Letter of Comment No: 14
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<u>VIA EMAIL</u>

September 8, 2005

Technical Director
File Reference No. 1215-001
Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Exposure Draft—Proposed Interpretation, Accounting for Uncertain Tax Positions, an interpretation of FASB Statement No. 109 (File Reference No. 1215-001).

Dear Technical Director:

Allergan, Inc., a Delaware corporation ("Allergan"), appreciates the opportunity to respond to the Financial Accounting Standards Board (the "Board") regarding the Exposure Draft, Proposed Interpretation, Accounting for Uncertain Tax Positions, an interpretation of FASB Statement No 109 (the "Proposed Interpretation"). Allergan is a publicly traded, specialty pharmaceutical company listed on the New York Stock Exchange under the symbol "AGN."

Allergan supports the Board's efforts to clarify the accounting for uncertain tax positions in accordance with FASB Statement No. 109, Accounting for Income Taxes. Allergan believes the Proposed Interpretation is generally well written and technically sound and agrees with the Board's positions detailed in Issues 1, 2, 3, 4, 5, 6, 8, 9 and 10. However, Allergan would like to provide the Board with (1) certain minor comments that it believes will help the reader better understand the language regarding Interest and Penalties; and (2) certain major comments regarding Issues 7 (Classification) and 11 (Effective Date and Transition).

Interest and Penalties

Allergan believes the Board should make the following minor language changes regarding the Interest and Penalties section in order to help the reader better understand the Proposed Interpretation:

• Paragraph 17 – Please change the first word of the first sentence from "When" to "If" or "In situations where" because the word "When" can be confused to connote timing for recognition purposes rather than applicability. Also, please

delete the words "for interest" from the first sentence so that it reads..." shall recognize a charge to income in the financial statements..." which is consistent with the format of the wording in the last sentence regarding a charge to income related to a penalty. This change is necessary to avoid a misinterpretation of the Board's position that the classification of interest, as either an above the line charge to interest expense or a below the line charge to the tax provision, is really not addressed in this Proposed Interpretation as indicated in paragraph B37 of Appendix B.

Classification

With respect to Issue 7, Allergan strongly believes that the Board should reconsider its position that companies separate the total accrued liability for uncertain tax positions accrued under FASB Statement No. 5 (formerly referred to as either "tax contingencies" or "cushion") between "current" and "long-term" categories of income tax liabilities. The following paragraphs summarize our reasons why we disagree with the Proposed Interpretation as it relates to Classification.

Consistency

Allergan believes the Board's position on Classification cannot be implemented in a consistent manner by companies if the Proposed Interpretation is adopted as presently constituted. Under the Proposed Interpretation, a company would be required to classify a portion of the liability for uncertain tax positions as "current" when the company "anticipates payment of cash within one year or the operating cycle, if longer." However, we believe experience has shown that companies cannot reasonably predict the timing of a cash tax payment for a disputed position since the timing typically depends upon agreement with a taxing authority – something that in many cases is a continuing process of negotiation with no set timeframe.

As discussed in paragraph B35, the Board believes that the liability should be classified based on the anticipated timing of the ultimate payment to taxing authorities. However, tax audits generally have a long time continuum, during which multiple issues are agreed to which have both positive and negative effects on tax liability estimates, and which can effectively cancel each other out before a determination can be made whether or not a net payment to a taxing authority will actually be required and when that payment will be made.

Additionally, there are situations when a company decides to make a tax payment to stop the accruing of interest for a specific issue that has become more clear as a result of a current evaluation of a taxing authority's audit position. The timing of this type of event is also difficult to foresee as the decision and judgment to make a tax payment is typically part of the audit negotiation process and is usually not known a year in advance. Therefore, companies could develop wide practices regarding the classification of possible tax payments in these situations.

¹ See ¶14 of the Proposed Interpretation.

The tax examination process could create great confusion to the preparers and users of financial statements if a company were to take a conservative position by classifying "agreed to" positions as "current" liabilities, only then to later change the amount of reported current liabilities as the audit progresses and the company has either negotiated or discovered favorable adjustments which offset the originally "agreed upon" liability with the tax authority.

In Statement of Financial Accounting Concepts No. 2, language regarding consistency states "the consistent use of accounting methods, whether from one period to another within a single firm, or within a single period across firms, is a necessary...condition of comparability" (emphasis added). In order to provide consistency across firms, Allergan believes that the classification of a tax liability related to an uncertain tax position becomes reasonably certain when (1) the audit concludes with a company receiving a final tax determination letter; or (2) when a company makes a final decision to make a tax payment to stop interest from accruing. To hold a company potentially liable for the geography determination on the balance sheet for these types of liabilities for each reporting period is overly burdensome and, we believe, will lead to continued inconsistent practices amongst firms, something this Proposed Interpretation is trying to eliminate.

Conservatism

Allergan believes that due to the reasons stated above regarding the difficulties in projecting the timing of cash tax payments, the Classification rules of the Proposed Interpretation would, as a practical matter, cause companies to classify the entire amount of accrued liabilities for uncertain tax positions as a "long-term" liability for most of the life of the recognized obligations. We believe that this default position of classifying the tax liabilities as "long-term" limits the ability of companies to be conservative in the presentation of their financial statements.

The risk of misreporting an amount as long-term is much greater than misreporting an amount as short-term, especially in light of current ratio requirements in debt covenants and the potential effect on debt rating agency evaluations. Allergan questions whether some companies will try to ignore or avoid the Classification rules of the Proposed Interpretation to err on the side of conservatism by recording more amounts as "short-term" than "long-term" to avoid the misreporting risk. But by doing so, a company will create reporting classification risk in its financial statement certifications and complicate each reporting period's closing procedures and subsequent review procedures by its auditor.

APB Statement No. 4 is directly on point when it states "frequently, assets and liabilities are measured in a context of significant uncertainties. Historically, managers, investors, and accountants have generally preferred that possible errors in measurement be in the direction of understatement rather than overstatement of net income and net assets. This

² See ¶121 of Statement of Financial Accounting Concepts No. 2.

has led to the convention of conservatism." Allergan believes the Classification rules as presently constituted hinder a company's ability to continue in the historical and generally preferred accounting tradition of conservatism.

Administrative Risk

Finally, the Classification rules of the Proposed Interpretation are not practical from an administrative disclosure risk point of view with taxing authorities. Because the liability for uncertain tax positions will generally be significant, most companies will be required to separately disclose the amount accrued for long-term income tax liabilities either on the face of the balance sheet or in the related notes, which will provide a readily visible red flag to all taxing authorities as to the magnitude of potential audit issues for which the taxing authorities should be looking. While this disclosure provides the users of financial statements with information regarding potential future cash flows associated with such liabilities, Allergan does not believe that it provides more useful information than that which would be available if the accrual for uncertain tax positions were entirely classified as a short-term liability.

Summary

Allergan agrees with the view expressed by certain Board members, as discussed in paragraph B33 of Appendix B, that the liability for uncertain tax positions is similar to a "due-on-demand note." The due date for the underlying obligation has already passed at the time of filing a tax return. Therefore, there is no certain specified future due date to pay the accrued liability. Without a stipulated contractual obligation to pay beyond one year, conservatism dictates that a company should report the liability as a potential current obligation because there is no reasonable certainty that payment of the obligation will occur beyond one year.

Additionally, the classification of the obligation as long-term seems to be a slick way to generate a positive current ratio benefit because the taking of an uncertain tax position in a filed tax return generates a current cash flow benefit that is reflected in the current asset position, but the corresponding accrued obligation for the uncertain tax position is recorded as a long-term liability, resulting in a mismatch of the economics.

If all liabilities for uncertain tax positions were reported in the current income taxes payable amount of the balance sheet, a company's decision regarding classification would be simplified, leading to (1) greater consistency among firms, (2) substantial reduction of the negative risks of reporting something that may or may not be truly long-term in nature, (3) conservative reporting of current ratios, and (4) elimination of potential administrative risks with taxing authorities resulting from separately disclosed accrued amounts for uncertain tax positions.

³ See ¶171 of APB Statement No. 4.

Effective Date and Transition

With respect to Issue 11, Allergan strongly believes that the Board should consider changing the effective date to require adoption of the Proposed Interpretation in the first fiscal quarter of fiscal years beginning after December 15, 2005 (i.e., for calendar year end companies, adoption will occur in the first fiscal quarter of 2006). Because this Proposed Interpretation will result in reporting a change in accounting principle, we believe the majority of public companies that use calendar year ends will benefit from the adoption in their first fiscal quarter of 2006, which is consistent with the way the effective date was handled for FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, the last accounting standard that caused Allergan to report a change in accounting principle in its financial statements. Allergan generally believes that reporting a change in accounting principle is less disruptive to financial performance expectations of users of financial statements if reported in the first fiscal quarter instead of the last fiscal quarter.

Thank you for your consideration.

Respectfully,

James F. Barlow
Senior Vice President
Corporate Controller
(Principal Accounting Officer)

Alex R. Thurman
Senior Manager
Corporate Tax Department