



Letter of Comment No: 72  
File Reference: 1215-001  
Date Received: 9/12/05

## AMERICAN FAMILY INSURANCE GROUP

6000 AMERICAN PKWY • MADISON WI 53783-0001 • PHONE: (608) 249-2111

September 12, 2005

Financial Accounting Standards Board  
Via Email  
[director@fasb.org](mailto:director@fasb.org)

**Re: File Reference 1215-0001**

### **Comments on FASB Proposed Interpretation, Accounting for Uncertain Tax Positions and Interpretation of FASB Statement No. 109**

Several paragraphs throughout the Notice for Recipients, Proposed Interpretation, and Appendices fail to recognize and/or clearly portray the fundamental relationship between current and deferred taxes with respect to timing differences. Specifically, the drafting seems to contemplate that an entity would book either a current or deferred tax benefit related to a timing position taken on a return (but not both) and thus overstate the earnings and equity of the entity. However, proper accounting for timing related tax positions requires that every current tax benefit be offset by a corresponding deferred tax expense. Similarly, a current tax expense for a timing item should be offset by a corresponding deferred tax benefit. In either case, there should be no net benefit to the financial statements recorded other than that which properly matches book income or loss to its ultimate tax expense or benefit.

A simple example should illustrate this concept. Assume that the entity has only an accrued financial statement expense of \$100 that is clearly tax deductible. The only question is whether the item is deductible currently, or at some point in the future. The entity's financial statements should show a loss of \$100 and a tax benefit (assuming a 35% rate) of \$35 for a net loss of \$65. If the entity decides that there is sufficient grounds for deducting the item currently it would record a current tax benefit. Since there is no timing difference in this case there would be no deferred tax impact. If the entity decides that the item is not deductible currently it will show a deferred tax asset of \$35 (for the future \$100 tax deduction) and a deferred tax benefit of \$35. In that case, there is no current tax benefit. Either way, the tax benefit is \$35 and net income is \$65.

Now let's assume that the entity decides that there is only a 50/50 chance of success upon audit. If the entity decides to deduct the item on its tax return it would record an initial tax benefit of \$35. However, in lieu of the fact that the IRS may challenge the position, the entity also establishes a reserve for \$50 of the deduction by charging \$17.50 to audit expense and \$17.50 to audit liability. If the entity stopped there, then it would be in a worse position than if it had not deducted anything (\$35 current benefit less \$17.50 audit expense for a net benefit of \$17.50). To complete the accounting, the entity would need to establish a deferred tax asset for the \$50 that will be deductible in the future which

results in a deferred tax benefit of \$17.50. The entity thus has a net current tax benefit of \$17.50 and deferred tax benefit of \$17.50 for a total tax benefit of \$35 related to the book loss of \$100. This results in the same net income and change in equity as either method above.

Using the same facts (assuming that the chances of sustaining the current deduction are only 50 percent), the interpretation would require that no "benefit" be recognized in the financial statements. The problem with this point of view is that, as demonstrated above, proper accounting already assures that no "benefit" is reported in the financial statements other than the proper amount of tax attributable to \$100 of deductions. However, literal application of the interpretation as written, including paragraphs A22 and A23 of Appendix A, would appear to result in the entity being in a worse financial position if it took the position on its return, than if it had not.

Applying paragraph A23, this entity would book a deferred tax asset of \$35 (and a corresponding deferred tax benefit of \$35), and establish a current liability for \$35 (resulting in a current expense of \$35). The sum of these two transactions is \$0. Thus, the entity shows a net loss and change in equity of \$100 rather than the correct amount of \$65. Nowhere in the Notice, Interpretation or Appendixes does the FASB mention that the entity should have also booked an initial \$35 tax benefit. Combined with the two prior entries this would result in a net tax benefit of \$35. This is exactly the same tax benefit recorded by the entity that does not take the position on its return.

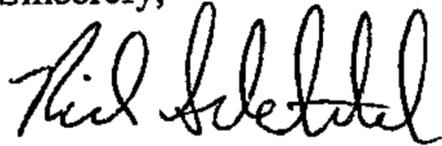
Assuming this is the result intended by the FASB there are several paragraphs throughout the Notice, Interpretation, and Appendixes which should be modified to specifically mention that the "initial" tax benefit is still recorded and that the entries which follow are in addition to that initial entry. These documents should be modified to clearly portray the relationship between current and deferred tax in both the balance sheet and income statement as they relate to timing differences. Unlike benefits associated with permanent book/tax differences, timing differences generally involve offsetting entries between current and deferred tax. It is this offsetting relationship which needs to be reflected in the documents to avoid confusion.

Alternatively, the FASB could clarify that the interpretation applies only to permanent differences which by their very nature result in tax benefits which do not match financial statement income. Such an interpretation would also be more consistent with FAS No. 5 which defines and discusses accounting for contingencies. Paragraph 2 of that pronouncement notes that, "Not all uncertainties inherent in the accounting process give rise to contingencies as that term is used in this statement." It goes on to state that, "the fact that estimates are used to allocate the known cost of a depreciable asset over the period of use by an enterprise does not make depreciation a contingency; the eventual expiration of the utility of the asset is not uncertain." There are numerous examples of taxpayers and the IRS arguing over whether an item is an expense or capital in nature, and over the useful life or depreciation method. In such situations there is no question that the taxpayer will ultimately receive a tax benefit for the expenditure. The only question is how and when. These types of "positions" as broadly defined by the

interpretation do not seem to rise to the level of a "contingency" as defined in FAS No. 5. Similarly, timing differences by their definition in FAS No. 109 should not be considered "contingencies" because the ultimate tax benefit is not in dispute.

If the FASB would like further clarification regarding my comments or specific areas where the Interpretation and Appendices should be amended please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "Rick Schelthelm". The signature is written in a cursive style with a large initial "R".

Rick Schelthelm  
Tax Manager – Property & Casualty  
American Family Mutual Insurance Company