

Letter of Comment No: 85 A
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KPMG LLP 757 Third Avenue New York, N.Y. 10017 9th Floor

Telephone 212-909-5600 Fax 212-909-5699

Technical Director – File Reference 1215-001 Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

RE: Exposure Draft: Proposed FASB Interpretation, Accounting for Uncertain Tax Positions, an Interpretation of Statement 109 (File Reference No. 1215-001)

Dear Technical Director:

Although we support the Board's efforts to provide additional guidance on the accounting and reporting of tax effects related to uncertain tax positions, we do not agree with the Board's recent decision at its November 22, 2005 meeting to reduce the recognition threshold for tax benefits of uncertain tax positions from "probable" to "more likely than not". We also believe that the combination of the reduced recognition threshold and a best estimate based on the single most-likely amount in a range of possible amounts may result in illogical results in certain situations and creates unnecessary complexity in the model.

While we recognize that there has been considerable debate with regard to the initial recognition threshold pursuant to an asset-based or benefit-recognition model, we continue to believe that the probable threshold is the most appropriate condition for initial recognition of tax benefits of uncertain tax positions under current accounting literature. When the accounting model is not based on a fair value measurement objective, "probable" is routinely applied as a recognition threshold in relation to transactions involving uncertainties regardless of their accounting classification. For example, potential claims for recovery of environmental losses and other insurance recoveries are not recorded unless realization of the recovery is probable (see AICPA Statement of Position 96-1, *Environmental Remediation Liabilities*, paragraph 140). The Board's recent decision also would create inconsistency in reporting benefits from uncertain tax positions as compared to recognition of losses from contingencies. Potential losses related to litigation, claims and assessments are not recorded unless it is probable that a liability has been incurred under FASB Statement No. 5, *Accounting for Contingencies*



Technical Director December 29, 2005 Page 2 of 4

(Statement 5). If a company has both an uncertain tax position that is 51 percent likely to be sustained and a loss contingency related to pending litigation that is 51 percent likely to result in an unfavorable outcome to the company, applying the more likely than not recognition threshold for the uncertain tax position may result in recognition of a benefit on the uncertain tax position, through either the recognition of an asset or a reduction to a liability. However, the application of Statement 5 will result in no recognition of a loss on the pending litigation, even though both transactions have the same likelihood of realization. That inconsistent approach will cause further complexity in the application of accounting standards and may not be understood by users of financial statements, particularly as compared to the general approach in Statement 5 to recognize loss contingencies earlier than gain contingencies are recognized.

We also believe that the recognition of tax assets/benefits with as much as a 49.99 percent level of uncertainty at an amount that is based on the single most-likely amount in a range of possible amounts may result in illogical results in certain situations. For example, assume an entity demonstrates that it is more likely than not that its position on a potential \$100 tax benefit will be sustained and concludes that there is a 49 percent chance of realizing \$0 and a 51 percent chance of realizing \$100. Based on the Board's recent decision, the entity would record a \$100 tax benefit in the financial statements despite the fact that virtually the same level of likelihood exists for realizing \$0. The Board reasoned in its Basis for Conclusions to Statement 5 (paragraph 59) that the loss contingency recognition requirements were established "...to prevent accrual in the financial statements of amounts so uncertain as to impair the integrity of those financial statements." We believe that same concern applies to recognition of tax benefits of uncertain tax positions.

Based on our understanding of the Board's recent decisions, it also appears that there may be other situations where the best estimate (single most-likely amount) may be \$0 even when it is more likely than not that the position will be sustained. For example, assume there is a 40 percent likelihood that the position will not be sustained and, as a result, a 40 percent likelihood that the benefit will be \$0. Also assume that there is 30 percent likelihood that the position will be sustained with a benefit of \$100 and a 30 percent likelihood that the position will be sustained with a benefit of \$75. In that situation, it appears that the best estimate (single most-likely amount) is \$0 even though it is more likely than not that the position will be sustained. It appears that result could



Technical Director December 29, 2005 Page 3 of 4

occur in those situations where there are multiple potential outcomes if the position is sustained. While we appreciate that in most situations the assignment of likelihood to each possible outcome of an uncertain tax position will not be as precise as shown above, we believe these examples illustrate the potential implications of the Board's tentative decisions. In the example in the previous paragraph, the entity would recognize a tax benefit of \$100 when there is only a 51 percent likelihood that it will be realized, but in the example in this paragraph, the entity would recognize no tax benefit even though there is a 60 percent likelihood that the benefit will be at least \$75. These examples illustrate the potential illogical results of the combination of the Board's recent decisions on the recognition threshold and measurement approach.

As discussed in our comment letter on the Exposure Draft, we believe that the most appropriate approach is to recognize all tax benefits that are probable of being sustained – the maximum amount of tax benefits that can be supported at the probable threshold. This simplified model maintains an appropriate threshold for the recognition of tax benefits of uncertain tax positions, acknowledges that there may be varying facts and circumstances that would support a conclusion that tax benefits, or a portion of such benefits, are probable of being sustained, and would eliminate the illogical results described in the examples above.

If the Board continues to believe that a more likely than not recognition threshold is appropriate, we believe that the Board should reconsider its most-likely outcome measurement approach to address the illogical measurement results described above and reduce the complexity of applying that approach. It may be difficult in many situations for companies to specifically identify a single most-likely amount in a range of possible estimated amounts. And, as described in the examples above, using the full range of estimates rather than the potential outcomes assuming the position is sustained may result in not recognizing any tax benefits even when it is more likely than not that the position will be sustained. The Board could simplify that approach by indicating that tax positions that are at least more likely than not to be sustained should be recognized in the financial statements and that a liability, or reduction of an asset, should be recognized to reduce the tax benefits of those positions when management believes it will settle the matter with the taxing authority at something less than the full amount of the benefit. In those situations, the liability, or reduction of an asset, should be based on management's



Technical Director December 29, 2005 Page 4 of 4

estimate of the amount that the company would be required to pay to settle the position with the taxing authority.

We appreciate your consideration of this letter. If you have questions or wish to discuss any of the matters in our letter, please contact Mark Bielstein at (212) 909-5419.

Sincerely,

KPMG LLP