

FIN 48 - A Reprieve?

FIN 48 Accounting for Uncertainty in Income Taxes is an interpretation of FASB 109. The interpretation provides for a recognition threshold and measurement attributes of a liability to be recorded for uncertain tax positions.

Recognition Threshold

Tax positions taken or expected to be taken on a future tax return must sustain a more likely than not threshold or a liability is to be recorded. The liability represents the effect of the tax position taken and the tax position that would meet a recognition threshold of more likely than not, that is greater than 50 percent. This threshold is assuming an examination by taxing authorities and full knowledge of all facts and circumstances.

Measurement

Once it is determined that the recognition threshold is met then a measurement must be applied to the tax position identified. The amount that is recognized is the largest benefit that would be realized based on the tax position that has a more than 50 percent chance of being realized on ultimate settlement.

Example:

ABC Company takes a deduction on its tax return that results in a \$100,000 tax benefit. This tax position is assessed as having the following chances of being settled:

Amount of tax benefit sustained	% of likelihood position sustained	Cumulative probability
\$100,000	30%	30%
\$80,000	10%	40%
\$50,000	15%	55%
\$30,000	25%	80%
20,000	20%	100%

In this case the largest benefit that is over the 50% probability is \$50,000 as that is the highest amount to be recognized under FIN 48 for this tax position. In some cases a table as shown above may be appropriate if there are varying probabilities on settlement while in other cases one outcome may be more probable than others.

Interest and Penalties

Interest and penalties for the uncertain tax position should also be accrued if they are applicable under current tax law. They start accruing during the first interim period that the tax law requires. The amount is calculated as the difference between the tax position taken on the return and the tax position recognized under FIN 48.

Classification

A liability is created for the unrecognized tax benefits and related interest and penalties. This liability is not a component of deferred taxes. It is also not appropriate to utilize a valuation allowance to recognize this liability. It should be classified separately from other tax balances and it based on the expected timing of the cash payments (current or long term).

Derecognition and Subsequent Recognition

At each balance sheet date all unresolved tax positions should be reassessed. For each tax position management should determine if the underlying factors of sustainability of the tax position have changed and if the amount of the recognized tax benefit is still appropriate.

Previously recognized tax positions that no longer met threshold should be derecognized in first reporting period that the threshold is not met. Use of a valuation allowance is not permitted. Likewise tax positions that previously failed the more likely than not threshold should be recognized in the first period when the threshold is met, the tax matter is ultimately settled through negotiation or litigation or the statute of limitation has expired.

Disclosures

Disclosures related to application of FIN 48 are required at the end of each annual reporting period presented and include tabular reporting of the total unrecognized tax benefits at the beginning and end of the reporting period including at a minimum

1. Gross increase or decrease in unrecognized tax benefits as a result of tax positions taken during prior periods

2. Gross increase or decrease in unrecognized tax benefits as a result of tax positions during current period
3. Decreases in unrecognized tax benefits relating to settlements
4. Reductions to unrecognized tax benefits as result of lapse of statute of limitations.

The disclosure must also include the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate. The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position.

Disclosure for positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date include:

1. The nature of the uncertainty
2. The nature of the event that could occur in the next 12 months that would cause the change
3. An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made may be recognized or continue to be recognized

The disclosure should also include a description of tax years that remain subject to examination by major tax jurisdictions.

Transition

All tax positions are subject to the application of FIN 48 upon initial adoption. Only the tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption. The cumulative effect of applying the provisions of FIN 48 are to be reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately.

The cumulative-effect adjustment does not include items that would not be recognized in earnings, such as the effect of adopting FIN 48 on tax positions related to business combinations. The amount of that cumulative-effect adjustment is the difference between the net amount of assets and liabilities recognized in the statement of financial position prior to the application and the net amount of assets and liabilities recognized as a result of applying the provisions of FIN 48.

The cumulative effect of the change on retained earnings in the statement of financial position as of the date of adoption is to be disclosed. This disclosure is required only in the year of adoption.

Changes in Judgment

“A change in judgment that results in subsequent recognition, derecognition, or change in measurement of a tax position taken in a prior annual period (including any related interest and penalties) shall be recognized as a discrete item in the period in which the change occurs. The provisions of paragraphs 35 and 38 in Statement 109 that pertain to intraperiod tax allocation are not changed by this Interpretation.” (Para. 13, FIN 48)

“A change in judgment that results in subsequent recognition, derecognition, or change in measurement of a tax position taken in a prior interim period within the same fiscal year is an integral part of an annual period and, consequently, shall be reflected pursuant to the provisions of paragraph 19 of APB Opinion No. 28, *Interim Financial Reporting*, and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*.” (Para. 14, FIN 48)

AFLAC 2007 Annual Report

From Note 1

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109. The provisions of FIN 48 clarify the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The evaluation of a tax position in accordance with FIN 48 is a two-step process. Under the first step, the enterprise determines whether it is more likely than not that a tax position will be sustained upon examination by taxing authorities. The second step is measurement, whereby a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006, with earlier application encouraged. We adopted the provisions of this standard effective January 1, 2007. The adoption of this standard did not have any impact on our financial position or results of operations (see Note 8).

From Note 8

We adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), on January 1, 2007 (see Note 1). There was no change in the liability for unrecognized tax benefits as a result of the implementation of FIN 48 and therefore no adjustment to retained earnings upon adoption. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

(In millions)	
Balance at January 1, 2007	\$ 43*
Additions for tax positions of prior years	18
Reductions for tax positions of prior years	(11)
Balance at December 31, 2007	\$ 50*

*Amounts do not include tax deductions of \$14 at January 1, 2007, and \$18 at December 31, 2007.

Included in the balance of the liability for unrecognized tax benefits at December 31, 2007, are \$51 million of tax positions for which the ultimate deductibility is highly certain, but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate, but would accelerate the payment of cash to the taxing authority to an earlier period. The Company has accrued approximately \$2 million for permanent uncertainties, which if reversed would not have a material effect on the annual effective rate.

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. We recognized approximately \$3 million in interest and penalties in 2007, compared with \$2 million in 2006 and \$1 million in 2005. The Company has accrued approximately \$32 million for the payment of interest and penalties as of December 31, 2007, compared with \$29 million a year ago.

As of December 31, 2007, there were no material uncertain tax positions for which the total amounts of unrecognized tax benefits will significantly increase or decrease within the next twelve months

What is a Tax Position?

A tax position is implicit in the filing of a tax return or the treatment of items affecting the tax return when recorded. Tax positions included decisions made about recognition of income and deduction of expenses including classifications. They are positions taken or planned to be taken on a tax return and can result in the reduction of income tax payable, a deferral of income taxes to future periods that would otherwise be due currently. They may also change the expected realizability of deferred tax assets.

Tax positions include but are not limited to the decision not to file a tax return, allocation or shift of income between tax jurisdictions, the characterization of income or the decision to exclude reporting taxable income and the decision to classify a transaction, entity or other position as tax exempt.

The reason why the tax return is not filed should be properly documented; unfiled tax returns have no statute of limitations. This means that all unfiled tax returns in jurisdictions that a return is required can become an uncertain tax position under FIN 48 if the benefit is material. In considering the tax positions for adoption of FIN 48 all unfiled tax returns must be considered.

Many times it may be advantageous to shift income from one jurisdiction to another for tax savings. These tax positions must also be considered in determining the application of FIN 48. Similarly the classification of income or the decision to exclude income from tax reporting can bring tax savings on a filed tax return. FIN 48 requires that these tax positions be reviewed using the recognition threshold and measurement attribute in accordance with the interpretation.

Not-for-profits may determine that an activity meets the requirements for exemption and is not taxable as unrelated business taxable income as well as potential uncertain tax positions claimed by for-profit subsidiaries.

Uncertain Tax Positions

An uncertain tax position is a position that does not meet the more likely than not threshold. It includes all of the above mentioned tax positions and more. For all uncertain tax positions the provisions of FIN 48 must be applied.

FASB 109

“The objectives of accounting for income taxes are to recognize (a) the amount of taxes payable or refundable for the current year and (b) deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an enterprise’s financial statements or tax returns.”

FASB 109 establishes accounting and reporting standards for income taxes and the effects that come from activities that occur during the current and preceding years. It requires an asset and liability approach to the accounting and reporting. It supersedes FASB Statement 96, Accounting for Income Taxes as well as supersedes or amends other pronouncements.

FASB 109 includes as its basic principles for accounting for income taxes:

- Current tax liability or asset for estimated tax
- Deferred tax liability or asset for future tax effects of temporary differences and carryforwards
- Measurement of current and deferred based on enacted tax law
- Measurement of deferred reduced by amounts not expected to be realized

Reprieve?

On February 1, 2008 FASB issued FASB staff Position No. FIN 48-2 titled Effective Date of FASB Interpretation No. 48 For Certain Nonpublic Enterprises. This was the formal position of the actions taken at the November 7, 2007 meeting which added to the agenda a project to defer the effective date of FIN 48. The deferral is for all nonpublic companies including nonpublic not-for-profit entities to fiscal years beginning after December 15, 2007. This essentially means calendar year 2008 year ends. This deferral does not defer the application of FIN 48 for nonpublic entity that had already adopted the provisions.

The FASB discussed two basic reasons for the deferral and they were somewhat related. The first had to do with the timing of CPE for those affected, the FIN was issued in July of 2006 after the start of the CPE season which considered changes of the past year that would become effective in that year. This meant that FIN 48 would not be included until revisions of CPE materials starting in June 2007 and would not give sufficient time for smaller entities to study and prepare for implementation as this was after the implementation date. Several board members did not believe that this was an effective argument for deferral and voiced that opinion in the minutes.

In addition initially the consensus was that this would have little to no affect on nonpublic companies since the majority of these entities were pass through entities for which FASB 109 does not address therefore FIN 48 would not apply. After further study it was determined that FIN 48 did have an impact on more nonpublic entities than was initially thought and that the nonpublic companies would have a more difficult time implementing the new interpretation. Many issues came up regarding pass through and the Private Companies Financial Reporting Committee wrote a letter to the FASB on September 24, 2007 asking for the deferral. This letter along with a few others to FASB gave them enough of a push to allow additional time to resolve the pass through entities issues. However the FASB determined that it was not going to issue any additional guidance on pass through entities as it believes that the application to pass through entities was clear in the original interpretation.

Nonpublic Entities and the Application of FIN 48

Pass through entities present numerous challenges for implementation of FIN 48. Partnerships and S-Corps are not addressed directly in FASB 109 and since the FIN 48 is an interpretation of FASB 109 it appears that it would not apply. However in the discussion on the deferral the board made it clear that FIN 48 does apply to pass through entities. One of the items of discussion about pass through entities was whether the pass through entity actually met the requirements of a pass through entity under IRS scrutiny. As was discussed, if there were aggressive tax positions taken in a pass through entity and the more likely than not recognition threshold for the pass through entity was not met then the entity would be subject to FASB 109 and FIN 48 would apply. If you examine this discussion a little further then it is apparent that the FASB intended for the interpretation to apply to pass through entities at the very lowest level, evaluation of the pass through as a qualified pass through. There is no further guidance so we have to evaluate the other aspects of the pass through questions based on this and other discussions.

Since pass through entities may take aggressive tax positions and those positions may not meet the more likely than not recognition threshold and the measurement attributes would belong to the entities to which the tax reporting is passed. What is not apparent is what affect this has on the pass through for reporting in accordance with FIN 48. In many small businesses that may have this occur and the uncertain tax position is not upheld in examination with the taxing authority, the business owner will withdraw cash from the pass through entity to meet the obligation. Since the cash to settle the tax is going to be withdrawn from the pass through entity should the FIN 48 liability be recorded at the pass through level?

This is just one example of the questions that exist for the pass through entity. Others include taxing jurisdictions that do not recognize the entity as a pass through for FASB 109 taxes. Each pass through entity will need to identify its particular circumstances and the application of FIN 48 in the circumstances. Once the application of FIN 48 is determined then the entity will need to meet the all of the requirements including disclosures.

Most nonpublic companies are more focused on tax savings rather than financial reporting and may not be as aware of the application of FIN 48 in their circumstances. As such they may have entered into uncertain tax positions as part of their tax savings strategy without regard to financial reporting requirements. In these circumstances the company will need to perform a review of all of its tax positions taken or planned. In order to facilitate this review a line by line review of all tax returns filed for years that are still open should be performed. The company should review all prior results of prior tax audits. The company should review its policies for recording revenue from the various jurisdictions for nexus and make sure that filing requirements have been made and that there are no material unfiled positions that are open. As these reviews are performed the company should document each tax position taken and document its understanding of the

position and the factors that are to be used in determining the recognition threshold. The company should place a higher emphasis on those positions that are close to the more likely than not threshold. After careful consideration the company will need to determine the measurement attribute and properly record the FIN 48 liability and interest and penalties that may apply.

The application of FIN 48 to nonpublic companies is going to require additional effort and time. Nonpublic companies have been given a reprieve primarily due to the pass through entity confusion. Given this reprieve the companies along with their CPA's should have already started the process of implementation, however those who have not because of the mistaken non application to pass through entities may have to be performing some catch up to get up to speed on the implementation of FIN 48.

FIN 48

Accounting for Uncertain Tax Positions A Reprieve?

Thomas E. Newell, Jr., CPA

Summary

- Clarifies accounting for uncertainty in income taxes recognized in accordance with FASB 109
- Provides a recognition threshold and measurement attribute for tax position taken or expected to be taken

- Also provides guidance on
 - Derecognition
 - Classification
 - Interest and penalties
 - Interim periods
 - Disclosure
 - Transition

- Effective date for years beginning after December 15, 2006

Definition of “Tax Position”

Paragraph 4 of FIN 48 states:

“A tax position can result in a permanent reduction income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets.”

Definition of “Tax Position”

Also encompasses but not limited to:

- Decision not to file a tax return
- Allocation or shift of income between jurisdictions
- Characterization of income or decision to exclude reporting taxable income
- Decision to classify a transaction, entity, or other position as tax exempt

FASB 109

“The objectives of accounting for income taxes are to recognize (a) the amount of taxes payable or refundable for the current year and (b) deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an enterprise’s financial statements or tax returns.”

FASB 109 Basic Principles

- Current tax liability or asset for estimated tax
- Deferred tax liability or asset for future tax effects of temporary differences and carryforwards
- Measurement of current and deferred based on enacted tax law
- Measurement of deferred reduced by amounts not expected to be realized

FIN 48 Transition

- Cumulative affect of applying FIN 48 is adjustment to opening balance of retained earnings, presented separately.
- Cumulative effect does not include items that would not be recognized in earnings. (i.e. effect of adoption FIN 48 on tax positions related to business combinations)

FIN 48 Transition

- Amount of cumulative effect is difference in net assets and liabilities recognized in statements prior and amount recognized after application
- Disclosure of cumulative effect of change in retained earnings in the financial statements as of the date of adoption. Only in year of adoption.

Recognition and Measurement

Two step process -

Recognition:

- More likely than not tax position will be sustained in examination
 - Including resolution of appeals or litigation
 - Must assume examination with full knowledge of facts

Recognition and Measurement

If more likely than not recognition is not met in period tax position is taken or expected to be taken, recognize in first interim period that meet one of the following: (Paragraph 10 of FIN 48)

- More likely than not threshold is met by reporting date
- Tax matter is ultimately settled through negotiation or litigation
- Statue of limitations to examine and challenge has expired

Recognition and Measurement

Measurement:

- Greater than 50% - Tax position that meets the more likely than not recognition threshold is measured as amount of benefit of tax position at largest amount of benefit being realized upon settlement.

Classification

As a result of FIN 48, benefit recognized in the financial statements may differ from the amount taken or expected to be taken in a tax return for the current year. These differences represent unrecognized tax benefits, which are the differences between a tax position taken or expected to be taken in a tax return and the benefit is to be recognized and measured as required by FIN 48.

Classification

A liability is created (or the amount of a net operating loss carryforward or amount refundable is reduced) for an unrecognized tax benefit because it represents an enterprise's potential future obligation to the taxing authority for a tax position that was not recognized pursuant to this Interpretation.

Classification

- Classified as current liability for unrecognized tax benefits to extent that will make a payment within one year or the operating cycle if longer.
- Not classified as deferred tax liability unless result is from a taxable temporary difference. This interpretation does not change classification requirements of deferred taxes.

Derecognition

- Tax provisions that previously failed more likely than not threshold should be recognized in first period when threshold is met.
- Previous recognized tax positions that no longer met threshold should be derecognized in first reporting period that threshold not met. Allowance is not appropriate.

Interim Reporting

- Paragraph 4 of FIN 48 “The term tax position as used in this interpretation refers to a position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in a measuring current or deferred income tax assets or liabilities for interim or annual periods.”

Interest and Penalties

- Paragraph 15 of FIN 48 – When tax law requires interest on underpayment must start recognizing interest expense in first period the interest would begin accruing. Amount should be at the applicable statutory rate calculated on difference between tax position under this interpretation and amount previously taken or expected to be taken in a tax return.

Interest and Penalties

- Paragraph 16 of Fin 48 – If tax position does not meet minimum threshold to avoid payment of penalties, recognize an expense for the statutory penalty in the period which the entity claims or expects to claim the position on the tax return.

Interest and Penalties

- If penalties were not recognized when position was initially taken, recognize them in the period when the entities judgment about meeting the minimum statutory threshold changes.

Interest and Penalties

- Previously recognized interest and penalties associated with tax positions that subsequently meet the conditions for derecognition (Paragraph 10 of FIN 48) should be derecognized in the period that the condition is met.

Disclosures

The following must be disclosed at the end of each annual reporting period presented:

- A. Tabular recording of total unrecognized tax benefits at beginning and end of period including at a minimum the following items:

Disclosures

1. Gross increase or decrease in unrecognized tax benefits as a result of tax positions taken during prior periods
2. Gross increase or decrease in unrecognized tax benefits as a result of tax positions during current period
3. Decreases in unrecognized tax benefits relating to settlements
4. Reductions to unrecognized tax benefits as result of lapse of statute of limitations

Disclosures

- B. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate
- C. The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position

Disclosures

- D. For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:
1. The nature of the uncertainty
 2. The nature of the event that could occur in the next 12 months that would cause the change
 3. An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made

Disclosures

E. A description of tax years that remain subject to examination by major tax jurisdictions.

Illustrative Disclosure

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2001. The Internal Revenue Service (IRS) commenced an examination of the Company's U.S. income tax returns for 2002 through 2004 in the first quarter of 2007 that is anticipated to be completed by the end of 2008. As of December 31, 2007, the IRS has proposed certain significant adjustments to the Company's transfer pricing and research credits tax positions. Management is currently evaluating those proposed adjustments to determine if it agrees, but if accepted, the Company does not anticipate the adjustments would result in a material change to its financial position. However, the Company anticipates that it is reasonably possible that an additional payment in the range of \$80 to \$100 million will be made by the end of 2008.

Illustrative Disclosure

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. As a result of the implementation of Interpretation 48, the Company recognized approximately a \$200 million increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Illustrative Disclosure

Balance at January 1, 2007	\$370,000
Additions based on tax positions the related to current year	10,000
Additions for tax positions of prior years	30,000
Reductions for tax positions of prior years	(60,000)
Settlements	<u>(40,000)</u>
Balance at December 31, 2007	<u>\$310,000</u>

Illustrative Disclosure

Included in the balance at December 31, 2007, are \$60 million of tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of the shorter deductibility period would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period.

Illustrative Disclosure

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. During the years ended December 31, 2007, 2006, and 2005, the Company recognized approximately \$10, \$11, and \$12 million in interest and penalties. The Company had approximately \$60 and \$50 million for the payment of interest and penalties accrued at December 31, 2007, and 2006, respectively.

Changes in Judgment

“A change in judgment that results in subsequent recognition, derecognition, or change in measurement of a tax position taken in a prior annual period (including any related interest and penalties) shall be recognized as a discrete item in the period in which the change occurs. The provisions of paragraphs 35 and 38 in Statement 109 that pertain to intraperiod tax allocation are not changed by this Interpretation.” (Para. 13, FIN 48)

Changes in Judgment

“A change in judgment that results in subsequent recognition, derecognition, or change in measurement of a tax position taken in a prior interim period within the same fiscal year is an integral part of an annual period and, consequently, shall be reflected pursuant to the provisions of paragraph 19 of APB Opinion No. 28, *Interim Financial Reporting*, and FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*.” (Para. 14, FIN 48)

Reprieve?

- February 1, 2008 FASB issued Staff Position No. 48-2
- This position represented the formal position taken in November 2007
- Affect was a deferral of application of FIN 48 for all nonpublic entities.

Reprieve?

Two reasons for deferral were presented at November 2007 meeting.

- Timing of CPE education about FIN 48
- Application to Pass Through Entities

Nonpublic Entities

- Most nonpublic entities are pass through
- Originally reasoned FIN 48 did not apply
- FASB however did intend FIN 48 to apply

Nonpublic Entities

- Partnerships

- S-corps

- LLCs

Pass Through

- FASB 109 does not directly apply to pass through
- Most reasoned that FIN 48 would not apply

Pass Through

- FASB indicated that consideration of pass through status is a FIN 48 consideration
- What about uncertain tax positions taken at pass through level

Pass Through

If aggressive tax position is taken at pass through level should the entity recorded liability for FIN 48 including penalty and interest?

Pass Through

What about decision not to file a tax return by the pass through?

Decision to treat income as not taxable to a jurisdiction?

Pass Through

Pass through entities can be subject to FASB 109 taxes and FIN 48

The reprieve is given so that the nonpublic entities can review the application of FIN 48 to their circumstances and comply with the requirements.

Resources

- <http://www.fasb.org/pdf/fin%2048.pdf>
- http://www.fasb.org/pdf/fsp_fin48-1.pdf
- <http://tax.aicpa.org/Resources/Professional+Standards+and+Ethics/Practice+Guide+on+Accounting+for+Uncertain+Tax+Positions+Under+FIN+48.htm>

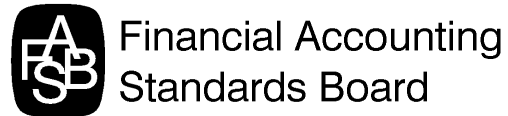
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MINUTES



To: Board Members
From: Delmonico ext. 393
Subject: Minutes of the November 7, 2007 Board Meeting; **Date:** November 29, 2007
Deferral of FASB Interpretation No. 48,
Accounting for Uncertainty in Income Taxes, for
non public entities – agenda decision
cc: Bolash, Chookaszian, Cosper Glotzer Golden, Bielstein, MacDonald,
Leisenring, Leverenz, Lott, Malcolm, Maples, R. Paul, Tully, Posta,
Gabriele, Klimek, Allen, Intranet

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: Deferral of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, for nonpublic entities

Basis for Discussion: Board Memorandum No. 1

Length of Discussion: 9:30 a.m. to 10:00 a.m.

Attendance:

Board members present: FASB: Herz, Batavick, Linsmeier Seidman, Smith,
and Young
IASB: Leisenring

Board members absent: Crooch

Staff in charge of topic: Glotzer

Other staff at Board table: Golden, Paul, and Delmonico

Summary of Decisions Reached:

At the November 7, 2007 Board meeting, the Board deliberated on a deferral of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, for nonpublic entities. At that meeting, the Board decided:

1. To add a project to its agenda to defer the effective date of Interpretation 48 for all nonpublic entities, including nonpublic not-for-profit entities, to fiscal years beginning after December 15, 2007. Nonpublic entities that have already adopted the provisions of Interpretation 48 would not be eligible for the deferral.
2. To proceed to a preballot draft of the proposed FSP with a 30-day comment period.

Objectives of Meeting:

The objective of the meeting was for the Board to decide whether it wanted to add a project to its agenda to defer the effective date of Interpretation 48 for nonpublic entities.

The objective was met.

Matters Discussed and Decisions Reached:

1. Mr. Glotzer began the meeting by stating that the staff had received a letter from the Private Company Financial Reporting Committee (PCFRC) which raised concerns about the effective date of Interpretation 48 for nonpublic entities. He noted, however, that this was not the first time the Board had been asked to deliberate delaying the effective date of Interpretation 48. Staff Memorandum 1 identified the arguments raised at previous Board meetings both for and against delaying the effective date. He indicated, however, that a letter received from the PCFRC raised issues relating to nonpublic entities that had not been considered in previous deliberations. He further stated that the PCFRC in its letter indicated that it believes that many nonpublic entities and their CPA practitioners are just now becoming aware of the implications of the Interpretation. Mr. Glotzer commented that one of the primary ways in which these entities and practitioners learn about new FASB standards is from continuing professional education sessions or CPE. CPE sessions are typically held in June and cover changes to GAAP that have occurred in the preceding year that become effective in the current year. He argued that since

Interpretation 48 was issued in July of 2006, the CPE sessions held in June of 2006 did not cover Interpretation 48 at all, or only superficially. The continuing education sessions covering Interpretation 48 would not have been held until June 2007, which is after the Interpretation became effective.

2. Mr. Glotzer commented that the staff was also aware of other ways in which nonpublic entities and their CPA practitioners learn of new FASB standards. He indicated that in addition to continuing education, these entities and practitioners learn from subscriptions to GAAP guides or from third party practice aids. Mr. Glotzer commented that the staff contacted a provider of practice aids used by many CPA practitioners to see what information about Interpretation 48 was provided and when it was issued. Through its contact, the staff learned that the 2006 edition issued in September of 2006 contained four paragraphs in the practice aid materials about Interpretation 48, all of which related to disclosure requirements. He commented that the staff also obtained a GAAP guide issued about the same time and noted that it made no mention of Interpretation 48. As a result, firms that use these materials for FASB updates did not learn about Interpretation 48 until the materials were issued in September of 2007, which is after the Interpretation became effective.
3. Mr. Glotzer then stated that the PCFRC raised a second issue, Interpretation 48's applicability to pass-through entities. He commented that the PCFRC is requesting that the Board issue guidance specifically geared towards pass-through entities. Since Interpretation 48 is an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*, many nonpublic entities and their CPA practitioners were not aware that it applied to pass-through entities. He stated that these CPA practitioners reasoned that as an interpretation of Statement 109, it was not applicable to their S-corporation and partnership clients.
4. Mr. Glotzer commented that the PCFRC letter recommended that the Board delay the effective date of Interpretation 48 until guidance could be issued on Interpretation 48's implications to pass-through entities. As written, the Interpretation does not contain specific examples illustrating how it impacts those entities.

5. Mr. Glotzer noted that several arguments have been presented in opposition to the PCFRC's recommendations. Those arguments include (a) by granting a delay for nonpublic entities, the Board is acting as an enabler so that nonpublic entities will not have an incentive to keep current and (b) nonpublic entities and their CPA practitioners should be responsible enough to keep up to date on their own and not rely on the methods currently used for GAAP updates.
6. Mr. Glotzer commented that the staff has identified three alternatives: (a) defer the effective date of Interpretation 48 for nonpublic entities to fiscal years beginning after December 15, 2007, (b) defer the effective date of Interpretation 48 just for pass-through entities to fiscal years beginning after December 15, 2007 or (c) retain the current effective date.
7. Mr. Glotzer then stated that the staff considered arguments both pro and con and recommended that the Board delay the effective date of Interpretation 48 for nonpublic entities to fiscal years beginning after December 15, 2007. The staff believes that it is not the FASB's responsibility to change the way nonpublic entities keep up with professional standards. Also, because the Interpretation did not provide guidance on how it applied to S-corporations and partnerships, the staff recommended that the Board add a project to its agenda to develop specific guidance for those entities.
8. Mr. Golden commented that while pass-through entities are clearly in the scope of Interpretation 48, he believes that the Interpretation was never clear on how it applied to pass-through entities and, therefore, understood how pass-through entities could have misunderstood its applicability. He commented that the Board's reasoning for scoping in pass-through entities in Interpretation 48 was because an entity could have taken an aggressive tax position in determining its pass-through status. He continued commenting that if it is less than more likely than not that upon audit by the Internal Revenue Service an entity's assertion that it is a pass-through entity would be sustained, then the entity should follow all aspects of Statement 109 and Interpretation 48. The confusion stems from the fact that Interpretation 48 did not

provide examples of how it could apply to pass-through entities. Mr. Golden commented that he does not believe it is necessary to add a project to the Board's agenda to provide formal guidance; rather he believes that the staff should be able to work with the private company constituents and resource groups in developing and disseminating guidance.

9. Mr. Herz stated that although he supported a deferral, he was concerned about the awareness issues for private constituents the staff had raised. He questioned how the process might be improved so that deferral requests such as this one would not occur in the future.
10. Mr. Linsmeier stated that he disagreed with the notion that CPE cycles should drive effective dates and deferral requests. He said that basing effective dates and deferral requests on whether newly issued standards have been included in CPE cycles opens the door to potential manipulation. Mr. Linsmeier further stated that constituents should be following the standard-setting process, rather than relying on third party providers for updates on new standards. Mr. Linsmeier commented that he believes the only legitimate reason for deferral in this instance is because of the confusion created by the applicability of Interpretation 48 to pass-through entities.
11. Mr. Herz said that although he agrees with Mr. Linsmeier in principle, he recognizes that to have good financial reporting, preparers must be able to obtain information and education about new standards in a timely manner. Mr. Herz suggested that the Board might benefit from better understanding how information about new standards are disseminated in the small private company market so that this type of issue does not occur again.
12. Mr. Golden also echoed Mr. Linsmeier's comments. He stated that it was not the staff's intention to provide a deferral based on what third-party providers had or had not included in their publications or education seminars. He commented that the staff's request for deferral was based on the confusion over the applicability of Interpretation 48 and Statement 109 to pass-through entities and the resulting need for guidance.

13. Mr. Batavick commented that he supported a deferral for all nonpublic entities, however, that decision was not based on the fact that information about the Interpretation was not published in educational materials. He commented that his decision to defer was based on the confusion that arose from the scoping in of pass-through entities for an interpretation of Statement 109 without providing guidance on how the Interpretation would apply to those entities. Mr. Batavick also commented that he thought guidance could be issued without adding a project to the Board's agenda.
14. Ms. Seidman commented that the letter from the PCFRC raised two issues that the Board needs to consider, one of which is the confusion brought on by the application of Interpretation 48 to pass-through entities and the other is what appears to be a breakdown in the education system, that is, constituents' awareness of newly released accounting standards and an understanding that they need to be in a position to implement those new standards by their effective dates. Ms. Seidman questioned why constituents were relaying on third-party providers to educate themselves about the release of new standards. Ms. Seidman commented that she would like to examine the reasons for this phenomenon and the Board's role in educating constituents so that this type of situation would not occur in the future. Ms. Seidman stated that although she did not find the educational materials argument persuasive, she did support a deferral for all nonpublic entities.
15. Mr. Linsmeier stated that he supported a deferral for nonpublic pass-through entities only. He believes that confusion created by the Interpretation's applicability to pass-through entities is sufficient to warrant a deferral for those constituents.
16. Mr. Young commented that he is also concerned about the potential precedent that a deferral could set, but at the same time believes that the standards release process for small businesses is overly complicated. He believes that it is difficult for the small entrepreneur to keep up with new standards based on the way those standards are currently released to the market place. He believes that the release process could be improved by packaging new standards together and releasing that package annually.

17. Mr. Smith commented that although he supports a deferral, he does not find the educational materials argument compelling. He did, however, understand how there could be confusion surrounding the applicability of Interpretation 48 to pass-through entities. However, rather than supporting a deferral for nonpublic pass-through entities only, Mr. Smith indicated that he supported a deferral for all nonpublic entities. Mr. Smith commented that a deferral for nonpublic pass-through entities only overly complicated the deferral mechanism.
18. Mr. Herz also commented that he supported a deferral for all nonpublic entities for the same reason Mr. Smith supported a deferral for all non public entities.
19. Mr. Golden clarified that an entity would only qualify for this deferral if that entity had not already adopted Interpretation 48. Mr. Golden also clarified that a non-SEC registrant would be used to determine whether an entity would be considered nonpublic.
20. The Board agreed with the staff's recommendation to defer the effective date of Interpretation 48 for all nonpublic entities, including not-for-profit entities, to fiscal years beginning after December 15, 2007. Nonpublic entities that have already adopted the provisions of Interpretation 48 would not be eligible for the deferral. (Five agreed [RHH, LWS, GJB, LFS, GMC by proxy]; two did not [TJL, DMY].)
21. Mr. Golden then asked if the Board wanted to proceed to a preballot draft of the proposed FSP with a 30-day comment period. The Board unanimously agreed to proceed to a preballot draft of the proposed FSP with a comment period of 30 days. (All Board members agreed [RHH, TJL, LFS, LWS, GJB, DMY, GMC by proxy].)

Follow-Up Items:

None.

General Announcements:

None.



Interpretation 48-Delay of Effective Date for Nonpublic Entities and Guidance for Pass-Through Entities

Board Meeting Handout

November 7, 2007

BACKGROUND

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, was issued in July 2006, effective for years beginning after December 15, 2006 (2007 for most nonpublic entities). Paragraph 1 of Interpretation 48 states that the Interpretation applies to pass-through entities. Paragraph 1 of Interpretation 48 mentions real estate investment trusts and registered investment companies as examples of entities whose tax liability is subject to 100 percent credit for dividends paid. The Interpretation, however, does not mention or provide examples specifically relating to its application to pass-through entities such as S-corporations or partnerships which are used more often than C-corporations by small nonpublic entities.

At the January 17, 2007 Board meeting, the Board redeliberated the issue of delaying the effective date based on a large volume of unsolicited comment letters requesting a one year delay. Many of the arguments for delaying the effective date in those letters were the same or similar to those discussed by the Board at its May 10, 2006 meeting. However, none of those letters address concerns specifically related to nonpublic entities and as a result nonpublic entity concerns were not discussed at the January 17, 2007 Board meeting.

Shortly after the issuance of Interpretation 48, a suggestion was made by the staff that guidance be issued regarding its application to pass-through and not-for-profit entities. It was argued that paragraph 1 of Interpretation 48 was counterintuitive. That is, pass-through entities, which traditionally had not been subject to the provisions of FASB Statement No. 109, *Accounting for Income Taxes*, would not understand how an interpretation of Statement 109 could apply. The staff agreed that guidance should be issued if and when the nonpublic entity constituency requested it. It was pointed out at that time that nonpublic entities and their CPA practitioners

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may not request guidance until after June of 2007 and possibly even as late as early 2008, when financial statements were being drafted by the entity's CPA firm.

PURPOSE

At this meeting, the staff will ask the Board:

1. Whether it wants to defer the effective date of Interpretation 48 for nonpublic entities.
2. Whether it wants to add a project to its technical agenda to provide guidance for how pass-through entities should apply Interpretation 48.
3. Whether it wants to the staff to proceed with a preballot draft of the proposed FSP that would have a 30-day comment period.

EFFECTIVE DATE AND GUIDANCE FOR PASS-THROUGH ENTITIES

The staff received a letter from the Private Company Financial Reporting Committee (PCFRC) which raised concern over the effective date of Interpretation 48 for nonpublic entities. In this letter, the PCFRC indicated that it believes that many nonpublic entities and their CPA practitioners are just becoming aware of the implications of Interpretation 48 since many do not have the resources to follow FASB proceedings. One of the primary ways in which these entities and practitioners learn about new FASB standards is from continuing education sessions. These continuing education sessions are typically held in June and address changes to GAAP that have occurred in the preceding year that become effective in the current year. Since Interpretation 48 was issued in July of 2006, the continuing education sessions held in June of 2006 would not have addressed Interpretation 48. The continuing education sessions covering Interpretation 48 would not have been held until June 2007, after Interpretation 48 became effective. Therefore, these entities and practitioners would not have had the necessary time to understand and apply the guidance required by the Interpretation before its effective date.

The staff is also aware of other ways in which nonpublic entities and their CPA practitioners learn of new FASB standards. In addition to continuing education, these entities and practitioners learn from subscriptions to GAAP guides or from third party practice aids. The staff contacted a provider of practice aids used by many CPA practitioners to see what information about Interpretation 48 was provided and when it was issued. Through its contact,

the staff has learned that the 2006 edition issued in September of 2006 contained four paragraphs in the practice aid materials about Interpretation 48, all of which related to disclosure requirements. No mention was made about its applicability to pass-through entities. In the 2007 edition, however, the practice aid materials were expanded to four pages. The staff also obtained a GAAP guide issued about the same time and noted that it made no mention of Interpretation 48. As a result, firms that use these materials for FASB updates did not learn about Interpretation 48's applicability to pass-through entities until September 2007.

The PCFRC also commented that Statement 109 does not directly address pass-through entities. When Interpretation 48 was issued as an interpretation of Statement 109, it was not perceived as having applicability to firms whose clients are typically S-corporations and partnerships. Until firms learned of its applicability in June of 2007, or later, they did not believe it applied to their clients. As a result, many did not read the interpretation. Having only learned of its applicability to pass-through entities in June of 2007, the PCFRC and the staff believe that a delay in the effective date to periods beginning after December 15, 2007 would give nonpublic entities the same 10-month window (assuming statements are issued for the first quarter of 2008) as public companies had when Interpretation 48 was issued in July, 2006.

STAFF RECOMMENDATION

The staff identified three alternatives: (1) grant a delay for all nonpublic entities, (2) grant a delay specifically for pass-through entities, and (3) not grant a delay and only issue guidance for pass-through entities. The staff supports alternative (1) because it believes the typical small nonpublic entity environment is unique enough to justify the delay. Since many nonpublic entities do not follow FASB proceedings and learned about Interpretation 48 after its effective date, a delay would provide these entities with the same 10-month period to prepare for and implement Interpretation 48 that public companies had when Interpretation 48 was issued in July of 2006. A delay in the effective date would also give the FASB time to issue guidance addressing how the Interpretation impacts S-corporations and other pass-through entities. This would help ensure that Interpretation 48 would be properly implemented. If the Board chooses to issue guidance, the staff is prepared to draft it.

If the Board chooses to delay the effective date for all nonpublic entities, the staff believes that the deferral should apply only to those entities that have not yet applied the provisions of

Interpretation 48. Those entities which have already applied the provisions of Interpretation 48 would be required to continue applying those provisions and therefore would not qualify for the delay. The staff notes that all other transition provisions of Interpretation 48 would continue to apply.

QUESTIONS FOR THE BOARD

- 1. Does the Board want to delay the effective date of Interpretation 48 for all nonpublic entities to periods beginning after December 15, 2007?**
- 2. If not, does the Board want to delay the effective date of Interpretation 48 for pass-through entities to periods beginning after December 15, 2007?**
- 3. Does the Board want to add a project to its agenda to have the staff develop guidance to explain how Interpretation 48 applies to pass-through entities?**
- 4. If yes, does the Board want to proceed with a preballot draft of the proposed FSP that would have a 30-day comment period?**



Financial Accounting Standards Board

Board Meeting Handout

STATEMENT 133 HEDGING

Fair Value Hedge Accounting Model for Cash Flow Hedges

November 7, 2007

PURPOSE

At today's meeting, the Board will discuss the proposed fair value accounting model for cash flow hedges in the context of (a) scope, (b) requirements for hedge accounting, (c) identification of the hedged transaction and determining the perfect derivative, and (d) measuring and reporting hedge ineffectiveness. Prior to its discussion of the identification of the hedged transaction and determining the perfect derivative, the Board will discuss a possible approach for accounting for an entity's own existing recognized debt within the proposed fair value hedge accounting approach for both fair value hedges and cash flow hedges.

BACKGROUND

At the May 23, 2007 meeting, the Board voted to undertake a project to fundamentally change the hedge accounting guidance in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to address constituent concerns and improve financial reporting. At that meeting, the Board instructed the staff to proceed with the development of a fair value approach to hedge accounting. At the October 17, 2007 meeting, the Board discussed the fair value approach for fair value hedges. Today's discussion specifically focuses on the fair value approach for cash flow hedges.

SCOPE

The proposed fair value model for cash flow hedges would allow an entity to designate a derivative instrument as hedging the variability in forecasted interest cash flows of existing financial assets and existing financial liabilities attributable to all risks. This includes financial assets and financial liabilities eligible for the fair value option but for which the option has not been elected. The variability in forecasted proceeds from the issuance of debt attributable to all risks and the variability in the forecasted interest cash flows on a forecasted issuance of debt attributable to all risks would also be allowed cash flow hedge accounting. However, cash flow

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hedge accounting would not be permitted if the fair value option will be elected for these financial liabilities.

The scope also includes the ability to hedge the variability in forecasted purchases or sales of nonfinancial assets and liabilities attributable to all risks (including price changes as a result of changes in the cost of transportation and other items).

Staff Recommendation

The staff recommends that cash flow hedging should be permitted for the items within the scope described above.

Question for the Board

Should cash flow hedge accounting be permitted for existing recognized financial assets and financial liabilities and forecasted transactions?

REQUIREMENTS FOR HEDGE ACCOUNTING

The proposed fair value model for cash flow hedges would permit an entity to designate a derivative instrument as hedging exposure to variability in the expected cash flows associated with the items identified in the scope. The proposed model would require identification of the hedging instrument, identification of the hedged transaction (identified as a probable single transaction or a group of probable individual transactions that share the same exposure for which they are designated as being hedged), and a qualitative evaluation of the nature of the risk that the entity is attempting to hedge and why the derivative should be effective in offsetting the variability in the hedged transaction attributable to all risks. In order to qualify for hedge accounting, the qualitative evaluation must demonstrate that (a) an economic relationship exists between the hedging instrument and hedged forecasted transaction, and (b) the derivative should be expected to reasonably offset the variability in the hedged cash flows attributable to all risks. In certain situations, a quantitative analysis may be more effective in demonstrating the relationship between the derivative instrument and the hedged risk. After inception, an entity would need to reassess effectiveness if circumstances indicate that the hedging relationship is no longer effective. These circumstances would depend on the nature of the hedging instruments and hedged transaction.

There are two issues to consider related to the requirements for cash flow hedge accounting. Those issues, listed below, are the same as those discussed related to the requirements for fair value hedge accounting and, since there are no fundamental differences between fair value hedges and cash flow hedges as it relates to those issues, the decisions previously made by the Board on those issues in the context of fair value hedges also apply to cash flow hedges.

- a. Whether assessing effectiveness should be required, and if so, (1) whether it should be based on a quantitative approach or a qualitative approach, and (2) when and how often and entity should be required to assess effectiveness
- b. Revocability (ability to dedesignate and redesignate).

ACCOUNTING FOR AN ENTITY'S OWN DEBT WITHIN THE CONTEXT OF FAIR VALUE HEDGES AND CASH FLOW HEDGES

Generally, from a fair value hedge perspective entities enter into interest rate derivatives on their own debt to:

- a. Synthetically create variable-rate debt – it may be cheaper to issue fixed-rate debt and buy a receive fixed/pay variable interest rate swap than it is to issue variable-rate debt.
- b. Take a position on interest rates – entities believe interest rates will fall so they enter into a receive fixed/pay variable interest rate swap to potentially lower interest costs.

Generally, from a cash flow hedge perspective entities enter into interest rate derivatives on their own debt to:

- a. Synthetically create fixed-rate debt – it may be cheaper to issue variable-rate debt and buy a receive variable/pay fixed interest rate swap than it is to issue fixed-rate debt.
- b. Take a position on interest rates – entities believe interest rates will rise so they enter into a receive variable/pay fixed interest rate swap to potentially lower interest costs.

Fair Value Hedges

For situations in which an entity synthetically creates variable-rate debt by issuing fixed-rate debt and entering into a receive fixed/pay variable interest rate swap, the interest rate swap may

be designated as hedging the exposure to changes in fair value of the fixed-rate debt attributable to changes in the designated benchmark interest rate. The ability to hedge changes in fair value attributable to changes in the benchmark interest rate applies only when there is formal, contemporaneous documentation of the hedging relationship which includes:

- a. Identification of the hedging instrument
- b. Identification of the hedged item
- c. Designation of the hedging relationship on the trade date of the debt. Differences between the trade date and the date the debt is recognized for accounting purposes (settlement date) would not prohibit the ability to hedge changes in fair value attributable to changes in the benchmark interest rate provided that the period of time between the trade date and the settlement date are within established conventions for that marketplace.
- d. A qualitative evaluation of the nature of the risk that the entity is attempting to hedge and why the derivative should be effective in offsetting changes in fair value of the hedged item that result from the hedged risk. In order to qualify for hedge accounting, the qualitative evaluation must demonstrate that (a) an economic relationship exists between the hedging instrument and hedged item, and (b) the derivative should be expected to reasonably offset changes in fair value of the hedged item related to the hedged risk (benchmark interest rate).

Designating changes in fair value of the fixed-rate debt attributable to changes in the designated benchmark interest rate is not permitted if the hedging relationship is entered into subsequent to the initial recognition of the hedged item.

Cash Flow Hedges

The approach for cash flow hedges is the generally the same as for fair value hedges, with the exception of the terminology used in cash flow hedges replacing the terminology used in fair value hedges.

For situations in which an entity synthetically creates fixed-rate debt by issuing variable-rate debt and entering into a receive variable/pay fixed interest rate swap, the interest rate swap may

be designated as hedging the exposure to variability in expected future interest cash flows that is attributable to changes in the designated benchmark interest rate. The ability to hedge variability in expected future interest cash flows attributable to changes in the benchmark interest rate applies only when there is formal, contemporaneous documentation of the hedging relationship which includes:

- a. Identification of the hedging instrument
- b. Identification of the hedged transaction
- c. Designation of the hedging relationship on the trade date of the debt. Differences between the trade date and the date the debt is recognized for accounting purposes (settlement date) would not prohibit the ability to hedge variability in interest cash flows attributable to changes in the benchmark interest rate provided that the period of time between the trade date and the settlement date are within established conventions for that marketplace.
- d. A qualitative evaluation of the nature of the risk that the entity is attempting to hedge and why the derivative should be effective in offsetting the variability in the hedged transaction attributable to changes in the benchmark interest rate. In order to qualify for hedge accounting, the qualitative evaluation must demonstrate that (a) an economic relationship exists between the hedging instrument and hedged forecasted transaction, and (b) the derivative should be expected to reasonably offset the variability in the hedged interest cash flows attributable to changes in the benchmark interest rate.
- e. The measurement of hedge ineffectiveness being based on a comparison of the change in fair value of the actual derivative designated as the hedging instrument and the change in fair value of a perfect derivative, which would be expected to perfectly offset the variability in the hedged interest cash flows attributable to changes in the benchmark interest rate. The change in fair value of the perfect derivative would be regarded as a proxy for the present value of the cumulative change in expected future cash flows on the hedged transaction.

Designating the risk of changes in interest cash flows attributable to changes in the designated benchmark interest rate is not permitted if the hedging relationship is entered into subsequent to the initial recognition of the issued debt.

Question for the Board

Does the Board agree with the approach for accounting for an entity’s own existing recognized debt within the context of both fair value hedges and cash flow hedges?

IDENTIFYING THE HEDGED TRANSACTION AND DETERMINING THE PERFECT DERIVATIVE

Identifying the hedged transaction and determining the perfect derivative are important aspects of cash flow hedge accounting for determining the amount of ineffectiveness to be reported in earnings, if any. Based on the proposed scope, the perfect derivative(s) that would be required to offset variability in cash flows attributable to all risks for the hedged transactions would be as follows:

Hedged Transaction	Hedged Risks	Perfect Derivative
The forecasted interest cash flows of an existing recognized financial asset	All risks (mainly interest rate risk and credit risk for variable–rate financial assets that contain an index and a fixed spread)	Derivative(s) that offset variability in interest rate risk and default risk
The forecasted interest cash flows of an existing recognized financial liability	All risks, except as noted in the section above on synthetically creating fixed-rate debt or in situations in which the variable-rate debt contains an index and a fixed spread	Given the characteristics of the debt, the perfect derivative generally will be one that offsets interest rate risk
The forecasted proceeds from the issuance of debt or the forecasted interest cash flows on debt to be issued	All risks (mainly interest rate risk and credit risk)	Derivative(s) that offset interest rate risk and credit risk (both spreads and default)
The forecasted purchase or sale of a nonfinancial asset	All risks	Derivative(s) that offset variability from all sources (ex. base commodity and transportation)

Questions for the Board

Does the Board agree with this approach? Are there other approaches that should be considered?

MEASURING AND REPORTING HEDGE INEFFECTIVENESS

The staff is presenting the Board with two alternatives for recording the cumulative change in fair value of the actual derivative and the cumulative change in fair value of the perfect derivative.

- a. Alternative 1 – Require that the balance of accumulated other comprehensive income reflect the lesser of either the cumulative change in the fair value of the actual derivative or the cumulative change in the fair value of a perfect hypothetical derivative. Ineffectiveness would only be reported in earnings to the extent that the cumulative changes in fair value of the actual derivative exceed the cumulative changes in fair value of the perfect hypothetical derivative. In other words, ineffectiveness would only be reported for an overhedge.

- b. Alternative 2 – Require that the balance of accumulated other comprehensive income reflect the cumulative change in the fair value of a perfect hypothetical derivative. The balance of accumulated other comprehensive income would reflect the cumulative change in the fair value of the perfect hypothetical derivative. Ineffectiveness would be reported in earnings to the extent that the cumulative change in fair value of the perfect hypothetical derivative differs from the cumulative change in the fair value of the actual derivative, regardless of which item has the higher cumulative change in fair value. In other words, ineffectiveness would be reported for an underhedge as well as an overhedge.

Staff Recommendation

The majority of the staff recommends Alternative 2, that is, ineffectiveness should be recorded for both overhedges and underhedges. One staff member recommends Alternative 1, that is, ineffectiveness should be recorded just for overhedges.

Question for the Board

Should ineffectiveness be recorded for both overhedges and underhedges or for just overhedges?

Private Company Financial Reporting Committee

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JUDITH H. O'DELL
Chair

September 24, 2007

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*

Dear Mr. Herz:

The Private Company Financial Reporting Committee ("PCFRC") offers the following recommendation to the FASB related to FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). The recommendation represents the unanimous views of the PCFRC members in attendance.

This recommendation is based upon preliminary research conducted by the PCFRC as part of its effort to better understand the issues that private company financial statement users, preparers, and CPA practitioners are facing with the requirements of FIN 48. The preliminary research consisted of responses from certain key constituent organizations, members from key constituent organizations, and individual PCFRC Resource Group members.

The preliminary research unmistakably revealed the need for this recommendation and the need to offer it now, inasmuch as many private company financial statement preparers will soon be addressing the requirements of FIN 48 in their year-end financial statements and incurring costs in that effort. Therefore time is of the essence and immediate action is needed.

Recommendation - The PCFRC recommends that the FASB delay the effective date of FIN 48 for private companies. The effective date should be delayed until 1) clarification and guidance is issued on FIN 48's

implications for pass-through entities, and 2) further consideration is given to the usefulness of FIN 48's disclosure requirements for private companies. Further, this delay will allow for a higher level of awareness and education about FIN 48.

Clarification and Guidance for Pass-through Entities

The PCFRC believes many private company financial statement users, preparers, and CPA practitioners are unaware or just becoming aware of the implications of FIN 48. Importantly, this includes a lack of awareness of FIN 48's applicability to pass-through entities, which applies to many private company structures. Many private companies do not have the resources to follow FASB proceedings and they often learn about new requirements like FIN 48 at continuing education sessions after the effective date. Many public companies are still struggling with implementation issues, based on a BNA Accounting Policy and Practice Special Report ("An Early Look at FIN 48 Disclosures"; July 13, 2007; Vol.3, #6). Thus "best practices" are not in place as examples for private companies.

FASB Statement No. 109, *Accounting for Income Taxes*, does not directly address pass-through entities. As a result, many private company financial statement preparers and their CPA practitioners are unaccustomed to accounting for income taxes and are unaware of the implications of FIN 48, despite the attempts of many organizations (including FASB) to create that awareness. Clarification and guidance about FIN 48's implications to pass-through entities is needed. A number of issues arise from FIN 48's applicability to pass-through entities, including nexus for state income taxes, the level at which taxes are assessed (owner or entity), and the ramifications of FIN 48's requirements on acquisitions and tax indemnification. FIN 48 may apply to entities to which FASB Statement No. 109 does not apply. The PCFRC believes that pass-through entities will encounter a significant compliance hurdle when assessing the implications of FIN 48.

Accounting consistency, comparability, and financial reporting quality may be less than ideal at pass-through entities as they implement FIN 48, absent further clarification and guidance. For example, if a pass-through entity determines it is necessary to record a liability for an uncertain tax position, what is the debit? Is it a charge to capital or does it run through the income statement? If it runs through the income statement, is it tax expense? Any liability resulting from a tax audit is that of the owners of the pass-through entity – not the entity itself.

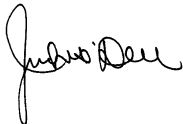
Usefulness of Disclosure Requirements

Preliminary research conducted by the PCFRC raises legitimate questions about the usefulness and relevance of the disclosure requirements of FIN 48 to users. Further research is necessary to determine whether the disclosure requirements of FIN 48 provide meaningful information to the lenders, sureties, investors, and others who use private company financial statements.

The PCFRC is continuing its outreach on FIN 48. We are conducting research with key constituent groups to gain additional knowledge about the issues they are facing as they assess the requirements of FIN 48. In particular, we are seeking input from key constituents about the usefulness and relevance of FIN 48's disclosure requirements, the implications for pass-through entities, and the need for implementation guidance. We may issue further recommendations to the FASB, based on the results of our research.

The PCFRC appreciates the FASB's consideration of this recommendation to delay the effective date of FIN 48. Please feel free to contact me if you have any questions or comments.

Sincerely,



Judith H. O'Dell
Chair
Private Company Financial Reporting Committee

Attachments

1. August 14, 2007 letter from National Rural Electric Cooperative Association.
2. September 18, 2007 letter from National Cooperative Business Association

THE COCA-COLA COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

December 31, (In millions except par value)	2007	2006
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 4,093	\$ 2,440
Marketable securities	215	150
Trade accounts receivable, less allowances of \$56 and \$63, respectively	3,317	2,587
Inventories	2,220	1,641
Prepaid expenses and other assets	2,260	1,623
TOTAL CURRENT ASSETS	12,105	8,441
INVESTMENTS		
Equity method investments:		
Coca-Cola Enterprises Inc.	1,637	1,312
Coca-Cola Hellenic Bottling Company S.A.	1,549	1,251
Coca-Cola FEMSA, S.A.B. de C.V.	996	835
Coca-Cola Amatil Limited	806	817
Other, principally bottling companies and joint ventures	2,301	2,095
Cost method investments, principally bottling companies	488	473
TOTAL INVESTMENTS	7,777	6,783
OTHER ASSETS	2,675	2,701
PROPERTY, PLANT AND EQUIPMENT—net	8,493	6,903
TRADEMARKS WITH INDEFINITE LIVES	5,153	2,045
GOODWILL	4,256	1,403
OTHER INTANGIBLE ASSETS	2,810	1,687
TOTAL ASSETS	\$ 43,269	\$ 29,963
LIABILITIES AND SHAREOWNERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	\$ 6,915	\$ 5,055
Loans and notes payable	5,919	3,235
Current maturities of long-term debt	133	33
Accrued income taxes	258	567
TOTAL CURRENT LIABILITIES	13,225	8,890
LONG-TERM DEBT	3,277	1,314
OTHER LIABILITIES	3,133	2,231
DEFERRED INCOME TAXES	1,890	608
SHAREOWNERS' EQUITY		
Common stock, \$0.25 par value; Authorized—5,600 shares; Issued—3,519 and 3,511 shares, respectively	880	878
Capital surplus	7,378	5,983
Reinvested earnings	36,235	33,468
Accumulated other comprehensive income (loss)	626	(1,291)
Treasury stock, at cost—1,201 and 1,193 shares, respectively	(23,375)	(22,118)
TOTAL SHAREOWNERS' EQUITY	21,744	16,920
TOTAL LIABILITIES AND SHAREOWNERS' EQUITY	\$ 43,269	\$ 29,963

Refer to Notes to Consolidated Financial Statements.

THE COCA-COLA COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

Year Ended December 31,	2007	2006	2005
<i>(In millions except per share data)</i>			
NET OPERATING REVENUES	\$ 28,857	\$ 24,088	\$ 23,104
Cost of goods sold	10,406	8,164	8,195
GROSS PROFIT	18,451	15,924	14,909
Selling, general and administrative expenses	10,945	9,431	8,739
Other operating charges	254	185	85
OPERATING INCOME	7,252	6,308	6,085
Interest income	236	193	235
Interest expense	456	220	240
Equity income—net	668	102	680
Other income (loss)—net	173	195	(93)
Gains on issuances of stock by equity method investees	—	—	23
INCOME BEFORE INCOME TAXES	7,873	6,578	6,690
Income taxes	1,892	1,498	1,818
NET INCOME	\$ 5,981	\$ 5,080	\$ 4,872
BASIC NET INCOME PER SHARE	\$ 2.59	\$ 2.16	\$ 2.04
DILUTED NET INCOME PER SHARE	\$ 2.57	\$ 2.16	\$ 2.04
AVERAGE SHARES OUTSTANDING	2,313	2,348	2,392
Effect of dilutive securities	18	2	1
AVERAGE SHARES OUTSTANDING ASSUMING DILUTION	2,331	2,350	2,393

Refer to Notes to Consolidated Financial Statements.

THE COCA-COLA COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREOWNERS' EQUITY

Year Ended December 31, (In millions except per share data)	2007	2006	2005
NUMBER OF COMMON SHARES OUTSTANDING			
Balance at beginning of year	2,318	2,369	2,409
Stock issued to employees exercising stock options	8	4	7
Purchases of stock for treasury	(35)	(55)	(47)
Treasury stock issued to employees exercising stock options	23	—	—
Treasury stock issued to former shareholders of glacéau	4	—	—
Balance at end of year	2,318	2,318	2,369
COMMON STOCK			
Balance at beginning of year	\$ 878	\$ 877	\$ 875
Stock issued to employees exercising stock options	2	1	2
Balance at end of year	880	878	877
CAPITAL SURPLUS			
Balance at beginning of year	5,983	5,492	4,928
Stock issued to employees exercising stock options	1,001	164	229
Tax (charge) benefit from employees' stock option and restricted stock plans	(28)	3	11
Stock-based compensation	309	324	324
Stock purchased by former shareholders of glacéau	113	—	—
Balance at end of year	7,378	5,983	5,492
REINVESTED EARNINGS			
Balance at beginning of year	33,468	31,299	29,105
Adjustment for the cumulative effect on prior years of the adoption of Interpretation No. 48	(65)	—	—
Net income	5,981	5,080	4,872
Dividends (per share—\$1.36, \$1.24 and \$1.12 in 2007, 2006 and 2005, respectively)	(3,149)	(2,911)	(2,678)
Balance at end of year	36,235	33,468	31,299
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)			
Balance at beginning of year	(1,291)	(1,669)	(1,348)
Net foreign currency translation adjustment	1,575	603	(396)
Net gain (loss) on derivatives	(64)	(26)	57
Net change in unrealized gain on available-for-sale securities	14	43	13
Net change in pension liability	392	—	—
Net change in pension liability, prior to adoption of SFAS No. 158	—	46	5
Net other comprehensive income adjustments	1,917	666	(321)
Adjustment to initially apply SFAS No. 158	—	(288)	—
Balance at end of year	626	(1,291)	(1,669)
TREASURY STOCK			
Balance at beginning of year	(22,118)	(19,644)	(17,625)
Stock issued to employees exercising stock options	428	—	—
Stock purchased by former shareholders of glacéau	66	—	—
Purchases of treasury stock	(1,751)	(2,474)	(2,019)
Balance at end of year	(23,375)	(22,118)	(19,644)
TOTAL SHAREOWNERS' EQUITY	\$ 21,744	\$ 16,920	\$ 16,355
COMPREHENSIVE INCOME			
Net income	\$ 5,981	\$ 5,080	\$ 4,872
Net other comprehensive income adjustments	1,917	666	(321)
TOTAL COMPREHENSIVE INCOME	\$ 7,898	\$ 5,746	\$ 4,551

¹ Common stock purchased from employees exercising stock options numbered approximately zero shares, zero shares and 0.5 million shares for the years ended December 31, 2007, 2006 and 2005, respectively.

Refer to Notes to Consolidated Financial Statements.

THE COCA-COLA COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

No. 160 also establishes disclosure requirements that clearly identify and distinguish between the controlling and noncontrolling interests and requires the separate disclosure of income attributable to controlling and noncontrolling interests. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact that the adoption of SFAS No. 160 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 was effective for our Company on January 1, 2008. The adoption of SFAS No. 159 did not have a material impact on our consolidated financial statements.

In September 2006, the SEC staff published SAB No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 addresses quantifying the financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. SAB No. 108 was effective for fiscal years ending after November 15, 2006. The adoption of SAB No. 108 by our Company in the fourth quarter of 2006 did not have a material impact on our consolidated financial statements.

As previously discussed, our Company adopted SFAS No. 158 related to defined benefit pension and other postretirement plans. Refer to Note 16.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure requirements about fair value measurements. SFAS No. 157 was effective for our Company on January 1, 2008. However, in February 2008, the FASB released a FASB Staff Position (FSP FAS 157-2—Effective Date of FASB Statement No. 157) which delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). The adoption of SFAS No. 157 for our financial assets and liabilities did not have a material impact upon adoption. We do not believe the adoption of SFAS No. 157 for our non-financial assets and liabilities, effective January 1, 2009, will have a material impact on our consolidated financial statements.

In July 2006, the FASB issued Interpretation No. 48 which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." Interpretation No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Interpretation No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. For our Company, Interpretation No. 48 was effective January 1, 2007. As a result of the adoption of Interpretation No. 48, we recorded an approximate \$65 million increase in accrued income taxes in our consolidated balance sheet for unrecognized tax benefits, which was accounted for as a cumulative effect adjustment to the January 1, 2007 balance of reinvested earnings. Refer to Note 17.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections, a replacement of Accounting Principles Board ("APB") Opinion No. 20 and FASB Statement No. 3." SFAS No. 154 requires retrospective application to prior periods' financial statements of a voluntary change in accounting principle unless it is impracticable. APB Opinion No. 20, "Accounting Changes," previously required that most voluntary changes in

THE COCA-COLA COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17: INCOME TAXES

Income before income taxes consisted of the following (in millions):

Year Ended December 31,	2007	2006	2005
United States	\$ 2,545	\$ 2,126	\$ 2,268
International	5,328	4,452	4,422
	\$ 7,873	\$ 6,578	\$ 6,690

Income tax expense (benefit) consisted of the following for the years ended December 31, 2007, 2006 and 2005 (in millions):

	United States	State and Local	International	Total
2007				
Current	\$ 664	\$ 75	\$ 1,044	\$ 1,783
Deferred	98	(13)	24	109
2006				
Current	\$ 608	\$ 47	\$ 878	\$ 1,533
Deferred	(20)	(22)	7	(35)
2005				
Current	\$ 873	\$ 188	\$ 845	\$ 1,906
Deferred	(72)	(25)	9	(88)

We made income tax payments of approximately \$1,596 million, \$1,601 million and \$1,676 million in 2007, 2006 and 2005, respectively.

THE COCA-COLA COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17: INCOME TAXES (Continued)

A reconciliation of the statutory U.S. federal tax rate and effective tax rates is as follows:

Year Ended December 31,	2007	2006	2005
Statutory U.S. federal tax rate	35.0%	35.0%	35.0%
State and local income taxes—net of federal benefit	0.6	0.7	1.2
Earnings in jurisdictions taxed at rates different from the statutory U.S. federal rate	(10.8) ^{1,2}	(11.4) ⁷	(12.1) ¹¹
Equity income or loss	(1.3) ^{3,4}	(0.6) ⁸	(2.3)
Other operating charges	0.5 ⁵	0.6 ⁹	0.4 ¹²
Other—net	0.0 ⁶	(1.5) ¹⁰	0.3 ¹³
Repatriation under the Jobs Creation Act	—	—	4.7 ¹⁴
Effective tax rates	24.0%	22.8%	27.2%

- ¹ Includes approximately \$19 million (or 0.2 percent) tax benefit related to tax rate change in Germany.
- ² Includes approximately \$85 million (or 1.1 percent) tax charge related to amounts required to be recorded for changes to our uncertain tax positions under Interpretation No. 48, including interest and penalties, in various international jurisdictions.
- ³ Includes approximately 0.4 percent impact to our effective tax rate related to charges recorded by our equity method investments. Refer to Note 3 and Note 19.
- ⁴ Includes approximately 0.4 percent impact to our effective tax rate related to the sale of a portion of our investment in Coca-Cola Amatil and the sale of our investment in Vonpar. Refer to Note 3 and Note 19.
- ⁵ Includes approximately 0.5 percent impact to our effective tax rate related to the impairment of assets and investments in our bottling operations and other restructuring charges. Refer to Note 18.
- ⁶ Includes approximately \$11 million (or 0.1 percent) tax charge related to amounts required to be recorded for changes to our uncertain tax positions under Interpretation No. 48, including interest and penalties, in certain domestic jurisdictions.
- ⁷ Includes approximately \$24 million (or 0.4 percent) tax charge related to the resolution of certain tax matters in various international jurisdictions.
- ⁸ Includes approximately 2.4 percent impact to our effective tax rate related to charges recorded by our equity method investees. Refer to Note 3 and Note 19.
- ⁹ Includes the tax rate impact related to the impairment of assets and investments in our bottling operations, contract termination costs related to production capacity efficiencies and other restructuring charges. Refer to Note 19.
- ¹⁰ Includes approximately 1.8 percent tax rate benefit related to the sale of a portion of our investment in Coca-Cola FEMSA and Coca-Cola Icecek. Refer to Note 3 and Note 19.
- ¹¹ Includes approximately \$29 million (or 0.4 percent) tax benefit related to the favorable resolution of certain tax matters in various international jurisdictions.
- ¹² Includes approximately \$4 million tax benefit related to the Philippines impairment charges. Refer to Note 19.
- ¹³ Includes approximately \$72 million (or 1.1 percent) tax benefit related to the favorable resolution of certain domestic tax matters.
- ¹⁴ Related to repatriation of approximately \$6.1 billion of previously unremitted foreign earnings under the Jobs Creation Act, resulting in a tax provision of approximately \$315 million.

THE COCA-COLA COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17: INCOME TAXES (Continued)

Our effective tax rate reflects the tax benefits from having significant operations outside the United States that are taxed at rates lower than the statutory U.S. rate of 35 percent. During 2007, the Company had several subsidiaries that benefited from various tax incentive grants. The terms of these grants range from 2010 to 2031. The Company expects each of the grants to be renewed indefinitely. The grants did not have a material effect on the results of operations for the years ended December 31, 2007, 2006 or 2005.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction and various states and foreign jurisdictions. U.S. tax authorities have completed their federal income tax examinations for all years prior to 2005.

With respect to state and local jurisdictions and countries outside the United States, with limited exceptions, the Company and its subsidiaries are no longer subject to income tax audits for years before 2001. Although the outcome of tax audits is always uncertain, the Company believes that adequate amounts of tax, including interest and penalties, have been provided for any adjustments that are expected to result from those years.

The Company adopted the provisions of Interpretation No. 48, effective January 1, 2007. As a result of the implementation of Interpretation No. 48, the Company recorded an approximate \$65 million increase in liabilities for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, balance of reinvested earnings. As of December 31, 2007, the gross amount of unrecognized tax benefits was approximately \$643 million. If the Company were to prevail on all uncertain tax positions, the net effect would be a benefit to the Company's effective tax rate of approximately \$147 million, exclusive of any benefits related to interest and penalties. The remaining approximately \$496 million, which was recorded as a deferred tax asset, primarily represents tax benefits that would be received in different tax jurisdictions in the event that the Company did not prevail on all uncertain tax positions. A reconciliation of the changes in the gross balance of unrecognized tax benefits amounts during 2007 follows:

Year Ended December 31,	2007
Beginning balance of unrecognized tax benefit	\$ 511
Increases related to prior period tax positions	22
Increases due to current period tax positions	51
Decreases related to settlements with taxing authorities	(4)
Reductions as a result of a lapse of the applicable statute of limitations	(1)
Increases/(decreases) from effects of exchange rates	64
Ending balance of unrecognized tax benefits	\$ 643

The Company recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. As of December 31, 2007, the Company had approximately \$272 million in interest and penalties related to unrecognized tax benefits accrued, of which approximately \$82 million was recognized through tax expense in 2007. If the Company were to prevail on all uncertain tax positions, the reversal of this accrual would also be a benefit to the Company's effective tax rate.

It is reasonably possible that the amount of unrecognized benefit with respect to certain of our unrecognized tax positions will significantly change within the next twelve months. These changes may be the result of settlement of ongoing audits, competent authority proceedings related to transfer pricing, or final settlements in transfer pricing matters that are the subject of litigation. At this time, an estimate of the range of the reasonably possible outcomes cannot be made.

THE COCA-COLA COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17: INCOME TAXES (Continued)

Undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$11.9 billion at December 31, 2007. Those earnings are considered to be indefinitely reinvested and, accordingly, no U.S. federal and state income taxes have been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the various foreign countries. Determination of the amount of unrecognized deferred U.S. income tax liability is not practical because of the complexities associated with its hypothetical calculation; however, unrecognized foreign tax credits would be available to reduce a portion of the U.S. tax liability.

As discussed in Note 1, the Jobs Creation Act was enacted in October 2004. One of the provisions provides a one-time benefit related to foreign tax credits generated by equity investments in prior years. The Company recorded an income tax benefit of approximately \$50 million as a result of this law change in 2004. The Jobs Creation Act also included a temporary incentive for U.S. multinationals to repatriate foreign earnings at an approximate 5.25 percent effective tax rate. During the first quarter of 2005, the Company decided to repatriate approximately \$2.5 billion in previously unremitted foreign earnings. Therefore, the Company recorded a provision for taxes on such previously unremitted foreign earnings of approximately \$152 million in the first quarter of 2005. During 2005, the United States Internal Revenue Service and the United States Department of Treasury issued additional guidance related to the Jobs Creation Act. As a result of this guidance, the Company reduced the accrued taxes previously provided on such unremitted earnings by \$25 million in the second quarter of 2005. During the fourth quarter of 2005, the Company repatriated an additional \$3.6 billion, with an associated tax liability of approximately \$188 million. Therefore, the total previously unremitted earnings that were repatriated during the full year of 2005 was \$6.1 billion with an associated tax liability of approximately \$315 million. This liability was recorded in 2005 as federal and state and local tax expenses in the amount of \$301 million and \$14 million, respectively.

THE COCA-COLA COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17: INCOME TAXES (Continued)

The tax effects of temporary differences and carryforwards that give rise to deferred tax assets and liabilities consist of the following (in millions):

December 31,	2007	2006
Deferred tax assets:		
Property, plant and equipment	\$ 45	\$ 58
Trademarks and other intangible assets	76	75
Equity method investments (including translation adjustment)	238	354
Other liabilities	845	190
Benefit plans	881	1,056
Net operating/capital loss carryforwards	554	593
Other	266	224
Gross deferred tax assets	2,905	2,550
Valuation allowances ^{1,2}	(611)	(678)
Total deferred tax assets	\$ 2,294	\$ 1,872
Deferred tax liabilities:		
Property, plant and equipment	\$ (670)	\$ (630)
Trademarks and other intangible assets	(1,925)	(504)
Equity method investments (including translation adjustment)	(841)	(622)
Other liabilities	(90)	(82)
Benefit plans	(226)	(190)
Other	(157)	(200)
Total deferred tax liabilities	\$ (3,909)	\$ (2,228)
Net deferred tax liabilities	\$ (1,615)	\$ (356)

¹ Noncurrent deferred tax assets of \$66 million and \$168 million were included in the consolidated balance sheets line item other assets at December 31, 2007 and 2006, respectively.

² Current deferred tax assets of \$238 million and \$117 million were included in the consolidated balance sheets line item prepaid expenses and other assets at December 31, 2007 and 2006, respectively.

³ Current deferred tax liabilities of \$29 million and \$33 million were included in the consolidated balance sheets line item accounts payable and accrued expenses at December 31, 2007 and 2006, respectively.

As of December 31, 2007 and 2006, we had approximately \$610 million and \$93 million, respectively, of net deferred tax liabilities located in countries outside the United States.

THE COCA-COLA COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 17: INCOME TAXES (Continued)

As of December 31, 2007, we had approximately \$2,827 million of loss carryforwards available to reduce future taxable income. Loss carryforwards of approximately \$207 million must be utilized within the next five years, \$67 million must be utilized within the next 10 years, and the remainder can be utilized over a period greater than 10 years.

An analysis of our deferred tax asset valuation allowances is as follows (in millions):

Year Ended December 31,	2007	2006	2005
Balance, beginning of year	\$ 678	\$ 786	\$ 854
Additions	201	50	43
Deductions	(268)	(158)	(111)
Balance, end of year	\$ 611	\$ 678	\$ 786

The Company's deferred tax asset valuation allowances are primarily the result of uncertainties regarding the future realization of recorded tax benefits on tax loss carryforwards from operations in various jurisdictions. In 2007, the Company recognized a net decrease in its valuation allowances of \$67 million. This decrease was primarily related to the reversal of valuation allowances on deferred tax assets recorded on the basis difference in equity investments. The Company also recognized a decrease in certain deferred tax assets and corresponding valuation allowances related to a change in German tax rates. In 2006, the Company recognized a net decrease in its valuation allowances of \$108 million. This decrease was primarily related to the reversal of valuation allowances that covered certain deferred tax assets recorded on capital loss carryforwards. A portion of the capital loss carryforwards was utilized to offset taxable gains on the sale of a portion of the investments in Coca-Cola Icecek and Coca-Cola FEMSA. In 2005, the Company recognized a decrease in its valuation allowances of \$68 million. This decrease was primarily related to a change in tax rates which resulted in a reduction of certain deferred tax assets and corresponding valuation allowances.

NOTE 18: RESTRUCTURING COSTS

During 2007, the Company took steps to streamline and simplify its operations globally. In North America, the Company reorganized its operations around three main business units: Sparkling Beverages, Still Beverages and Emerging Brands. In Ireland, the Company announced a plan to close its beverage concentrate manufacturing and distribution plant in Drogheda in September 2008. The plant closure is expected to improve operating productivity and enhance capacity utilization. The costs associated with this plant closure are included in the Corporate segment. Selected other operations also took steps to streamline their operations to improve overall efficiency and effectiveness.

Employees separated or to be separated from the Company as a result of these streamlining initiatives were offered severance or early retirement packages, as appropriate, that included both financial and nonfinancial components. The expenses recorded during the year ended December 31, 2007 included costs related to involuntary terminations and other direct costs associated with implementing these initiatives. Other direct costs included expenses to relocate employees; contract termination costs; costs associated with the development, communication and administration of these initiatives; accelerated depreciation; and asset write-offs. During 2007, the Company incurred total pretax expenses related to these streamlining initiatives of approximately \$237 million. These expenses were primarily recorded in the line item other operating charges in our consolidated statement of income. The Company currently expects the total cost of these initiatives to be approximately \$342 million. The Company expects to expense the remainder of the costs in 2008. The remaining costs primarily relate to severance pay and benefits and accelerated depreciation related to the closing of the Drogheda Plant.