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Ms. Suzanne Bielstein Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference 1215-001

Dear Ms. Bielstein:

Merrill Lynch appreciates the opportunity to comment on the Proposed Interpretation, "Accounting for Uncertain Tax Positions – an Interpretation of FASB Statement No. 109" ("the ED"). We agree with the objective of the ED in that it strives to ensure consistency in reporting. However, we believe that the combination of establishing an asset approach, using a higher threshold and applying a two-step model will lead to unduly high liabilities that are likely to be reversed in future periods. The following paragraphs express our comments and recommendations for those provisions in the ED that are relevant to Merrill Lynch.

Overall Comments

We believe that use of an asset approach versus a contingent liability model creates a higher standard for tax contingencies than for other contingencies (e.g., litigation reserves recorded under SFAS No. 5). The asset approach fundamentally assumes that a taxpayer has an asset that needs to be substantiated as opposed to a liability that is subject to measurement. Income tax benefits from uncertain tax positions should not be viewed as assets, but as reductions of potential future claims by the taxing authorities against the taxpayer. Accordingly, we believe that a contingent liability model is more appropriate in that it ultimately relates to tax liabilities which are satisfied with future outflows of cash or claims against assets. Furthermore, we are concerned that the asset approach may lead to a greater degree of inaccuracy and serve to overstate tax liabilities which would likely be adjusted down in subsequent years, when an audit is settled or the statute of limitations expires.

The two-step method may also result in less accurate financial reporting. Presentation may be confusing and not representative of economic reality in cases where the probability threshold is not met but some amount of benefit would be derived. This model may preclude a company from reflecting the ultimate benefit that it expects to derive. If, for example, a tax position initially meets the probability criterion but (in the measurement analysis) a best estimate results in a significant difference between the benefit taken on the return and the benefit reflected in the financial statements, this may be interpreted to mean that no benefit can be recognized. In instances where an issue initially meets the probable standard for recognition, it is unclear whether an enterprise "crosses the line" and does not meet the threshold if the amount to be realized is significantly lower than, say, 70% or more of the total benefit (or whatever percentage is defined as "probable"). If so, this would result in the recognition of a tax liability of which a substantial portion may later be reversed. To alleviate confusion over the Board's intent, we recommend that language from paragraph B29 be incorporated into the standard itself. We specifically refer to the following:

"The Board also believes that when the validity of a tax position is not in question, but the benefit is reduced in anticipation of a dispute with taxing authorities that will center on valuation assumptions, significant differences between the claimed benefit and the most likely estimate will not necessarily call into question the conclusion that the probable recognition threshold has been met."

If the asset approach is ultimately adopted, we recommend that a "more likely than not" threshold for initial recognition should be incorporated. Otherwise the estimated tax benefits that are likely to be realized may actually result in an overstatement of tax liabilities, as discussed further below.

In addition to our overall comments, we have the following specific comments regarding the captioned areas of the ED.

Initial and Subsequent Recognition

The Board concluded that the recognition threshold should presume that a taxing authority will, during an audit, evaluate a tax position taken when assessing recognition of a tax position.

Paragraph 6 states that "An enterprise shall initially recognize the financial statement effects of a tax position when that position is probable of being sustained on audit by taxing authorities based solely on the technical merits of the position." We interpret "sustained on audit" to mean that the examining authority (e.g. the Internal Revenue Service) is the final authority on determining the outcome of a tax position. Practically speaking, many uncertain tax positions are sustained through a variety of means subsequent to the audit process (Appeals Process, Court Decisions). In fact, the IRS has often disagreed with interpretations of the law and not been ultimately upheld by the

Courts. We believe this distinction should be explicitly acknowledged in the final standard so as to avert any unintended change in practice going forward.

In addition, the ED proposes that the evaluation of a tax position is to be based on the technical merits, without consideration of offset or aggregation with other positions. Disputes with tax authorities are typically resolved through negotiation whereby a reasonable settlement is reached with the taxing authorities for issues that are not clearly defined by tax law. We believe that such aggregation of issues should be permitted to be explicitly considered in determining the amount of the tax position, based on the taxpayer's experience and expertise in managing tax audits and resolving such disputes.

We also disagree with the ED's presumption that a taxing authority will examine *all* tax positions. While we acknowledge the Board's theoretical objection to incorporating detection risk into the accounting for uncertain tax positions, we believe that such an approach will not result in accounting that captures the best estimate of the ultimate tax liability, and therefore will not result in representationally faithful financial statements. This is because there are many positions that are not examined during an audit; and once an audit is concluded without a change to an item, it becomes less likely that the specific tax position will be reviewed again in a subsequent audit (even though it is possible). Requiring an accrual for all tax positions that have never been raised on audit, even though a probable level of confidence may not be satisfied, will result in accruals for tax liabilities that the enterprise never reasonably expects to pay. An enterprise must first determine whether the assertion of a claim (i.e., proposed disallowance) is probable. If it is not probable that the taxing authority will disallow the tax position, for whatever reason, then no accrual should be required.

We believe that it should be presumed that all *material* tax positions and significant transactions will be examined by the tax authorities. However, the standard for recognition of tax benefits should be "more likely than not" when there is a reasonable basis that the taxing authorities will succeed in challenging and disallowing a tax position. Otherwise tax liabilities are likely to be overstated when applying the higher "probable" standard. The "more likely than not" standard would result in a more representationally faithful estimate of the amount that an enterprise ultimately expects to settle for.

The higher "probable" standard moves one step closer to an "all-or-nothing" outcome in which a liability is recorded for the entire position that does not meet the threshold. All-or-nothing recognition guidance (including explicit and implicit references to bright lines) is being increasingly questioned by the users of financial statements. Many view the all-or-nothing approach for leasing activities as deficient because economically similar arrangements may receive different accounting if they are just to one side or the other of the bright line test. While leasing is admittedly a different issue, we believe that the general concept, that the balance sheet should reflect the most likely liability, can and should be applied in this situation.

In the Board's consideration of recognition and measurement approaches, it also considered the use of fair value which would have alleviated the shortcomings of using the "probable" standard of confidence. As noted in paragraph B9, the Board felt that fair value measurement can yield representationally faithful financial reporting even when there is a low probability of realization associated with the item being measured. Fair value combines recognition and measurement uncertainty into a single measurement attribute and therefore eliminates the all-or-nothing shortcoming. We note that although the Board rejected the fair value approach, it did so only on the basis of the discounting requirements. Therefore, we believe that recognition at the "more likely than not level" is preferable, in that it brings an enterprise closer to the result that would have been obtained using fair value measurement.

Change in Judgment

In paragraph B36, the Board concluded that the financial statement impact of a change in judgment about sustainability or the best estimate of a tax position taken in a prior period should be recognized entirely in the period in which the change in judgment occurs (the "discrete method"). The Board did not articulate a clear basis for this conclusion in the ED, and we struggle to understand the reason for this approach. We do not believe that this approach will improve the comparability, consistency, and reliability of financial statements. We believe that the current rules under APB Opinion No. 28, requiring adjustment of the effective annual tax rate over the remainder of the year, are the most appropriate in this instance.

APB Opinion No. 28 clearly views each interim reporting period as an integral part of the annual reporting period. As such, it provides for use of an estimated effective annual income tax rate for each interim reporting period. The deferred provision for income taxes is based on the change in the deferred income tax assets and liabilities for the annual period. We view the change in current tax assets and liabilities in the same manner (i.e. the provision for income taxes should be determined on a full-year basis along with changes in estimates affecting the provision). If, for example, a tax position is accounted for in the first quarter and its ultimate resolution occurs in the third quarter of the same year, it should impact the full year tax rate.

However, in contrast, if the same issue is resolved in the first quarter of the following year, its impact would be accounted for using the discrete method under the approach espoused in the ED. We fail to understand the reason for this disparity. We acknowledge the fact that, typically, changes in estimate regarding a reserve recorded in a prior period, such as a reserve for a legal contingency, would be recorded in the interim period in which the change in estimate occurs. However, we believe that tax reserves are distinct in that the initial provision is not recorded in any one interim period (as a legal reserve would be), but rather relates to, and is recorded in, the full year period. Therefore, we believe that any adjustment to such a provision, regardless of whether it applies to the current or the prior period, should be recorded in the same manner, *i.e.*, as an adjustment to the full year provision. We further believe this is appropriate as changes in estimates

for provisions relating to prior years frequently arise as a result of changes in estimates relating to current years, and are themselves subject to future revision. That is, the estimation process, even for prior periods, is influenced by current events and is a constantly evolving process. Therefore, we believe it is more appropriate to account for these changes as an integral part of the full year period.

Clarification of language

Paragraph 16 of the ED indicates that the impact of a change in judgment for a tax position "taken in a prior interim or annual period . . . shall be recognized entirely in the interim period in which the change in judgment occurs." We question whether the Board intended the reference to prior interim periods in the language. As previously stated, APB Opinion No. 28 views each interim reporting period as an integral part of the annual reporting period and provides for use of an estimated effective annual income tax rate. We believe that the intent of the ED was to clarify accounting for changes in judgment applicable to prior annual reporting periods; not changes in judgment applicable to a single fiscal year. If this is the case, we request this language to be revised accordingly.

Disclosures

Upon reading the ED, we believe the Board felt no additional disclosures are necessary beyond those discussed in SFAS No. 5. We interpret this to mean the ED requires no change in the approach to disclosures using the new asset methodology. If this is not the Board's intention and significant changes to disclosures are expected, we recommend that the Board re-expose at least this section of the ED.

Effective Date and Transition

We are concerned with the proposed effective date of the ED (year-end 2005 for calendar year corporations). The thrust of the ED is to require each reporting entity to justify taking all tax positions in the first place, which is a much different approach than justifying potential loss positions. It requires consideration of all tax positions that meet the probable recognition criteria at the effective date. In addition, it is our view that the proposed ED would require significant additional documentation and modification of a company's financial reporting control framework to comply with Section 404 of the Sarbanes-Oxley Act. This may be a complex and time consuming exercise for both multi-national corporations operating in many tax jurisdictions as well as for smaller companies which may have limited resources. We feel that this places an undue burden on many companies. Accordingly, we are in favor of delaying implementation to no sooner than six months after issuance of a final standard.

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In closing, we understand and acknowledge the Board's desire to address diversity in the practice of accounting for uncertain tax positions. However, we believe that the change from a contingent liability approach to an asset approach, coupled with a higher standard for recognition, will potentially result in overstatement of liabilities (or understatement of receivables/deferred tax assets) and consequently trigger reversals of larger amounts in future periods. We believe that the "probable" threshold yields a more accurate result when applied in a traditional contingent liability model. We also feel that preparers, practitioners and other users of financial statements would be better served if the Board were to delay issuance of the ED until after these issues are addressed and to allow sufficient time for implementation.

Thank you again for the opportunity to comment on the ED. If you have any questions regarding our comments, please do not hesitate to contact either me, Kathy Skero, Controller of Merrill Lynch, at 212-449-0173, or Marc Pasternak of the Accounting Policy Department, at 212-449-2125.

Sincerely,

/s/ Esther Mills

First Vice President