Technical Application and Implementation Activities
File Reference 1215-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Proposed Interpretation Accounting for Uncertain Tax Positions, an interpretation of FASB Statement No. 109

Technical Director:

We appreciate the opportunity to comment on the proposed interpretation of FASB Statement No. 109 as it relates to accounting for uncertain tax positions. We agree that this is an area where further guidance is required for financial statements to consistently meet the objectives of financial reporting provided by the FASB in its Conceptual Framework. However, we do not believe the guidance proposed in this interpretation to be consistent with the Conceptual Framework.

FASB has published the objectives of financial reporting in conjunction with its Conceptual Framework project. The Conceptual Framework has determined that the overriding objective of financial reporting is to provide information to assist users in making investment, credit and similar resource allocation decisions. Among the characteristics of information identified for accounting information to be useful in meeting this objective are relevance and faithful representation. Relevance is defined as information capable of making a difference in the economic decisions of a user by helping them evaluate the effect of past and present events on future net cash inflows. Faithful representation is defined such that accounting information should be a complete presentation of economic reality.

Accounting for uncertain tax positions must be faithful representations of expected cash flows to meet the objectives of financial reporting required by the Conceptual Framework. The accounting guidance in the proposed interpretation
fails to meet these objectives. Tax liabilities and expense will initially be overstated. Subsequent correction of the overstatement will add erroneous volatility to earnings. Both of these conditions will hinder an investor's or creditor's ability to make sound economic decisions.

Specifically, paragraphs 6 – 9 require that a tax position must be probable of being sustained on audit by taxing authorities based solely on the technical merits of the position. This requirement supercedes the possibility that the resulting liability is not probable of ever resulting in a future transfer of cash or other assets. This is contrary to the guidance provided in FAS 5, “Accounting for Contingencies” which requires contingent liabilities to be probable and reasonably estimable to be recorded. As such, the liability recorded under this interpretation is not a faithful representation of expected cash flows and fails to meet the stated objectives of financial reporting.

Overall, we strongly support the alternative views expressed in paragraphs B46 and B47. These views are consistent with the objectives for financial reporting stated in the Conceptual Framework and much easier and cost-effective to implement. The definitions of tax positions that meet the thresholds to avoid statutory penalties are at least as well understood as those required to reach a “should prevail” conclusion and generally can be supported at a much lower cost. More importantly, the resulting liability will be much more reflective of expected cash flow.

We also agree with the statements in paragraphs B9 and B10 that fair value measurement is the most reliable alternative. While we understand the limitations imposed by FAS 109 to fully implementing fair value measurement to tax liabilities, we believe that the alternative views expressed in paragraphs B46 and B47 will more closely approximate fair value. The results better reflect actual amounts expected to be paid upon settlement and are inherently preferable.

The following responses address the specific issues in the proposed interpretation. All responses are within the context of our support for the alternative views.

Issue 1 – We agree that the proposed interpretation should be broadly applied to all tax positions, including assets and liabilities acquired in business combinations and to tax positions taken in previously filed returns.

Issue 2 – We do not agree that the recognition threshold should presume a taxing authority will evaluate a tax position. The overall objective should be that financial statements faithfully represent expected future cash flows. To make
such a presumption would be analogous to presuming that all potential claims will be asserted and that all claims asserted will be paid in full. All relevant facts and circumstances, including the degree of aggressiveness of the taxing authority to audit returns and the history of the taxing authority in settling uncertain positions should all be considered.

The proposed conclusion to Issue 2 appears to be based on beliefs stated in paragraphs B13 and B14. We do not agree with these beliefs. Tax obligations are not freely negotiated amounts between two willing parties, as would result from the accounts payable analogy. They are a charge imposed by a taxing authority based on various criteria. The fact that a separate legal discipline has evolved dealing solely with tax law provides evidence that an analogy to FAS 5, "Accounting for Contingencies" provides a better framework. This position is further supported by the structure of FASB Concepts No. 6, "Elements of Financial Statements". Paragraph 39 describes liabilities imposed by governmental entities or courts, including tax liabilities, judgments and other nonreciprocal transfers separately from obligations incurred in exchange transactions. This structure infers that tax liabilities are more analogous to legal obligations and should be accounted for in the same manner.

Issue 3 – We do not agree with the dual threshold approach to accounting for uncertain tax positions. We believe that this approach will result in material misstatements in liabilities through the recognition of amounts that will never be paid and unwarranted volatility in earnings as these erroneously overstated liabilities are reversed. We believe that a single threshold approach based on the substantial authority criteria as presented in paragraphs B46 and B47 is preferable. This approach is based on criteria that is easy to understand, can be determined without a substantial investment of resources in expert opinions of dubious value and results in financial statements more compliant with the Conceptual Framework.

Issue 4 – We generally agree with the conclusion reached in Issue 4. Any position that did not meet the initial recognition criteria, regardless of whether that criteria is "should prevail" or "substantial authority", should be recognized when the criteria are subsequently met.

Issue 5 – We agree with the conclusion that a valuation allowance should not be used to reflect derecognition of the benefit of a tax position. As stated in paragraph B25, a valuation allowance should be provided against deferred tax assets based solely on the sufficiency of future taxable income. Any other changes in the value of tax positions should be recognized directly. However, the discussion in paragraph B23 in support of derecognition criteria further
highlights the inconsistencies of the dual threshold method. A position that initially met the probable criteria for recognition would not be fully derecognized if it subsequently failed to meet those criteria. The position would only be derecognized if it subsequently failed to meet the more likely than not criteria. This adds a third layer of complexity to implementation of this interpretation that would largely be avoided by adopting the views expressed in paragraphs B46 and B47.

Issue 6 – We believe that the best estimate of the amount that ultimately will be paid to settle the obligation is the preferable amount to be recognized in all circumstances. This amount should be based on all relevant facts and circumstances. The best estimate is the closest representation of fair value and the amount most-consistent with the Conceptual Framework.

Issue 7 – We agree that only liabilities that arise from taxable temporary differences should be classified as deferred tax liabilities. All other amounts should be recognized as current tax liabilities.

Issue 8 – We agree that changes in judgment regarding the recognition, derecognition, or measurement of a tax position should be recognized entirely in the interim period that the change occurs.

Issue 9 – We agree that the tax liability should include interest and penalties. This is consistent with the best estimate approach for recognizing tax liabilities.

Issue 10 – We agree that uncertain tax positions should be disclosed in sufficient detail as required by FAS 5. However, we believe that all uncertain tax positions that have met the substantial authority level of support meet the definition of loss contingencies and are subject to these disclosure requirements. The guidance provided in this interpretation misclassifies these as gain contingencies. The cautionary language in paragraph 17.b. of FAS 5 must be overlooked to fairly present the amount of gain contingency that management fully expects to be recognized in future periods. We believe that this will make the financial statements less meaningful to users.

Issue 11 – We believe that the transition period is insufficient to implement this interpretation as drafted. Substantial effort and expense will be required to prepare the level of documentation necessary to support “should prevail” positions. However, this transition period would be sufficient to implement an interpretation based on a “substantial authority” threshold.
In conclusion, we strongly support the alternative views expressed in paragraphs B46 and B47. These views result in a consistent method of accounting for uncertain tax positions that conform to the Conceptual Framework, do not overstate tax liabilities or expense, and most-closely approximate fair value accounting.

Sincerely:

John C. Morrow  
Senior Vice President,  
Director of Accounting and Reporting

Shelly A. Cleveland  
Senior Vice President,  
Corporate Tax Director