MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Uncertain Tax Positions Team (Gagon, ext. 322)
Subject:	Minutes of November 17, 2004 Board Meeting
Date:	November 22, 2004
cc:	Smith, Bielstein, Petrone, Leisenring, Project Team, Golden, Swift, Polley, Gabriele, Vincent, Getz, Sutay, Intranet (e-mail)

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic:	Transition date for the proposed Interpretation and measurement issues
Basis for Discussion:	Board Memorandum 2 dated October 27, 2004, and Board Memorandum 2 Supplement dated November 11, 2004
Length of Discussion:	10:00 a.m. to 10:40 a.m.
Attendance:	
Board members present:	Herz, Trott (by phone), Schipper, Batavick, Seidman, and Schieneman
Board members absent:	Crooch
Staff in charge of topic:	Thomas
Other staff at Board table:	Smith, Cassel, Golden, Kispert, and Gagon

Outside participants: None

<u>Summary of Decisions Reached</u>:

At today's meeting, the Board discussed transition date and measurement issues for the proposed Interpretation on uncertain tax positions. The Board made the following decisions at this meeting:

1. A taxpayer should record the financial statement benefit of an uncertain tax position based on the "best estimate" of the amount that will be ultimately sustained upon resolution of the litigation or appeals process.
2. The proposed Interpretation should be effective for all companies for the first annual period ending after December 15, 2005. Early adoption is encouraged.

The Board revisited the tentative decision reached at the July 27, 2004 Board meeting on the method for transition. The Board did not change the tentative decision made at the July 27, 2004 meeting, but it may reconsider that tentative decision at a future Board meeting.

<u>Objective of Meeting</u>:

The objectives of the Board meeting were for the Board to decide (1) what amount should be recorded in the financial statements for tax benefits that arise from uncertain tax positions once the probable threshold is met and (2) what the effective date for the proposed Interpretation should be. Both objectives were met.

<u>Matters Discussed and Decisions Reached</u>:

1. Mr. Thomas began the meeting by stating that at the July 27, 2004 meeting, the Board directed the staff to complete further research and provide a recommendation to the Board for a transition date for the proposed Interpretation.
2. Mr. Thomas stated that to complete its research, the staff discussed the proposed Interpretation with several constituents, including preparers, analysts and audit practitioners. He stated that, based on the discussions with various constituents, the staff believes that the following issues remain to be addressed:

   a. Measurement

   b. Transition date

   c. Leveraged leases.

3. Mr. Thomas stated that the leveraged lease issue will be addressed in a separate memorandum at a separate Board meeting. He stated that the purpose of today's meeting was to address transition date and measurement issues. Each of those issues is discussed below.

Measurement

4. Mr. Thomas stated that through the discussions with various constituents, the staff believes that a significant number of tax matters are ultimately settled by negotiation. Through discussion, the staff believes that many taxpayers settle disputes with the taxing authorities even though the taxpayer has a high degree of confidence in the validity of the tax position. The staff believes that many taxpayers would settle a dispute with taxing authorities for a 10–20 percent reduction in the claimed benefit to avoid the significant costs (investor perceptual and actual cash costs) of litigation with the taxing authorities.

5. Therefore, Mr. Thomas presented three measurement alternatives for the Board to consider. All of the alternatives deal with the measurement of the net tax benefit once the probable threshold is met. The alternatives are:

Alternative 1—(No measurement) Under this alternative, once the probable threshold is met, the resulting tax benefit would be recognized in the financial statements. Effectively, through this approach, either all of the tax benefit is recognized or none of the benefit is recognized.

Alternative 2—(Best estimate) Under this alternative, the taxpayer would record the financial statement benefit based on the "best estimate" of the amount that would be ultimately realized. The staff believes that for this methodology to be conceptually consistent with the probable assertion, a significant portion of the tax benefit should be determined to be sustainable. When events and circumstances change, the taxpayer would remeasure the benefit to the best estimate.

Alternative 3—(Statement 5 approach) Under this alternative, the taxpayer would measure the tax benefit by reducing it by the amount that is probable of being lost in settlement of the matter. When events and circumstances change, the taxpayer would remeasure the benefit to reduce it by the amount that is probable of being lost in settlement of the matter.

6. Mr. Thomas stated that the staff recommends the Board adopt Alternative 2.

7. Ms. Seidman asked Mr. Thomas to explain how Alternative 2 would work with the derecognition approach in the proposed Interpretation.

8. Mr. Thomas stated that the key is the probable threshold. He stated that the probable threshold is the determination that a taxpayer has claimed a valid deduction under the tax law. After the probable threshold has been established, the taxpayer would then determine how much of the benefit should be recorded in the financial statements. He also stated that any reduction in the benefit should be minor in order to not rebut the probable assertion.

9. Mr. Golden stated that the recognition/derecognition model in the proposed Interpretation is really a two-step model. The first step is that an entity must believe that it is probable that the benefit will be sustained—if it is probable, the entity would recognize the benefit; if it is not probable, the entity would not recognize the benefit (or would derecognize any benefit previously recognized). The second step is to measure how much of the tax benefit should be recognized in the financial statements.

10. Mr. Golden continued by stating that in the situation where an entity thinks that it is probable that a tax benefit will be sustained, they would account for the tax position. If circumstances change (for example, an examination by a taxing authority or a decision in the courts), and a taxpayer concludes that it is no longer probable that the benefit will be sustained, the entity would derecognize 100 percent of that position. If the taxpayer continues to believe that the benefit is probable of being sustained but their judgment about the amount of the benefit that would be ultimately sustained has changed, then the entity would only account for the change in the measurement.

11. Mr. Thomas stated that at some point, the reduction in the claimed benefit could be so significant that it would rebut the probable assertion. At that point, the preparer could disaggregate the benefit into a lower unit of account to assess the probability that the benefit will be sustained or derecognize the entire benefit.

12. Ms. Schipper clarified her understanding of the measurement objective of Alternative 2. She stated that under the two-step approach that Mr. Golden mentioned earlier, the first step would be to apply a Statement 5 threshold to the deduction to ensure that the deduction is valid. In other words, the Statement 5 threshold would ensure that if this deduction was contested all the way through the court system, it would be probable that the deduction would be sustained. She stated that the second step would assert that while it is probable that an entity will

receive its claimed deduction, as a practical matter it may be costly to go through the whole system; therefore, for practical reasons, an entity may take a reduction in the benefit to avoid potentially more costly alternatives of trying to litigate these benefits. Thus, measurement issues may arise.

13. Mr. Thomas concurred with Ms. Schipper's assessment while adding that some areas, such as transfer pricing, may be judgmental and subject to differences in opinions in valuation.

14. Ms. Schipper stated that she agreed with Alternative 2 for measurement and also agrees with the derecognition method that Mr. Golden described earlier in the meeting.

15. Mr. Batavick agreed with Ms. Schipper's statements and supports Alternative 2. He believes that Alternative 2 is a more practical approach for this issue and is more consistent with the probable approach of the proposed Interpretation.

16. Mr. Trott stated that he also supports Alternative 2. He agrees with Alternative 2 based on the fact that this approach is the common methodology used in a non-fair value measurement approach. Since Statement 109 does not use fair value for measurement purposes, he believes that Alternative 2 is appropriate.

17. Mr. Herz asked if any Board members would object to the staff's recommendation;no Board members indicated they would object. The Board decided to use Alternative 2 when measuring uncertain tax positions.

Transition and Effective Date

18. Mr. Thomas stated that due to the recent implementation of internal control testing pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, many SEC registrants have been contending with a significant amount of additional work.

19. Mr. Thomas stated that in small group meetings, one Board member indicated that a December 2004 issuance of the Exposure Draft coupled with a 60-day comment period would require preparers and their audit firms to fully understand and comment on the proposed Interpretation during January and February. Accordingly, that Board member suggested the comment period be extended to the middle of May.

20. Given this information, the staff proposed new alternatives for a comment period and effective date.

Comment Period

21. Mr. Thomas stated that on July 27, 2004, the Board tentatively decided the Exposure Draft should be exposed for comment for a period of 60 days. Mr. Thomas stated that the staff is recommending a comment period that would expire on Friday, May 13, 2005, or 60 days from issuance of the proposed Exposure Draft, whichever is later.

22. The Board members all agreed with the staff recommendation for the comment period.

Effective Date

23. Mr. Thomas stated that given a December 2004 issuance date for the Exposure Draft and a comment period that would extend to May 13, 2005, any alternatives that would require implementation of the final standard prior to December 31, 2005, would practically require a period of less than six months from the date of issuance to the effective date of the final Interpretation.

24. Mr. Thomas presented the following alternatives for effective dates for the Board's consideration:

Alternative 1—Require implementation for all companies for the first annual periods ending after December 15, 2005. Early adoption is encouraged.

Alternative 2—Require implementation for all companies for the first annual period beginning after December 15, 2005. Early adoption is encouraged.

25. Mr. Thomas stated that the staff recommends the Board adopt Alternative 1.

26. Mr. Golden clarified that Alternative 1 would be for the balance sheet; the income statement would essentially be effective beginning after January 1, 2006. He stated that a cumulative effect adjustment would not require entities to go back to January 1, 2005 and restate interim period information. This would be similar to the effective date prescribed for the proposed Interpretation of Statement 143.

27. Mr. Trott stated that another thing that needs to be discussed is not only the transition date, but the transition method. He stated that while he believes this would be a cumulative effect adjustment, he would not expect the adjustment to be

shown as a change in accounting principle. He stated this would be very much like the transition guidance for Statements 121 and 144 where the guidance was applied to recognize impaired assets as of a date and thereafter; however, the impact of recognizing the effect of that new guidance was not recorded as a cumulative effect of a change in accounting principle.

28. Mr. Thomas stated that at the July 27, 2004 Board meeting, the Board had tentatively decided that adoption of this Interpretation would be treated as a cumulative effect of a change in accounting principle. Therefore, the question the staff was asking the Board was concerning the implementation date. Mr. Trott stated that he had forgotten that the Board had already addressed this issue at the July 27, 2004 meeting. He requested that the staff bring this issue back to the Board in a week to allow the Board more time to think about the issue.

29. Mr. Cassel stated that he agrees with Mr. Trott and would recognize the change in the income tax line of the income statement for the year, and then fully disclose that effect in the footnotes.

30. Mr. Trott stated that it is an Interpretation and, therefore, is not a change in accounting principle.

31. Ms. Seidman stated that she believes that there is enough confusion among constituents to require an Interpretation and that the proposed Interpretation should be treated like a change in accounting principle.

32. Mr. Thomas stated that he agrees with Ms. Seidman's remarks and believes that there is significant diversity in practice with regards to this issue. Therefore, he believes this should be treated as a change in accounting principle.

33. Mr. Herz broke this issue into two parts—the effective date and the transition method. Mr. Herz called for a vote on the effective date. The Board decided that the effective date should be for all companies for the first annual period ending after December 15, 2005. Early adoption is encouraged. Some Board members expressed some concern with the effective date but were willing to expose that date in the Exposure Draft and see what concerns, if any, constituents raise about the effective date in their comment letters.

34. With respect to the transition method, Mr. Smith suggested that the staff come back in a week to allow the Board more time to think about this issue. The Board agreed with Mr. Smith's suggestion and deferred any final decisions on this issue.

Follow-up Items:

The Board asked the staff to consider different transition methods for the proposed Interpretation in another memorandum to the Board, which will be discussed at a future Board meeting.

General Announcements:

None