Uncertain Income Tax Positions: An analysis of FIN 48, IRC Penalty Disclosure and Circular 230

Ian J. Redpath, Thomas Vogel, George Kermis, & Eric Redpath

In June 2006, the Financial Accounting Standards Board issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109” (FIN 48). This pronouncement created a two-step process to evaluate uncertain tax positions. The first step is to determine whether the position meets a “more likely than not” (MLTN) standard for being upheld upon audit. In May of 2007, Congress, at the behest of the Internal Revenue Service, expanded the preparer penalties in IRC§6694 that are applicable to positions taken on a return. IRC§6694 adopted the MLTN standard for disclosure of a return position based upon a “reasonable basis” to believe that it is “more likely than not” that the position would be sustained at audit. This standard brought a synergy with the FIN 48 standard on tax positions. In October of 2008, IRC§6694 was again amended adopting a lesser standard of “substantial authority”. This change was made retroactive to May of 2007 and made it consistent with the disclosure standards for taxpayers. In addition the Internal Revenue Service has amended Circular 230 and the Due Diligence standards for taking a tax position. This paper will analyze the application FIN 48, IRC penalty disclosure rules and Circular 230 as they apply to professionals taking tax positions.

1. Introduction

Because income taxes are generally self-computed and reported, there is a tendency to be as aggressive as possible, within the limits of the law,
in the reporting of uncertain tax positions. There is an obvious benefit to an entity’s successful participation in tax avoidance while being careful not to cross the line into tax evasion. Very often, however, the merits of a particular tax position will not be fully determined unless the appropriate taxing authority formally audits the position before the statute of limitations expires. Until this occurs, taxpayers and tax preparers must be aware of disclosure requirements for these uncertain tax positions.

In recent years, the disclosure requirements have been modified for both the financial statements (by the Financial Accounting Standards Board) and the income tax returns (by the Internal Revenue Service and Congress). There now exists major differences between financial and tax accounting as to the timing and information disclosed for uncertain tax positions. For tax reporting, disclosures are often driven by the desire to avoid potential penalties associated with the position. In financial reporting, the disclosure is focused on the potential liability that would result assuming the uncertain tax position is audited by the tax authority.

In this paper, we outline the disclosure requirements for tax returns and financial statements and discuss the implications for taxpayers and tax preparers. The remainder of the paper is organized as follows: Section 2 summarizes the tax return disclosures for taxpayers; Section 3 discusses the recent changes in the Internal Revenue Code for required disclosures of tax preparers; Section 4 discusses the financial reporting disclosures required by Interpretation #48 (FIN48) issued by the Financial Accounting Standards Board in 2006; Section 5 provides a comparison of the requirements; We conclude in Section 6.

**2. Internal Revenue Code Penalties for Taxpayers**

Taxpayers have long had penalties for the understatement of their tax liability. Additionally, Congress also implemented penalties to attempt to control preparers’ actions in preparing returns. These penalties on the preparer and taxpayer are cumulative and not exclusive.

The taxpayer penalties are found in IRC§6662. The taxpayer is held to a standard of “substantial authority” for a position on a return or claim
made to the Internal Revenue Service. If the taxpayer has “substantial authority” for position it may be taken without further disclosure. Commentators have generally viewed this as a 40% chance of being sustained on audit. It is an objective standard that is applied by taking into account the weight of relative weight of authority both supporting and to the contrary. The good faith belief of the taxpayer is not relevant.

Treasury Regulation §1.6662-4 provides:

The weight accorded an authority depends on its relevance and persuasiveness, and the type of document providing the authority. For example, a case or revenue ruling having some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is otherwise inapplicable to the tax treatment at issue. An authority that merely states a conclusion ordinarily is less persuasive than one that reaches its conclusion by cogently relating the applicable law to pertinent facts. The weight of an authority from which information has been deleted, such as a private letter ruling, is diminished to the extent that the deleted information may have affected the authority’s conclusions. The type of document also must be considered. For example, a revenue ruling is accorded greater weight than a private letter ruling addressing the same issue. An older private letter ruling, technical advice memorandum, general counsel memorandum or action on decision generally must be accorded less weight than a more recent one. Any document described in the preceding sentence that is more than 10 years old generally is accorded very little weight. However, the persuasiveness and relevance of a document, viewed in light of subsequent developments, should be taken into account along with the age of the document. There may be substantial authority for the tax treatment of an item despite the absence of certain types of authority. Thus, a taxpayer may have substantial authority for a position that is supported only by a well-reasoned construction of the applicable statutory provision.

The regulations provide a listing of authorities that are considered to provide “substantial authority”. Treatises and articles are not among the authorities, even though they may be relied on under the American
Institute of Certified Public Accountants (AICPA) standards (AICPA Interpretation 1–1.6, 2000).

If the taxpayer does not have “substantial authority” they may still avoid penalties by disclosing the position taken, provided the position is not frivolous (IRC §6662). Frivolous is generally viewed as a 5–10% or less chance of being sustained on audit.

3. STANDARDS FOR PREPARERS

3.1. IRC§6694

In 2007, Congress made sweeping changes to the penalties applicable to tax preparers. Amended IRC§6694 adopted a return position disclosure that mirrored FIN 48 with a “more likely than not” (MLTN) standard. Prior to 2007, the Service required that the preparer disclose any position for which there was not a “Realistic Possibility” that it would be sustained on audit. If the position was not frivolous but there was not a “Realistic Possibility” of success, the preparer could still take the position provided it was properly disclosed to the government. A “Realistic Possibility’ was generally considered to be a more than 1/3 chance of success if the item was audited. Exhibit 1 summarizes the disclosure requirements for preparers.

“Realistic possibility” is similar to “substantial authority” but is a much lower threshold. This created a situation where the preparer would have no disclosure requirement, but the taxpayer did. From a realistic view, the preparer would not place the client at risk and would thus disclose any position for which there was not “substantial authority”.

This all changed in May of 2007 when Congress imposed a duty to disclose if the position does not meet the MLTN standard. The tax MLTN standard requires the preparer have reasonable belief that the supporting authority provides a more than 50% chance of success if audited.

In determining if there is a reasonable belief, a tax return preparer may, in good faith and without verification, rely on information furnished by the taxpayer, another advisor, tax return preparer or other third party. The preparer is not required to independently verify or review the
items reported on tax returns, schedules or other third party documents to determine if the items meet the MLTN standard. However the preparer may not turn a “blind eye” in reviewing the information provided and its implications.

The frivolous standard has been replaced with a “reasonable basis” standard for preparers. Thus the preparer may not take a position, even if disclosed, for which there is not a “reasonable basis” that the position will be sustained on audit (IRC§6694). A “reasonable basis” is a lesser standard than a “realistic possibility” but a higher standard than “non-frivolous”. The standard will be somewhere around a 15% chance of being sustained on its merits. Thus the preparer may not take a position if the position does not have a “reasonable basis” for being sustained on its merits. Like the MLTN standard, a tax return preparer may rely in good faith and without verification on information furnished by the taxpayer, another tax return preparer or other third party. The “blind eye” test will also apply.

In October of 2008, Congress again revised the preparer penalties and adopted the “substantial authority” standard for preparers. This standard is the same as that of the taxpayer but is less than the MLTN standard of FIN 48.

3.2. Who is a preparer?
There are now two types of preparers—signing and non-signing (IRC §7701). Both can be subject to penalties. A person who prepares a return or claim, or a substantial portion thereof, for compensation or employs persons to prepare such return or claim for compensation is a tax return preparer. They must sign the return (Treas. Reg.§1.7701-15). If a person provides sufficient information as to the taxpayer such that the actual completion is merely clerical they are a preparer even though they do not actually “prepare” the physical return.(Id)-not sure what id is. Should it be cited? If a person is preparing the returns or claims as an officer, director or employee of an employer then such person is not considered a tax return preparer.(Id)

It should be noted that the rules do not apply to advice on contemplated transactions. It is important to maintain the distinction between
contemplated and complete transactions. A person could possibly transform their position to that of a non-signing preparer if they engage in any post-transaction activity with respect to the same matter. It could be as simple as providing the preparer an opinion on how the activity should be reported on the return or claim.

When an employee or partner is subject to the penalties, the employer or partnership may also be subjected to penalties. This will apply if: (1) one or more members of the principle management participated in or knew of the conduct giving rise to the penalties, (2) the employer or partnership failed to provide reasonable and appropriate procedures to review the positions in question or (3) such review procedures were disregarded in the determining the advise or in the preparation of the return or claim (Treas. Reg. §1.6694-2(a)(2)).

### 3.3. Disclosure and Penalties

The disclosure requirements vary depending on whether a person is a signing or non-signing preparer. A signing tax return preparer discloses the position on a properly completed and filed Form 8275, Disclosure Statement, or 8275-R, Regulation Disclosure Statement, as appropriate, or on the tax return in accordance with the annual revenue procedure described in Treasury Regulation §1.6662-4(f)(2). The regulations provide certain items that will be considered disclosed if the normal Forms are properly completed. This does not relieve the preparer of the standard if the position is unusual, such as deducting an item that does not fall within the traditional definition of materials and supplies.

Non-signing preparers also must disclose under the standards to avoid penalties. A non-signing preparer shall be deemed to meet the requirements of IRC§6694 if the advice to the taxpayer includes a statement informing the taxpayer of any opportunity to avoid penalties under IRC§6662 (taxpayer penalties) that could apply to the position as a result of disclosure, if relevant, and of the requirements for disclosure (Notice 2008-13; 208-3 IRB 1).

If a non-signing preparer provides advice to another tax return preparer, the non-signing preparer must include a statement that disclosure
under IRC §6694(a) may be required. If the advice with respect to a position is oral, the statement also may be oral. If oral, a contemporaneously prepared document in the non-signing preparer’s files is sufficient to establish that the statement was given to the other tax return preparer. (Id)

The penalties under IRC §6694(b)(1) for preparers are the greater of $1,000 or 50% of the fees from the engagement. If the acts are willful in any manner then the penalty is raised to the greater of $5,000 of 50% of the fee from the engagement. Taxpayer penalties are generally 20% of the understatement of tax.

3.4. Reasonable Cause and Good Faith Exception
There is a general safe harbor exception to the penalty provisions. This exception is based upon reasonable cause and good faith (IRC §6662 & §6694). Among the factors are: the nature of the error causing the understatement, the frequency of errors, the materiality of the errors, the preparer’s normal office procedures to identify errors and reliance on the advice of another preparer.

3.5. Circular 230—General
In addition to the statutory penalties, Circular 230 may apply to anyone authorized to practice before the Internal Revenue Service. The monetary penalties can be as much as 100% of the revenue generated or expected to be generated from the tax Service (Treas. Reg. §10.50).

Practitioners who can practice before the Service are attorneys, certified public accountants, enrolled actuaries and enrolled agents. The enrolled actuaries and agents must pass an extensive examination administered by the Service in order to qualify to practice. Changes made effective 2008 define the term “matter before the IRS” (Treas. Reg. §10-20(e)). The term includes tax planning and advice, preparing or filing a return, assisting in preparing or filing returns, claims for refunds or credits. In addition it includes all things connected with the presentation to the Service of anything related to the taxpayer’s rights, or liabilities under the tax law. It can be simple correspondence or other communication with
the Service or with the client and representing the client in conferences, meeting or hearings with the Service (Id and Treas. Reg. §10.34).

New revisions to ethical standards set forth under Circular 230, have been proposed by the Service to be enforced against tax practitioners conducting tax preparation. It is important to remember the expansive definition of a practitioner as opposed to the limited one of a preparer when dealing with these new enforcement issues. A practitioner may not advise a client to take a position on a tax return, or prepare the portion or a tax return on which a position is taken, unless, (1) the practitioner has a reasonable belief that the position satisfies the substantial authority standard; or (2) the position has a reasonable basis and is adequately disclosed to the Internal Revenue Service (Treas. Reg. §10.34(b)).

3.6. Due Diligence
When applied to a tax practitioner’s responsibility, Circular 230 employs a due diligence standard. The tax preparer may rely on the taxpayer’s representations of the facts but may be required to investigate the accuracy of certain facts when inconsistencies arise that bring into question the accuracy of those facts being asserted. The due diligence standard further applies to the preparer delineating what facts need to be addressed and the investigation into ascertaining what those facts are.

Finally the new Circular 230 regulations require that the practitioner must advise their client as to the penalties that may arise from the position taken if it is reasonably likely that these types of penalties would be imposed. This new requirement applies to almost anything submitted to the Service not just returns.


4.1. Financial Reporting Prior to FIN48
Prior to the issuance of FIN48 in 2006, guidance for the recording and reporting of uncertain tax positions was provided in SFAS No. 5, Accounting for Contingencies (SFAS5, 1975). Essentially, uncertain tax
positions taken on tax return(s) were treated as a loss contingency. The accounting treatment for loss contingencies in SFAS No. 5 (1975) was determined by the likelihood that the loss would be incurred and the reasonableness of estimating the loss in question. If a company with an uncertain tax position deemed the loss to be “probable” and determined that the loss could be reasonably estimated, a liability was recorded for the estimated loss contingency. If the loss was “reasonably possible” with respect to occurring, the company was obligated to disclose the contingent loss, and range of potential outcomes, in its footnotes. If the loss was considered “remote” with respect to occurring, no disclosure was required.

These divergent views of likelihood for uncertain tax positions created a reporting environment where comparability and consistency became impaired. Two companies with similar tax positions could interpret the likelihood of a loss contingency differently—i.e. one company may determine the contingent loss is probable and accrue the loss while the other determines the loss to be remote and does not accrue, or even disclose the contingent loss in its footnotes. Financial statement disclosures associated with uncertain tax positions were minimal and tended to focus only on events associated with ongoing audits. Discussions of uncertain tax positions not currently under audit were extremely rare.

4.2. Reporting Uncertain Tax Positions Under FIN48

FASB undertook the reporting of uncertain tax positions in order to improve comparability in the financial reporting of these items. This Interpretation clarifies the application of Statement 109 by defining a criterion that an individual tax position must meet for any part of the benefit of that position to be recognized in an enterprise’s financial statements. Additionally, this Interpretation provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

FIN48 created a two-step process to account for uncertain tax positions. The first step is to determine whether it is more likely than not (MLTN) that the tax position will be sustained based solely on the
technical merits of the position. The MLTN evaluation is determined based on the following:

- The company is to assume the appropriate taxing authority will audit the position. This eliminates the bias that could influence the likelihood of the loss contingency resulting from a belief that the company will not be audited. It is further assumed that the taxing authority has full knowledge of all relevant information related to the uncertain position. Exhibit 1 contains an illustration of the impact resulting from this change.
- The authorities should support the technical merits of the position in the tax law such as legislation and statutes, regulations, rulings, and case law.
- The technical merit of the position may be further strengthened by the receipt of a “more likely than not” opinion letter from an independent tax professional.

If an uncertain tax position fails to meet the MLTN criterion, the company must accrue a liability (and increase its income tax expense) for the entire tax benefit of the position.

If the tax position meets the MLTN criterion, the second step in the process is the measurement of the tax benefit to be reported. As discussed in paragraph 8 of FIN48 (2006), “A tax position that meets the more-likely-than-not recognition threshold shall initially and subsequently be measured as the largest amount of the tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. Measurement of a tax position that meets the more-likely-than-not recognition threshold shall consider the amounts and probabilities of the outcomes that could be realized upon ultimate settlement using the facts, circumstances, and information available at the reporting date.”

As a result, management must estimate potential outcomes of the tax position by the appropriate taxing authority and assign probabilities
to each outcome. The potential outcomes may include settlements that management would consider in the event of an audit. Exhibit 2 contains an example of the measurement process as provided in FIN48 (2006). As discussed in this example, the tax benefit recorded is the expected benefit where the aggregate probability of occurring is greater than 50%. The company would then report a liability for the difference between the tax benefit in question, $100, and the tax benefit recorded, $60. It is important to note that the company must also accrue interest and penalties where applicable. Regarding interest, the company must accrue an amount determined by multiplying the applicable statutory rate of interest to the difference between the tax benefit reported on the tax return and the tax benefit reported in accordance with FIN48. Regarding penalties, the company must record the estimated amount of penalties that would be due if the tax position does not meet the minimum statutory threshold to avoid payment of penalties.

4.3. FIN 48 Required Disclosures
Paragraph 21 of FIN48 (2006) outlines the following required disclosures at the end of each reporting period presented:

a. A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum:
   (1) The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period
   (2) The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period
   (3) The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities
   (4) Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations
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

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

e. A description of tax years that remains subject to examination by major tax jurisdictions.

As one might suspect, the disclosure requirement has become the most controversial requirement in the implementation of FIN48. Companies are reluctant to disclose specific information about the uncertain tax positions because the information becomes available to all users of the financial statements, including the taxing authorities. Perhaps the most controversial of the disclosures is the requirement to disclose those tax positions that are due to expire in the next in the next 12 months (part d). This disclosure could help the taxing authorities plan the timing of their audit. Exhibit 3 contains the disclosure of uncertain tax positions from Merck, Inc. at December 31, 2008.

5. COMPARING TAX RETURN AND FINANCIAL STATEMENT DISCLOSURES

The appropriate disclosure in the financial statement will not necessarily parallel the recognition of a position on the applicable tax return. The government has a penalty regime for positions taken on a return. Avoidance of possible penalties for uncertain positions relies on the
U n c e r t a i n I n c o m e T a x P o s i t i o n s

need to disclose that position to the Internal Revenue Service with the return.

The disclosure standards set forth in the Internal Revenue Code and Circular 230 do not coincide with the FIN 48 standards of disclosure. The disclosures required under FIN 48 do not center on penalty avoidance. Rather, each uncertain tax position will require a disclosure of estimated tax that would be due upon the audit of that position. In this sense, every position is disclosed in the financial statements regardless of the likelihood of penalties being applied.

While the issue of potential penalties is important, there are a couple other factors that must be considered/applied by tax professionals for the disclosure of uncertain tax positions:

- An estimate of the likely success of the tax position must be established for both income tax and financial statement disclosure. As noted in Exhibit 1, the estimate for income tax is needed to establish a basis to avoid penalties. For financial statements, the estimate is needed to determine the potential liability that would result if the position were audited.
- It can be argued that financial statement disclosures can provide tax authority auditors with important information about uncertain tax positions not available through tax return disclosures. For example, if substantial authority exists for a position, and the probability of success for position taken is greater than 50%, the position does not need to be disclosed on the tax return. In the financial statement disclosures, however, the estimated liability of the position would be disclosed. It is no wonder that taxing authorities, such as the IRS, have trained auditors on the specifics of FIN48 disclosures.

6. CONCLUSION

A taxpayer/company or preparer when confronted with an uncertain tax position will be faced with different standards relating to disclosure for
financial statement purposes and the disclosure required to the Internal Revenue Service to avoid possibly significant penalties. While the purpose of both is to provide transparency in regards to tax positions, the standards are significantly different. The standard for disclosure to avoid penalties is lower than that of FIN 48 for disclosure on the financial statement. Great care must be taken to assure adequate compliance with both FIN 48 and the appropriate tax compliance rules.

**Exhibit 1.** Summary of Disclosure Requirements for IRC§6694 and Circular 230.

<table>
<thead>
<tr>
<th>Taxpayer Confidence</th>
<th>Probability of Success of Position Taken</th>
<th>§6694</th>
<th>Circular 230</th>
</tr>
</thead>
<tbody>
<tr>
<td>Will</td>
<td>(&gt;90%) Virtual Certainty</td>
<td>ND</td>
<td>ND</td>
</tr>
<tr>
<td>Should</td>
<td>(&gt;70%) Preponderance and weight favorable</td>
<td>ND</td>
<td>ND</td>
</tr>
<tr>
<td>More Likely Than Not</td>
<td>(&gt;50%) Greater than fifty percent the position will prevail</td>
<td>ND</td>
<td>ND</td>
</tr>
<tr>
<td>Substantial Authority</td>
<td>(&gt;40%) Authorities in support outweigh Authorities against</td>
<td>ND</td>
<td>ND</td>
</tr>
<tr>
<td>Realistic Possibility</td>
<td>(&gt;33%) Well-informed reasonable position by tax authority</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td>Reasonable Basis</td>
<td>(&gt;15%) One or more Authorities support the position</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td>Non-frivolous</td>
<td>(&gt;10%) Some merit exists for position taken</td>
<td>P</td>
<td>P</td>
</tr>
<tr>
<td>Frivolous</td>
<td>(&lt;10%) No merit for position</td>
<td>P</td>
<td>P</td>
</tr>
</tbody>
</table>

ND: No Disclosure Needed.
D: Disclose To Avoid Possible Penalty.
P: Penalty Applied.

In applying the recognition criterion of the Interpretation, an enterprise has determined that a tax position resulting in a benefit of $100 qualifies for recognition and should be measured. The enterprise has considered the amounts and probabilities of the possible estimated outcomes as follows:

<table>
<thead>
<tr>
<th>Possible Estimated Outcome</th>
<th>Individual Probability of Occurring (%)</th>
<th>Cumulative Probability of Occurring (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>80</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td>60</td>
<td>25</td>
<td>55</td>
</tr>
<tr>
<td>50</td>
<td>20</td>
<td>75</td>
</tr>
<tr>
<td>40</td>
<td>10</td>
<td>85</td>
</tr>
<tr>
<td>20</td>
<td>10</td>
<td>95</td>
</tr>
<tr>
<td>0</td>
<td>5</td>
<td>100</td>
</tr>
</tbody>
</table>

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

If the Company were to recognize the unrecognized tax benefits of $3.66 billion at December 31, 2008, the income tax provision would reflect a favorable net impact of $2.91 billion.

The Company recognizes interest, penalties and exchange gains and losses associated with uncertain tax positions as a component of Taxes on Income in the Consolidated Statement of Income. Interest and penalties associated with uncertain tax positions amounted to $101 million in 2008 and $270 million in 2007. Liabilities for accrued interest and penalties included in the Consolidated Balance Sheet were $1.68 billion, $1.60 billion and $2.40 billion as of December 31, 2008, December 31, 2007 and January 1, 2007.

As previously disclosed, the IRS has completed its examination of the Company’s tax returns for the years 1993 to 2001. As a result of the
EXHIBIT 3. FIN 48 Disclosure of Merck, Inc. at December 31, 2008 (Excerpted from Merck’s 10-k).

On January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* ("FIN 48"), which resulted in the recognition of an $81 million decrease in the Company’s existing liability for unrecognized tax benefits, with a corresponding increase to the January 1, 2007 Retained earnings balance. After the implementation of FIN 48, as of January 1, 2007, the Company’s liability for unrecognized tax benefits was $5.01 billion, excluding liabilities for interest and penalties.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance as of January 1</td>
<td>$3,689.5</td>
<td>$5,008.4</td>
</tr>
<tr>
<td>Additions related to current year positions</td>
<td>269.4</td>
<td>284.5</td>
</tr>
<tr>
<td>Additions related to prior year positions</td>
<td>64.2</td>
<td>187.8</td>
</tr>
<tr>
<td>Reductions for tax positions of prior years</td>
<td>(310.5)</td>
<td>(87.0)</td>
</tr>
<tr>
<td>Settlements(^{(1)})</td>
<td>(38.8)</td>
<td>(1,703.5)</td>
</tr>
<tr>
<td>Lapse of statute of limitations</td>
<td>(8.8)</td>
<td>(0.7)</td>
</tr>
<tr>
<td>Balance as of December 31</td>
<td>$3,665.0</td>
<td>$3,689.5</td>
</tr>
</tbody>
</table>

\(^{(1)}\) Reflects the settlement with the Internal Revenue Service ("IRS") discussed below.

examination, the Company made an aggregate payment of $2.79 billion in February 2007. This payment was offset by (i) a tax refund of $165 million received in 2007 for amounts previously paid for these matters and (ii) a federal tax benefit of approximately $360 million related to interest included in the payment, resulting in a net cash cost to the Company of approximately $2.3 billion in 2007. The impact for years subsequent to 2001 for items reviewed as part of the examination was included in the payment although those years remain open in all other respects. The closing of the IRS examination did not have a material impact on the Company’s results of operations in 2007 as these amounts had been previously provided for.
WORKS CITED


5. Internal Revenue Code of 1986, as amended, cited as IRC.
