September 12, 2005

Technical Director – File Reference 1215-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Exposure Draft: Proposed FASB Interpretation, Accounting for Uncertain Tax Positions, an Interpretation of Statement 109 (File Reference No. 1215-001)

Dear Technical Director:

We support the Board’s efforts to provide additional guidance on the accounting and reporting of tax effects related to uncertain tax positions and we agree with the Board’s conclusion that the probable threshold established in the proposed Interpretation is the most appropriate condition for initial recognition of those benefits. We believe that application of the probable threshold appropriately acknowledges the operational challenges unique to judgments associated with tax positions, maintains a comparable level of assurance with the level generally applied in other areas of GAAP for the recognition of assets and benefits in the financial statements, and promotes consistency in financial reporting.

While we recognize that there has been considerable debate with regard to the initial recognition threshold, we strongly support the probable threshold because it establishes an appropriately high level of assurance to support asset/benefit recognition consistent with FASB Concepts Statement No. 6, Elements of Financial Statements (Concepts Statement 6) and integrates an existing framework used by tax experts for assessing the likelihood that a deduction (or credit) will be sustained upon examination by the tax authority. Many entities currently use a probable threshold in accounting for the tax effects of certain transactions and those entities have been able to operationalize such policies. The use of a substantial authority threshold, with a reserve established for estimated settlements, is not appropriate for purposes of concluding on accounting recognition for uncertain tax positions. That approach is inconsistent with the level of assurance required to record assets/benefits in other areas of GAAP and lacks any framework for determining the appropriate level of the reserve. While developing the best estimate of benefits probable of being sustained is a highly judgmental area, the probable threshold provides a framework for companies to apply in assessing and accounting for uncertainties regarding positions taken or to be taken on tax returns.
We also strongly support the dual threshold approach for initial recognition and derecognition. The dual threshold approach appropriately addresses the operational difficulty under a single threshold approach which would require an entity to initially determine, and thereafter monitor, with a necessarily high level of precision whether a position is probable of being sustained. Although we believe that FASB Statement No. 5, Accounting for Contingencies (Statement 5), would support a probable loss threshold for derecognition, we do not disagree with the selection of more likely than not for purposes of derecognizing a previously recognized tax position. We believe this threshold is sensitive to the highly judgmental nature of evaluating the level of confidence associated with sustaining a tax position and minimizes the noncomparability resulting from use of a dual threshold approach.

To summarize, we strongly support the Board’s conclusions regarding the probable threshold for initial recognition and the dual threshold for initial recognition and derecognition. The suggestions and comments provided below are intended to simplify the model described in the proposed Interpretation and clarify certain aspects of the proposed guidance.

Simplified Model

While we strongly support the dual threshold approach for recognition (it is probable that the position will be sustained) and derecognition (it is more likely than not that the position will not be sustained) of uncertain tax positions, we believe that the two-step model as set forth in the proposed Interpretation which requires that separate analyses be performed to (1) determine when to recognize an asset/benefit and (2) measure any recognizable asset/benefit could be simplified. We believe the Board should consider establishing a combined recognition/measurement principle that benefits of uncertain tax positions should be recognized only to the extent that such benefits are probable of being sustained. Under this combined model, an entity would evaluate, using the general guidelines on the evidence that would meet the probable threshold, what portion of a tax benefit, if any, is probable of being sustained. As compared to the two-step approach in the proposed Interpretation, this simplified model would result in recognition of a portion of the benefits of an uncertain tax position even though the overall position may not be probable (for example, not supported by a “should prevail” tax opinion) when there is sufficient evidence to support a conclusion that it is probable that a portion of the benefits will be sustained. Under the two-step approach in the proposed Interpretation, no benefits would be recognizable if the overall position does not first meet the probable threshold. The simplified model could retain the derecognition threshold in the proposed Interpretation at more likely than not that the position will not be sustained.
FASB Technical Director
September 12, 2005
Page 3 of 7

We believe this simplified model maintains the appropriate threshold for the recognition (and derecognition) of tax benefits of uncertain tax positions and acknowledges that there may be varying facts and circumstances that would support a conclusion that tax benefits, or a portion of such benefits, are probable of being sustained. This model would also avoid the potential confusion in the two-step approach regarding identification of the unit of account.

Support of Probable

Paragraph 9 provides guidance with respect to demonstrating a probable level of confidence. We agree with the Board’s conclusion that the probable threshold generally is consistent with a should prevail tax opinion and that evidence other than a should prevail tax opinion may be adequate to support a determination that the probable recognition threshold has been met. However, we believe additional clarification is necessary for consistent application of the probable criterion and to expand the examples of evidence that support a conclusion that tax benefits are probable of being sustained.

We recommend the following enhancements (added text is underscored and deleted text is struck out):

9. The appropriate unit of account for a tax position, and whether the probable recognition threshold is met for a tax position is a matter of the individual facts and circumstances of that position evaluated in light of all available evidence. The following are examples of evidence specific facts and circumstances that may, based on consideration of all facts, circumstances, and other, in the absence of opposing evidence, demonstrate a probable level of confidence:

a. Unambiguous tax law supporting the tax position
b. An unqualified should prevail tax opinion from a qualified expert that is supported by appropriate evidence considering the specific facts and circumstances of the tax position for which all conditions are objectively verifiable
c. Similar positions taken in prior years—that upon review tax returns that have been obviously presented in the tax returns and have been either accepted or not disallowed or challenged by taxing authorities during an examination
d. Legal precedent from similar positions taken by other taxpayers, where analogy is appropriate, that have been favorably resolved through litigation with taxing authorities.
The list above is not intended to be all-inclusive. Significant differences between the benefit recognized or to be recognized in the financial statements and the tax position taken in the tax return, discussed in paragraph 12, could be opposing evidence.

We believe that the combination of the simplified approach described above and our suggested changes to paragraph 9 would address potential concerns regarding the application of the provisions of the proposed Interpretation for certain tax positions, such as determinations as to whether an entity is subject to tax in a particular jurisdiction, that may not be supported by should prevail tax opinions yet it is probable that the tax benefits, or a portion of those tax benefits, will be sustained.

Unit of Account

Paragraph 9 acknowledges that judgment will be required in order to determine the “unit of account” for a tax position. While an example has been provided in Appendix A (paragraphs A2-A11), the unit of account for positions taken on the tax return needs to be clarified if the Board does not agree with the simplified model described above. (Discussion of the unit of account is not necessary under the simplified model.) The determination as to whether a deduction (or credit) taken or to be taken on a tax return is probable of being sustained may involve consideration of numerous alternative positions that could be taken by the taxing authority. The deduction or credit may be disallowed for many different reasons. The approach included in the proposed Interpretation may result in different accounting results depending on the selection of the unit of account.

For example, Enterprise A (in Appendix A) identified the unit of account as the individual R&D projects themselves and has concluded that recognition is limited to the best estimate of the benefit that is probable of being sustained associated with the first two projects (i.e., $4.5 million). Had Enterprise A identified the unit of account to be the category of salary expenditure claimed on the tax return (perhaps identified based upon the related job functions), it may have determined that certain categories of salary expenditures within projects three and four were probable of being considered qualifying expenditures and would therefore record its best estimate of those probable benefits.

If the Board does not agree with the simplified model, the unit of account concept would be more consistently applied if it were identified simply as the nature of the actual deduction (or credit) taken on the tax return (e.g., whether the type of salary expenditure was a qualifying salary expenditure). This assessment may require analysis.
at various levels, but we believe this clarification would simplify application and promote consistency across various entities and various tax positions.

Best Estimate

We agree with the conclusion that measurement of tax benefits should be based on the best estimate of the amount that is probable of being sustained on audit. The simplified model described above is based on that underlying concept. However, if the Board does not agree with the simplified model, clarification is necessary with regard to how to apply the “best estimate” guidance in the approach included in the proposed Interpretation.

The measurement guidance in the first sentence of paragraph 11 states that the benefit recognized equals the best estimate of the amount that is probable of being sustained. We have interpreted that guidance to mean that an entity would measure the benefit associated with a tax position that is probable of being sustained at the maximum amount that is at least probable of being sustained. We agree with that approach. However, the last sentence of paragraph 11 refers to the best estimate as the single most-likely amount in a range of possible estimated amounts. It is unclear to us whether the estimate referred to in the first sentence of paragraph 11 is necessarily the same as the estimate that would result from applying the last sentence of paragraph 11. For example, if an entity is 100% likely to sustain a benefit of at least $70 and 90% likely to sustain a benefit of $80 (and there are only two possible outcomes), would it recognize a benefit of $80, on the basis that this is its best estimate of the maximum amount that is at least probable of being sustained, or would it recognize a benefit of $70, on the basis that this is the single most likely outcome? In other situations, the single most likely outcome for a position that is probable of being sustained may actually exceed the amount that is probable of being sustained. We believe that clarifying language and/or an example may be helpful to illustrate the Board’s intention with respect to the application of best estimate.

Changes in Judgment

We agree with the Board’s conclusion with respect to changes in judgment related to a tax position taken in a prior annual period; however, we believe that paragraph 19 of APB Opinion No. 28, Interim Financial Reporting (APB 28), and FASB Interpretation No. 18, Accounting for Income Taxes in Interim Reports (FIN 18), currently address changes in estimates related to a tax position related to a prior interim period within the same fiscal year and thus analogy to paragraph 194 of FASB Statement No. 109, Accounting for Income Taxes (Statement 109), is neither necessary nor appropriate. APB 28 views
interim periods primarily as an integral part of an annual period and consequently requires an entity to make its best estimate of the effective tax rate expected to be applicable for the full fiscal year, including the impact of tax planning alternatives. We believe that a change in estimate related to a tax position for a prior interim period of the same fiscal year should be reflected as an adjustment to the estimated annual effective tax rate. That adjustment is related to current year operations.

**Transition**

The proposed effective date of the Interpretation is not realistic given the level of effort required to compile and analyze an entity’s tax positions, particularly for those entities operating in multiple (including foreign) jurisdictions. We also believe the Interpretation should be effective at the beginning of an entity’s fiscal year. Assuming that the final Interpretation is issued no later than early 2006, we recommend an effective date as of the beginning of the first reporting period in fiscal years beginning after December 15, 2006.

With regard to the proposed transition provisions (requiring recognition of only those tax positions that meet the probable threshold at the adoption date), the guidance mitigates valid concerns about the ability to determine and verifiably demonstrate the perceived sustainability of an uncertain tax position in prior periods when an entity has not historically been using a framework comparable to the framework established in the proposed Interpretation. However, we believe that many entities have been using a comparable framework to that proposed, and thus should be permitted to compute and report a “true” cumulative-effect adjustment as defined in paragraph 20 of APB Opinion No. 20, *Accounting Changes*, (or apply the Interpretation retroactively) if it is “practicable” pursuant to FASB Statement No. 154, *Accounting Changes and Error Corrections* (Statement 154). It seems illogical to us that an entity would be required to reflect a cumulative-effect type adjustment related to items that have historically been accounted for consistently with the accounting principle being adopted.

Also, we believe the cumulative effect adjustment with respect to tax positions acquired in a business combination should be recorded as an adjustment to goodwill in accordance with EITF Issue No. 97-3, “Uncertainties Related to Income Taxes in a Purchase Business Combination,” and FASB Staff Q&A 17 on FASB Statement No. 109 as this guidance remains effective for such adjustments post-transition.
We have summarized our views on the specific issues raised in the proposed Interpretation in the attachment to this letter. If you have questions about our comments or wish to discuss any of the matters in our letter, please contact Mark Bielstein at (212) 909-5419.

Sincerely,

KPMG LLP
Appendix – Responses to Issues Identified in the Proposed Interpretation

<table>
<thead>
<tr>
<th>Issue</th>
<th>KPMG’s Views</th>
</tr>
</thead>
<tbody>
<tr>
<td>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?</td>
<td>We generally agree with the scope of the proposed Interpretation. Please refer to the “Other Comments” section below regarding the application of the proposed Interpretation to entities that carry substantially all of their assets at fair value.</td>
</tr>
<tr>
<td>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?</td>
<td>We agree that the recognition threshold should presume a taxing authority will evaluate a tax position taken or expected to be taken when assessing recognition of an uncertain tax position.</td>
</tr>
<tr>
<td>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</td>
<td>As discussed in our comments, we strongly support the dual threshold approach as well as the selection of probable as the appropriate threshold for initial recognition of benefits. In our letter, we suggest a simplified approach to the two-step model for recognition and measurement included in the proposed Interpretation.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>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?</td>
<td>We agree that a tax position that did not previously meet the probable recognition threshold should be recognized in any later period in which the enterprise subsequently concludes that the probable recognition threshold has been met.</td>
</tr>
<tr>
<td>4. The Board concluded that a tax position that did not previously meet the probable recognition threshold should be recognized in any later period in which the enterprise subsequently concludes that the probable recognition threshold has been met. (Refer to paragraph B22 in the basis for conclusions.) Do you agree? If not, why not?</td>
<td>As discussed in our comments, we believe that the more likely than not threshold for derecognition of a previously recognized tax benefits is appropriate. However, the more likely than not derecognition threshold proposed conflicts with paragraph 39 of Statement 5, which requires the application of a probable loss threshold with respect to previously recognized tax benefits of an uncertain tax position. We believe the Board should make the necessary amendments to Statement 5 to eliminate this inconsistency.</td>
</tr>
<tr>
<td>5. The Board concluded that a previously recognized tax position that no longer meets the probable recognition threshold should be derecognized by recording an income tax liability or reducing a deferred tax asset in the period in which the enterprise concludes that it is more likely than not that the position will not be sustained on audit. A valuation allowance as described in Statement 109 or a valuation account as described in FASB Concepts Statement No. 6, <em>Elements of Financial Statements</em>, should not be used as a substitute for derecognition of the benefit of a tax position. (Refer to paragraphs B23-B25 in the basis for conclusions.) Do you agree with the Board's conclusions on derecognition of previously recognized tax positions? If not, why not?</td>
<td></td>
</tr>
</tbody>
</table>
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?

As discussed in our comments, we generally agree with the conclusions on measurement. However, the Board should further clarify how to apply the "best estimate" approach in situations in which the amount of benefit that meets the probable threshold differs from the single most likely amount within the range of possible amounts. We believe that the amount of tax benefits recognized should represent the maximum amount that is at least probable of being sustained. The simplified model described in our letter would appropriately address that 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 support the Board's conclusion regarding classification. While we acknowledge that the consideration of the timing of detection in concluding on classification may be viewed as inconsistent with the Board's premise that detection risk should not be considered for purposes of recognition, we believe that the classification guidance appropriately incorporates the statutory administrative processes unique to income tax systems.

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.

As discussed in our comments, we agree with the Board's conclusion with respect to changes in judgment related to a tax position taken in a prior annual period; however, APB 28 and FIN 18 adequately address changes in estimates related to a tax position.
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>9.</strong> The Board concluded that if the relevant tax law requires payment of interest on underpayment of income taxes, accrual of interest should be based on the difference between the tax benefit recognized in the financial statements and the tax position in the period the interest is deemed to have been incurred. Similarly, if a statutory penalty would apply to a particular tax position, a liability for that penalty should be recognized in the period the penalty is deemed to have been incurred. Because classification of interest and penalties in the income statement was not considered when Statement 109 was issued, the Board concluded it would not consider that issue in this proposed Interpretation. (Refer to paragraphs B37-B39 in the basis for conclusions.) Do you agree with the Board’s conclusions about recognition, measurement, and classification of interest and penalties? If not, why not?</td>
<td><strong>The Board’s conclusion on recognition and measurement of interest and penalties is consistent with the model established for initial recognition of tax positions in the proposed Interpretation. However, we believe that it is possible to make a distinction between the recognition threshold for the actual tax benefits of a position and the accrual of interest on that position. Accordingly, we believe the Board should consider an approach for the recognition threshold for interest and penalties relating to tax positions that have not been partially or fully recognized as a tax benefit in the financial statements based on the recognition threshold for other contingent liabilities under Statement 5.</strong></td>
</tr>
<tr>
<td><strong>10.</strong> The Board concluded that loss contingencies relating to previously recognized tax positions should be disclosed in accordance with the</td>
<td><strong>We believe that the Interpretation should be explicit with regard to disclosure requirements and provide example disclosures. Referencing Statement 5 only</strong></td>
</tr>
</tbody>
</table>
provisions of paragraphs 9-11 of Statement 5. The Board also concluded that liabilities recognized in the financial statements pursuant to this proposed Interpretation for tax positions that do not meet the probable recognition threshold are similar to contingent gains. Therefore, those liabilities should be disclosed in accordance with the provisions of paragraph 17 of Statement 5. (Refer to paragraph B40 in the basis for conclusions.) Do you agree with the disclosure requirements? If not, why not?

11. The Board concluded that this proposed Interpretation should be effective as of the end of the first fiscal year ending after December 15, 2005. Only tax positions that meet the probable recognition threshold at that date may be recognized. The cumulative effect of initially applying this proposed Interpretation would be recognized as a change in accounting principle as of the end of the period in which this proposed Interpretation is adopted. Restatement of previously issued interim or annual financial statements and pro forma disclosures for prior periods is not permitted. Earlier application is encouraged. (Refer to paragraphs B41-B43 in the basis for conclusions.) Do you agree with the Board's conclusions on effective date? If not, how much time would you anticipate will be necessary to apply the provisions of this proposed Interpretation? Do you agree with the

generally may result in disclosure of very limited information given the perceived ambiguity of the extent of disclosure required under Statement 5. Regardless of the Board’s decision with respect to the reference to the disclosure requirements in Statement 5, we believe that specific and explicit guidance should be provided in the Interpretation cautioning preparers regarding premature disclosure of unrecognized tax benefits when it is unlikely those benefits will be sustained.

As discussed in our comments, the proposed effective date of the Interpretation is not realistic given the level of effort required to compile and analyze an entity's tax positions, particularly for those entities operating in multiple (including foreign) jurisdictions. Further, we believe that an entity should be permitted to compute and report a "true" cumulative-effect adjustment (or apply the Interpretation retroactively) unless it is impracticable to do so, pursuant to Statement 154.

Also, we believe the cumulative effect adjustment with respect to tax positions acquired in a business combination should be recorded as an adjustment to goodwill in accordance with EITF Issue No. 97-3, "Uncertainties Related to Income Taxes in a Purchase Business Combination," and FASB Staff Q&A 17 on FASB Statement No. 109 as this guidance remains effective for such adjustments post-transition.
Board’s conclusions on transition? If not, why not?

Other comments

Scope

We believe that the Board should consider the potential implications of the proposed Interpretation on entities that carry substantially all of their assets at fair value, such as investment companies that issue and redeem equity shares at net asset value. Because the proposed Interpretation is not a fair value model, the inability to obtain the necessary evidence to support a probable level of assurance with respect to the qualifications to be a regulated investment company may result in a net asset value that no longer represents the fair value of the entity.

Application to the failure to take a deduction

Note 2 referenced in paragraph 5 states that a tax position could include failing to take an otherwise valid tax deduction. As this circumstance presumably would result in an entity recognizing an asset and related benefit in the financial statements for a deduction not taken on the tax return, we believe an example is necessary to clarify the types of situations to which this provision was intended to apply.

Resolution through negotiation

Paragraph 8(b) allows for the recognition of tax benefits that did not initially meet the probable recognition threshold if the tax matter is ultimately resolved through negotiation or litigation with the taxing authority. We believe that guidance should be clarified. To the extent that “resolution” of a tax matter was intended to be interpreted in a manner consistent with the “realization” of a gain contingency under Statement 5 or the “extinguishment” of a liability under FASB Statement No.140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, the language in paragraph 8 should more explicitly define resolution in those terms.

Legal precedent

We recommend clarifying the application of paragraph 9(d) on the use of legal precedent with respect to similar positions to demonstrate a probable level of confidence as compared to the statement in paragraph A16 indicating that example only applies to transfer pricing positions.