

**FASB PROPOSED INTERPRETATION OF FAS 109 "ACCOUNTING FOR
UNCERTAIN TAX POSITIONS": COMMENTS ON EXPOSURE DRAFT**

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Letter of Comment No: 79
File Reference: 1215-001
Date Received: 9/12/05

General comments

Additional guidance in this area is helpful. However, we would prefer a standard which is more closely aligned to International Accounting Standards than the current Exposure Draft, in both the principle proposed and the methods of implementing them. In particular we are aware that the Board and the IASB are currently undertaking a quite extensive short-term convergence project on FAS 109/IAS 12 and we feel that it would be a missed opportunity not to develop such guidance as part of this project.

We consider that the Board's recognition threshold for tax benefits to be unhelpful. In our view, tax is no different to any other item which may give rise to a contingent liability at the balance sheet date. In accordance with the guidance given in SFAS 5 in relation to loss contingencies, we believe that the appropriate test is to make an accrual for such an item if it is expected that additional tax will become due rather than anticipating that a benefit will be sustained.

We suggest that the recognition threshold be modified as follows:

- The standard should not be based upon the concept of "sustained on audit". This imparts to tax audit greater authority than the tax law of many jurisdictions. The reference should be to sustained under the applicable laws, whether in audit or other proceeding.
- The threshold of assessing the recording or reversal of a liability should be consistent with that utilized in Statement 109 in other aspects of accounting for income taxes. The threshold of 'probable' is stated to be different from 'more likely than not' and indeed the two tests are proposed to apply to different types of tax contingency reviews. A single threshold consistently applied is optimal. We would expect that the distinction between two such standards would be difficult to apply consistently in practice leading to more diversity instead of less.
- The illustrative means of demonstrating a probable level of confidence in paragraph 9 are unduly prescriptive and legalistic. Such a specific approach as contained in the Exposure Draft may be called for to determine the proper accounting of positions arising from "aggressive" tax planning, but not to ongoing operations. This list of

examples should be modified to require greater detail if a matter is large and unusual, and more in line with tax audit evidence for ongoing matters.

Specific questions asked

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?

Yes, we agree with this scope interpretation.

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?

Yes, we agree that it is appropriate that it should be assumed that the tax authorities will evaluate the tax position taken.

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?

No, we do not agree with the dual threshold approach. We view this approach as inconsistent with SFAS 109 and inconsistent with the accounting practices applied to other contingency items in the accounts.

We also agree with the alternative views expressed in paragraph B46 that the proposed interpretation would be unduly complex, and difficult to apply in practice.

For example, we would see no practical difference between the cases where there was doubt as to whether a specific item was tax deductible and this arose because of a doubt at the time a tax return was filed or only because the tax authority chose to challenge it at a later date. In the first case, a benefit would only be recognised if it were probable that the item would be treated as tax deductible. By contrast, in the second case a benefit would be recognised initially (since there was no doubt at that point) and then a reserve only booked if it was more likely than not that the tax authority would prevail. Hence, there would be inconsistent accounting for essentially the same circumstances.

Using this example, if an external stakeholder were to carry out a review of the application of the proposed approach then it would be virtually impossible to determine whether a reserve should have been booked, as this would involve a judgement as to what

knowledge existed at the time the accounts were prepared and or tax return filed in relation to potential doubt over deductibility.

In addition, we do not believe that a single threshold would lead to significant fluctuations in effective tax rates or that the dual threshold proposed would make the judgements required simpler. Specifically, the events, which would typically lead to a reassessment of the level of confidence in a tax position, are usually significant in nature, such as a court decision. Such an event would lead to a measurable difference in the probability assessment and hence it is unlikely period on period that one exposure item would fluctuate between a probable and non-probable event.

We suggest that a single threshold would be more transparent and easier to apply.

If, however, the Board were to adopt the proposed dual approach, it would be helpful to have clear guidance as to which recognition threshold should be applied to exposures which exist at the date of implementation.

Issue 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?

Yes. The recognition threshold should be applied consistently across periods and to all tax contingencies whenever arising. Regular review of positions required by the proposal is a necessary element of this consistency.

Issue 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, Elements of Financial Statements, 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?

Yes. Please note that we have interpreted “sustained on audit” to mean that the position will be ‘ultimately sustained’ after all due process i.e. including going through the court system if applicable. We make this clarification as in some jurisdictions tax audit is merely one specific stage in the process of agreeing the tax returns with the tax authority.

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?

In most cases this is an appropriate methodology, however there will be a number of cases where there is no single best estimate of the eventual amount that would be sustained, for example where it is expected that there will be a negotiated settlement. In this instance, we consider that the methodology contained in FIN 14 (interpreting FAS 5), whereby the lowest amount in the range of possible outcomes is booked, is most appropriate. We would see this as having greater consistency with the Board’s comments in paragraph B17 of the exposure draft relating to ease of application and reducing areas for dispute between different stakeholders.

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?

Yes.

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?

Yes.

Issue 9: 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?

We agree with the recognition and measurement of interest and penalties. We would encourage the board to consider the classification of interest and penalties as part of the international convergence project.

Issue 10: The Board concluded that loss contingencies relating to previously recognized tax positions should be disclosed in accordance with the 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?

We agree that additional disclosures should not be required and consider that including such additional disclosures would be potentially misleading to users of the accounts.

Issue 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 Board’s conclusions on transition? If not, why not?

We support the Board’s desire to implement clarification in this area as soon as practical to do so, however, this is subject to our general comments made above with regard to convergence with International Accounting Standards.