



September 12, 2005

Mr. Lawrence Smith
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Letter of Comment No: 104
File Reference: 1215-001
Date Received: 912/05

RE: File Reference No. 1215-001, Accounting for Uncertain Tax Positions an interpretation of FASB Statement No. 109

Dear Mr. Smith:

Citigroup is pleased to have the opportunity to submit comments on the Proposed Interpretation of FASB Statement No. 109, Accounting for Uncertain Tax Positions. We applaud the FASB's efforts in drafting guidelines in this area and agree that such guidelines are necessary in light of the disparity in treatment of their tax positions by various enterprises. While the basic structure of the Exposure Draft (ED) provides a workable framework, we believe that the provisions of the ED, as drafted, would result in a material overstatement of the tax liabilities of most enterprises. Consequently, the financial condition of such enterprises would be understated and misleading to the users of the financial statements, as expressed in the Alternative Views contained in paragraphs B46 and B47 of the ED.

Much of the public debate concerning uncertain tax positions and much of the guidance in the ED are geared to tax motivated transactions. We understand and agree with the FASB's efforts to reduce the diversity in practice in that area to ensure that tax positions that appear to be gain contingencies are not recognized until that contingency is resolved. However, we also believe that the Board should recognize that the vast majority of issues that come up in practice are not related to tax motivated transactions, but instead relate to the proper treatment of income and expenses arising out of the normal business operations of an enterprise. We believe that the model proposed in the ED has significant deficiencies when applied to these common types of situations.

As explained in the attachment to this letter, Citigroup recommends the following changes to the ED to improve the accuracy and usefulness of the tax liabilities related to uncertain tax positions:

- We recommend that the threshold for recognizing the financial statement effects of a tax position in paragraph 6 be based upon a "more likely than not" rather than a "probable" standard.
- We believe that the principles of this standard do not accurately reflect the way in which tax disputes get resolved between enterprises and the taxing authorities. Specifically, we recommend that the phrase "based solely on the technical merits"

of the position" in paragraph 6 be modified to, "based on the technical merits of the position, including administrative practices of the taxing authority" and that paragraph 9(c) be amplified or another example be added as paragraph 9(e) to allow consideration of administrative practices of the taxing authority and company experience (e.g., the taxing authority has a history with the taxpayer or announced practice of settling audits for a certain amount of revenue, has issued audit settlement guidelines which the enterprise expects to utilize, or has a history or an announced practice of only assessing a certain number of open years in instances where returns have not been filed).

- We would amplify paragraph 8(c) to apply only when no audit has occurred and add paragraph 8(d), which would state, "upon completion of an audit of the taxable periods involved."
- We would change best estimate in paragraph 11 to the amount that management expects to realize ("expected value") and delete the last sentence.

Citigroup believes that a careful reconsideration of the "Alternative Views" set forth in paragraphs B46 and B47of the ED by the Board is crucial to refocus the principles in the ED to ones which would produce a proper tax expense in the period to which the earnings relate and the proper amount of tax liability an enterprise ultimately expects to pay on its balance sheet.

We would be pleased to discuss our views and comments on this ED. Please contact me at (212) 559-7721.

Regards,
Robert Trafficanti B

Robert Traficanti

Vice President and Deputy Controller

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## Attachment

We believe that the principles of this standard do not accurately reflect the way in which tax disputes get resolved between enterprises and the taxing authorities. Citigroup will address the issues below in the same order as they are presented in the Exposure Draft.

#### Scope

Issue 1: This proposed Interpretation would broadly apply to all tax positions accounted for in accordance with Statement 109, including tax positions that pertain to assets and liabilities acquired in business combinations. It would apply to tax positions taken in tax returns previously filed as well as positions anticipated to be taken in future tax returns. Do you agree with the scope of the proposed Interpretation? If not, why not?

We agree with the proposed scope.

# **Initial Recognition**

Issue 2: The Board concluded that the recognition threshold should presume a taxing authority will, during an audit, evaluate a tax position taken or expected to be taken when assessing recognition of an uncertain tax position. (Refer to paragraphs B12-B15 in the basis for conclusions.) Do you agree? If not, why not?

We have no comments with regard to this Issue.

Issue 3: The Board decided on a dual threshold approach that would require one threshold for recognition and another threshold for derecognition. The Board concluded that a tax position must meet a probable (as that term is used in Statement 5) threshold for a benefit to be recognized in the financial statements. (Refer to paragraphs B16-B21 in the basis for conclusions.) Do you agree with the dual threshold approach? Do you agree with the selection of probable as the recognition threshold? If not, what alternative approach or threshold should the Board consider?

We do not agree with the dual threshold approach. We believe that by establishing a "probable" standard, the ED requires the presumption that an enterprise will lose 100% of an issue for which it has a "more likely than not" chance of succeeding, but not "probable". In fact, it would be rare for an enterprise to capitulate completely on such an issue. This type of issue would usually be won by the taxpayer, settled or traded-off for a majority of the tax benefit of the position. Using the "probable" standard to recognize the benefit of a tax position would result in a material overstatement of an enterprise's tax liabilities. Operating results would be understated in the period to which the tax liability relates and overstated in an arbitrary manner in a subsequent period when the matter has been adjudicated. Using a "more likely than not" standard would alleviate the awkward result raised in paragraph B18 of the ED. The crux of this issue seems to be the Board's belief that the enterprise has a determinable income tax liability and is engaging in tax motivated transactions to reduce their taxes and, as such, these benefits should be recognized using an asset-based analysis. In fact, the vast majority of issues relate to the proper treatment of income and expenses arising out of the normal business operations of an enterprise. As such, the question is determining how much tax liability is owed to a

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specific taxing jurisdiction. Thus, a liability based approach would be a more appropriate recognition standard although a compromise asset-based standard such as "more likely than not" could be an acceptable appropriate recognition threshold, and is supported by the Board's own analysis in paragraph B23 of the ED. The other apparent cause of this defect in the ED is the inability to discount tax assets and liabilities as implied by paragraphs B9 and B10 of the ED. While it may not be practical to address the discounting issue, the use of a "more likely than not" standard combined with the use of a probability-weighted estimate to measure the liability would achieve an overall tax liability closer to the actual amount owed than would a "probable" standard combined with a single best estimate.

In addition, with regard to paragraph 9 of the ED, we feel that more guidance is needed. Unlike audits conducted by the IRS, whose agents' performance cannot be measured by revenues raised, many jurisdictions do concern themselves with the level of revenue generated by an audit. Occasionally, settlements are related to such level of revenue as opposed to the technical merits of individual issues. The standard of "probable," or as we suggest "more likely than not," should take into account past audit history of the enterprise with the taxing jurisdiction in question as it relates to a settlement based upon a given level of revenue, the issuance of settlement guidelines on certain issues by a taxing jurisdiction or any "amnesties" issued by a taxing authority that an enterprise expects to utilize. In addition, past history of the taxpayer or similar taxpayers or announced practice by the taxing authority with respect to the assessing of a given number of open back years when returns have not been filed should be sufficient to meet the recognition The aforementioned are examples of a taxing authority using its threshold. administrative discretion in enforcing unclear statutes and should be given due weight in assessing whether the recognition threshold has been met. Therefore, the end of the first sentence of paragraph 6 of the ED should be amended to "based on the technical merits of the position, including administrative practices of the taxing authority."

#### **Subsequent Recognition**

Issue 4: The Board concluded that a tax position that did not previously meet the probable recognition threshold should be recognized in any later period in which the enterprise subsequently concludes that the probable recognition threshold has been met. (Refer to paragraph B22 in the basis for conclusions.) Do you agree? If not, why not?

We generally agree with the Board's conclusion on subsequent recognition addressed in Issue 4. However, paragraph 8(c) concerning the statute of limitations would improperly delay the recognition of benefits with regard to tax positions. While FASB uses a "probable" level to recognize a benefit, it in effect turns this into a 100% standard by not allowing a benefit to be recognized at the time when it is "probable" an amount has been sustained. For an enterprise that has been audited, the time to recognize a benefit for issues which have not been raised in the audit is the receipt of the final audit report, or if there is none, the conclusion of the audit. Because of appeals and litigation, statutes can remain open for many years after an audit has concluded when there is virtually no chance any unraised issues will be pursued for the years covered by the audit. In fact, the

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IRS has recently issued restrictive guidelines to its field force as to when an audit cycle can be reopened.

In addition, paragraph B22 of the ED needs clarification or an example. Is this a reference to the discovery of previously unknown facts or merely a change in subjective judgment?

#### Derecognition

Issue 5: The Board concluded that a previously recognized tax position that no longer meets the probable recognition threshold should be derecognized by recording an income tax liability or reducing a deferred tax asset in the period in which the enterprise concludes that it is more likely than not that the position will not be sustained on audit. A valuation allowance as described in Statement 109 or a valuation account as described in FASB Concepts Statement No. 6, Elements of Financial Statements, should not be used as a substitute for derecognition of the benefit of a tax position. (Refer to paragraphs B23-B25 in the basis for conclusions.) Do you agree with the Board's conclusions on derecognition of previously recognized tax positions? If not, why not?

We agree with the Board's conclusions on derecognition.

#### Measurement

Issue 6: The Board concluded that once the probable recognition threshold is met, the best estimate of the amount that would be sustained on audit should be recognized. The Board concluded that any subsequent changes in that recognized amount should be made using a best estimate methodology and recognized in the period of the change. (Refer to paragraphs B9-B11 and B26-B29 in the basis for conclusions.) Do you agree with the Board's conclusions on measurement? If not, why not?

Issue 6 raises some concerns. The specific wording of paragraph 11 seems to conflict with the intent of the paragraph. Since an enterprise must have a 70-75% expectation of winning the issue to record a benefit, it is hard to conceive that any estimate would be more likely than the full amount of the benefit. For a \$10 million issue for which a 25% reserve is deemed appropriate by management, the literal language of paragraph 11 would require the enterprise to prove that \$7,500,000, and not \$7,400,000 or \$7,600,000, was more likely than winning the issue completely. Such a standard would be unworkable. The "best estimate" measurement standard should be changed to be the amount that management expects to realize from a given tax position ("expected value"), and the last sentence of paragraph 11 should be deleted.

Additionally, subsequent changes should be made using "expected value" and recognized in the period of change.

### Classification

Issue 7: The Board concluded that the liability arising from the difference between the tax position and the amount recognized and measured pursuant to this proposed Interpretation should be classified as a current liability for amounts that are anticipated Mr. Lawrence Smith September 12, 2005

to be paid within one year or the operating cycle, if longer. Unless that liability arises from a taxable temporary difference as defined in Statement 109, it should not be classified as a deferred tax liability. (Refer to paragraphs B30-B35 in the basis for conclusions.) Do you agree with the Board's conclusions on classification? If not, why not?

We have no comments with regard to this Issue.

# Change in Judgment

Issue 8: The Board concluded that, consistent with the guidance in paragraph 194 of Statement 109, a change in the recognition, derecognition, or measurement of a tax position should be recognized entirely in the interim period in which the change in judgment occurs. (Refer to paragraph B36 in the basis for conclusions.) Do you agree with the Board's conclusions about a change in judgment? If not, why not?

We agree with the Board's conclusions.

## **Interest and Penalties**

Issue 9: The Board concluded that if the relevant tax law requires payment of interest on underpayment of income taxes, accrual of interest should be based on the difference between the tax benefit recognized in the financial statements and the tax position in the period the interest is deemed to have been incurred. Similarly, if a statutory penalty would apply to a particular tax position, a liability for that penalty should be recognized in the period the penalty is deemed to have been incurred. Because classification of interest and penalties in the income statement was not considered when Statement 109 was issued, the Board concluded it would not consider that issue in this proposed Interpretation. (Refer to paragraphs B37–B39 in the basis for conclusions.) Do you agree with the Board's conclusions about recognition, measurement, and classification of interest and penalties? If not, why not?

We agree with the Board's conclusions.

### **Disclosures**

Issue 10: The Board concluded that loss contingencies relating to previously recognized tax positions should be disclosed in accordance with the provisions of paragraphs 9-11 of Statement 5. The Board also concluded that liabilities recognized in the financial statements pursuant to this proposed Interpretation for tax positions that do not meet the probable recognition threshold are similar to contingent gains. Therefore, those liabilities should be disclosed in accordance with the provisions of paragraph 17 of Statement 5. (Refer to paragraph B40 in the basis for conclusions.) Do you agree with the disclosure requirements? If not, why not?

We believe that only disclosures that are meaningful to the users of the financial statements should be required. We agree with the conclusion set forth in paragraph B40 of the ED that "no additional disclosures beyond those in Statement 5 should be required"