

FIN 48 (FASB ASC 740)*: A PRACTICAL APPROACH TO ADOPTION AND COMPLIANCE

Private Companies Must Begin Preparing Now

**Although the launch of the Codification changed the authoritative reference of FIN 48 to Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) 740, this article continues to use the more familiar terminology of FIN 48 throughout.*

Due to inconsistencies in both accounting treatment and financial statement disclosures over the past several years, the Financial Accounting Standards Board (FASB) adopted Interpretation 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, the standard by which entities must account for uncertain tax positions. Since 2006, all public companies and some non-public companies have been accounting for their uncertain tax positions under FIN 48. FIN 48 is effective for all other entities, including S-corporations, partnerships, and not-for-profit organizations, for annual periods beginning after December 15, 2008.

Therefore, calendar-year-end, non-public companies are required to adopt FIN 48 effective as of January 1, 2009 in their annual financial statements for the year ending December 31, 2009. Non-public calendar-year companies will need to reassess existing tax positions previously recorded under Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, as well as review and document all uncertain tax positions for all tax periods where the statute of limitations remains open, under all applicable foreign and domestic jurisdictions where they operate.

A Brief Refresher

FIN 48 provides guidance on recognizing, “derecognizing,” measuring, classifying, and disclosing the tax effects of uncertain tax positions. A tax benefit may be reflected in an entity’s financial statements only if it is “more-likely-than-not” that the entity will be able to sustain the tax return position based on its technical merits. What is the definition of “more-likely-than-not”? Assuming that the respective tax authorities (Federal, state, and foreign) have full knowledge of all

- The characterization of income or a decision to exclude reporting taxable income in a tax return; or
- A decision to classify a transaction, entity, or other position in a tax return as tax exempt.

Recommended Steps to Successful Adoption

- **Communicate with key personnel**
An initial meeting between the entity’s chief financial officer, finance departments at all locations, tax

FIN 48 provides guidance on recognizing, “derecognizing,” measuring, classifying, and disclosing the tax effects of uncertain tax positions.

known facts, the company must be able to conclude that the applicable tax law, case law, and regulations provide enough supporting evidence that the tax position will be sustained at a more than 50 percent likelihood. If the tax position cannot meet the “more-likely-than-not” threshold, the entire tax benefit must be reserved as an uncertain tax position in the financial statements.

A tax position is a filing position that an entity has taken or expects to take on its tax return. A tax position may include any of the following:

- A tax deduction;
- A decision to not file a tax return;
- An allocation or shift of income between jurisdictions;

department, and external consultants (where financial and tax functions are outsourced) is essential. All parties must understand the technical requirements of FIN 48 in order to gather the information the company requires to develop a process to properly assess its uncertain tax positions. Management must designate the person or department (normally the tax department) responsible for taking the lead role to develop a plan that is communicated and understood by all departments. There are critical roles and functions—including some that overlap—in both the finance and tax departments with regard to data, workflow, business environment, and operations and technology. The following actions should be taken:

- ◆ Arrange meetings with all critical finance and tax personnel so that everyone is clear on the necessary financial data (a specific, detailed list is helpful), the timing of information to be received, and the expectations and deliverables required by each department.
- ◆ Discuss all material events and transactions that have occurred over the past few years—FIN 48 covers all prior periods where the statute of limitations is still open for all jurisdictions—including reorganizations, acquisitions, debt restructuring, and IRS, state and foreign exams.
- ◆ Engage the expertise of external tax professionals with experience in specific jurisdictional tax matters, including Federal, state, local, and foreign.
- ◆ Evaluate state and foreign tax returns, status of audits, and uncertain tax positions in each “material” jurisdiction.

Communication and coordination with the company’s external audit team is also very important. Conduct a meeting that outlines timing, materiality, documentation requirements, and overall expectations. All relevant issues must be documented.

Specific Considerations

Specific points include materiality, scope, and documentation; timing; and disclosures.

- **Materiality, scope, and documentation**
The tax department or external tax professional should clearly document the agreed-upon scope and materiality while performing their review of uncertain tax positions. Management needs to determine what the scope and materiality will be during implementation; obtaining such information from your external auditor up front will help set expectations. A memorandum that clearly describes the processes the company performed when analyzing its overall tax positions will be required. It should also include what source documentation was reviewed including financial statements, tax returns, intercompany transactions,

transfer pricing data, periods reviewed, state nexus evaluation, etc. This document should also include a final conclusion summarizing the review.

- **Timing**

Ideally, your FIN 48 implementation plan and documentation should be completed and reviewed by your auditor prior to the company’s year-end. Trying to complete the documentation requirements of FIN 48 during the year-end close will inevitably cause timing issues both internally and with your external audit firm. If uncertain tax positions are detected during FIN 48 implementation, significant time and effort will be needed to (1) evaluate the tax position and, (2) calculate the overall exposure. Detecting an uncertain tax position may require a company to review prior-year documentation to calculate the total exposure which will also include the calculation of interest and penalties. Your goal should be to complete FIN 48 documentation by the end of your third or fourth quarter, so that your audit firm can complete its review prior to year end.

- **Disclosures**

Drafting the appropriate financial statement footnote disclosures will also require coordination with the financial reporting group. Although there are reduced reporting requirements for private companies under FIN 48, private companies will still be required to disclose the total amount of interest and penalties recognized in the financial statements; the nature of uncertainties that could significantly change within 12 months; and a description of tax years that remain subject to examination by major jurisdictions.

Consider All Pertinent Details

In order to comply with the various requirements of FIN 48, attention to detail is required. Consider the following points and work them into your action plan:

- **Work with appropriate professionals**
Management should consider engaging external specialists if, for example, the

company has taken R&D credits on its tax return but has not contemporaneously documented its calculation and supporting data. In this instance, it will need the guidance of a specialist to determine whether any areas surrounding the process for calculating the Research and Development (R&D) credit are uncertain, i.e., qualifying R&D activities. Other issues where specialists are often consulted include transfer pricing, treatment of professional fees paid during acquisitions, legal opinions on the taxability of certain transactions and character of gain or loss, review of the Section 199 calculation, analysis of foreign tax credit calculations, and the review of state tax nexus.

- **Document thoroughly and carefully**

We can’t say it enough—thorough documentation is the key to successfully complying with FIN 48. Preparing a plan to obtain all relevant tax information including various elections, for example Subchapter S elections, tax return schedules; documentation obtained from tax consultants, i.e., opinions on tax positions; R&D studies; transfer pricing reports; prior IRS and state exams; a copy of all Federal, state and foreign tax returns for open statutes; financial statements; and tax provisions. An analysis of all tax workpapers and returns will need to be completed to determine whether the tax positions taken by the company on its tax returns are either highly certain or uncertain. Management has to assume that the IRS has all of the necessary information and documentation that the company has and is aware of all the facts when evaluating a tax position.

- **Consider the use of interest and penalty software**

If uncertain tax positions are detected, not only will the related tax liability need to be calculated, but also the applicable interest and penalties. Interest and penalty software is available to assist in the calculation of interest and penalties for uncertain tax positions.

Watch for These High-Risk Areas of Concern

The areas of acquisitions, tax attributes (i.e., R&D, foreign tax credits, and net operating losses), transfer pricing, and state and foreign tax nexus are among the most common issues that emerge when assessing compliance with FIN 48.

■ **Acquisitions**

Care should be taken to document tax positions taken during an acquisition. If a company performs a stock acquisition of a target, the acquirer will need to perform due diligence on the target to determine whether any tax positions exist from its prior-year tax returns. The purchase agreement will also need to be analyzed to determine if any indemnifications exist with respect to the target's previously filed returns. Asset acquisitions must be evaluated for proper classification of asset lives and valuation.

■ **Tax Attributes**

There must also be sufficient support for all tax attributes including R&D credits, foreign tax credits, net operating losses (all jurisdictions), and state credits. The calculations and tax positions

must be documented, otherwise attributes that cannot be adequately supported may need to be adjusted or written off.

■ **Transfer Pricing**

Both domestic and foreign intercompany transactions will need to be analyzed to determine whether the transactions were performed at arms-length, i.e., comparable third-party transactions. An up-to-date transfer pricing study will be required in order to demonstrate that an appropriate intercompany transaction fee was charged.

■ **Nexus**

State and foreign nexus issues have been the biggest exposure areas under FIN 48. Companies must examine both their domestic and foreign operations carefully and will need to perform a thorough analysis of property locations, rents paid, payroll and employee location, inventory storage, supply chain, and title passage in order to conclude whether any uncertain tax positions exist. As mentioned earlier, companies will also need to coordinate this review with each foreign location.

When to Get Started? Don't Wait!

Now is the time for your tax department and advisors to begin preparing a plan and process to successfully adopt FIN 48. First and foremost, FIN 48 is your responsibility—companies need to take ownership of the requirements just as they would for any other financial statement presentation and disclosure requirements. Preparing a detailed plan with specific due dates will help monitor the project's progress.

Public companies have already experienced the adoption of FIN 48. Those that were successful in adopting FIN 48 started the process sooner rather than later. FIN 48 can be a time-consuming standard to adopt for some companies—tax positions must be identified, documented, evaluated, and concluded. Expect the unexpected and give yourself plenty of time to work through the complex issues of FIN 48. ■

Neil Gerard, CPA, is a J.H. Cohn tax partner. He can be reached at ngerard@jhcohn.com or 877-704-3500.

California

San Diego

4180 Ruffin Road, Suite 235
San Diego, CA 92123
858-535-2000

Los Angeles

Good Swartz Brown & Berns,
A Division of J.H. Cohn LLP
11755 Wilshire Boulevard, 17th Floor
Los Angeles, CA 90025
310-477-3722

Warner Center

Good Swartz Brown & Berns,
A Division of J.H. Cohn LLP
21700 Oxnard Street, 7th Floor
Woodland Hills, CA 91367
818-205-2600

Cayman Islands

P.O. Box 1748 GT
27 Hospital Road
George Town, Grand Cayman
877-704-3500 x7839

Connecticut

Glastonbury

180 Glastonbury Blvd.
Glastonbury, CT 06033
860-633-3000

New Jersey

Roseland

4 Becker Farm Road
Roseland, NJ 07068
973-228-3500

Eatontown

27 Christopher Way
Eatontown, NJ 07724
732-578-0700

Lawrenceville

997 Lenox Drive
Lawrenceville, NJ 08648
609-896-1221

Metro Park

333 Thornall Street
Edison, NJ 08837
732-549-0700

New York

Manhattan

1212 Avenue of the Americas
Suite 1200
New York, NY 10036
212-297-0400

Charles Brucia & Co.,
A Division of J.H. Cohn LLP
1212 Avenue of the Americas
New York, NY 10036
212-682-2459

Frederic Kantor & Company,
A Division of J.H. Cohn LLP
1212 Avenue of the Americas
New York, NY 10036
212-727-2300

Long Island

100 Jericho Quadrangle
Suite 223
Jericho, NY 11753
516-482-4200

White Plains

1311 Mamaroneck Avenue
White Plains, NY 10605
914-684-2700



877-704-3500
www.jhcohn.com

The Accounting Newsletter is published by J.H. Cohn LLP for the general information of its clients, friends, and business associates and should not be acted upon without prior professional consultation.