

Letter of Comment No: 53
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September 12, 2005

Mr. Lawrence W. Smith
Director, Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1215-001

Proposed Interpretation, "Accounting for Uncertain Tax Positions"

Dear Mr. Smith:

FPL Group, Inc. appreciates the opportunity to comment on the Financial Accounting Standards Board's proposal regarding accounting for uncertain tax positions. Our principal subsidiary, Florida Power & Light Company, is a rate-regulated utility engaged in the generation, transmission, distribution and sale of electric energy. The Company also owns and operates independent power facilities through its wholesale electric generation subsidiary, FPL Energy, LLC.

The Company has followed this issue for some time and first expressed our concerns about the tentative conclusions being reached by the Board in our letter to Donald Thomas of the FASB staff dated December 16, 2004. Many of those concerns are repeated in this letter, together with additional concerns about the practical ability to implement the proposal and the timing of implementation.

## No Need for a Change

We firmly believe that current accounting standards adequately address the accounting for income tax assets and liabilities. Paragraph 8(a) of FAS 109 states that "a current tax liability or asset is recognized for the estimated taxes payable or refundable on tax returns for the current year." This statement makes clear that the measurement of a current tax asset or liability is to be based on the tax return. Since tax benefit positions included in tax returns generally result in a reduction in otherwise payable taxes, there is no question as to whether or not an asset (i.e., cash) has been realized.

Inherent in many positions taken in preparing a tax return is some level of uncertainty around how taxing authorities might view the characterization of a given transaction. Tax law is complex and often unclear, frequently requiring interpretation. As a result, disputes with taxing authorities over positions taken are not uncommon. FAS 5 provides

the needed guidance for dealing with this uncertainty and any resulting loss contingencies. In fact, paragraph 39 of FAS 5 uses the specific example of litigation of an income tax matter to illustrate the appropriate measurement of an accrual for litigation, claims and assessments. Under FAS 5, a loss contingency reserve is recorded only if it is probable that the tax position will be disallowed on audit and the amount of such liability can be reasonably estimated.

Unlike the proposed interpretation, the FAS 5 approach to recording liabilities for uncertain tax positions results in recording amounts that meet the definition of a liability in Statement of Financial Accounting Concepts No. 6 (CON 6). Paragraph 35 of CON 6 states that "liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." If the proposed interpretation was followed, entities would record tax liabilities that are *not* probable of payment, and financial statements would be misleading to the extent of such overstated liabilities.

We see no compelling characteristic of tax liabilities that justifies them being treated differently than other liabilities. Further, we are not persuaded that the proposal results in better accounting or validates the need for a change in current GAAP. For these reasons, the Company recommends that the Board withdraw this current exposure draft. If concerns exist about diversity in practice in the area of uncertain tax positions, interpretive guidance should be issued to clarify that FAS 5 is the appropriate framework in which to evaluate uncertain tax positions.

## <u>Issues with the Exposure Draft</u>

If a decision is made to move forward with a change in the accounting for uncertain tax positions, we ask the Board to consider the following primary points of concern in the proposal. First, the proposal as currently written would result in companies recording tax liabilities that the company never expects to pay. Entities are first required to assess whether a particular tax position is probable of being sustained in a presumed audit by the taxing authority (that is, whether the tax position meets the threshold for recognition). If the probable threshold is not met, no benefit may be recorded in the financial statements. This is true even when the entity believes that it is more likely than not that the position will be sustained. Accordingly, the company is required to record a tax liability, unadjusted for the expected benefit, in its financial statements. In the context of interpreting complex tax law, we believe it will often be difficult to assert that a particular outcome is probable of occurring. Accordingly, the proposal will result in companies including in their financial statements liabilities that they do not expect to pay, violating a fundamental principle of the conceptual framework (the definition of a liability) as set forth in CON 6. The proposal will cause a systematic overstatement of liabilities and make financial statements misleading to users.

We understand that some respondents are proposing that the recognition threshold be changed to a "more likely than not" or a "substantial authority" standard. While this may

serve to reduce the amount of the overstatement of liabilities, the same conceptual issues exist with these thresholds. They create an "all or nothing" approach to recording tax benefits, rather than recording the amount that, in the entity's judgment, is the probable amount to be paid. As discussed above, we believe the FAS 5 approach to dealing with uncertainty surrounding tax positions is the more conceptually sound approach.

Our second concern is the definition of a tax position. The definition of a tax position is so broad that it could conceivably encompass every deduction taken or not taken, exclusion from income, inclusion in income or tax credit on (or not on) the tax return. This scope will result in undue effort in implementation and complexity, with no discernable improvement in financial reporting. Possibly a better solution would be to limit the provisions of a new standard to specific types of transactions, such as "listed transactions" and reportable transactions with a significant tax avoidance purpose. Additionally, footnote 2 of the proposed interpretation includes a statement that failing to take a deduction could also be a tax position. Because the spirit of the proposal seems to have been focused on tax benefits, we believe further clarification in the definition of a tax position is needed if, in fact, the Board meant to include in the scope of the proposed interpretation positions that increase income tax expense or reduce a tax benefit.

Third, we disagree with the notion in paragraph 7 that, in assessing the probability of sustaining a position, a presumption that the tax position will be reviewed by the taxing authorities must be made. We believe it is appropriate to include the likelihood of review in assessing the probability of sustaining a tax position. Without considering all the relevant factors influencing tax liabilities, reported amounts will not reflect the amounts probable of payment. As a practical matter, material positions and significant transactions at large companies are likely to be reviewed. However, recent statistics demonstrate that only 0.2% of business tax returns are audited. Thus, when considering all companies, the presumption is incorrect more than 99% of the time. Accordingly, we believe management's judgment in determining the likelihood of review is a valid and important input in determining the correct amount of tax assets and liabilities recorded in the financial statements.

Fourth, the disclosure requirements in paragraph 18 state that "an enterprise shall disclose loss contingencies relating to previously recognized tax positions in accordance with paragraphs 9-12 of Statement 5." The words "shall disclose" in connection with paragraph 9 of FAS 5 are likely to cause confusion. Paragraph 9 of FAS 5 states that disclosures may be necessary for the financial statements not to be misleading. If the intention of the Board is to amend FAS 5 and require disclosure of the nature and amount of recorded tax accruals, this intention should be clearly stated. If the intention of the Board is that companies follow paragraph 9 in determining whether or not disclosure is

<sup>&</sup>lt;sup>1</sup> A tax position, for purposes of applying the proposed interpretation, is defined as an individual filing position in a previously filed tax return or an expected filing position reflected in measuring current or deferred income tax expense or benefit for interim or annual periods prior to filing a tax return. The term tax position also encompasses a decision not to file a tax return, a decision to exclude reporting a tax position in a tax return, or the choice made in reporting a transaction in a tax return. A tax position ordinarily would relate to a tax benefit. However, a tax position could include failing to take an otherwise valid tax deduction.

appropriate, less determinative language should be used, such as "an enterprise should follow the disclosure guidance in paragraphs 9-12 of Statement 5 for loss contingencies relating to previously recognized tax positions."

Also, we have considerable concern about the requirement to disclose tax benefits that have not been partially or fully recognized as a tax benefit in the financial statements and that might have a recognizable financial statement benefit in the future. Based on the current broad scope of the definition of a tax position (discussed above), this disclosure could encompass a large number of items. Presumably this disclosure could be made in the aggregate, which would help to reduce these concerns. If the Board decides to retain this requirement, it should provide an example of how a company would disclose a tax position that is more likely than not correct, but did not attain the "probable" threshold.

Finally, we are concerned that the proposal would be extremely difficult and complex to implement and would not achieve the desired increase in comparability. Our participation in conferences and industry group meetings where the proposal has been discussed leads us to the conclusion that there are still many questions and differing views about how to implement the proposed rules. Also, the proposal indicates that determining the appropriate unit of account for a tax position is "a matter of the individual facts and circumstances of that position evaluated in light of all available evidence," with little guidance about how to perform that evaluation. This provision alone could result in a significant lack of comparability among companies with similar tax positions. We strongly encourage the Board to consider all the comment letters received and take the time necessary to resolve implementation issues prior to issuing a final standard.

## **Effective Date**

If the provisions of the exposure draft, or similar provisions, are issued in a final statement, we strongly recommend that the effective date be delayed by at least one year. Due to the significant implementation questions surrounding the proposal, we suggest that the Board consider conducting field tests to verify the workability of the proposal and to flush out and resolve implementation issues prior to the rules becoming effective. If, as we suspect, the field tests indicate the need for modification and/or clarification of the proposal, re-exposure of the proposed rules may be in order.

Once final accounting guidance is issued, companies will have a daunting task ahead of them to identify tax positions taken, assess the probability of sustaining those positions on audit, and measuring the benefit for those positions that are recorded. Companies will need to work with their independent audit firms to determine what level of documentation will be required to support an assertion that a position meets the sustainability threshold and, in many cases, time will be needed to gather and/or produce the required documentation. Additionally, new processes will have to be developed, documented and tested in accordance with the Sarbanes—Oxley Act of 2002. We believe a period of not less than nine months after issuance of a final standard will be required for companies to implement the new rules.

## Conclusion

FPL Group earnestly recommends that the Board withdraw the current exposure draft. We believe that existing accounting standards adequately and appropriately address the accounting for uncertain tax positions. If the decision is made to move forward with a new standard, the proposal should be revised such that it can be implemented with a high degree of comparability, re-exposed for comment, and field-tested to ensure identification of all implementation issues.

Thank you for the opportunity to express our concerns about this very important issue.

Sincerely,

K. MICHAEL DAVISK. Michael DavisController and Chief Accounting Officer