the Board provide a concise definition and more examples to clarify what constitutes unit of account. Lack of a proper definition could compromise the comparability of financial statements.

The Proposals in this ED and its interplay with deferred tax asset/liability are not clear. The example provided in paragraphs A22 and A23 on "Differences Related to Timing" is not straight forward. It would appear that any timing difference must be split between recognition of deferred tax asset/liability and an additional liability for the difference between the as-filed tax return and the benefit that is considered probable of being sustained. Determination of the deferred tax asset/liability is also based on whether the tax benefit is probable of being sustained. The logic in this example appears to be circular and would be difficult to apply in real life situations. We recommend the Board provide clarification to assist implementation.

## ED increases amount of documentation required to support the tax positions

Per paragraph 9 of the ED, "whether the probable recognition threshold is met for tax position, is a matter of the individual facts and circumstances of that position evaluated in light of all available evidence." The ED also provides four examples where the probable level of evidence is demonstrated. Based on the spirit of this paragraph, we anticipate increased levels of documentation in order to support both recognition and de-recognition of tax positions, which also increases the level of operational complexity. We recommend the Board to reconsider the adoption timing allowed given the increased documentation standard.

#### **Effective Date:**

This Interpretation, when finalized, would be effective as of the end of the first fiscal year ending after December 15, 2005. This proposed adoption date does not allow sufficient time for a

reporting entity to perform a thorough analysis of the ED in conjunction with its inventory of open tax positions for appropriate implementation. Given the complexity of this interpretation and the inherent requirement that an entity must review each outstanding tax position in detail, we recommend that the implementation date be delayed a full year.