



Letter of Comment No: 11
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Technical Director—File Reference 1215-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1215-001
Exposure Draft on *Accounting for Uncertain Tax Positions—an interpretation of FASB Statement No. 109*

Dear Sir/Madam:

J.P. Morgan Chase & Co. (“JPMorgan Chase”) appreciates the opportunity to comment on the Financial Accounting Standards Board’s (“FASB”) July 14, 2005 Exposure Draft on *Accounting for Uncertain Tax Positions— an interpretation of FASB Statement No. 109*.

JPMorgan Chase has actively participated in the preparation of the comment letter submitted by the New York Clearing House Association. Many of the concerns of JPMorgan Chase are reflected in the comment letter and JPMorgan Chase urges the FASB to consider the views and adopt the recommendations (as they relate to changes to the Exposure Draft) set forth in the letter. Nonetheless, JPMorgan Chase has significant concerns regarding this proposed Interpretation and thought it worthwhile to provide its views separately.

Generally, JPMorgan Chase supports many of the issues raised by the Board’s proposed Interpretation. However, JPMorgan Chase dissents strongly with the Board on two issues: the establishment of a dual recognition/“probable” threshold for recognizing the benefits of tax positions and the proposed effective date of the standard.

In brief, JPMorgan Chase believes that the “probable” threshold has the effect of distorting financial statement net income by essentially over-accruing for uncertain tax positions in early years and then reversing, or “releasing” those accruals (including the associated gross-up for interest) in future years. Establishing tax reserves using an overly conservative approach, rather than an approach guided by a realistic assessment and measurement of the likely end result with respect to potential tax issues, will result in reported earnings that are not representative of the true underlying economics. To mitigate these concerns, JPMorgan Chase recommends a “more likely than not” threshold coupled with a “best estimate” approach.

In addition, if the Exposure Draft is finalized in its current form, JPMorgan Chase requests that the Board reconsider the effective date of the final standard as implementation will be difficult given the short time frame and the need to obtain and generate information that is not currently available (e.g., the time needed to reassess open tax positions worldwide, review the financial

statement impact with JPMorgan Chase's auditors and Senior Management, and develop and implement the related Sarbanes-Oxley Act key controls and documentation).

The response of JPMorgan Chase to the issues raised by the Board is presented in the Attachment.

Due to the significance of the issues addressed in this letter, JPMorgan Chase looks forward to any questions you have or any further discussions you would like to have on this matter. If you have any questions or would like to discuss our comments, then please do not hesitate to contact James Weyant at (212) 648-1095, Shannon Warren at (212) 648-0906, or me at (212) 270-7559.

Very truly yours,

Joseph L. Sclafani

Attachment

J.P. Morgan Chase & Co.'s Comments on the Exposure Draft on *Accounting for Uncertain Tax Positions—an interpretation of FASB Statement No. 109*

ATTACHMENT

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?

JPMorgan Chase agrees with the scope of the proposed Interpretation, with one exception. As set forth in JPMorgan Chase's comment letter on the proposed FASB Staff Position 13-a, *Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease*, we believe that companies engaged in a settlement process with the IRS can estimate the settlement with a high degree of probability, and thus should use the estimated settlement in the leveraged lease recalculation regardless of the probability that the tax position could be sustained on audit. Accordingly, we recommend that leveraged leases be excluded from the scope of the proposed Interpretation.

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. Do you agree? If not, why not?

JPMorgan Chase agrees with the Board's conclusion. JPMorgan Chase operates under the presumption that taxing authorities will evaluate all of the organization's tax positions.

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. 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?

JPMorgan Chase is strongly opposed to the dual threshold approach and the "probable" recognition threshold.

Although the Board does not explicitly mention a percentage equated with the term "probable," the reference made to the Statement 5 definition and the Board member deliberations seem to equate "probable" as 70% confidence level. The main concern of JPMorgan Chase is that the "probable" threshold will result in a continual over-reserving of tax positions and artificial understatement of income.

For example, if JPMorgan Chase believes that, based solely on its technical merits, a tax position has a two-thirds chance of succeeding, JPMorgan Chase would have to reserve 100% for this position under the “probable” threshold. Only in subsequent years, once the audit closes, can JPMorgan Chase recognize the benefit of the tax position. The resulting reserve release (and over-accrual) would distort what otherwise would have been a much clearer reflection of income. JPMorgan Chase believes that the over-accruing and the subsequent release that results from adhering to the “probable” threshold is not representationally faithful to the economics of these positions and results in a biased accounting presentation, as benefits that are 100% reserved will only be recognized in the year the audit closes.

In order to measure the financial statement benefit of a tax position that is more consistent with the best estimate of cash flows, JPMorgan Chase suggests that recognition be based on a “more likely than not” threshold. The “more likely than not” threshold is consistent with the Statement 109 recognition criteria for deferred tax benefits as well as the recently enacted penalty rules pursuant to the Jobs Creation Act of 2004.

JPMorgan Chase would suggest that the dual threshold approach be replaced with a “best estimate” approach utilizing a “more likely than not” threshold (as described above) for both recognition and derecognition. Simply put, a realistic 40% risk weight determined by JPMorgan Chase would dictate the establishment of a 40% reserve.

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. Do you agree? If not, why not?

JPMorgan Chase agrees on the conceptual aspect of the point made in Issue 4. However, as stated previously, JPMorgan Chase recommends the use of the “more likely than not” threshold.

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. Do you agree with the Board’s conclusions on derecognition of previously recognized tax positions? If not, why not?

JPMorgan Chase agrees on the conceptual aspect of the conclusion made in Issue 5. However, as stated previously, JPMorgan Chase does not agree with the “probable” threshold and recommends the use of the “more likely than not” threshold for both recognition and 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. Do you agree with the Board's conclusions on measurement? If not, why not?

JPMorgan Chase agrees with the Board's conclusions to utilize a "best estimate" approach when measuring the amount of benefit on a tax position.

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 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. Do you agree with the Board's conclusions on classification? If not, why not?

JPMorgan Chase supports the Board's conclusions on classification.

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. Do you agree with the Board's conclusions about a change in judgment? If not, why not?

JPMorgan Chase agrees with the Board's conclusions about a change in judgment.

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. Do you agree with the Board's conclusions about recognition, measurement, and classification of interest and penalties? If not, why not?

JPMorgan Chase agrees on the conceptual aspect of the conclusions made in Issue 9. However, JPMorgan Chase is concerned that increasing the reserves for interest on positions below the

“probable” threshold but above the “more likely than not” (50%) confidence level will serve to increase the amount of reserves released in future years when the tax positions are sustained on audit. We are making this point here to further highlight the JPMorgan Chase response to Issue #3.

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. Do you agree with the disclosure requirements? If not, why not?

JPMorgan Chase agrees with the disclosure requirements.

Effective Date and Transition

Issue 11: The Board concluded that this proposed Interpretation should be effective as of the end of the first fiscal year ending after December 15, 2005. Only tax positions that meet the probable recognition threshold at that date may be recognized. The cumulative effect of initially applying this proposed Interpretation would be recognized as a change in accounting principle as of the end of the period in which this proposed Interpretation is adopted. Restatement of previously issued interim or annual financial statements and pro forma disclosures for prior periods is not permitted. Earlier application is encouraged. Do you agree with the Board’s conclusions on effective date? If not, how much time would you anticipate will be necessary to apply the provisions of this proposed Interpretation? Do you agree with the Board’s conclusions on transition? If not, why not?

JPMorgan Chase is strongly opposed to the Board’s conclusions on the effective date. The time required to review and implement the new standards will involve several disciplines throughout the firm, and it will be across multiple jurisdictions. In addition, more time and effort will be required with outside auditors to review the new standard and the conclusions reached by JPMorgan Chase. Finally, one must consider the Sarbanes-Oxley Act and the key control standards and documentation that must be put into place.

Assuming the Board issues a final Interpretation within the coming months, JPMorgan Chase anticipates that applying the new provisions will take the better part of the next tax cycle. Accordingly, JPMorgan Chase would recommend a year-end 2006 implementation.

Regarding transition, JPMorgan Chase supports the Board’s conclusions to report the cumulative effect of adoption as a “change in accounting principle” rather than restating prior-period financial statements.