September 12, 2005

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

Re: File Reference No. 1215-001
Proposed Interpretation
Accounting for Uncertain Tax Positions

Ladies and Gentlemen,

We submit herein our comments on the Financial Accounting Standard Board’s Exposure Draft of a Proposed Interpretation on Accounting for Uncertain Tax Positions, Reference No. 1215-001 (“proposed Interpretation”). Halliburton appreciates the efforts of the FASB to maintain the integrity of our financial reporting system and supports the FASB in its goal of providing accurate financial statements which provide relevant and complete information to users.

It should be noted that we have not addressed all of the "Issues" noted in the proposed Interpretation. As we believe that the foundation for the uncertain tax positions project needs to be revisited by the Board, we have not included comments on all the issues. Our comments are limited to these foundation issues and key conceptual issues with the proposed Interpretation.

Executive Summary

Recommendation #1 – The Board appears to believe that it is appropriate to address the accounting for uncertain tax positions despite the existence of a standard which already achieves this important goal. We believe that the Board has not put forward a clear statement as to the current situation, the accounting issues arising in the current situation, and how the proposed Interpretation resolves those issues. Should the Board wish to continue its examination of this accounting issue, we recommend that further analysis of the proposed Interpretation be suspended. As a next step, the above noted analysis should be developed to ensure that all parties are working toward a common goal which will produce enhanced quality in our accounting standards.
Recommendation #2 – The proposed Interpretation has noted that resolving inconsistency in reporting of uncertain tax positions is its objective. Inconsistent application of an existing standard should be addressed through measures to increase consistency of application, not by discarding the standard. We recommend retention of the current accounting standard with respect to uncertain tax positions. Additional guidance should be issued as appropriate to clarify the standard and its proper application.

Recommendation #3 – The “probable” confidence level recognition framework of the proposed Interpretation represents a less sound alternative, both from a conceptual and practical perspective, as compared to current accounting principles. We share the views of the dissenting Board members noted in the proposed Interpretation.\(^1\) We recommend that the current accounting framework with respect to uncertain tax positions be retained.

Framing the Issues Addressed in the Proposed Interpretation - Objectives of FASB

Before assessing the positions in the proposed Interpretation, it is essential to have a clear understanding of foundation elements, specifically (1) the current situation, (2) the history of the current situation, and (3) the concerns which arise from the current situation. Only with such an understanding can we make informed judgments in the efforts to improve accounting standards.

The proposed Interpretation does not clearly set forth this foundation, which creates ambiguity. This ambiguity leads both to difficulty in establishing a defined purpose for initiating review of the uncertain tax positions issue as well as understanding a clear rationale for the approach ultimately set forth in the proposed Interpretation.

What is the Current Situation?

The introductory comments prefacing the proposed Interpretation note the following reason for its issuance:\(^2\)

"Generally, the validity of a tax position is a matter of tax law. No controversy exists with recognizing the benefit of a tax position in an enterprise’s financial statements when the degree of confidence is high that a tax position will be sustained upon audit by a taxing authority. However, in some cases, the law is subject to significant and varied

\(^1\) Proposed Interpretation, paragraph B46 – B47
\(^2\) Proposed Interpretation, introductory comments, under “Reason for Issuing This Proposed Interpretation”.

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interpretation and whether a tax position will ultimately be sustained may be uncertain. Statement 109 does not explicitly prescribe a confidence threshold to be met for the benefit of an uncertain tax position to be recognized. As a result, diverse accounting practices have developed resulting in inconsistency in the criteria used to recognize, derecognize, or measure benefits related to uncertain tax positions. This diversity in practice results in noncomparability in reporting income tax expense that is not discernible by the users of the financial statements."

The comments within the text of the proposed Interpretation state:³

"This Interpretation clarifies the application of Statement 109 by defining a criterion that an individual tax position must meet, for the benefit of that position to be recognized in an enterprise’s financial statements. Additionally, this Interpretation provides guidance on measurement, derecognition of tax benefits, classification, interim period accounting, disclosure, and transition requirements in accounting for uncertain tax positions."

These comments appear to suggest that the Board believes there is no current standard for accounting for uncertain tax positions. The lack of a standard results in noncomparability in the reporting of income tax expense.

For this situation to exist, it would be required that (1) tax accounting standard setters overlooked the fundamental issues around uncertain tax positions when developing the standards, (2) such issues were not already addressed in the existing accounting principles, and, therefore (3) the current tax accounting standards provide no structure which addresses uncertain tax positions.

We are of the view that there is an existing structure in place which addresses uncertain tax positions.

**FAS 109**

Under FAS 109⁴, the basic principles to be applied in accounting for income taxes include⁵ –

1. A current tax liability or asset is recognized for the estimated taxes payable or refundable on the tax returns for the current year.

2. A deferred tax liability or asset is recognized for the estimated future tax effects attributable to temporary differences and carryforwards.

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³ Proposed Interpretation, paragraph 3.
⁵ FAS 109, paragraph 8.
3. The measurement of deferred tax assets is reduced, if necessary, by the amount of any tax benefits that, based on available evidence, are not expected to be realized.

As set forth above, FAS 109 clearly requires that a current tax liability be recognized with respect to taxes reflected on the tax return. The current liability includes no adjustment for uncertain tax positions which may be disallowed in the future.

In determining tax expense, FAS 109 requires the recording of a valuation allowance against deferred tax assets in certain circumstances. The realization of a deferred tax asset is based on evidence of the generation of sufficient future taxable income to utilize the asset. (Four sources of future taxable income are set forth FAS 109.) Accordingly, if the prospects for future profitability are sufficient, a benefit is recorded for the tax asset.

In summary, we believe that FAS 109 structures the tax accounts with reference to filed, or expected to be filed, tax returns. The current tax liability is generated from the current tax return. The deferred tax liability is calculated with reference to future temporary differences and carryforwards expected to occur in future tax returns. A valuation allowance is created to the extent future income may not be sufficient to absorb deferred tax asset(s). The FAS 109 mechanics do not place emphasis on the realizability of tax positions taken or to be taken in tax returns. If the requirements of FAS 109 are met with respect to a particular tax benefit, it is assumed to be realized and recorded accordingly.

The ultimate realization of amounts included in the provision is critical to the accuracy of the tax accounts. The analysis to ensure only the net expected tax consequences are recorded in the financial statements is undertaken with reference to FAS 5. The liability recorded for tax contingency under FAS 5 should be viewed as the potential liability for repayment of the tax benefits accrued under FAS 109.

FAS 5
The provisions of FAS 5 essentially impose a three part analysis for accrual of a liability with respect to a loss contingency involving a potential increase in tax liability –

1. It must be probable that the reported tax treatment will be challenged on audit.
2. It must be probable that a liability will be incurred to resolve the potential challenge.

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6 FAS 109, paragraph 21
7 Statement of Financial Accounting Standards No. 5 – Accounting for Contingencies.
3. The amount of the liability must be reasonably estimable.

We are of the view that this application of FAS 109 in conjunction with the FAS 5 analysis should, from a structural perspective, produce a relatively complete and accurate computation of tax expense when properly applied.

The lack of discussion in the proposed Interpretation of the current accounting structure for addressing uncertain tax positions is a significant oversight. First, the public debate in general would be more firmly grounded with a commonly defined starting point. Second, an acknowledgment of the current accounting structure and the history behind its evolution would provide a framework for understanding the concerns truly being addressed by the proposed Interpretation (e.g., why is this project being undertaken) as well as prior historical reference upon which the current debate can build.

**Recommendation #1** – The Board appears to believe that it is appropriate to address the accounting for uncertain tax positions despite the existence of a standard which already achieves this important goal. We believe that the Board has not put forward a clear statement as to the current situation, the accounting issues arising in the current situation, and how the proposed Interpretation resolves those issues. Should the Board wish to continue its examination of this accounting issue, we recommend that further analysis of the proposed Interpretation be suspended. As a next step, the above noted analysis should be developed to ensure that all parties are working toward a common goal which will produce enhanced quality in our accounting standards.

**What are the Problems with the Current Situation?**

In summary, the proposed Interpretation offers as its stated concern that there is inconsistency in the criteria used to report the tax benefits related to uncertain tax positions, which results in noncomparability in reporting income tax expense. As discussed above, this noncomparability appears to arise, according to the proposed Interpretation, from a lack of guidance in our current tax accounting standards.

Based on the forgoing, it is not clear why accounting for uncertain tax positions is the subject for an Interpretation of FAS 109 for this issue, since current accounting principles appear to provide a methodology to account for uncertain tax positions.

Furthermore, the proposed Interpretation does not include in its reason for issuing the proposal that:
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- Trends have been noted or concerns raised toward over-reporting or under-reporting of tax benefits or tax expense around uncertain tax positions;
- Concerns exist with regard to the application of FAS 5 by those enterprises which apply a FAS 5 approach (e.g., concerns with poor judgment creating skewed results, over-reporting tax benefits related to aggressive transactions, etc.) in managing the reporting of uncertain tax positions; or
- Concerns exist from a conceptual perspective with the use of FAS 5 in managing the reporting of uncertain tax positions. ⁸

These issues are not included in the purpose for the proposed Interpretation. The objectives of the proposed Interpretation focus on the consistency issue noted above.

Recommendation #2 – The proposed Interpretation has noted that resolving inconsistency in reporting of uncertain tax positions is its objective. Inconsistent application of an existing standard should be addressed through measures to increase consistency of application, not by discarding the standard. We recommend retention of the current accounting standard with respect to uncertain tax positions. Additional guidance should be issued as appropriate to clarify the standard and its proper application.

Conceptual Concerns with a Confidence Level Standard, the Use of “Probable” as that Level and a Dual Recognition Standard

Despite the ambiguous context in which it arises, the question framed by the Board seems to be “is not the standard set forth in the proposed Interpretation optimal for accounting for uncertain tax positions?”

Some comments regarding this standard are presented below.

Proposed Use of a “Probable” Confidence Level Standard

The proposed Interpretation would allow an enterprise to recognize the financial statement benefit of a tax position when that position is probable of being sustained by the enterprise following an audit by the taxing authorities as follows:

⁸ During the course of the general discussion on accounting for uncertain tax positions, we have observed a number of comments suggesting that issues similar to those noted above either exist in the marketplace or are implicitly being addressed in the proposed Interpretation. Given the exclusion of these issues from the stated purpose of the proposed Interpretation, coupled with an absence of any factual discussion relating to such concerns, it appears that such issues do not represent a significant concern of the FASB which needs to be addressed in this project.
"An enterprise shall initially recognize the financial statement effects of a tax position when that position is probable of being sustained on audit by taxing authorities based solely on the technical merits of the position."\(^9\)

The proposed Interpretation clarifies the probable threshold and explains its use, in part, as follows –

"The Board considered the recognition threshold first in setting a dual recognition-derecognition threshold. The Board selected 'probable' as that term is defined in paragraph 3(a) of Statement 5 as the appropriate recognition criterion. The Board concluded that probable expresses the appropriate threshold for recognition of tax positions given the limitations of the measurement attribute. Additionally, the Board believes that there is a common understanding on the part of financial statement preparers, auditors, and regulators about the confidence level expressed by probable and that a probable recognition threshold is not inconsistent with the perceived level of confidence of an unqualified should prevail tax opinion."\(^{10}\)

Finally, the proposed Interpretation sets forth a derecognition standard, with respect to tax benefits which were previously recognized, as follows: \(^{11}\)

"A previously recognized benefit from a tax position that no longer meets the probable recognition threshold shall be derecognized by recording an income tax liability or reducing a deferred tax asset in the period in which it becomes 'more likely than not' that the tax position would not be sustained on audit."

The proposed interpretation therefore concludes (1) that a confidence level based exclusively on a technical assessment of the position should control whether a tax benefit can be initially recorded, (2) the appropriate confidence level is "probable", (3) the derecognition of a tax benefit which was previously recognized should occur when the confidence level drops below "more likely than not", and (4) a "probable" level of confidence is approximately equal to a "should" level of confidence as that term is commonly used in the financial community.

We will use the term "should" interchangeably with "probable" going forward, unless expressly distinguished.

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\(^9\) Proposed Interpretation, paragraph 6.  
\(^{10}\) Proposed Interpretation, paragraph B19.  
\(^{11}\) Proposed Interpretation, paragraph 10.
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Uncertain Tax Positions – The Tax System

The objective of accounting for income taxes is to capture the elements of an enterprise’s income taxation in the financial statements. To achieve this goal, it is first necessary to understand the nature and function of the income tax system. Upon this foundation, assessment can be made as to which options for accounting for uncertain tax positions might be most aligned with the overall accounting principles with which the option should comply.

Enterprises operating in multiple jurisdictions can be exposed to the jurisdiction of many income tax regimes with significantly different characteristics. For purposes of illustration, set forth below is a summary of certain characteristics of the US tax system.

Tax Authority - Taxpayer Tension

Adversarial tension between the government and taxpayers is integral to the tax system. Tax law is drafted with the intention of collecting sufficient revenue from taxpayers to finance government activities. The government seeks to maximize tax collections through the application of tax law, and taxpayers seek to minimize tax payments through the application of tax law. To the extent legislators and others have believed that balanced footing between the government and taxpayers has been lost, balancing measures have been implemented. Historically, these measures have, at different times, favored taxpayers and favored the government.

The volume of tax controversy, including original casework, appeals process and litigation as well as the amounts at issue show that the tension has been and continues to be a major element of our tax system.

Tax Law Ambiguity

A second characteristic inherent in the tax system is tax law ambiguity. Complex tax legislation created to satisfy numerous policy and revenue objectives fosters ambiguity. This ambiguity manifests itself across most areas of tax law. Activity in the tax shelter area in recent years illustrates the central and pervasive role ambiguity plays in the US tax system.

The structural tension coupled with opportunity of tax law ambiguity creates the environment whereby both taxpayers and government actively seek to optimize their respective tax outcomes.

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12 Were tax law unambiguous, presumably the government would be successful in essentially all tax controversy situations – as the government would only choose to pursue claims in which the taxpayer was asserting an improper tax position.
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Statutory Structure of / Role for Levels of Confidence

Tax law sets forth statutory provisions, taxpayers prepare tax returns reporting tax positions, the government makes claims against certain taxpayer positions. The final disposition of an asserted claim is determined through the controversy process. Tax law does not utilize a "level of confidence" framework for determining the appropriateness of a particular position. A "should" level position will not necessarily prevail through the controversy process. Likewise, a "substantial authority" position will not necessarily fail through the controversy process.

Tax law, however, does utilize confidence levels for certain purposes – primarily in the area of penalty assessment. For example, with respect to the accuracy-related penalty on understatements, a position which rises to the level of at least substantial authority can generally be reported in a tax return without any additional disclosure of the position and without additional penalty risk. In other words, a substantial authority position can generally be reported in a manner similar to a "should" level position without understatement penalty exposure for a failure to sufficiently disclose the position. Certain positions falling below this level of confidence can still avoid understatement penalty exposure, but only if the position is "adequately disclosed" in the tax return and certain other conditions are met. A key purpose for this additional disclosure is to highlight the position for the tax return examiners.

The penalty provisions are not designed to indicate "what is right" when it comes to assessing a tax position. The provisions are intended to discourage taxpayers from taking excessively aggressive positions in their tax returns without appropriate disclosure to the government. The existence and operation of the substantial authority confidence level in the understatement penalty provisions indicate that a position which falls well below should level can represent a valid tax return position.

Resolution of Controversy and the Role of the "Should" Confidence Level

As described above, the US tax system is not designed to preclude taxpayers from taking tax return positions that fall below a "should" level of confidence. As a practical matter, taxpayers may fall within a spectrum from more conservative to moderate to more aggressive.

13 "Substantial authority" with respect to a tax position is a level of confidence which generally held to represent at least a one in three chance that the position will be sustained.
14 IRC Sec. 6662(a).
15 This penalty exception does not apply to an item attributable to a tax shelter; IRC Sec. 6662(d)(2)(c).
In broad terms, the following possibilities arise with respect to an issue from the time it is raised by the government until the statute closes:

- The issue is raised by the government and the position of the taxpayer and/or government is accepted
- The issue is settled in the audit / appeals process
- The issue is settled through litigation

Non-US Jurisdictions

The comments above represent a brief walk through the US tax reporting / controversy process. There are a number of other jurisdictions which have broadly similar principles to the US model. It is also important to note that many jurisdictions vary significantly. Many of these jurisdictions have similar ambiguity, but arising from different sources. Tax systems with a less developed foundation can have less clarity and consistency with respect to controversy. Tax law and related guidance can be less developed. Political developments can quickly impact tax law and tax controversy processes in unforeseen ways.

As an additional point, in many jurisdictions, the "should" confidence level as utilized within the US financial community is very difficult to achieve. A lack of sufficient statutory, administrative and judicial guidance coupled with a volatile tax environment, can create difficulties. Additionally, many non-US tax practitioners find difficulty in interpreting local jurisdiction tax law in terms of our "should" confidence level, as such a standard is not of relevance in the local jurisdiction. Accordingly, determining the validity of a "should" opinion would need to be carefully considered.

Concerns with the Use of a Confidence Level Standard

Through the controversy resolution process, some issues will likely be resolved primarily on the basis on confidence level supporting the position. These will likely be issues more toward the ends of the spectrum (either conservative or aggressive). Positions toward the middle may be settled in the favor of taxpayers (as discussed above) or may be settled on non-technical grounds. Many different factors come into play, varying by issue and by fact pattern, in determining the ultimate settlement of the issue.

The use of a simple confidence level standard to measure the outcome of controversy draws an artificial line which does not reflect the realities which exist in the tax system in arriving at a final settled tax liability. Taxpayers are generally not directed (beyond penalty management) to file their tax returns according to a
confidence level analysis. The settlement of controversy issues frequently does not revolve around a simple confidence level analysis.

Allowing for the use of sound reasoning and judgment to influence the tax reporting with respect to uncertain tax positions will create a more reasoned and accurate reporting of tax assets and liabilities. This approach is more fully realized under current accounting principles.

Concerns with the Use of a "Probable" Confidence Level

Tax law is complex and ambiguous, requiring expertise to interpret. It is common for tax specialists to disagree about the merits of a particular technical argument and the confidence level which it achieves. It can also be difficult to achieve a "should" level opinion from a tax practitioner, even for seemingly straightforward, non-aggressive positions due to ambiguity, lack of sufficient affirming guidance on point, and other factors.

These factors make a "should" level of confidence overly restrictive and would cause the artificial line described above to be drawn at a very high level. The application of such an approach would systematically overstate tax expense and net tax liabilities in certain periods and create releases of such amounts in future periods when the exposures are settled.

Accordingly, use of the "probable" confidence level as described in the proposed Interpretation does not provide an accurate basis for making determinations with respect to uncertain tax positions.

Concerns with a Dual Recognition Standard

The proposed Interpretation sets forth the following comments in relation to the benefits of a dual recognition standard:¹⁶

"Some Board members were concerned that a single threshold could result in significant period-to-period changes in tax expense, solely because of changes in the assessment of a tax position. In addition, the Board believes that a dual recognition threshold will be easier to apply than a single threshold for both recognition and derecognition and that there will be greater consistency in application of a dual threshold. Finally, the Board believes that preparers, auditors, and regulators would be less likely to disagree about the judgments needed in applying the dual threshold. Therefore, the Board decided to require a dual recognition-derecognition threshold.

¹⁶ Proposed Interpretation, paragraph B17
The Board acknowledges the inconsistency which can arise with a dual recognition system. Simply stated, two enterprises with identical issues at different points in time can record different tax expense results. This difference is magnified after consideration of the accrual of interest and penalties under the proposed Interpretation.

We believe that the proposal could create some benefits as described above. However, we believe that a single recognition standard is preferable, since (1) inconsistency is reduced, (2) the lower derecognition standard reduces the integrity of the tax accounts by allowing amounts to remain accrued which did not initially meet the required standard for recognition, (3) some of the complexities noted for a single recognition standard will likely not be particularly burdensome, and (4) there will likely be some additional complexities with a dual recognition standard.

We believe that, in this model, a single recognition threshold at a lower threshold (e.g., “more likely than not”) would be more appropriate.

No Conceptual Preference for Use of “Probable” Confidence Level Standard

In discussing the appropriate confidence level, the proposed Interpretation notes:

“In deliberating the validity of a tax position, the Board considered an approach that would require financial statement recognition (a) when a tax position meets the minimum statutory threshold to avoid the payment of penalties and (b) when it is not probable that an additional amount would be paid to the taxing authority to settle any underpayment controversies. The Board concluded that the confidence level expressed by this threshold would not be consistent with the definition of an asset in Concepts Statement 6.”

We believe that current accounting principles, through FAS 109 / FAS 5 are not inconsistent with the principles of CON 6. It is almost certain that an “asset” will be realized when a tax asset is utilized in a tax return (e.g., cash savings through tax expense reduction created by utilizing a tax asset). Under a typical self-assessment tax regime, the filing of the return allows for the recognition of the benefit of current tax assets, through reduction of current tax payable. Future tax returns will allow for the recognition of deferred tax assets. The issue is not whether the asset should be recognized, but whether a liability should be

17 Proposed Interpretation, paragraph B18
18 Proposed Interpretation, paragraph B16.
recorded for the potential disallowance that might arise in the post-filing audit process. This should be addressed by FAS 5.

CON 6, in substance, provides guidance as to when an asset or liability truly exists with sufficient certainty to justify recording. The current accounting principles for uncertain tax positions should produce an accurate representation of assets and liabilities which an enterprise can expect to realize. We have observed much of the public debate around CON 6 arising in the context of aggressive tax planning. However, as described above, the objectives of the proposed Interpretation are silent regarding such concerns. Additionally, it appears that some of the more high profile examples of aggressive tax planning were accompanied by "should" level opinions from outside advisers. Accordingly, even if there were concerns regarding overreporting of assets / underreporting of liabilities under the CON 6 argument, it is questionable whether the methodology of the proposed Interpretation would represent a superior alternative to address the concern.

Finally, a question arises as to whether there are areas of concern with current accounting principles which can be addressed by the proposed methodology. As discussed above, the limited statement of objectives provided with the proposed Interpretation suggest that no significant deficiencies have been identified as a target for the proposed Interpretation.

**Recommendation #3** – The “probable” confidence level recognition framework of the proposed Interpretation represents a less sound alternative, both from a conceptual and practical perspective, as compared to current accounting principles. We share the views of the dissenting Board members noted in the proposed Interpretation. We recommend that the current accounting framework with respect to uncertain tax positions be retained.

Halliburton appreciates the opportunity to comment on the proposed Interpretation and would be pleased to discuss its comments with the FASB. If you should have any questions about the comments, please do not hesitate to contact Chris Ing on 1 281 575 3061 (chris.ing@halliburton.com)

Respectfully submitted,

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