

J. Howard Stecker Chief Tax Officer Tax Department Letter of Comment No: (o)
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#### Prudential Financial, Inc.

213 Washington St, 8th Floor, Newark NJ 07102-2992 Tel 973 802-4174 Fax 973 802-8180 howard\_stecker@prudential.com

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Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Accounting for Uncertain Tax Positions

Reference No. 1215-001

### Dear Sir or Madam:

Prudential Financial, Inc. ("Pru") would like to share our views on the Proposed Interpretation – Accounting for Uncertain Tax Positions, an interpretation of FASB Statement No. 109 ("Proposed Interpretation"). Pru is one of the largest financial service companies in the world with over \$400 billion of assets and more than \$2 trillion of life insurance in force.

We support the Board's attempt to clarify the accounting for uncertain tax positions and to take action to avoid the highly publicized accounting scandals of recent years. These factors impair the public perception towards, and faith in, public financial statements. However, the Proposed Interpretation over-reaches in this endeavor by establishing a standard that is equally applicable to everyday tax law interpretations as well as aggressive tax positions, regardless of the taxpayer's intent or motivation.

## Our comments will explain the following:

- Under the ethical and professional standards applicable to tax professionals and due to the process by which tax laws are developed, companies will be unable in many cases to satisfy the "should prevail" standard provided for in the Proposed Interpretation, and
- As a result, for financial statement reporting purposes companies will be required to routinely overstate tax reserves, which will in turn result in a deterioration of the reliability of financial statements as true reflections of a company's strength and results from operations.

Accurate and reliable financial statements are an essential element of well-functioning economic markets. Lenders, investors, and many others must be able to rely on these financial statements as true indicators of a company's financial strength and results of operations. As the Board has noted, while conservatism may have its place in accounting results, purposeful and routine overstatement of reserves is not an acceptable accounting practice.<sup>1</sup>

We do not believe the dramatic change proposed is warranted in order to achieve the Board's goals. Instead, the Board should retain the existing approach founded in the principles established long-ago under FAS 5 and provide clarification to address any perceived deficiencies in application by companies preparing financial statements in accordance with GAAP.

# Ambiguities in the Tax Law are Intended

The process by which companies prepare their income tax returns inherently involves the application of a vast array of rules and regulations – many of which are written as general rules that must be interpreted and applied by each taxpayer to its own operations. Tax rules are written to apply to a wide range of situations and industries. The rules are written intentionally to not specifically cover every variation that may occur from company to company or industry to industry. Much like the process that CPAs must follow in interpreting and applying the litany of general rules under GAAP<sup>2</sup>, in many cases tax professionals must interpret the general tax rules and apply them to their companies. Many of the uncertain tax positions that will be subject to the Proposed Interpretation arise through this interpretive process.

In countless cases, the taxing authorities have purposefully avoided publishing specific rules or regulations since in more complex areas (such as insurance) it is virtually impossible to identify and provide guidance on all variations that might occur. For example, in practically every tax bill Congress specifically delegates to the Treasury Department to write regulations interpreting a tax statute and to provide rules for its application. However, in many cases due to the difficulty with providing all-inclusive guidance that equitably addresses different taxpayers in different industries and

<sup>&</sup>lt;sup>1</sup> Paragraph 96, ("CON 2"), Statement of Financial Accounting Concepts No.2, May 1980.

<sup>&</sup>lt;sup>2</sup> Paragraph 17, ("CON 6"), Statement of Financial Accounting Concepts No. 6, May 1980 provides: "The best accounting policies will provide information that best achieves the objectives of financial reporting. But whatever information is provided, it cannot be expected to be equally useful to all preparers and users, for the simple reason that individual needs and objectives vary.... In setting accounting standards, the Board also strives to leave as much room as possible for individual choices and preferences while securing the degree of conformity necessary to attain its objectives."

situations, Treasury has chosen not to publish regulations<sup>3</sup>. Instead, the tax law develops case-by-case and issue-by-issue.

This lack of authoritative guidance from the taxing authorities in most instances leaves companies without any means to ascertain the taxing authority's interpretation of existing law to a particular set of facts and circumstances. Accordingly, tax professionals routinely must make choices regarding the intent, meaning, and application of the tax law in a manner similar to that described for accountants in CON 2.4

## Ambiguous Tax Law Prevents Tax Experts from Reaching Should Prevail Opinion

The Proposed Interpretation provides examples of how to demonstrate the technical merits of a tax position to satisfy the probable threshold including (i) that there is unambiguous tax law supporting the position or (ii) an unqualified should prevail tax opinion from a qualified expert. However, under the ethical and professional standards applied to tax professionals, a tax professional cannot satisfy the should prevail standard of the Proposed Interpretation without authoritative guidance on the subject matter. As we have explained, this level of certainty does not exist in a great array of tax matters. It cannot go unnoticed that under these same ethical and professional standards, taxing authorities would likewise be unable to achieve the should prevail level of opinion. In other words, the Board needs to recognize that the lack of a should prevail level of opinion does not mean the taxpayer should lose. It simply means that in many areas of uncertainty the unambiguous guidance sought by the Proposed Interpretation that would allow a tax professional to satisfy a probable or should standard does not exist. The inability to offer such a conclusion exists regardless of the tax professional's individual degree of confidence on the probability of a success.

The lack of unambiguous tax law support arises not only when there is a purposeful lack of interpretative guidance from the taxing authorities but also, as often is the case, when the changing nature of business occurs faster than changes in the tax laws. Obviously, the lack of authoritative guidance is not an excuse for a company not to comply with their tax obligations; therefore a thoughtful and structured analysis or interpretation of the company's tax position must be developed and followed. Where the taxing authority has not made its position known, tax professionals are required to interpret the rules and regulations taking into account alternative readings of the tax statutes and related

In many areas, decades have passed since Congress granted this authority and no regulations have been written. See, for example Internal Revenue Code of 1986, as amended, ("IRC") Sections 382(l)(l)(B), 385, 1059(g), and certain aspects of 1502, consolidated tax return regulations.

<sup>&</sup>lt;sup>4</sup> In addition, IRC Section 446 requires that most U.S. corporations use GAAP income as the starting point for determining taxable income and make adjustments as required by the IRC. Therefore, tax professionals must understand the interpretations of the general GAAP principles and make determinations if such conclusions are in conformity or conflict with general principles of tax law.

regulations and rulings that would be contrary to the company's reading, then ascertain how strong of a position the taxing authority has regarding that contrary reading<sup>5</sup>. Unfortunately, due to the iterative, time-consuming, and in some cases adversarial process that taxing authorities develop tax law, in a significant number of areas it is simply not possible under ethical and professional standards to reach the should prevail level of confidence required by the Proposed Interpretation. This dilemma exists even if the tax professional takes a completely reasonable view of all existing factors and all potential interpretations. The dilemma exists not only in very aggressive tax schemes but in everyday decisions made by tax professionals. The Proposed Interpretation over-reaches in this regard.

Therefore, the Proposed Interpretation will result in requiring companies to treat as tax contingencies all amounts for which authoritative guidance does not exist, regardless of the reasonableness of the taxpayer's interpretation. Under the Proposed Interpretation there is no room for the tax accountants to exercise responsible professional judgment as currently exists today under the FAS 5 approach<sup>6</sup>. As a result, the Proposed Interpretation will result in a consistent overstatement of tax accruals for uncertain tax positions for virtually any company reporting its financial statements in accordance with GAAP.

### Consistent Overstatement will Negatively Effect Financial Statement Reliability

The consistent overstatement of tax accruals for uncertain tax positions will have the effect of understating the financial position of the reporting company, and in turn, reduce the usefulness of the financial statements to investors. CON 6 provides that

"...any attempt to understate results consistently is likely to raise questions about the reliability and the integrity of information about those results and probably be self-defeating in the long run.... As a result, unjustified excesses in either direction may mislead one group of investors to the possible benefit or detriment of others."

Accordingly, implementation of the Proposed Interpretation will have the effect of consistently overstating the tax accruals for uncertain tax positions in direct conflict with the conceptual framework of the Board. As a result, the approach of the Proposed

<sup>&</sup>lt;sup>5</sup> AICPA Professional Standards, TS Section 100, *Tax Return Positions*, paragraph .08, August 2000 regarding alternative acceptable positions.

<sup>&</sup>lt;sup>6</sup> The Board has noted in paragraphs 7 - 10, Statement of Financial Accounting Concepts No. 2, 1980 ("Con 2"), that in preparing financial statements "choices arise at every turn" and that "those who must choose among alternatives are forced to fall back on human judgment to evaluate the relative merits of competing methods".

<sup>&</sup>lt;sup>7</sup> Supra, note 6 at paragraph 95 and 96.

Interpretation should be modified to retain the current FAS 5 approach and provide clarification on application where appropriate.

Lastly, the non-economic, unrealistic, overstatement of reserves that will undoubtedly result from implementation of the Proposed Interpretation may not be in conformity with the standards applied by the IASP. The Board currently has a project underway to reconcile the existing differences in accounting for income taxes with IAS, so adoption of the Proposed Interpretation would likely create an additional impediment to this reconciliation project. Moreover, American companies competing in a competitive global environment will be disadvantaged by financial statements that do not accurately reflect the company's strength and results from operations.

## Comments on Specific Questions Raised in Proposed Interpretation

In lieu of providing our own specific comments on the 11 issues specifically identified in the Proposed Interpretation, we believe the comments provided to the FASB in letters from Financial Executive International ("FEI") and the American Council of Life Insuers ("ACLI") articulate the areas of concern and provide reasonable and prudent alternatives to the Proposed Interpretation.

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#### Summary

Based upon the comments provided above and the comments of FEI and ACLI, we respectfully request that the FASB retain the current FAS 5 approach to establishing and evaluating uncertainties related to taxes and provide clarification to address any perceived deficiencies in application. In addition, we request that the implementation of any modifications to existing accounting literature take effect no earlier than the end of fiscal years ending after December 15, 2006 in order to give companies sufficient time to evaluate and implement the changes.

We appreciate the FASB's consideration of this important matter and we will be pleased to meet with you and your staff to address any questions.

Respectfully submitted,

Vice President and Chief Tax Officer

Prudential Financial, Inc.

Howard Stecker