



Software Finance & Tax Executives Council
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Via Email

LETTER OF COMMENT NO. 9

Mr. Robert H. Herz
Chairman, Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed FASB Staff Position-FIN 48-a

Dear Chairman Herz:

On behalf of the Software Finance and Tax Executives Council (SoFTEC), I write to comment on proposed FASB Staff Position No. FIN 48-a, Definition of *Settlement* in FASB Interpretation No. 48 (the "FSP"). Specifically, we request that the final FSP include guidance on how the statute of limitation provisions of FIN 48 apply in the case of tax benefits arising in an earlier year that can be claimed in a later year, such as net operating losses. FIN 48 provides that one of the conditions requiring subsequent recognition of a previously unrecognized tax benefit is the expiration of the statute of limitations on the examination or challenge of the position by a tax administrator. We believe that statutes of limitation are so intertwined with when an issue is considered "settled" that the issue should be addressed within the context of the current FSP.

SoFTEC is a trade group providing software industry focused public policy advocacy in the areas of tax, finance and accounting. Many software companies experienced net operating losses in the wake of the technology downturn in the early part of this decade and have unused net operating loss carryforwards from those years. Those companies have an interest in clarifying their reporting requirements with respect to those tax assets in light of the statute of limitations provisions of FIN 48.

FIN 48 provides that one of the conditions requiring subsequent recognition of a previously unrecognized tax benefit is the expiration of the statute of limitations on the examination or challenge of the position by a tax administrator. For federal income tax purposes, the normal statute of limitation for the Internal Revenue Service to propose a deficiency in taxes for a given year is three years from the date the return is filed. However, in the case of a net operating loss carryforward, the IRS may examine a loss year within three years after the return is filed on which a deduction for the loss carryforward is claimed. Net operating losses may be carried forward for 20 years.

There are many tax reasons why an enterprise may not be able to use a net operating loss as a deduction in later years. For instance, the loss may have been incurred

by a business which had been acquired and the successor cannot use the carryforward to offset income unrelated to the acquired business. These NOL carryforwards can thus drag on unused for many years

If a taxpayer claims a deduction for an NOL carryforward in the 20th year after the loss year, the IRS will have 23 years to examine any item on the original return on which the net operating loss was reported. This very long time lag raises issues under FIN 48. First, we think 23 years is an unreasonable amount of time to require that a taxpayer wait to fully recognize a tax asset such as a net operating loss carryforward when an item on the return that contributed to the loss does not meet the “more likely than not” test of FIN 48. Recognition of a 23-year old tax benefit does not provide financial statement users with useful information about the current performance of the enterprise.

Additionally, it is not clear how a financial statement preparer would handle a situation where recognition of a tax benefit is required 3 years after the tax benefit has expired. If the taxpayer did not fully exhaust its net operating loss carryforward by the 20th year after it was incurred, it would expire unused. However, the statute of limitations would require some financial statement treatment in the third year after it expired because that is the year in which the statute of limitations would expire on the examination of the loss year return.

We propose that you include in the FSP guidance that would permit a preparer to treat the statute of limitations with respect to a loss year as having expired upon the expiration of the normal three-year statute of limitation without consideration of the NOL carryforward. If the preparer later claims the benefit of the NOL carryforward, then the preparer should reevaluate the position on the loss year return that previously did not meet the “more likely that not” test of FIN 48. This will start a three year statute of limitations at least with respect to the portion of the NOL carryforward deducted in that year. If the preparer deducts portions of the loss in subsequent years, then presumably each such year will give the IRS another 3-year opportunity to examine the loss year and require that the preparer conduct another reevaluation of its reporting positions on the loss year return. This proposed treatment would be fully consistent with the underlying philosophy of FIN 48 by requiring periodic reevaluations of whether a benefit should be recognized based on specific facts and circumstances.

We thank you for your attention to this matter and look forward to working with you and your staff on this issue. I can be contacted at (202) 331-9533 with any questions.

Respectfully submitted,



Mark E. Nebergall
President
Software Finance and Tax Executives Council