

CHIRON

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Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 1215-001

Dear Sir/Madam:

Chiron Corporation is a publicly traded biopharmaceutical company with approximately \$1.7 billion in revenues and 5,500 employees. Chiron Corporation maintains a staff of eleven full-time tax professionals and also engages several accounting firms and law firms in order to comply with the tax laws and regulations of over fifteen countries in which it has operations. Chiron wishes to share its views on the Financial Accounting Standards Board's ("FASB") Proposed Interpretation, *Accounting for Uncertain Tax Positions* (the "Proposed Interpretation").

The Company's principal comment is related to the proposed effective date of the proposed Interpretation, which is for fiscal years ending after December 15, 2005. This would require calendar year reporting companies such as Chiron to first adopt the interpretation in the fourth quarter of 2005.

We believe that the effective date should be postponed until fiscal years ending after December 15, 2006 (i.e., a one year deferral). The proposed Interpretation is a significant change in accounting practice and will require a major implementation effort, particularly in analyzing and computing the cumulative effect of the accounting change. Furthermore, it appears that the Board believed that a 2005 effective date was feasible was because calendar year companies would have completed their 2004 tax filings and would therefore be in a position to analyze the cumulative effect of the accounting change (Paragraph B41). This assumption is incorrect, as many companies have significant non-U.S. tax exposures and the filing deadlines in non-US jurisdictions are often later. Finally, the Board should be aware that the process of identifying uncertain tax positions, documenting the level of assurance and insuring correct financial statement classification in a Sarbanes-Oxley (SOX) compliant manner will require companies to significantly change their approach to establishing tax reserves and accordingly will require significant revisions to controls and procedures on a worldwide basis.

In addition to our view that the effective date should be postponed, we respectfully offer other comments on a number of other issues about which the Board has requested comment, which are appended to this letter.

We appreciate the opportunity to comment on the proposed Interpretation.

Very truly yours,

A handwritten signature in black ink, appearing to read 'David V. Smith', with a stylized, flowing script.

David V. Smith
Senior Vice President and Chief Financial Officer

A handwritten signature in black ink, appearing to read 'Don Rath', with a stylized, flowing script.

Don Rath
Vice President, Tax

Attachment

COMMENTS ON SPECIFIC ISSUES

Issue 1: This proposed Interpretation would broadly apply to all tax positions accounted for in accordance with Statement 109, including tax positions that pertain to assets and liabilities acquired in business combinations. It would apply to tax positions taken in tax returns previously filed as well as positions anticipated to be taken in future tax returns. Do you agree with the scope of the proposed Interpretation? If not, why not?

First, the proposed Interpretation does not define what an "uncertain" tax position is. It is unduly broad in that it requires a company to analyze *all* of its tax positions.

Few if any tax positions are "certain" in an absolute sense. However taxpayer experience or industry practice may allow a taxpayer to reliably conclude that an issue is not susceptible to challenge because in normal course it does not involve an area that the tax authorities are concerned with.

Second, we do not believe that the proposed Interpretation should be applied to tax positions for which only the timing of, and not the entitlement to the benefit under applicable tax law, is uncertain. The application of the proposed Interpretation to temporary differences provides little useful financial information but could require a great deal of work for public companies.

Application of the proposed Interpretation to temporary differences will in almost all cases result in "grossing up" of deferred tax assets and liabilities and income taxes payable without any net change to the income statement. The time and effort to track different tax bases of assets and liabilities for purposes of the proposed Interpretation as well as for book and tax return purposes are not justified in view of the limited (if any) financial information provided.

The fact pattern described in paragraphs A22-A23 is not uncommon. For example:

- A company acquires a group of intangible assets. It is uncertain whether the assets acquired constitute a "trade or business." Therefore it is uncertain whether the intangibles should be amortized over 15 years (Internal Revenue Code Section 197) or a different (shorter) life.
- A company completes a major facility expansion and performs a cost segregation study in order to appropriately classify its costs for depreciation purposes. It is uncertain whether the tax authorities may treat amounts assigned to tangible personal property (5 and 7 year assets) as real property (a 39 year asset).

- It is sometimes uncertain whether ERP implementation costs should be in part deductible as software development costs under IRC Section 174 or capitalized and depreciated over 3 years.
- It is sometimes uncertain whether certain types of milestone payments paid by a pharmaceutical company to a collaborator for drug development are currently deductible or amortized over the term of the collaboration agreement.

Furthermore, we believe it is “overkill” to apply a rigorous “probable” standard to items where the company is assured of obtaining the tax benefit, and the only uncertainty relates to timing. Adoption of a “more likely than not” standard, as suggested under Issue #3 below may lessen concern in this area, as companies will usually obtain such level of assurance for a material return filing position, even if it is a “timing” item.

Finally, we believe that companies provide for interest exposure on material temporary differences and so the risk of uncertainty for temporary differences is already being considered under current practice.

Issue 2: The Board concluded that the recognition threshold should presume a taxing authority will, during an audit, evaluate a tax position taken or expected to be taken when assessing recognition of an uncertain tax position. (Refer to paragraphs B12–B15 in the basis for conclusions.) Do you agree? If not, why not?

While there is general agreement with the Board’s position that application of the standard should not take into account the probability of audit *detection*, there should be room for taking into account the probability of *assertion*.

Taxpayer experience or industry practice may allow a taxpayer to reliably conclude that an issue is not susceptible to challenge because in normal course it does not involve an area that the tax authorities are concerned with as a matter of policy or practice. Probability of assertion is also an appropriate consideration in situations where an unfavorable adjustment to an uncertain tax position may lead to a corresponding favorable adjustment to another item, in which case the tax authorities have little incentive to assert a contrary position.

Issue 3: The Board decided on a dual threshold approach that would require one threshold for recognition and another threshold for derecognition. The Board concluded that a tax position must meet a probable (as that term is used in Statement 5) threshold for a benefit to be recognized in the financial statements. (Refer to paragraphs B16–B21 in the basis for conclusions.) Do you agree with the dual threshold approach? Do you agree with the selection of probable as the recognition threshold? If not, what alternative approach or threshold should the Board consider?

First, we believe that the probable standard is too difficult to meet in practice and should be replaced with a "more likely than not" standard coupled with a "best estimate" approach.

- The term "probable" as used in Statement 5 is not quantified, but is commonly interpreted by public accounting firms to be a probability threshold of 70-75%. On this basis, 100% reserves would be established on positions that have a 50-70% (or 75%) likelihood of being sustained.
- The timing mismatch between when income from a transaction is recognized and when a significant portion of the related tax effect is recognized is detrimental to the objective of accurate financial reporting.
- Companies could very well be faced with being required to produce "should" opinions for all of their tax positions to their auditors to avoid a proposed adjustment. There are many situations in which a "should" opinion is impractical but there is a low level of risk to the position being challenged. For example, there may be ample authority based on private letter rulings or other taxpayer-favorable advice from the tax authorities which may not be cited as precedent, or there may be known administrative practices or public comments that would lead one to believe that the risk on an uncertain tax issue is low.
- A more operable approach would be to set the initial recognition criteria at the "more likely than not" level (i.e., greater than 50%). Combining this with the use of a "best estimate" outcome should result in accounting results that better approximate management's best estimate of the ultimate outcome of all tax positions.

Second, having a different standard for recognition and derecognition is conceptually troubling.

- The proposed dual threshold approach could frequently lead to inconsistencies in a company's financial reporting. One example is the situation where a company takes the same position on successive tax returns but the company's judgment on the sustainability of the position changes from "probable" to "more likely than not" due to a tax ruling or a third party court case, which often happens in practice. In such cases, the company would not "derecognize" the benefits recorded for the tax position in the earlier years in which a "probable" standard was met, but could not recognize the benefit for the same type of item in subsequent years in which a "more likely than not" standard was met.
- A single recognition/derecognition threshold of "more likely than not" can be practically applied and avoids potential inconsistencies.

Issue 6: The Board concluded that once the probable recognition threshold is met, the best estimate of the amount that would be sustained on audit should be recognized. The Board concluded that any subsequent changes in that recognized amount should be made using a best estimate methodology and recognized in the period of the change. (Refer to paragraphs B9-B11 and B26-B29 in the basis for conclusions.) Do you agree with the Board's conclusions on measurement? If not, why not?

We generally agree with this approach, subject to our comments under Issue #3 above. However, we believe it would be helpful if the proposed Interpretation clarified that the "unit of account" approach in Paragraphs A2-A11 is illustrative of one approach that could be taken and is not required.

An example in the proposed Interpretation which appears to require a "unit of account" analysis could lead to a situation where companies are expected to be able to apply the proposed Interpretation on a transactional basis. There are many issues on which a set of tax positions on similar items are likely to be settled on a consistent basis even where there are not equal levels of assurance on individual items.

Issue 7: The Board concluded that the liability arising from the difference between the tax position and the amount recognized and measured pursuant to this proposed Interpretation should be classified as a current liability for amounts that are anticipated to be paid within one year or the operating cycle, if longer. Unless that liability arises from a taxable temporary difference as defined in Statement 109, it should not be classified as a deferred tax liability. (Refer to paragraphs B30-B35 in the basis for conclusions.) Do you agree with the Board's conclusions on classification? If not, why not?

We believe that liabilities related to uncertain tax positions should continue to be classified as current liabilities on the balance sheet.

The view that tax contingencies should be "current" because they are theoretically "due on demand" is no more and no less "correct" than the view that tax contingencies should be classified as "current" and "noncurrent" based on the expected timing of payment. However, the timing of payment is often difficult to predict because of the nature of the audit and settlement process. There is considerable risk that a company may appropriately classify a contingent tax liability as "current," expecting a quick conclusion of an audit cycle, only to subsequently learn of a new issue being raised, a change in audit personnel or a change in the decision to appeal an audit result will delay final settlement.

Furthermore, we are concerned that classification of contingent tax liabilities as noncurrent may more readily identify such balances as "tax reserves," possibly resulting in the need to disclose separately the nature of the contingency in a manner that may

compromise the company's ability to settle an uncertain tax position upon audit. Such a situation creates an imbalance between the interest of the shareholders in accurate financial reporting and the interests of the shareholders in favorable audit outcomes.

Issue 8: The Board concluded that, consistent with the guidance in paragraph 194 of Statement 109, a change in the recognition, derecognition, or measurement of a tax position should be recognized entirely in the interim period in which the change in judgment occurs. (Refer to paragraph B36 in the basis for conclusions.) Do you agree with the Board's conclusions about a change in judgment? If not, why not?

We generally agree with this approach. However in practice this will require companies to perform a full review of the level of assurance on each of their uncertain tax positions on a quarterly basis. Consideration should be given to allowing companies to apply the proposed Interpretation on an annual basis, similar to the impairment test required for goodwill under FAS 142.

We believe a year-end adoption is more consistent with the normal tax cycle that most companies work through in determining the level of assurance of their tax positions. A "once a year" approach on the overall documentation of the level of assurance on each of its major tax positions, coupled with recording of specific changes (e.g., actual settlements, statute expirations) in the interim period within which they occur would lead to accurate financial reporting in the majority of cases.