
12.04.2006 | UPDATES

Public companies, and other companies that need audited financial statements, must begin accounting for uncertain income tax positions under a new rule: Financial Accounting Standards Board Interpretation No. 48, which was released in July, and is effective for fiscal years beginning after December 15, 2006. Most reporting companies will implement the new rule for their first quarter 2007 financial statements.

FIN 48 — Background

The Financial Accounting Standards Board adopted FIN 48 to provide specific guidance for accounting for uncertain income tax positions and eliminate existing inconsistencies in accounting practices that "resulted in noncomparability in reporting income tax assets and liabilities." Under FIN 48 a tax position is generally subject to a two-step analysis.

**Step One: Recognition.** Is the tax position "more likely than not" to be sustained on examination based on its technical merits (assuming the position will be audited, and including administrative and judicial appeals)? This "recognition" step will require careful legal analysis of the tax position, taking into account the relevant facts and circumstances.

- **If No, No Tax Benefit Recorded.** If the tax position is not "more likely than not" to be sustained on examination based on its technical merits, then none of the tax benefit derived from the position is recorded.

- **If Yes, Go to Step Two.** If the tax position is "more likely than not" to be sustained on examination based on its technical merits, proceed to the second step in the analysis.

- **Should You Obtain a Tax Opinion?** While FIN 48 states that a tax opinion is not required in order to demonstrate that the position is more likely than not to be sustained, it also noted that a tax opinion "can be external evidence supporting a management assertion and that management should decide whether to obtain a tax opinion after evaluating the weight of all available evidence and the uncertainties of the applicability of the relevant . . . law."

**Step Two: Measurement.** If the tax position is more likely than not to be sustained, what amount of the tax benefit derived from the position is recorded?

- **May Be Less Than Full Amount.** Even if the tax position is more likely than not to be sustained, the tax benefit to be recorded may not necessarily equal the full amount of the benefit reflected on the relevant tax return. Rather, the amount of the benefit to be recorded is "the largest amount of 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."

This second step, known as the "measurement" step, assumes an ability to quantify the likelihood of potential litigation settlements with numerical precision that, as a practical matter, may be difficult to implement.

The IRS Responds — Expedited Resolution Initiative

Recognizing that in light of FIN 48 "some taxpayers may wish to request a greatly accelerated examination and resolution before the end of their current financial statement accounting year of uncertain tax positions," the IRS established an initiative by which "the Service will be able to greatly expedite examination and accelerate resolution of important issues." Under this initiative, eligible taxpayers could approach the IRS with uncertain tax positions, and the IRS would work with the taxpayer to resolve them.

The IRS initiative appears to have gone over like a lead balloon. For calendar-year taxpayers, the deadline for applying to participate in the program was November 15. Although the program was available to thousands of calendar-year taxpayers that must grapple with FIN 48, it appears that the IRS received only a handful of requests to participate. This low participation likely stemmed from the burdensome requirements for participation: participating taxpayers generally have to provide the IRS with all information necessary to determine the issue, including all documents related to the transaction (including all related legal and accounting opinions), a description of the issue and summary of relevant facts and a document setting forth all relevant legal authorities (including authorities contrary to the taxpayers' position).

**What Are Taxpayers' Other Alternatives for Help With FIN 48 Compliance?**
D-I-Y ... or Get Outside Help. FIN 48 is complex and far-reaching, and raises numerous accounting issues. In the absence of a user-friendly IRS program to assist taxpayers in resolving their uncertain tax positions, taxpayers must rely on their internal tax professionals and/or outside tax advisors to evaluate the technical merits of these positions under the standards provided by FIN 48.

Additional Information

IMPORTANT TAX INFORMATION: This communication is not intended or written by Perkins Coie LLP to be used, and cannot be used by the taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under the Internal Revenue Code of 1986, as amended.

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