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

Reference No. 1215-001

Dear Mr. Smith:

I appreciate the opportunity to provide comments on the Financial Accounting Standards Board's Exposure Draft, Accounting for Uncertain Tax Positions-an interpretation of FASB Statement No. 109. Developing an interpretation that improves financial reporting consistency and transparency while maintaining an accurate representation of the economic substance of an enterprise's tax obligations would be helpful for both users as well as preparers of financial statements.

Financial statement recognition of an enterprise's tax obligation should as close as possible reflect the underlying economic substance of the ultimate tax burden. The nature of tax compliance as a self-assessment system (subject to subsequent tax administration review) is better analyzed as the measurement of an existing contingent liability (an impairment approach) as opposed to an asset recognition approach. Tax benefits resulting from tax positions are generally realized when tax returns are filed. These benefits are most often reflected as incremental cash on financial statements. Potential incremental tax obligations resulting from an audit represent unasserted claims that are best evaluated and measured as contingent liabilities. The liability approach also provides a consistent framework for measurement of a transaction's pretax and after tax impact on the financial statements.

The establishment of the "probable" threshold in the asset approach as provided in the proposed Interpretation will lead to a systematic overstatement of the enterprise's tax obligation resulting in information with little predictive value. Artificial volatility of reported tax rates will result as these overstated tax liabilities are resolved-usually upon completion of an audit. The volatility will be compounded when multiple years are

settled in a single reporting period. An alternative that seeks to record the best available measurement of the contingent liability based upon the available technical evidence and likely economic outcome would lead to financial statements more true to accounting's fundamental principles.

Also of concern is the application of the "probable" recognition threshold to the measurement of deferred taxes. The revised measurements will lead to complexity and significantly more implementation burden with no meaningful improvement to financial reporting. Adequately accounting for the significant number of temporary differences requires considerable resources from estimation in the provision process to ultimate reconciliation to filed tax returns. The resource requirements grow dramatically as companies do business across state lines and within various foreign jurisdictions. Recording and reconciling deferred tax balances to "filed" tax returns provide an objective basis for measurement and often provides automation capabilities to existing tax compliance software. Maintaining parallel records modified for subjective risk assessments will greatly increase resource demands, limit automation possibilities, and lead to less objectivity of reported balances.

Of final note is the proposed year-end 2005 implementation timing. In order to assure that a well reasoned approach to accounting for uncertain tax positions is developed and properly executed; implementation should be deferred beyond 2005.

I appreciate the opportunity to provide comments as the Board deliberates this important issue. Attached are comments to the 11 specific issues identified for comment by the exposure draft for the Board's consideration. I believe you will find them to be consistent with comments provided by many of the respondents. They are provided in support of the Board's efforts to improve financial reporting in this area. If you have questions regarding the comments please contact me at (313) 594-4469.

Sincerely,

Timothy L Gibbs  
Director and Tax Office Controller  
Ford Motor Company

## Responses to Specific Issues

### 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?*

The scope of the proposed Interpretation is appropriate.

### 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 paragraph B12-B15 in the basis for conclusions.) Do you agree? If not, why not?*

The recognition threshold should presume a taxing authority would evaluate the tax position.

*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 the 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?*

The dual threshold approach appears to have little conceptual justification under accounting concepts and seems to be a concession designed to mitigate the potential adverse financial reporting results of adopting the "probable" standard. It will result in a degradation of comparability (a major objective of the proposed Interpretation) as a result of applying different carrying values to items with identical risk assessments merely as a

result of past assessments. The history of risk assessments of a given tax position should be irrelevant to measurement at the current balance sheet date. A single threshold seems more appropriate.

The application of the probable standard could result in systematic overstatement of tax liabilities followed by a reduced tax expense in the subsequent year of settlement. The result is high volatility in tax rates that is not supported by the underlying economics, less predictability, and a mismatch in the period of reporting a transaction and its related tax consequences. A liability measurement model would better reflect the economic substance of tax uncertainties if, based upon the weight of available evidence, a liability is recorded for the "best estimate" of the potential future assessment which considers the technical support for a tax position as well as quantitative assessment of the ultimate liability. Such an approach is simpler in concept and accordingly would lead to increased consistency and comparability than under current practice. According to earlier Board reviews a "best estimate" approach is currently commonly used. Convergence to a method in existing practice (instead of defining an entirely new conceptual framework) would simplify the process while still achieving the Board's broad goals for accounting for tax contingencies.

### **Subsequent Recognition**

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

In the context of the probable recognition threshold the Board's conclusion is appropriate. Under a "best estimate" approach balances would be adjusted as events change management's risk assessments without the need for an arbitrary threshold for recognition.

### **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?*

Previously recognized tax positions that no longer meet the recognition threshold should be derecognized in the context of the "asset approach". However, a single recognition/derecognition approach is preferable. Under a "best estimate" approach balances would be adjusted as events change management's risk assessments without the need for an arbitrary threshold for 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 the best estimate methodology and recognized in the period of change. (Refer to paragraphs BB9-B11 and B26-B29 in the basis for conclusions.) Do you agree with the Board's conclusions on measurement? If not, why not?*

I agree with the Board's conclusions.

### **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. (Refer to paragraphs B30-B35 in the basis for conclusions.) Do you agree with the Board's conclusions on classification? If not, why not?*

I agree with the Board's conclusions.

### **Change in Judgment**

*Issue 8: The Board concluded the, 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?*

I 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 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?)*

I agree with the Board's conclusion but note the potential adverse impact on reported interest amounts resulting from the potential overstatement of tax liabilities resulting from the probable threshold. Because interest calculations will include several years (company's generally have several "open" tax years) adjustments to tax contingency amounts will result in the accrual of interest for several years recorded in a single period. This volatility in reported interest amounts is compounded when recognition or derecognition thresholds are crossed in the period. This compounding affect is avoided if tax contingencies are recorded based upon management's "best estimate".

## **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 for 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?*

I agree that uncertain tax positions should be disclosed in accordance with Statement 5.

## **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 the 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 the prior periods is not permitted. Earlier application is encouraged. (Refer to paragraphs B41-B43 in the basis for conclusions.) 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 conclusion on transition? If not, why not?*

The proposed effective date is too aggressive to provide sufficient time to review and understand the final form of the Interpretation and subsequently implement the potential changes. I agree with the Board's conclusion on transition. Elimination of the recognition/derecognition thresholds would also simplify adoption by eliminating transition rules.