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Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference 1215-001; Exposure Draft relating to Accounting for Uncertain Tax Positions, an interpretation of FASB Statement No. 109

Dear FASB Members and Staff:

I commend the efforts of the FASB to promulgate uniform standards in connection with accounting for uncertain income tax positions, and appreciate the opportunity to comment on the Exposure Draft referenced above that relates to that topic.

This comment letter addresses matters identified in *Issues 2 and 3* set forth in the preamble to the Exposure Draft, as well as certain related matters. In that regard, please consider the following comments which support the proposition that the final Interpretation should not require enterprises to record a liability in connection with an income tax position when a tax expert provides an unqualified tax opinion that the tax position is *more likely than not to prevail*. Note that certain points made below as to why a *should prevail* standard is inappropriate could be considered to support a recognition standard that is even less rigorous than the *more likely than not to prevail* standard. These points have principally been made to illustrate why adoption of a *should prevail* standard is a significant deviation from the current GAAP literature.

A More Likely Than Not Standard Best Reflects Whether An Event Is Likely To Occur Paragraph 6 of the Exposure Draft states, "The term probable is used in this Interpretation...to mean that 'the future event or events are likely to occur" (underscore added). Paragraph 9 provides that one of the items that an enterprise may consider as to whether a position is probable is whether an unqualified should prevail opinion has been provided by a tax expert. A more likely than not to prevail standard would better reflect whether an event is "likely to occur" than would a should prevail standard.

A More Likely Than Not Standard Would Reduce The Number Of Instances Of Incorrect Reporting When Hindsight Is Applied

A more likely than not to prevail standard would provide more meaningful information to financial statement users since there would be a higher likelihood that the financial statements are correct, which would diminish the concern expressed by two Board members in paragraph B46 of the Exposure Draft. Their concern is that the proposed Interpretation "...would result in a systematic overstatement of tax liabilities...[that] would result in systematic reversals of such recorded liabilities to income as either an enterprise's tax returns are audited by the taxing authorities or the statute of limitations for taxing authorities to audit has expired." By definition, if a tax position is more likely than not correct.

For example, suppose an enterprise has an uncertain tax position that reduces its reported taxes on a tax return by \$100, and that it is more likely than not correct. If the enterprise provides a tax benefit for \$100 and the position is ultimately sustained, which is the more likely result, then the enterprise's financial statements will accurately reflect this item in both the tax period to which the tax return position relates and the tax period during which the position was ultimately resolved. If, instead, the enterprise recorded a tax liability for the \$100 item on its financial statements for the period to which the tax return position relates, the enterprise's tax expense would have been initially overstated by \$100 and correspondingly understated by \$100 when the position was later resolved favorably to the enterprise, which was the more likely result all along. These two misstatements would have been avoided if the enterprise had reflected the treatment of the tax position in the manner that was most likely to occur.

Obviously, this unfortunate circumstance will occur more than 50% of the time when a position meets the *more likely than not to prevail* standard but not the *should prevail* standard since by definition the likelihood of success must be higher than 50%. In many instances, the likelihood of an overstatement of income tax expense will be significantly higher than 50% since the threshold to meet the *should prevail* standard is significantly higher than a 50% probability and enterprises will be recording income tax liabilities in situations where the likelihood that the liability will occur is much lower than 50%. For instance, if a tax position has a 67% probability of success, it would most likely not warrant a *should prevail* opinion, but it would be 67% likely to be correct. Thus, under a *should prevail* standard, the enterprise would record a liability when there would only be a 33% chance that recording the liability would prove to be correct.

The Exposure Draft Does Not Explain Why The More Likely Than Not Standard Already Provided In Statement 109 Should Not Be Applied To Uncertain Income Tax Positions
The only probability standard that currently applies to income tax accounting in Statement 109 is found in paragraph 17, which requires the application of a more likely than not standard in determining whether a valuation allowance should be recorded to reduce deferred tax assets that may not be realizable. This standard has proven successful in its application since adopted, and the Exposure Draft does not explain why different standards should be applied for recognizing income tax savings when the

realization of the tax savings are uncertain because income recognition is uncertain versus a situation where the tax savings are uncertain because of questions regarding the likelihood that an income tax position will be sustained.

Forthcoming Tax Opinions Will More Accurately Reflect The Likelihood That A Tax Position Will Be Successful Due To Recent Changes In IRS Circular 230

If the Board has preliminarily adopted the use of the *should prevail* standard instead of the *more likely than not to prevail* standard because of concerns that certain tax experts may have historically provided *more likely than not to prevail* opinions when they were not warranted, the changes to Circular 230, governing practice before the Internal Revenue Service, which became effective on June 20, 2005, should go a long way towards allaying these concerns. As you may be aware, Circular 230 now requires practitioners before the IRS to engage in a more rigorous analysis than previously as a prelude to providing opinions upon which enterprises may rely, with severe consequences for those who do not abide by these higher standards. These changes have been taken very seriously by the tax practitioner community and substantial changes have been made since June 20 in the manner in which accounting firms and law firms are now providing tax advice upon which their clients can rely.

Elimination Of The Dual Recognition/Derecognition Thresholds Eliminates Concerns Of Noncomparability Of Financial Statements

A further anomaly caused by the use of a *should prevail* standard is identified in the Exposure Draft at paragraph B18, which indicates that the Board acknowledges that the use of a dual threshold for recognition and derecognition may lead to noncomparable financial reporting for tax positions whose probabilities of being met lie between the two recognition thresholds. Obviously, as the Board recognizes, these noncomparability issues would not exist if a single *more likely than not to prevail* standard were adopted.

Uncertain Income Tax Liabilities Are Not Distinguishable From Other Uncertain Liabilities And The Exposure Draft Creates a Much Lower Standard for Accruing Income Tax Liabilities

Although some practitioners and enterprises have viewed reductions in income taxes payable as being similar to the creation of assets, since taxes are not a source of revenue to enterprises (unless the enterprises have the power to levy and collect taxes—which will be assumed to not be the case), taxes always constitute an expense; thus, the discussion of uncertain tax positions should be focused on the recognition of liabilities and not assets. The general standards for recognition of contingent liabilities are set forth in paragraph 8 of Statement 5, which requires that it be probable that a loss will occur before being accrued. By using a *should prevail* standard before a tax liability can be reduced, essentially, the Board is requiring that a liability be recognized when the probability that the liability will be actually incurred is substantially less than likely,

3

¹ Paragraph 2 of the Exposure Draft notes that in analyzing uncertain tax positions some enterprises have applied guidance for gain contingencies in paragraph 17 of FASB Statement No. 5, Accounting for Contingencies (hereinafter "Statement 5"). Again, a reduction in taxes is not income or a gain, and taxes are more properly analyzed as expenses, losses or liabilities.

which is a much lower standard for recognition than requiring it to be probable that the liability has been incurred.

The Exposure Draft Does Not Address The Question Of Why Uncertain Income Tax Positions Should Be Treated Differently Than Other Uncertain Liabilities, Even If Assertion Is Considered Probable

Paragraph B14 of the Exposure Draft, discussed below, is the only instance where the Exposure Draft attempts to distinguish uncertain tax positions from other uncertain liabilities. The point made in paragraph B14 relates to paragraph 38 of Statement 5, and only addresses why *unasserted* tax claims may be different from other *unasserted* claims, not why a more stringent standard should be used for analyzing income tax contingencies when it is probable that they will be asserted. In other words, the general test set forth in paragraph 8 of Statement 5 for analyzing whether a loss contingency should be accrued has not been addressed—the Exposure Draft only attempts to distinguish a subset of uncertain liabilities, i.e., those relating to unasserted claims and assessments. Thus, the Exposure Draft does not address the basic question of why uncertain tax positions should be treated differently than other uncertain liabilities. In particular, since many contingent liabilities, including those for income taxes, relate to the application of facts to rules of law (which rules may not be clear), why should an asserted tax claim be analyzed differently than any other type of claim that has been asserted against an enterprise?

The Exposure Draft Does Not Effectively Address Why Unasserted Income Tax Positions Are Distinguishable From Other Unasserted Claims

Paragraph 38 of Statement 5 requires that before an unasserted claim or assessment is recognized there first needs to be a determination as to whether the assertion of the claim is probable, and then a second judgment must be made as to whether it is probable that there will be an unfavorable outcome. In paragraph B14 of the Exposure Draft, an attempt is made to differentiate uncertain tax positions from other unasserted claims by simply stating that "The Board does not believe that [paragraph 38 of Statement 5] guidance is applicable to tax positions because a tax return is generally required to be filed." While it is true that tax returns are generally required to be filed, a significant number of uncertain tax issues arise because enterprises that operate internationally or in multiple states are often unclear as to whether the enterprise is subject to income tax in a particular taxing jurisdiction if it has limited or no physical presence in that jurisdiction. In these instances, tax uncertainties arise because of the fact that no tax return is filed the issue being whether a return needs to be filed. In situations in which tax returns are filed, there are many reasons why a claim may not be asserted by a taxing authority: (1) the return may not be audited; (2) the issue may not be readily apparent on the face of the return; or (3) certain auditors are not as thorough or as well trained as other auditors. Thus, it is a substantial leap to conclude that most tax issues will be reflected on tax returns that will be audited and the auditors will assert claims for the issues.

The Exposure Draft Does Not Address Why It Reaches Conclusions That May Be Inconsistent With Those Found In Paragraph 39 Of Statement 5 In Connection With Income Taxes

Paragraph 39 of Statement 5 contains an example that specifically relates to the accrual of uncertain income tax liabilities. In the example, an enterprise involved in litigating an income tax matter was required to accrue the portion of a potential tax liability that was probable to have been incurred; an accrual was not considered appropriate for another exposure item that had a reasonable possibility of occurring. Presumably, if the standards provided in the Exposure Draft were applied to this example, the enterprise would be required to record a liability for the item that had a reasonable possibility of occurring unless it could be demonstrated that its position *should prevail*. Although theoretically possible, it is submitted that from a practical standpoint it would be difficult for an enterprise to obtain an unqualified *should prevail* opinion from a tax expert after litigation had commenced in connection with a matter. Thus, the Exposure Draft appears to apply a stricter standard as to when an income tax liability is required to be recorded than does the example.

In short, for the reasons set forth above, financial statement users will be better served if the Interpretation does not require enterprises to record a liability in connection with an income tax position when a tax expert provides an unqualified tax opinion that the tax position is *more likely than not to prevail*.

If you have any questions regarding these comments, I would be pleased to discuss them further. I can be reached at 401-770-3660.

Respectfully submitted,

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