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LETTER OF COMMENT NO. 5

Via email: director@fasb.org

Re: *Proposed FASB Staff Position No. FIN 48-a*

Dear Chairman Herz:

On February 27, 2007, the Financial Accounting Standards Board issued for public comment a proposed amendment to FIN 48 on *Accounting for Uncertainty in Income Taxes*. The proposed *FASB Staff Position No. FIN 48-a* would provide guidance on how an enterprise should determine whether a tax position is effectively settled for purposes of recognizing a previously unrecognized tax benefit. On behalf of Tax Executives Institute, I am pleased to submit the following comments.

Tax Executives Institute is the preeminent association of corporate tax executives in the world. Our more than 6,900 members are accountants, attorneys, and other business professionals employed by approximately 3,000 of the leading companies in the United States, Canada, Europe, and Asia. TEI represents a cross-section of the business community, and is dedicated to the development and implementation of sound tax policy and to promoting the uniform and equitable enforcement of the tax laws. The Institute is proud of its record of working with congressional committees, government agencies, and other policy-making bodies (including the Financial Accounting Standard Board and Public Company Accounting Oversight Board) to minimize the cost and burden of tax administration and compliance to the mutual benefit of the government, business, and ultimately the public. TEI supports efforts to ensure that companies fairly present their financial position in financial statements prepared for investors and in documents filed with the Securities and Exchange Commission.

TEI members are responsible for conducting the tax affairs of their companies, ensuring compliance with the tax laws, and properly reporting the effect of tax positions on their financial statements. Thus, members deal with the tax code in all its complexity, as well as with the Internal Revenue

Service and other tax administrators, on a daily basis. Nearly all of the companies represented by our members issue financial statements that are governed by the FASB's pronouncements and most are SEC registrants. In addition, they are subject to scrutiny by the IRS and various other agencies in the United States and foreign jurisdictions on a continual basis.

Background

The FASB staff received inquiries on whether it is appropriate for an enterprise to recognize a previously unrecognized tax benefit when the only factor that has changed since determining that no benefit should be recognized is the completion of an examination by a taxing authority. On February 27, 2007, the Board directed the FASB staff to issue for public comment Proposed FASB Staff Position No. FIN 48-a, which would amend Interpretation 48 to clarify that a tax position can be effectively settled upon examination by a taxing authority. The principal changes to FIN 48 are an amendment to Paragraph 10, especially the addition of paragraphs 10A-10C, and the addition of illustrative examples of effective settlement in new paragraph A 34. Other amendments conform FIN 48's language with the proposed FSP. The changes are proposed to be effective upon the initial adoption of Interpretation 48. FIN 48 is effective for financial statements issued for fiscal years beginning after December 15, 2006.

A. Paragraph 5 of the FSP and Amended Paragraph 10A of Interpretation 48

Under Paragraph 5 of the FSP and Paragraph 10A of the Amendments to Interpretation 48, a tax position shall be considered *effectively settled* through examination when all of the following conditions have been satisfied:

- a. The taxing authority has completed its examination procedures including all appeals and administrative reviews that the taxing authority is required or expected to perform for the tax position.
- b. The enterprise does not intend to appeal or litigate any aspect of the tax position for the completed examination.
- c. 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, *presuming the taxing authority has full knowledge of all relevant information.* (Emphasis added.)

In the tax years under examination, a tax position does not need to be specifically reviewed or examined by the taxing authority to be considered effectively settled. If the taxing authority has specifically examined a tax position during the examination process, an enterprise shall consider this information in assessing the likelihood that the taxing authority subsequently would reexamine that tax position for the completed examination.

1. *Highly Unlikely.* Neither U.S. accounting literature nor U.S. tax law uses the phrase *highly unlikely* in an authoritative sense. TEI interprets the phrase to mean that the probability of a

subsequent examination or reexamination is “remote” in the FAS 5 sense of the term or that the circumstances under which a taxing authority will reexamine a return are circumscribed and rare.¹ Under FAS 5, remote is defined as the “chance of the future event or events occurring is slight.” We believe this definition is consistent with the FSP. Thus, TEI recommends that the FSP be clarified either by substituting “remote” for “highly unlikely” or by defining the phrase “highly unlikely.”

2. *Presuming the taxing authority has full knowledge of all relevant information.* The meaning and purpose of including the foregoing phrase in paragraph 5(c) of the FSP and paragraph 10A(c) of the amendments to the Interpretation are unclear. The intent may be to reinforce identical statements in paragraphs 7(a) and 8 of the Interpretation that the “taxing authority has full knowledge of all relevant information.” In the context of paragraphs 7(a) (in respect of recognition of tax positions) and 8 (measurement of tax positions) of the Interpretation, the purpose of the phrase is clear: to prevent an enterprise from considering the risk of detection of a position by taxing authorities when recognizing and measuring a tax position. In the context of an *examination* of a taxpayer’s return (or a reevaluation of an enterprise’s tax positions during or following examination), the phrase is confusing. Moreover, it seemingly conflicts with the subsequent sentence, which states that “a tax position does not need to be specifically reviewed or examined . . . to be considered effectively settled.” Absent fraud, malfeasance, concealment, or misrepresentation of facts or transactions by an enterprise, the taxing authority will know what it knows based on its examination of the tax return and related books and records. TEI is uncertain what additional *knowledge* the taxing authority should be *presumed* to have (but seemingly does not have) following its examination. Hence, TEI recommends deleting the phrase “presuming the tax authority has full knowledge of all relevant information” from paragraph 5(c) of the FSP and Paragraph 10A(c) of the Amendments to Interpretation 48. The conditions for recognition of an effectively settled position are properly stated in paragraphs (a), (b), and so much of (c) through and including the word examination.

3. *Other conditions should permit an “effective settlement.”* In many taxing jurisdictions, an enterprise can negotiate a legally binding agreement that effectively settles the tax treatment of a position. For example, in the United States a taxpayer can enter into a closing agreement that is a legally binding contractual agreement governing a tax year or years. A taxpayer may also enter into an agreement on Form 870, 870AD, or 872 (restricted consent) that will govern the treatment of the tax positions and years covered by the Form. We recommend that the FASB acknowledge alternative means of concluding that a tax position is “effectively settled.” For example, where a legally binding arrangement between the enterprise and the taxing authority has been adopted, an enterprise should be permitted to recognize any previously unrecognized tax positions that are “effectively settled” upon entering into the agreement, including the execution of Form 870, 870AD, or 872.

¹ For example, under Rev. Proc. 2005-32, 2005-23 I.R.B. 1206 (June 6, 2005), the IRS will not reopen a case closed after examination to make an adjustment to liability unfavorable to the taxpayer unless: (1) there is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of material facts; (2) the closed case involved a clearly defined, substantial error based on an established IRS position existing at the time of the examination; or (3) other circumstances exist indicating that a failure to reopen the case would be a serious administrative omission. A serious administrative omission generally involves items or transactions that present significant potential for abuse.

B. Application of Guidance and the Examples

Overall, the examples provided in the FSP are welcome, but could be helpfully clarified.

1. *Examples 1 and 2.* Between the facts and conclusions of Examples 1 and 2, it is unclear what effect a review of a refund case by the Joint Committee on Taxation has on the recognition of examined and unexamined positions in the United States.

Example 1 assumes that an enterprise has three positions (Positions A, B, and C) in tax year 20X5 that did not meet the recognition criteria prior to an examination by a taxing authority. Positions A and B are examined, but Position C is not. Following the examination, the enterprise and taxing authority reach agreement in respect of Positions A and B. The facts assume that only Position A is subject to review by an “oversight committee” and that the taxing authority does not reexamine positions once submitted to the oversight committee. Upon the exercise of judgment, the enterprise concludes that Positions B and C can be recognized in 20X7. Position B is recognized because information obtained during the examination causes the enterprise to reevaluate whether the more-likely-than-not standard of paragraph 10 is satisfied. Position C is recognized because it meets the conditions for being “effectively settled” under paragraphs 10 and 10A of the FSP. Position A is not recognized until it is reviewed by the oversight committee.

In Example 2, the facts are similar except that the taxing authority has recently announced a change in its policy on reopening examinations that will cause more examinations to be reopened. In Example 2, the enterprise must wait until the expiration of the statute of limitations to recognize the tax benefit from any position unless it can conclude that the tax positions satisfy the more-likely-than-not-recognition criteria based on evidence obtained during the examination.

The Joint Committee on Taxation (JCT) is required to perform an administrative review of cases where the amount to be refunded or credited to a taxpayer exceeds \$2 million. In conducting its review, the JCT generally does not review individual positions; it reviews the case in total and makes comments to the IRS about it.² Hence, under Example 1 it may *not* be appropriate for the enterprise to recognize either tax position A *or* C unless the enterprise concludes that it is highly unlikely (or remote) that the oversight committee (JCT) would propose that the taxing authority (IRS) revise its determination. Position B might still be recognized if the information obtained during the examination causes the enterprise to conclude that the position meets the more-likely-than-not standard. The results in Example 2 would remain the same.

² The “oversight committee” examples reflect a conservative approach for determining when a U.S. tax position (or case) is considered “effectively settled.” The JCT does not have the authority to approve or disapprove refunds or credits. Moreover, although it would be prudent for the IRS to take account of the JCT’s comments, the IRS is not legally required to follow the JCT’s recommendations or accede to its comments. In addition, the IRS generally exercises heightened diligence and extreme care in the preparation of cases submitted for JCT review. As a result, it is rare for the JCT to raise new issues or make comments that would cause the IRS to modify its position. Hence, in a refund case involving a contested issue, it will be possible under the FSP for an enterprise to conclude with a high degree of probability (more than 90 percent) that a case is “effectively settled” upon the IRS’s concession to the taxpayer’s position. Despite the IRS concession and the conclusion that the position is highly probable of success, the enterprise would be unable to recognize the tax position pending final administrative review by the JCT.

2. *Example 3.* In Example 3, it is unclear whether Enterprise Z cannot recognize Tax Positions B or C because they are leverage for negotiating settlements with respect to Position A or because the taxing authority can examine or reexamine other issues during the appeals process. We recommend that the FASB elaborate on this example and provide guidance on the recognition of an examined issue (Position D) and an unexamined issue (Position E) that are unrelated to Position A.

3. *Effective Settlement of "Cases" v. Tax Positions.* One challenge in applying the practical guidance in the examples is that taxpayers settle *cases* with taxing authorities and those cases consist of multiple tax positions. Cases in the IRS's Coordinated Issue Case program can consist of one or more tax years as part of an examination cycle (or even consist of multiple cycles). As the FSP notes, some tax positions are inextricably linked with others and must be considered together with the related tax positions to determine whether any of the positions is effectively settled. What is not noted in the FSP is that other unrelated tax positions can be swept into an overall hotchpot of contentious issues that are resolved on a percentage basis to reach an effective settlement. In addition, although a taxpayer may express its views and reach agreements about particular tax positions, the agreement on one or more of the issues may be conditioned on reaching an overall resolution with respect to all positions that are raised (or potentially raised) by an examination team (or Appeals). As a result, we believe that enterprises should be permitted to apply the effectively settled standard on a tax-position-by-position basis *or*, with respect to issues that the enterprise considers potentially contentious, on a tax year or tax cycle basis. Theoretically, FIN 48 applies to each tax position, but on a practical basis "effective settlement" of examinations, appeals, or litigation often requires "trading" of related and unrelated issues. An enterprise should not be compelled to prematurely recognize tax positions if doing so would jeopardize the prospects for an overall settlement.

C. Effective Date

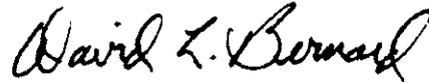
The guidance in the FSP is effective upon an enterprise's initial adoption of Interpretation 48. Since FIN 48 is already in effect for enterprises whose fiscal years began after December 15, 2006, many enterprises have likely made required disclosures under Staff Accounting Bulletin 74 about the effect of adopting FIN 48. Moreover, depending on when the FSP is promulgated, many enterprises will have issued one or more quarterly statements based on FIN 48. Finally, in light of the proposed FSP, many enterprises are reassessing the status of foreign (non-U.S.) tax examinations with their foreign advisors in order to determine whether the examinations can be reopened or are effectively settled. Obtaining professional advice in order to form a judgment about the status of foreign tax positions is time consuming and enterprises may not have had sufficient time to apply the FSP retrospectively. To minimize hardships and prevent potential restatements caused by differences between FIN 48 and FIN 48-a, we recommend that enterprises be permitted to apply the FSP prospectively in the first quarter following its issuance.

Conclusion

Tax Executives Institute appreciates the opportunity to comment on the proposed FASB Staff Position No. 48-a and would be pleased to discuss its comments with the Financial Accounting Standards Board. If you should have any questions about the comments, please do not hesitate to

contact me at 920.721.2230 or either Eli J. Dicker, the Institute's Chief Tax Counsel, or Jeffery P. Rasmussen of the Institute's legal staff at 202.638.5601 or, respectively, edicker@tei.org and jrasmussen@tei.org.

Respectfully submitted,

A handwritten signature in black ink that reads "David L. Bernard". The signature is written in a cursive style with a large, prominent initial "D".

David L. Bernard
International President