



Preparing your private company for FIN 48 today

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By the end of the session, you should be able to:

- > Discuss general background of FIN 48
- > Describe common “tax positions”
- > Describe the scope of FIN 48
- > Understand FIN 48 disclosure requirements
- > Understand Topic 740 - Implementation Guidance on FIN 48
- > Understand the recent IRS proposal to report uncertain tax positions

- > FIN 48 - *Accounting for Uncertainty in Income Taxes* (codified primarily in FASB ASC740-10) established a new model for recognizing, measuring, and disclosing uncertainties in an entity's decisions about how to recognize income tax events in past, current, or future years.
- > Uncertainty in "tax positions" reported in tax returns must be considered before using them to determine tax provision vs. defaulting to tax return as basis for determination of tax provision.
- > Applicable to non-public companies for years beginning after December 15, 2008 – unless adopted early

What is the reason for FIN 48?

- > Diverse practices in accounting for income tax expense
- > Lack of comparability
- > Income tax identified as an area that is less familiar to management
- > SEC comment letters

When booking income tax accruals, how, if at all, do you account for the contingency that the returns may be audited by the taxing authority resulting in disallowance of some or all of the positions taken on the return?

- > Using a valuation allowance to reduce deferred income tax assets for the estimated effects of the uncertainty
- > Reflecting a “cushion” by increasing the recorded liability for income taxes currently payable for the estimated effects of the resolution of the uncertainty
- > Establishing a predetermined confidence threshold for initially recognizing income tax benefits from positions taken and applying the FAS 5 “probable” criterion for recording contingent losses associated with those positions

***Where is your company in
the FIN 48 process?***

Recognition and measurement

- > If the “more likely than not” standard is not met for a particular tax position, it is not recognized in the financial statements.
- > If the “more likely than not” standard is met, the tax position must be measured.
- > The largest amount of tax benefit that is greater than 50 percent likely of being realized is recorded.

What is a tax position?



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Certain and uncertain tax positions can include:

- > Decisions as to whether or not to file a tax return
- > Decisions to exclude the reporting of taxable income
- > Characterization of income or losses as capital or ordinary
- > Allocations of income between tax jurisdictions
- > Decisions to classify transactions, entities, or other tax positions as tax exempt

> Income taxes subject to FAS 109



> Nonprofits

Initial “recognition” of the financial statement effects of a tax position should occur when it is more likely than not (MLTN), based on technical merits, that the tax position will be upheld upon examination.

Guidelines for evaluating recognition of tax positions

- > Presume taxing authority will examine position with full knowledge of relevant data.
- > Derive technical merits of tax position from authoritative tax laws and their applicability to facts and circumstances of tax position.
- > Take into account past practices and precedents of taxing authority.
- > Evaluate each tax position independently.

A tax position that previously did not meet the recognition threshold gets recognized in the first interim period in which:

- > The MLTN recognition threshold is met by the reporting date.
- > The tax matter is settled through negotiation or litigation.
- > The statute of limitations for the tax position has expired.
- > A tax matter need not be legally extinguished to subsequently recognize or measure a tax position.
- > Based on management's best judgment in view of facts, circumstances, and information available at reporting date

Subsequent derecognition



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- > Derecognize (previously recognized) tax position in the first interim reporting period in which it is no longer more likely than not that the position will be sustained upon examination.
- > Valuation allowance is not a substitute for derecognition.
- > Based on management's best judgment in view of facts, circumstances, and information available at reporting date

Facts

- > The business has determined that a tax position resulting in a benefit of \$100 qualifies for recognition and, accordingly, should be measured.
- > The business has considered the amounts and probabilities of the estimated outcomes.

Illustrative guidance



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Possible Estimated Outcome	Individual Probability of Occurring	Cumulative Probability of Occurring
\$100	5%	5%
\$90	20%	25%
\$80	30%	55%
\$60	25%	80%
\$30	10%	90%
\$10	5%	95%
\$0	5%	100%

Illustrative guidance



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- > \$80 or more is the largest amount of benefit that is greater than 50 percent likely of being realized upon settlement.
- > The “At Least” Test: Book the largest that MLTN will allow.

Interest

- > Interest accrual required if position in tax return is not recognized in financial statements under FIN 48
- > When tax law requires interest on underpayment, start recognizing in the first period it would begin accruing under tax law
- > Amount is statutory interest rate times the difference between FIN 48 tax position and amount taken in tax return

Penalties

- > Recognize when the tax position does not meet minimum statutory threshold to avoid payment of penalties.
- > Recognize in period in which company claims or expects to claim position in tax return.

Required by all entities

- > Amounts of interest and penalties recognized in the statement of operations and total amount of interest and penalties recognized in the statement of financial position
- > Information related to unrecognized tax benefits that significantly increase or decrease within 12 months of the reporting date, including the nature of the uncertainty, nature of the event that could occur in the next 12 months causing change, and an estimate of the range of the reasonable possible change or statement that an estimate of the range cannot be made
- > Description of the tax years that remain subject to examination by major tax jurisdictions

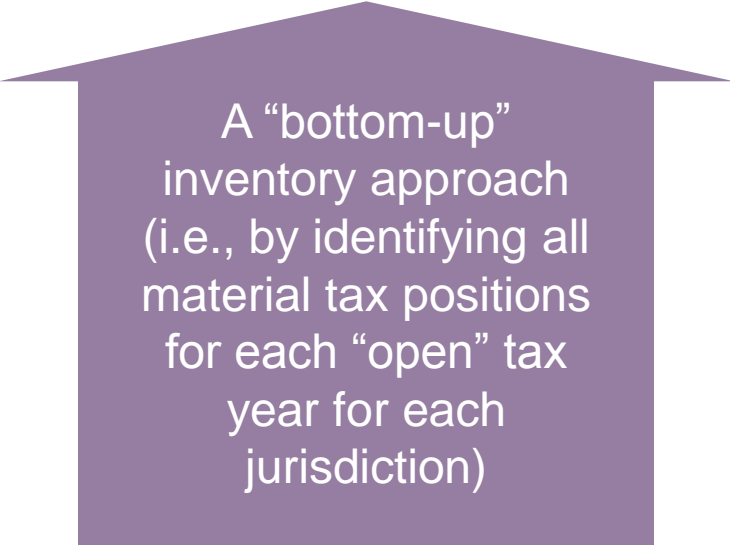
Required by public entities, in addition to the previous

- > A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period

FIN 48 defines scope to include all tax positions

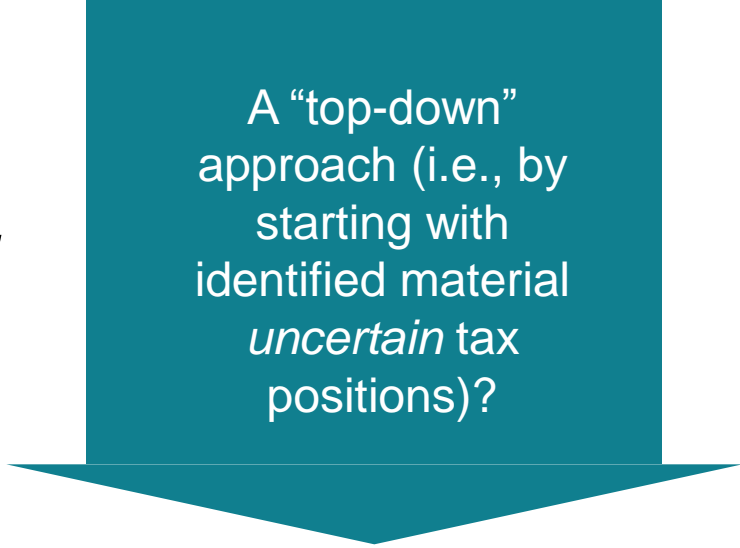
- > As a matter of practicality, highly certain tax positions do not need to be analyzed.
- > To what extent should companies document tax positions as being highly certain tax positions?

To what extent should FIN 48 be implemented by way of:



A “bottom-up”
inventory approach
(i.e., by identifying all
material tax positions
for each “open” tax
year for each
jurisdiction)

VS.



A “top-down”
approach (i.e., by
starting with
identified material
uncertain tax
positions)?

- > As a result of NOLs or tax credits, the statute of limitations related to certain historical periods is often extended to align with the statutes for years in which attributes were utilized.
- > Notwithstanding the scope of all possible open periods, taxing authorities often limit their examination to years defined within a particular cycle.
- > Is it appropriate to rely on this administrative practice to recognize tax benefits in periods prior to the defined cycle?

Lessons learned by public companies



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Auditor perspective of FIN48 has evolved since FIN48 was first required - practical application.

Begin with an overview of the tax return and the material adjustments, but make sure to consider items not included in the tax return.

Are there jurisdictions we should be filing in that we are not? Consider state tax notices and nexus questionnaires received.

Consider prior IRS audits and items of adjustment.

What can I do today to prepare for FIN 48?



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1. Talk to your tax advisor!
2. Understand jurisdictions you currently file in and consider activities taking place in jurisdictions you are not currently filing in.
3. Understand tax return adjustments and any related risk.
4. Understand financial statement transactions that have a tax impact not currently reported in your tax return.
5. Understand open statutes of limitations (consider impact of NOLs and jurisdictions you may not be filing in but should be).
6. Understand the amount of income tax reserve currently included in your financial statements prior to 2009.
7. Talk to your auditors about documentation requirements.
8. Understand your auditors materiality threshold.
9. If part of a complex structure, understand entities that are included in financial statements and FIN 48 impact.
10. Analyze tax years that have been examined by authorities and any adjustments made.

How many of you are preparing financial statements for a flow-through entity (S corporation or partnership)?

Income tax attributable to owners or entity?

- > If tax is attributable to entity, should be accounted for consistency with FIN 48
- > If tax is attributable to owner, transaction should be recorded as a transaction with owners

Clarification made that management's determination of the taxable status of the entity, including its status as pass-through, tax exempt, or nonprofit is a tax position subject to the standards required for FIN 48

Clarification that a reporting entity must consider the tax positions of all entities within a related group of entities regardless of the tax status of the reporting entity (for example, a partnership owning a corporate entity that is required to file consolidated financial statements)

- > On January 26, Commissioner of IRS unveiled a proposal for a tax schedule requiring large businesses (assets > \$10M) to report uncertain tax positions and related dollar amounts when they file their returns.
- > Brief description of the issue and maximum amount of U.S. exposure would be required.
- > Intent is to reduce time it takes IRS to find issues.
- > More to come...

Questions and comments

Contact information

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