Letter of Comment No: 4
File Reference: 1215-001
Date Received: 8/11/05

Radin, Glass & Co., LLP

Certified Public Accountants

360 Lexington Avenue New York, NY 10017 www.radinglass.com 212.557.7505

Fax: 212.557.7591

والمراز والمراز والمراز فرفر فرفر فرفر فرافر فرافر فرافر فرافر فرافر فرافر فراز والمراز والمراز والمراز والمراز

August 11, 2005

Technical Director
File 1215-001
Accounting for Uncertain Tax Positions

I am pleased to have the opportunity to comment on the Exposure Draft of the proposed interpretation of FAS 109. I agree with the need for further guidance in accounting for uncertain tax positions. However, I believe that the approach in the Exposure Draft will result in presentations that do not reflect the underlying economic reality, especially as to state tax positions.

I suggest that the accounting principle that would most reflect the economic reality of providing for uncertain tax positions is that of Expected Cash Flow, as used in Statement of Concepts 7, starting with paragraph 42. This approach has been used by companies and their auditors for many years relating to uncertain tax positions.

Issue 2 - Overall issue:

The Proposed Interpretation requires that all uncertain tax positions be evaluated by assuming (1) that the taxing authority will perform an audit, and (2) that the auditor will challenge each and every uncertain tax position. While I understand the logic of paragraphs B12 to B15, historically the portion of uncertain tax positions taken by taxpayers actually audited and challenged by taxing authorities is significantly less than the 51% required by FAS 5 for recognition. Therefore, for both federal income taxes and for states where returns are filed, in the years when uncertain tax positions are taken there will be tax accruals, the majority of which will be reversed when the statute of limitations expires.

As indicated above, I believe that a more appropriate methodology is the one in Statement of Concepts 7 – Appendix A. While those examples are intended to evaluate expected cash revenues, I believe that the technique is appropriate for expected disbursements.

Issue 2 - Uncertain Tax Positions for State returns where no return has been filed:

I do not believe that the Board's assumption that taxing authorities will examine all tax positions is appropriate for US state tax exposures where the Enterprise has decided not to file a return. I disagree specifically with the position taken in the second sentence of B14 as the taxing authority is not aware of the claim. I believe that the guidance of paragraph 38 of Statement 5 on unasserted claims would be more appropriate for state issues where no return has been filed.

While all US companies must file US income tax returns, it is not always clear, under the various state laws, whether or not a state return is required to be filed:

The US Supreme Court has ruled that a level of contacts of an out of state Enterprise must exist for the Enterprise to have "nexus", and therefore be taxed in the state. A common occurrence for many Enterprises is to have a salesperson with merchandise in his vehicle visit a potential customer, show the merchandise to the customer, but then have the customer directly order from an out of state location; under these circumstances the Enterprise is not doing business in the state and is not required to file a return. If, however, the salesperson sells some merchandise from the vehicle, performs installation or other services, then the Enterprise is doing business in the state and has to file a return.

Most states have subjective de minimus rules relating to whether an Enterprise is doing business in a state and, therefore, required to file a return. For example, does one piece of equipment in a state that is leased to a customer create sufficient nexus for filing? The states' rules and regulations are not clear.

The mere presence of employees in a state, including the Enterprise paying withholding taxes for the employees, does not necessarily require the filing of an income tax return.

I believe that in the above instances, most, if not all, companies would opt for not filing state income tax returns. Tax professionals will frequently inform their clients that state laws are not clear but, on audit and litigation, the tax professionals believe that the state involved would require the payment of taxes. Experience has shown that such liabilities for taxes relating to the above examples are very rarely raised by state authorities, with the possible exceptions of very large corporations.

The accounting issue relates to the fact that if a return is never filed, the statute of limitations never expires and never eliminates the exposure. Therefore, once a potential liability is established, it is never eliminated. For the remainder of the existence of the company, this liability will remain recorded, accreted each year

by interest and penalties. The result is the one indicated in paragraph B47, without the expiration of the statute of limitations.

Issue 2 - Uncertain Tax Positions for a State where a return has been filed:

An issue not addressed in the Proposal is whether similar issues should be grouped by issue or by taxing authority.

An Enterprise can be subject to numerous taxing authorities in the United States, each with a right to audit. While it is not probable that any one state or municipality will audit, it is probable that a few will audit. As an example the Enterprise has a transfer pricing issue described in paragraphs A16 to A23. For transfer pricing issues, each state is different, sometimes as to the law, almost always as to rulings, regulations and court cases. The Enterprise files appropriate returns in each state and municipality. Each year, out of the 45 states that require income tax returns, our experience indicates that there will be three or four audits by the taxing authorities. Generally, on audit, a compromise is made with the taxing authorities. It is not possible to obtain an expert evaluation in accordance with paragraph 9 of the Proposal, as almost all areas of this issue are subjective.

If the position taken on each state return is assumed to be a separate uncertain tax position, under the Proposed Interpretation, an accrual would have to be recorded for each state's or municipality's return, which accrual would be reversed on the expiration of the statute of limitations, as indicated in paragraph B46.

Alternatively, the uncertain tax position can be evaluated based on treating the issue as one position for all states. Under this approach, estimates of both the number of taxing authorities that would audit and the ultimate settlement with such authorities could be made, which would result in an accrual closer to the real economic cost incurred and the future cash flow.

Issues 3, 4 and 5 - Paragraph 9:

The evidence referred to in paragraph 9 of the Proposed Interpretation to support recognition of an Uncertain Tax Position is far greater than is found in practice. Rarely is there an Uncertain Tax Position "for which all conditions are objectively verifiable." I believe that the approach indicated in B47 is more appropriate.

Issues 3 and 5 - Recognition and Derecognition:

I believe that "probable" is defined in the dictionary as "more likely than not". The Proposed Interpretation appears to treat these two statements differently as indicated under the first sentence of paragraph 3. Please make the distinction clearer.

Issue 9 - Interest and Penalties:

The Internal Revenue Service has almost no authority to waive interest; it has broad authority to waive penalties. While I appreciate that the accrual of interest and penalties is not considered in FAS 109, their non recognition is inappropriate. Interest is charged by the Internal Revenue Service in almost every case; the potential imposition of penalties can be evaluated on the same basis as the Uncertain Tax Position itself. Accordingly, they both should be recognized.

Issues 1, 6, 7, 8, 10, and 11 are not addressed in this letter.

I appreciate the opportunity to comment on the Exposure Draft. If you have any questions, please feel free to contact me at 212-557-7505.

Very truly yours,

Arthur J. Radin
Partner, Radin Glass and Co., LLP