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414 Nicollet Mall Minneapolis, MN 55401-1993

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To: Technical Director

Re: FASB Project on Uncertain Tax Positions

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Xcel Energy Inc. is a major U.S. electric and natural gas company with annual revenues of over \$8 billion. Based in Minneapolis, Xcel Energy operates in 10 western and midwestern states. The company provides a comprehensive portfolio of energy-related products and services to 3.3 million electric customers and 1.8 million natural gas customers. In terms of customers, Xcel Energy is the fourth-largest combination electric and natural gas company in the nation.

Xcel Energy has reviewed the Exposure Draft ("ED") on Uncertain Tax Positions that was issued on July 14, 2005, and respectfully requests that the Board modify its proposed Interpretation in light of the following conceptual and operational issues.

Conceptual

In an effort to achieve reporting consistency for income taxes, the Board proposes the adoption of an asset model utilizing a probable recognition threshold. Xcel Energy believes, however, that taxes are more appropriately viewed as a liability, and that the tax return reporting position of an issue should serve as the initial recognition threshold. Thus, Xcel Energy believes that the "asset approach" is not the appropriate framework for the accounting evaluation of uncertain tax positions.

The asset approach that the Board is proposing is not the appropriate framework for the accounting evaluation of uncertain tax positions since cash is

¹ The ED indicates that the current diversity in reporting practices is due to the fact that FAS 109 does not explicitly prescribe a recognition threshold to be met for a tax benefit of an uncertain tax position.

² Under an asset approach, the tax benefit from a deduction or credit is not recognized unless the level of certainty of sustaining that benefit meets a certain threshold, despite the enterprise immediately realizing an asset or a reduction in a liability as a result of a reduced tax payment.

often realized immediately from tax benefit positions taken on a company's income tax return. As a result, the evaluation is not one of asset realization, since the asset in fact has been realized, but rather a loss contingency evaluation as to whether the reported tax position will be disallowed. The principles of FAS 5 would directly apply to that impairment issue, and would require that a contingent liability be recognized when a loss is probable (likely to occur) and the amount can be reasonably estimated.

As proposed, the ED would result in a systematic overstatement of liabilities due to an unrealistically high recognition threshold. Consequently, the reported amount of liabilities would not be consistent with the amount of tax and interest that an enterprise expects to ultimately pay to taxing authorities. Further, the reported amounts would not be consistent with the definition of a liability as defined in paragraph 35 of FAS CON 6 and paragraph 8 of FAS 109.

Xcel Energy believes consistency in tax reporting will best be achieved through the use of the current FAS 5 loss contingency approach. In other words, taxes should be recognized based on the filing positions of the enterprise's tax return, with a contingent liability recorded for amounts that are probable of being paid in the future to taxing authorities based on the specific facts and circumstances.³ If the Board is concerned that FAS 5 and/or FAS 109 do not provide enough definitive interpretative guidance to ensure consistency in practice, Xcel Energy believes the appropriate response should be to provide additional guidance in specific reference to income tax contingencies rather than establishing a new model for tax assets.

Operational

From Xcel Energy's perspective, the ED contains several significant operational impediments. If the asset approach is ultimately adopted, these impediments must be addressed. Problem areas include scope, recognition thresholds, measurement, recording of interest costs, and effective date and transition. Each of these is discussed below.

Scope

Since tax laws are by their very nature subject to uncertainty, the Board needs to specifically limit the scope of an "uncertain tax position" in order to make

³ Because of unique circumstances that could result from varying interpretations of the tax law, prior history related to specific issues, or even different agents assigned to an audit, seemingly similar facts and circumstances may ultimately result in a different overall tax obligation when comparing two companies. The evaluation of specific facts and circumstances is critical in determining the appropriate recognition level of tax liabilities on an entity's financial statements.

the proposed Interpretation administratively practical. Otherwise, the proposed Interpretation would be onerous to implement and supporting documentation would be substantial.

One effective way to define an uncertain tax position would be to limit the scope to only certain tax avoidance transactions such as defined under IRC Section 6662A, relating to listed and certain other reportable transactions.⁴ These tax avoidance transactions are subject to specific accuracy-related penalty rules under the tax law, and as such would serve as an appropriate and clear boundary to limit the scope of the final Interpretation. Due to the unique nature of these tax avoidance transactions, where an enterprise is seeking to gain a certain tax advantage, an asset recognition approach may be acceptable for those circumstances.

Recognition Thresholds

With tax laws being complex and subject to differing interpretations, a probable threshold would be unrealistically high for financial statement recognition, and would therefore result in a significant overstatement of tax liability. An entity's tax expense and effective tax rate would also be more volatile with a probable recognition threshold due to the systematic delays in the initial recognition of tax positions until audits are completed. The result would not be more consistent reporting of taxes and financial statement users may actually be more frustrated with the proposed approach, due to the distortion of earnings that would occur in various periods as the expected tax benefits related to pretax accounting transactions would not be recorded in the same period as the transactions.

However, a "more-likely-than-not" threshold would result in a more realistic representation of an enterprise's tax liability and produce a better matching of tax benefits with related pretax accounting transactions. A more-likely-than-not threshold would result in a more realistic liability because it would be more consistent with the standard used by a company for reflecting a tax position in their tax return, result in similar thresholds for recognition and derecognition, and align with the FAS 109 standard used for application of valuation allowances. Elimination of the dual thresholds would also reduce the ability for earnings management.

Measurement

⁴ Section 6662A applies to listed and other reportable transactions that have a significant purpose of avoiding or evading federal income tax.

Xcel Energy agrees that an uncertain tax position should be measured and reported based on the best estimate of the amount that is probable of being sustained upon audit by taxing authorities. However, the unit of account measurement approach that the proposed Interpretation advocates does not comport with reality. Tax positions cannot always be easily broken down into sub-issues or components as the ED would suggest, and even if they could be on a particular issue, such a detailed analysis would be of questionable value. The approach is not practical or reflective of how tax issues are often resolved and would be too time consuming to implement.

A more reasonable approach would be to simply allow an enterprise to reduce the total tax benefit associated with an issue by the amount that management estimates is probable of not being sustained upon audit. Management's judgment would be based on the specific facts and circumstances of the issue. These loss contingency estimates are already being prepared by management today under the current FAS 5 requirements, and are being reviewed by independent auditors as part of the financial statement audit process.

Recording of Interest Costs

The proposed Interpretation requires that interest be recorded on all tax positions that do not reach the probable threshold, even if the taxpayer has no expectation of losing any portion of the issue or owing any interest. That would result in a significant overstatement of liability.

The need to record interest arises not from the non-recognition of the tax benefit from a financial statement perspective, but rather from the strength of the position from a tax perspective. Similar to the approach adopted for the recording of penalties, interest should not be required to be recorded unless the nature of the tax position would warrant such recording. Under FAS 5 principles, interest obligations need not be recorded until they are considered probable of payment.

Effective Date and Transition

Given the multitude of issues that surround the ED and the expectation that the Board will receive numerous comments from interested parties, the Board should delay the effective date of the Interpretation. It should take more than a few months for the Board to thoughtfully consider the comments through the deliberation process; therefore, a 2005 effective date is not practical.

⁵ See paragraphs A2 – A11 of the proposed Interpretation.

When implementing the new rules, the Board should consider using a beginning of period effective date. That way the new rules would be reflected for the entire reporting period and the tax footnote disclosures would be more meaningful.

Conclusion

Xcel Energy is confident that the Board will re-assess its position on the accounting for uncertain tax positions. It is the company's belief that the existing tax accounting rules (utilizing a loss contingency approach) under FAS 109 and FAS 5 provide an appropriate framework that should not be changed.

A prescribed recognition threshold is not necessary to achieve reporting consistency for income taxes. Reporting consistency can be achieved if the asfiled tax position serves as the initial recognition threshold, with a contingent liability recorded for amounts that are probable of being paid in the future to taxing authorities based on the specific facts and circumstances. Accordingly, the proposed Interpretation should focus its guidance on the contingent liability requirements under FAS 5, and provide additional clarification where necessary.

However, if the Board insists on issuing an Interpretation adopting an asset approach, it should then consider the operational recommendations discussed above. If these areas identified above are not addressed, the Interpretation⁷ will not achieve greater validity and consistency in financial reporting.

Thank you for your consideration.

James J. Duevel Director, Tax Services

⁶ The proposed Interpretation would be effective as of the end of the first fiscal year ending after December 31, 2005.

⁷ As proposed the ED is not an interpretation but rather a fundamental change in accounting for income taxes. As such it would be more appropriate to consider it an amendment to FAS 109.