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Financial Accounting Standards Board
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Comments on the Exposure Draft of the Proposed Interpretation of
FASB Statement No. 109, Accounting for Income Taxes,
Uncertain Tax Positions

Members and Staff of the Financial Accounting Standards Board:

We are pleased to offer our comments on the July 14, 2005 Exposure Draft (ED) of a Proposed Interpretation of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (Statement No. 109), regarding accounting for Uncertain Tax Positions.

We support the issuance of the ED as a final Interpretation; however, we offer the comments and suggestions set forth below for your consideration in deliberations toward final standard setting. We preface our specific remarks by noting that the Board is addressing a uniquely complex issue because: (i) income taxation impacts global business and governmental decisions on a daily basis, and, (ii) the stated objectives of income tax laws (e.g., primarily to raise money for the government, but in other cases to encourage or discourage certain socio-economic behavior) are not the same as generally accepted accounting principles. As a result, there is a very broad range of stakeholders in this project, with many seeking differing results.

We also believe that the area of accounting for income taxes has historically been the subject of diverse accounting practice (both in the U.S. and internationally), which began *prior* to the recent heightening of concerns with the validity of financial reporting in general. While most everyone agrees that it is in the best interests of the U.S. capital markets for financial information to be as uniform and meaningful as possible, the process of production and review of that information in a timely manner must also be a workable exercise. Balancing these competing goals is indeed a daunting, but necessary task.

Overview of Our Comments on the ED:

Based largely on the existing definitions and concepts making up U.S. generally accepted accounting principles (e.g., the current definitions of assets, liabilities, income recognition and the matching concept), simply stated, we believe that, with respect to accounting for income taxes: **(i) income should be recognized when it is *probable* that it will be collected, and (ii) liabilities should be recognized when it is *probable* that they will be owed.**

Discussion of Specific Items:

1. We believe that the **dual-threshold approach** of recognition/derecognition of the ED should be applied with the following principles:
 - a) The Board should emphasize that the ***probable*** criterion should be applied to the initial recognition of *permanent differences* (meeting the definition of ***tax position*** as defined by the ED) *that result in reductions of income tax expense*. We believe that since the net financial accounting effect of these items (ignoring timing) is to increase net income in the period via reduction in income tax expense (or increase in income tax benefit), rules similar to the “gain recognition” rules of paragraph 17 of SFAS No. 5 (in addition to Appendix B of the ED) should provide guidance. Similar to the ED, examples would be: tax credits such as the credit for increasing research activities under Internal Revenue Code (IRC) Section¹ 41, permanent exclusions from income such as the IRC Section 199 deduction for income attributable to domestic production activities, or intercompany state or cross-border “planning strategies” that purport to shift income or deductions between jurisdictions with the intent of lowering the overall tax rate paid by the enterprise.
 - b) After initial recognition at a probable standard, should the quality of the tax position erode, but not below a ***more-likely-than-not*** standard, the ***best estimate*** of the revised position would remain on the books, and the decreased amount would be expensed in the period of the change in judgment. We believe that this “buffer” in judgment is appropriate in order to avoid implying a level of precision related to all material tax positions that, in our view, will be unlikely attainable (at a reasonable cost) if the probable standard were the only standard utilized. Additionally, applying the highest level of scrutiny at the outset of a transaction or position seems the appropriate time to strongly focus on evaluation, as most tax consequences are determinable at that time. However, we do not believe that a tax position in this circumstance (initially viewed as probable but revised to more-likely-than-not) should then be eligible for additional benefit recognition until such time that the position were to be favorably resolved by the enterprise.

¹ Unless otherwise stated, all statutory references in this letter are to the Internal Revenue Code of 1986, as amended, and as in effect on the date of this letter.

- c) Should the quality of a recognized tax position fall below the more-likely-than-not standard, we agree that complete derecognition of the remaining tax benefit is appropriate at that time.
 - d) We agree that if a tax position did not initially meet the definition of probable but were subsequently judged to meet that standard, it should be recognized at that point and a “true-up” of interest expense may be necessary.
 - e) We agree that the guidance of the ED should also apply to temporary differences, subject to the comments on *best estimate, interest expense, and classification* below.
2. The definition of **best estimate** (as defined in the ED) should be used to quantify the pre-interest (and penalty, if any) effect of *any* tax position as the amount management believes is the single most likely amount that will be sustained upon examination by taxing authorities.
- a. *This amount should be determined without regard to the probability conclusion reached with respect to the tax position in question.*
 - b. The *best estimate* of a tax position may be relevant to either a permanent, temporary, or “other” book-tax difference. For this purpose, an “other” book-tax difference is a difference between the “as-filed” (tax return) position and the amount reflected on the financial statements (*if any*) as either an allowable permanent difference, or a temporary difference adjudged to be “probable” in likelihood of being sustained, as the case may be (as generally suggested in the ED).
3. With respect to **interest and penalties**, we believe that interest (and, if warranted, penalties) should be computed *when applicable* based upon the difference between the “as-filed” (tax return) position and the *best estimate* of the position. We believe that this approach most accurately estimates the obligations an enterprise would incur if it were to settle its tax contests at the amounts it believes that are most likely to occur. We believe this treatment is not inconsistent with the existing criterion of SFAS No. 5, since, by acknowledging that the enterprise will receive an amount less than 100% of its “as filed” position, it seems to us that it is effectively treating that portion of the tax position as “probable” that it will **not** be sustained. This treatment strikes us as meeting the definition of a traditional liability, and should be recorded as such.
- a. We suggest that this interest and penalty computation method should take into account any existing tax attributes that an enterprise might have that would reduce the amount of interest actually owed if the enterprise were to settle its tax contest at the best estimated amount, but incur no actual out-of-pocket

interest expense due to use of an existing tax attribute in the tax year of settlement to offset the tax effect of the difference between the “as filed” position originally claimed and the actually settled amount. In other words, no interest should be accrued if no interest would actually be payable, even if the tax position in question were overturned by taxing authorities.

- b. Interest reassessment is required as the result of the passage of time and the changing makeup of the potential underreported tax liability of an enterprise based upon its examination results. We believe that, largely consistent with existing authority, interest and penalty assessments should be revisited no less than quarterly or upon the occurrence of a meaningful tax event.
 - c. We note that interest accrual under this method will likely give rise to a temporary difference of its own as much, if not all, of the interest computed under this method will likely be non-deductible on the current tax return of the enterprise since the claim may be treated as “unasserted” as of the balance sheet date by taxing authorities. Such interest is usually deductible when paid, however, so the temporary difference should reverse in the future to the extent it is actually funded.
 - d. We believe that **a presumption of examination by any pertinent taxing authority is an appropriate element of accounting for uncertain tax positions, as it is an appropriate duty** from a public policy perspective to expect enterprises to faithfully embrace the “self-assessment” system of U.S. taxation for accurate reporting of income and net assets for financial accounting purposes. While enterprises are still free to advocate their tax positions in accordance with their interpretation of the law as they see fit, proper financial accounting seems to demand an honest assessment by management “under the bright light of day” of the merits of any material position, and the probable effects of that position on income and equity of the enterprise.
4. We agree that **the tax effect of “other” tax positions should not be treated as deferred tax liabilities or temporary differences**, as these “other” positions may attract interest expense (discussed above) **and are more appropriately disclosed with non-deferred tax liabilities**. We also believe **that the current vs. non-current balance sheet classification of “other” tax differences and related accrued interest or penalties should follow the present definitions of current and non-current liabilities**. Thus, the classification for a particular enterprise may well depend upon where it is in its process of examination by taxing authorities, commonly referred to as its “examination cycle”. For example, for the December 31, 20X5 balance sheet of an enterprise with an ongoing examination cycle of calendar years 20X1-4 that had just begun, accrued “other” tax liabilities and related interest expense would not likely be treated as current liabilities unless there was an expectation or agreement that the “cycle” would close prior to December 31, 20X6.

5. We believe that **this ED should apply to all tax positions of enterprises**, including those previously incurred or acquired through business combinations.
6. We believe **that changes in judgment should be reflected in the period the change comes to fruition**. We note, however, the possibility of confusion and inconsistent application when the change in position relates to the expiration of the statute of limitations when such expiration occurs close to a quarter end, or the statute for varying years or jurisdictions for the same tax positions straddle² quarter-end. We request the FASB Staff to consider issuing additional guidance in this area through either FASB Staff Positions or an Implementation Guide (similar to that accompanying SFAS No. 96).
7. Additionally, we suggest that **subsequent guidance should give more examples of appropriate evidence to consider in evaluating: (i) the validity of tax positions, and (ii) the definition of units of account.**
 - a. We note that effective June 21, 2005, the U.S. Treasury and the Internal Revenue Service revised Circular 230 which governs practice before the IRS. A number of standards of tax practice and, in particular, the form and requirements of communicating tax advice were changed by this new guidance. Many of these changes will have a broad impact on all tax professionals. We believe that this independent event will likely have an impact on the workability of the guidance under the ED, and we believe additional consideration by the Board and Staff in concert with the tax community is warranted.
 - b. With regard to *units of account*, we believe that this concept will initially give rise to significant diversity in practice, as preparers of financial statements and their external auditors deal with the virtually limitless combinations of facts and scenarios that affect taxation. We believe, however, that unit of account should typically refer to all the facts needed to determine the amount of a discreet item (e.g., a *tax position*) on a tax return for a taxable year (or period, if a short-year return is involved). While we recognize that enterprises with multiple tax years under examination may have similar or recurring circumstances in more than one tax year, the annual theory of tax returns³ strikes us as having direct relevance in the validity of even similar tax items⁴.

² For example, a calendar year enterprise could have a federal statute of limitations expiring on September 15 of a year and the corresponding state statutes of limitations may expire on October 15 of the same year. For the enterprise's 3rd calendar quarter ending September 30, might it revise its tax reserves to reflect only the federal statute expiration but wait until the 4th quarter to reflect the state, even though it would know by October 16 of that year if the state statute of limitations in fact expired?

³ See IRC Section 441 and its legislative history.

⁴ For example, an IRC Section 29 gas credit may be available in one tax year based upon facts traceable to a particular producing oil property, but may not be available in a subsequent year due to the circumstances

We believe, however, that this is an area requiring further evaluation to provide consistent guidance.

8. We believe that tax “gain contingency” disclosures resulting from application of the ED should be no more or less notable than non-tax gain contingency disclosures.
9. We believe that the transition should be as suggested in the ED, and that the effective date for the ED should be deferred until at least periods beginning after June 15, 2006, in light of the complexity involved, and the apparent need to revise tax internal control and reporting procedures needed to comply with Sarbanes-Oxley requirements.

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We again thank the Board and the Staff for the opportunity to comment on this important enhancement in accounting literature. Should you have any questions related to our comments or other matters regarding the ED, please contact Lynn Loden at 713 221-3910.

Yours truly,

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By: _____

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