

PROPOSED FASB STAFF POSITION

No. FIN 48-a

Title: Definition of *Settlement* in FASB Interpretation No. 48

Comment Deadline: March 28, 2007

Introduction

1. This FASB Staff Position (FSP) amends FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, to provide guidance on how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits.

Background

2. The FASB staff has received inquiries on whether it is appropriate for an enterprise to recognize a previously unrecognized tax benefit when the only factor that has changed since determining that a benefit should not be recognized is the completion of an examination or audit by a taxing authority. The inquiries have asked for clarification under Interpretation 48 of the following:

- a. The meaning of the term *ultimate settlement*, as used in paragraph 8
- b. The meaning of the terms *ultimately settled* and *negotiation*, as used in paragraph 10(b)
- c. The general concept that “a tax position need not be legally extinguished and its resolution need not be certain to subsequently recognize or measure the position,” as set forth in paragraph 12.

3. The Board directed the FASB staff to issue this FSP to amend Interpretation 48 to clarify that a tax position could be effectively settled upon examination by a taxing authority. Assessing whether a tax position is effectively settled is a matter of judgment because examinations occur in a variety of ways. In determining whether a tax position is effectively settled, an enterprise should make the assessment on a position-by-position basis, but an enterprise could conclude that all positions in a particular tax year are effectively settled.

FASB Staff Position

4. For purposes of applying paragraph 10(b) of Interpretation 48, settlement has effectively occurred if the taxing authority has completed all of its required or expected examination procedures, the enterprise does not intend to appeal or litigate any aspect of the tax position, and it is considered highly unlikely that the taxing authority would reexamine the tax position.

5. When all of the following conditions have been satisfied, a tax position shall be considered effectively settled through examination:

- a. The taxing authority has completed its examination procedures including all appeals and administrative reviews that the taxing authority is required or expected to perform for the tax position.
- b. The enterprise does not intend to appeal or litigate any aspect of the tax position for the completed examination.
- c. Based on the taxing authority's widely understood policy, the enterprise considers it highly unlikely that the taxing authority would subsequently examine or reexamine any aspect of the tax position included in the completed examination, presuming the taxing authority has full knowledge of all relevant information.

In the tax years under examination, a tax position does not need to be specifically reviewed or examined by the taxing authority to be considered effectively settled through examination. If the taxing authority has specifically examined a tax position during the examination process, an enterprise shall consider this information in assessing the likelihood that the taxing authority subsequently would reexamine that tax position for the completed examination.

6. If an enterprise that had previously considered a tax position effectively settled becomes aware that the taxing authority may examine or reexamine the tax position, the tax position is no longer considered effectively settled and the enterprise shall reevaluate the tax position in accordance with Interpretation 48.

7. An enterprise may obtain information during the examination process that enables that enterprise to change its assessment of the technical merits of a tax position for similar tax positions taken in other periods. However, the effectively settled conditions in paragraph 5 of this FSP may not be the sole basis for the enterprise to change its assessment of the technical merits of any tax position in other periods.

Effective Date and Transition

8. The guidance in this FSP shall be applied upon the initial adoption of Interpretation 48. An entity that applied Interpretation 48 in a manner consistent with the provisions of this FSP would continue to apply the provisions in this FSP from the date of initial adoption of Interpretation 48. However, an entity that did not apply Interpretation 48 in a manner consistent with the provisions of this FSP is required to retrospectively apply the provisions in this FSP to the date of the initial adoption of Interpretation 48.

Alternative View

9. One Board member believes that the request for guidance with respect to the term *ultimately settled* in paragraph 10(b) of Interpretation 48 is the result of FASB constituents' beliefs that the actions of a taxing authority in examination of returns or other actions, short of a change in tax law or regulations or a change that results from litigation, do not provide new information that should be considered in determining whether the recognition criteria have been met or continue to be met as discussed in paragraphs 10(a), 11, and 12. This Board member believes that the actions of a taxing authority in examination of returns or other actions provide new information that should be considered. The Board member also believes that the sources of authorities in the tax law listed parenthetically in paragraph 7(b) of Interpretation 48 are illustrative and do not restrict the number of possible sources to only those that are listed.

10. A situation in which a taxing authority examines a position and does not propose an adjustment is significant evidence that the taxing authority accepts the position based on its technical merits. A situation in which an adjustment is proposed provides significant evidence that the taxing authority does not accept the position. A situation in which the taxing authority decides not to propose an adjustment for one position in exchange for the taxpayer's agreeing to a change in another position provides very little evidence on which to analyze the first position. If the position is not examined, no new evidence is obtained. This Board member believes that FASB constituents should be able to determine which positions have been examined by the taxing authority.

11. This Board member does not believe that the proposed guidance with respect to the term *effectively settled* is appropriate. Using the “closing of a tax year” as a basis on which to treat a position as settled when a taxing authority has the ability to reopen and examine additional positions inappropriately allows unexamined positions to be treated as “effectively settled.”

Appendix

AMENDMENTS TO INTERPRETATION 48

A1. Interpretation 48 is amended as follows: [Added text is underlined and deleted text is ~~struck out.~~]

a. Paragraph 8:

A tax position that meets the more-likely-than-not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ~~ultimate~~ settlement with a taxing authority that has full knowledge of all relevant information. Measurement of a tax position that meets the more-likely-than-not recognition threshold shall consider the amounts and probabilities of the outcomes that could be realized upon ~~ultimate~~ settlement¹ using the facts, circumstances, and information available at the reporting date. As used in this Interpretation, the term *reporting date* refers to date of the enterprise's most recent statement of financial position.

b. Paragraph 10:

If the more-likely-than-not recognition threshold is not met in the period for which a tax position is taken or expected to be taken, an enterprise shall recognize the benefit of the tax position in the first interim period that meets any one of the following three conditions:

- a. The more-likely-than-not recognition threshold is met by the reporting date.
- b. The tax ~~matter—~~position is ~~ultimately~~effectively settled through examination, negotiation, or litigation.
- c. The statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired.

A tax position need not be legally extinguished and its resolution need not be certain to subsequently recognize, derecognize or measure the position.

c. Paragraphs 10A–10C are added as follows:

10A. When all of the following conditions have been satisfied, a tax position shall be considered effectively settled through examination:

- a. The taxing authority has completed its examination procedures including all appeals and administrative reviews that the taxing authority is required or is expected to perform for the tax position.
- b. The enterprise does not intend to appeal or litigate any aspect of the tax position for the completed examination.
- c. Based on the taxing authority’s widely understood policy, the enterprise considers it highly unlikely that the taxing authority would subsequently examine or reexamine any aspect of the tax position included in the completed examination, presuming the taxing authority has full knowledge of all relevant information.

In the tax years under examination, a tax position does not need to be specifically reviewed or examined by the taxing authority to be considered effectively settled. If the taxing authority has specifically examined a tax position during the examination process, an enterprise shall consider this information in assessing the likelihood that the taxing authority subsequently would reexamine that tax position for the completed examination.

10B. If an enterprise that had previously considered a tax position effectively settled becomes aware that the taxing authority may examine or reexamine the tax position, the tax position is no longer considered effectively settled and the enterprise shall reevaluate the tax position in accordance with Interpretation 48.

10C. An enterprise may obtain information during the examination process that enables that enterprise to change its assessment of the technical merits of a tax position for similar tax positions taken in other periods. However, the effectively settled conditions in paragraph 10A may not be the sole basis for the enterprise to change its assessment of the technical merits of any tax position in other periods.

d. Paragraph 12:

Subsequent recognition, derecognition, and measurement shall be based on management's best judgment given the facts, circumstances, and information available at the reporting date. ~~A tax position need not be legally extinguished and its resolution need not be certain to subsequently recognize or measure the position.~~ Subsequent changes in judgment that lead to changes in recognition, derecognition, and measurement should result from the evaluation of new information and not from a new evaluation or new interpretation by management of information that was available in a previous financial reporting period.

e. Paragraph A3:

Relatively few disputes are ~~ultimately~~ settled in litigation, and very few are taken to the court of last resort. Generally, the taxpayer and the taxing authority negotiate a settlement to avoid the costs and hazards of litigation. As a result, the measurement of the tax position is based on management's best judgment of the amount the taxpayer would ultimately accept in a settlement with taxing authorities.

f. Paragraph A4:

This Interpretation requires that the enterprise recognize the largest amount of benefit that is greater than 50 percent likely of being realized upon ~~ultimate~~ settlement.

g. Paragraph A22:

Because \$60 is the largest amount of benefit that is greater than 50 percent likely of being realized upon ~~ultimate~~ settlement, the enterprise would recognize a tax benefit of \$60 in the financial statements.

h. Paragraph A24:

Because \$75 is the largest amount of benefit that is greater than 50 percent likely of being realized upon ~~ultimate~~ settlement, the enterprise would recognize a tax benefit of \$75 in the financial statements.

i. Paragraph A25:

In applying the recognition criterion of this Interpretation, an enterprise has determined that a tax position resulting in a benefit of \$100 qualifies for recognition and should be measured. In a recent settlement with the taxing authority, the enterprise has agreed to the treatment for that position for current and future years. There are no recently issued relevant sources of tax law that would affect the enterprise's assessment. The enterprise has not changed any assumptions or computations, and the current tax position is consistent with the position that was recently settled. In this case, the enterprise would have a very high confidence level about the amount that will be ultimately realized and little information about other possible outcomes. Management will not need to evaluate other possible outcomes because it can be confident of the largest amount of benefit that is greater than 50 percent likely of being realized upon ~~ultimate~~ settlement without that evaluation.

j. Paragraph A26:

In year 1, an enterprise acquired a separately identifiable intangible asset for \$15 million that has an indefinite life for financial statement purposes and is, therefore, not subject to amortization. Based on some uncertainty in the tax code, the enterprise decides for tax purposes to deduct the entire cost of the asset in year 1. While the enterprise is certain that the full amount of the intangible is ultimately deductible for tax purposes, the timing of deductibility is uncertain under the tax code. In applying the recognition criterion of this Interpretation, the enterprise has determined that the tax position qualifies for recognition and should be measured. The enterprise believes it is 25 percent likely it would be able to realize immediate deduction upon ~~ultimate~~ settlement, and it is certain it could sustain a 15-year amortization for tax purposes. Thus, the largest year 1 benefit that is greater than 50 percent likely of being realized upon ~~ultimate~~ settlement is the tax effect of \$1 million (the year 1 deduction from straight-line amortization of the asset over 15 years).

k. Paragraph A29:

Upon adoption, the enterprise evaluates the tax position in accordance with the provisions of this Interpretation. The enterprise determines that it is certain that the entire cost of the acquired asset is fully deductible, so the more-likely-than-not recognition threshold has been met. However, the enterprise believes that the largest benefit that is greater than 50 percent likely of being realized upon ultimate settlement is straight-line amortization over 7 years.

1. Paragraph A34, which includes the following illustrative examples, and the heading preceding it are added as follows:

Effective Settlement

A34. The following examples illustrate the application of the guidance.

Example 1

Fact Pattern:

- A taxing authority examines Enterprise X for the 20X5 tax year.
- Three positions (Positions A, B, and C) did not meet the recognition criteria prior to the examination.
- Positions A and B were examined by the taxing authority, and Position C was not examined by the taxing authority.
- Enterprise X obtained new information during the examination that would result in Enterprise X's changing its evaluation of the technical merits for Position B.
- In 20X7 the taxing authority completed the examination for the 20X5 tax year and communicated the results of the examination in its customary fashion.
- The taxing authority's widely understood policy is to not reopen an examination once it is closed unless specific conditions exist, although the taxing authority has the legal ability to do so.
- Enterprise X does not intend to appeal any of the tax positions.

- Based on the specific tax code, an oversight committee of the taxing authority is required to review Position A. That review is expected to occur in 20X8. The oversight committee's practice is to evaluate only Position A.
- The statute of limitations expires in 20X9.

Evaluation:

Enterprise X determines based on new information that Position B meets the more-likely-than-not criteria in paragraph 10. Enterprise X also determines that Position C has been effectively settled in 20X7 because it has satisfied the criteria in paragraphs 10 and 10A. The determination that Position C has been effectively settled is based on the following considerations:

- The taxing authority has closed the examination for the 20X5 tax year.
- Enterprise X does not intend to appeal any aspect of the tax positions.
- Enterprise X believes that none of the specific conditions exist under which the taxing authority would reexamine the position based on its widely understood policy.

Enterprise X should not recognize Position A until the oversight committee has completed its evaluation of the tax position.

Example 2

Fact Pattern:

- A taxing authority examines Enterprise Y for the 20X5 tax year.
- Three positions (Positions A, B, and C) did not meet the recognition criteria prior to the examination.
- Positions A and B were examined by the taxing authority, and Position C was not examined by the taxing authority.
- In 20X7 the taxing authority completed the examination for the 20X5 tax year and communicated the results of the examination in its customary fashion.

- Prior to 20X7 the taxing authority’s widely understood policy was to reopen an examination it previously considered closed only when specific conditions exist. The taxing authority recently announced a change in how it would evaluate the specific conditions, which would routinely result in more examinations being reopened.
- Enterprise Y does not intend to appeal any of the positions.
- Based on the specific tax code, an oversight committee of the taxing authority is required to review Position A. That review is expected to occur in 20X8. The oversight committee will evaluate only Position A.
- The statute of limitations expires in 20X9.

Evaluation:

Based on how the taxing authority would now evaluate the specific conditions in its policy, Enterprise Y could not assert that it is highly unlikely that the taxing authority will not reexamine the positions. Accordingly, Enterprise Y must wait until the statute of limitations expires in 20X9 to recognize the tax benefits unless it can conclude that the positions would meet the more-likely-than-not recognition criteria based on evidence obtained through the examination process.

Example 3

Fact Pattern:

- A taxing authority examines Enterprise Z for the 20X5 tax year.
- Three positions (Positions A, B, and C) did not meet the recognition criteria prior to the examination.
- Positions A and B were examined by the taxing authority.
- In 20X7 the taxing authority completed the examination for the 20X5 tax year and communicated the results of the examination in its customary fashion.

- Enterprise Z intends to appeal Position A based on the findings of the field agent.
- The taxing authority's widely understood policy is that when an enterprise appeals a taxing position, any other tax position in the examination period can be examined or reexamined during the appeals process. Enterprise Z understands that in the past the taxing authority has used Positions B and C as leverage for negotiating settlement of Position A.
- The statute of limitations expires in 20X9.

Evaluation:

Because Enterprise Z intends to appeal Position A and it is the taxing authority's widely understood policy to examine or reexamine other tax positions in negotiating settlements, Enterprise Z could not conclude that Position A, B, or C are effectively settled until the appeals process is resolved.