



BDO Seidman, LLP
Accountants and Consultants

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Subject:

FASB Exposure Draft on Uncertain Tax Positions

Tax Alert

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Affecting/ Timing:

All companies following U.S. GAAP for years ending after December 15, 2005. The comment deadline is September 12, 2005.

Details:

On July 14 the Financial Accounting Standard Board (FASB) issued an exposure draft of an interpretation of FASB Statement 109 addressing accounting for uncertain tax positions. This interpretation is intended to reduce perceived inconsistencies in the application of the accounting rules related to income tax contingencies.

Initial Recognition

The proposed interpretation employs a dual threshold approach for recognizing the benefits of tax positions and the continued recognition of the benefit of the tax position.

In order to initially recognize a benefit in the tax provision, it must be probable that the position would be sustained on the merits of the position. The probability that a taxing authority would neither audit nor identify the issue cannot be taken into consideration. The term “probable” has the same meaning as used in FASB Statement 5, “the future event or events are likely to occur.” Although the FASB does not believe that tax opinions are required or appropriate in all instances, they noted that an unqualified “should prevail” tax opinion from a qualified expert for which all conditions are objectively verifiable, may help to demonstrate that the probable threshold has been met.

Derecognition

If in any subsequent period it becomes “more likely than not” that the tax position would not be sustained on audit, the benefit must be derecognized by recording an income tax liability or reducing a deferred tax asset.

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Measurement

Once it is determined that a benefit for a tax position may be recognized (as described above), the amount must be determined based on the best estimate (defined as the single most likely amount in a range of possible estimated amounts) of the amount that will be sustained. For example, if a company believes that its position would be sustained upon litigation but typically settles with the taxing jurisdiction to avoid the expense and hazards of litigation, the company would record the most likely settlement amount as the benefit.

Effective Date and Transition

The interpretation is expected to be effective for years ending after December 15, 2005; early adoption is encouraged. The provisions of the Interpretation are required to be applied to tax positions in all open tax years. Only positions that meet the probable threshold on the date of adoption will be recognized or will continue to be recognized. In other words, all tax positions for all open years must be re-evaluated applying this new interpretation. The cumulative effect of applying the provisions of the Interpretation will be reported as a change in accounting principle as of the end of the period in which adopted.

Recommended Action

As proposed, this Interpretation will be effective for 2005 calendar year-end companies. Income tax contingency accounting practices that companies have employed have been varied and many companies may find that all the information regarding the tax positions reported on tax returns is not readily available. Companies should quickly inventory the tax positions taken in all reported years and evaluate which positions will require significant analysis to substantiate the level of confidence that a position will be sustained as well as the best estimate of the amount to be sustained. Many companies may find that their tax analysis and documentation is insufficient to evaluate the GAAP consequences of this proposed interpretation.

How BDO Seidman Can Assist

BDO Seidman tax professionals can evaluate the tax positions that the company reported in its tax filings and assist with the evaluation of the potential tax consequences of those positions. Typically, the types of tax analysis that support the evaluation of accounting for uncertain tax positions include preparing tax opinions, research credit and other credit studies, transfer pricing studies, permanent establishment analysis, Sub Part F analysis, loss limitation analysis, and methods of accounting studies. BDO Seidman can provide these services as well as a full range of tax services.

Under certain circumstances, BDO Seidman could also assist the company in analyzing the implications of this interpretation on the financial statements.

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