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Accountants and Business Advisors

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LETTER OF COMMENT NO. 10

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
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Proposed FSP FIN 48-a, "Definition of *Settlement* in FASB Interpretation No. 48"

Dear Mr. Smith:

We appreciate the opportunity to comment on proposed FASB Staff Position FIN 48-a, "Definition of *Settlement* in FASB Interpretation No. 48."

We support the Board's decision to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. We have the following comments on the proposed FSP.

Widely understood policy

One of the conditions that the proposed FSP requires for a tax position to be considered effectively settled through examination is that, based on the taxing authority's *widely understood policy*, the enterprise considers it highly unlikely that the taxing authority would subsequently examine or reexamine any aspect of the tax position included in the completed examination. We believe that rather than introducing another term related to the degree of probability of an event occurring, the FSP should be revised to use the word remote instead, with an indication that it is used in the same sense as in Statement 5, *Accounting for Contingencies*.

In assessing the more-likely-than-not criterion, paragraph 7b of Interpretation 48, *Accounting for Uncertainty in Income Taxes*, states that an enterprise should take into account widely understood past administrative practices and precedents of the taxing authority in its dealings with the enterprise or similar enterprises. If the Board intends for the term widely understood policy to have the same meaning as past administrative practices and precedents used in paragraph 7b, we believe that the proposed FSP would be more consistently applied if the term from paragraph 7b is used. If there are

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differences in the concepts, then we believe it would be important for the proposed FSP to discuss those differences and provide examples of what constitutes a widely understood policy.

Changes to widely understood policy

We believe the Internal Revenue Service currently has a well understood policy with respect to reopening cases closed after examination as found in Rev. Proc. 2005-32 and Policy Statement P–4–3. The revenue procedure provides that the Internal Revenue Service will not reopen a case closed after examination to make an adjustment to a liability unfavorable to the taxpayer unless: (1) there is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact; (2) the prior closing involved a clearly defined substantial error based on an established Internal Revenue Service position existing at the time of the previous examination; or (3) other circumstances exist which indicate failure to reopen would be a serious administrative omission. The other circumstances that would permit the reopening of closed cases include cases with items or transactions, such as reportable transactions under Treas. Reg. Sec. 1.6011-4(b), that present significant potential for abuse for which a limited examination was performed. All reopenings require prior high level approval.

However, Internal Revenue Service executives have recently indicated that the policy on reopening closed cases may be revisited. For example, speaking at a February 8, 2007, D.C. Bar meeting, the Senior Advisor to the Commissioner of the Large and Mid-Size Business Division indicated that the information included in Interpretation 48 disclosures could trigger the other circumstances exception to the Internal Revenue Service's general policy against second examinations. The Senior Adviser subsequently clarified that "the IRS might reopen an audit more often than has been the past practice to ask about a Interpretation 48 disclosure." The Senior Adviser further stated that "while current law allows for second examinations of previously examined years in special circumstances, the IRS policy is not to conduct second exams, and that they are rare." The Senior Adviser went on to state "whether the transparency in Interpretation 48 disclosures could cause an increase in second examinations when they are appropriate because the required special circumstances for reopening an exam may be signaled in published financial statements."

While in our view, the Senior Adviser's statements do not constitute a change to the Internal Revenue Service's widely understood policy, we do acknowledge that some enterprises may now feel uncomfortable making an assessment that it is highly unlikely that the Internal Revenue Service would subsequently examine or reexamine any aspect of the tax position included in a completed examination. Accordingly, guidance on evaluating when a change in a widely understood policy has occurred would be helpful in applying the FSP.

Effectively settled

The Internal Revenue Service can correct an erroneous accounting method (even for an otherwise closed year) by making a section 481(a) adjustment in the taxpayer's first open year. The section 481(a) adjustment effectively puts a taxpayer in the same tax paying position that it would have been in had it been using a correct method of accounting. A similar issue exists with respect to net operating loss (NOL) and tax credit carryforwards. Specifically, the Internal Revenue Service can examine or reexamine the year the NOL or credit was generated (even if that year is closed) and, if

appropriate, make an adjustment to an open year to reflect the correct carryforward. In both of these circumstances, a tax position that was not specifically reviewed or examined by the taxing authority in the tax years under examination should not be considered effectively settled through that examination, as the taxing authority can still make adjustments to the position in subsequent examinations. We suggest that the FASB consider using these situations as examples of positions that are not effectively settled.

Amendment to Interpretation 48, paragraph A34

Example 2 includes a fact pattern in which the tax authority announced a change in its policy regarding reopening an examination considered previously closed. In the evaluation of the fact pattern, the conclusion is reached that tax benefits cannot be recognized until the statute of limitations expire, unless there was sufficient evidence obtained through the examination process to meet the more-likely-than-not criterion. However, the fact pattern does not clearly state whether the taxing authority's change in its policy for reopening examinations will be applied to all open tax years or prospectively. We believe the example would be enhanced if the application was clearly indicated and the effect on open years prior to the change in the policy was discussed in the evaluation.

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We would be pleased to discuss our comment with Board members or staff. Please direct your questions or comments to L. Charles Evans at (832) 476-3614 or Joseph Graziano at (732) 516-5560.

Sincerely,

/s/ Grant Thornton LLP