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Re: FASB project on Uncertain Tax Positions

Dear Sirs:

I am writing to make you aware of confusion that exists about the tentative decisions the Board has reached on this project. I am among the confused. I hope your consideration of the questions raised in this letter will help you make sure that the ED you issue will be clear on how the new model for recognizing and measuring taxes is intended to work.

To illustrate my concern, please consider the following example:

ABC Company files a tax return for year 1, pays the tax and records the amount paid as filed. There are no known contingencies at that time.

In year 6, as a result of an IRS audit of year 1, ABC becomes aware of a controversy. After discussion with Counsel, ABC concludes that there is more than a remote risk that a final litigation result might be adverse and, in that case ABC would be required to pay additional taxes of \$1MM. ABC estimates the probability of such an adverse outcome at 25%, with a 75% chance of prevailing and paying nothing. (Probable is presumed to be >80%)

Assuming ABC expects to litigate, what should be the accounting?

Should ABC consider this a "gain contingency", and, because the "gain" is less than probable, recognize a liability and a loss?

If so, how should the liability be measured? Is the "best estimate" measurement of \$0 what the Board intends? If not, is it the "expected value" (as in CON 7) of \$250,000? Or is it the full amount of "gain" that is not probable of \$1,000,000?

Alternatively, if ABC intends to settle to avoid the cost and uncertainty of litigation, does that change the accounting? Suppose the company, after consulting with counsel, concludes that the likelihood of settlement amounts is as follows:

- 80% probability that settlement will be at least \$100,000 (probable loss)
- 50% probability that settlement will be at least \$250,000 (more likely than not)
- 20% probability that settlement will exceed \$400,000 (i.e., a "gain" of \$600,000 relative to the worst case outcome of \$1,000,000 is probable).

What amount should be recognized as a liability?

I observe that CON 7 focuses on fair value, but FIN 46 uses a similar methodology in a different context. Also, I am concerned that under FAS 109 the same financial statements may have tax benefits recognized using a more likely than not threshold. It would be useful for the ED to illustrate how those two provisions interact, for example when a loss carry forward would be realizable if the tax on the uncertain position is paid, but not otherwise.

Some have described the approach the Board is exploring as a "gain contingency" model. If the project continues with that approach, it would be useful to explain how it relates to FAS 5 which does not, as I read it, provide for recognition of all gain contingencies that are probable. Also, if a new approach to contingencies is constructed for this project, it would be helpful for the Board to make clear whether this is a unique exception or a new general rule.

The basic issue in this project is when to apply the general FAS 5 loss contingency model and when to make an exception. For some tax contingencies (see the example above), it is my view that the loss contingency model works better than the proposed alternative (to the extent I understand it). For others, including aggressive tax shelters, I agree that something else is needed. The challenge, of course, is to define and distinguish the two. If that is impossible and a single model is needed, I would think that something based on more likely than not and expected value would be better.

Thank you for the opportunity to comment. If further discussion of any of the points in this letter would be useful, please call.

Timothy S. Lucas