

An Overview of the Project on Uncertain Tax Positions

By Donald B. Thomas

Background

On July 14, 2005, the Financial Accounting Standards Board issued an Exposure Draft of a proposed Interpretation, *Accounting for Uncertain Tax Positions*. This Exposure Draft would interpret FASB Statement No. 109, *Accounting for Income Taxes*. This article summarizes the history of the project and key provisions of the Exposure Draft, provides an overview of the comment letter process, and outlines the FASB's immediate plans for this project.

In 2004, the FASB staff became aware of significant diversity in practice in the accounting for uncertain tax positions. In fact, the FASB staff's research confirmed that three fundamentally different methodologies to account for uncertain tax positions are currently used in practice. The FASB is concerned that the application of fundamentally different recognition methodologies erodes the comparability of financial information produced by different financial statement issuers for identical transactions.

In researching the issues of this project, the FASB staff met with financial statement preparers, auditors, tax attorneys, and taxing authorities and discussed accounting for uncertain tax positions, income tax dispute, resolution and settlement processes, and difficult taxation issues that could lead to implementation difficulties.

Summary of Key Provisions

The key provisions of the Exposure Draft follow:

1. Recognition: A tax position taken or expected to be taken must be probable of being sustained before the benefit of that position can be recognized in the financial statements of the enterprise. The term *probable* is used in the proposed Interpretation consistent with use of the term in FASB Statement No. 5, *Accounting for Contingencies*, to mean that "the event or events are likely to occur." This recognition criterion is referred to as the probable recognition threshold.
2. Detection: The probable recognition threshold would require that the enterprise presume that the tax position will be evaluated by the taxing authority when making the assessment that the position is probable of being sustained.
3. Subsequent Recognition: A tax position not previously recognized would be recognized in the first fiscal period in which the probable recognition threshold is met.

4. Derecognition: The benefit of a tax position would be derecognized in the first fiscal period that it becomes more likely than not that the tax position will no longer be sustained.

5. Measurement: Management's *best estimate* of the amount that is expected to be sustained would be recognized. The term *best estimate* is used in the proposed Interpretation with the use of the term in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, to mean the single most likely amount in a range of possible estimated amounts.

6. Classification: The liability arising from the difference between the tax position taken and the amount recognized and measured in the proposed Interpretation would be classified as a current liability to the extent it is anticipated to be paid within one year or the operating cycle, if longer. Unless the liability arises from a taxable temporary difference as the term is used in Statement 109, it should not be classified as a deferred tax liability.

7. Change in Judgment: A change in judgment about the recognition, derecognition, or measurement of a tax position would be recognized entirely in the first fiscal period that the change in judgment occurs.

8. Disclosures: The proposed Interpretation does not require any additional disclosures, rather, it refers to Statement 5 for appropriate disclosures on gain or loss contingencies.

9. Transition and Effective Date: The impact of initially applying the proposed Interpretation would be accounted for as the cumulative effect of a change in accounting principle. Early adoption is encouraged, and retroactive restatement is not permitted. While the proposed Interpretation would be effective as of the end of the first fiscal year ending after December 15, 2005, the FASB's new project plan recognizes that this final Interpretation will be issued such that the proposed Interpretation's effective date is highly unlikely to be retained in a final Interpretation.

In addition, two Board members expressed an alternative view. That alternative view would require financial statement recognition of a benefit taken in a tax return when the position had met the minimum statutory threshold to avoid payment of penalty. Thereafter, an accrual for a loss contingency would be recorded for additional income tax liability pursuant to the provisions of Statement 5.

Comment Letters

The Board is required by its Rules of Procedure to solicit and consider comments from the public prior to issuing authoritative guidance in the form of an Interpretation. When comment letters are received, they are posted to the FASB's website and become part of the public record on the project. Additionally, the

comment letters are distributed to all Board members, staff members on the project team, and any other staff members interested in the project.

The staff summarizes the views expressed in the comment letters and presents a summary of the comment letters to the Board. The staff considers the results from the comment letters when researching and preparing recommendations to the Board during redeliberation of the project's issues. The Board considers the results from the comment letters when considering the staff's recommendation.

As noted above, the Exposure Draft was issued on July 14, 2005. The comment period expired on September 12, 2005.

Future Project Activities

Early in the project, the IASB staff concluded that the issues that arose in this project are also applicable to IAS 12. While the FASB has taken the lead in deliberations to date, the IASB will be considering the FASB's decisions as well as the project issues within the context of the IASB's framework.

The IASB deliberated on uncertain tax positions at its September meeting and the FASB and IASB will determine at the October joint meeting whether to proceed with deliberations as a joint project, or to proceed separately. The following are the significant fourth-quarter events anticipated by the staff on this project.

- October 10, 2005: FASB to hold public roundtable meeting in Norwalk, Connecticut
- October 25, 2005: FASB and IASB whether to proceed as a joint project
- December 2005: Complete redeliberations

The FASB and IASB staffs anticipate presenting a recommendation to both Boards for joint deliberation of the way forward (for example, asset approach, liability approach, or some other approach). After the joint meeting, the FASB will redeliberate the project issues and consider the issuance of a final Interpretation.

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