Private Companies Will Feel the Impact of FIN 48

By Ted Thomas

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), represents the most significant change in accounting for income taxes in many years.

FIN 48, Appendix B, "Background Information and Basis for Conclusions," addresses the consideration that the Financial Accounting Standards Board (FASB) gave to private companies prior to the issuance of the interpretation. FASB noted that unless a private company has earlier reporting requirements, such as interim-period debt covenant calculations or financial statement requirements, the company will have until the end of the year of adoption to report the impact of FIN 48.

With this additional time for most private companies, FASB concluded that the organizations should be subject to the same requirements as public companies with respect to the effective date, recognition, measurement and disclosure requirements. Thus, private companies must fully implement FIN 48 for their first fiscal year beginning after Dec. 15, 2006.

Of particular note, FIN 48 applies to all types of entities, including not only C corporations — which pay taxes at the business entity level — but also for not-for-profits; pass-through entities (for which the owners generally pay the tax), such as partnerships, limited-liability companies and S corporations; real estate investment trusts; and regulated investment companies.

Many private companies are pass-through entities and do not have to pay taxes, a tax position that must be evaluated under FIN 48. In addition, state, local or foreign income taxes may apply to a pass-through that is not subject to federal income tax, resulting in tax positions subject to FIN 48's evaluation requirements.

Understanding that every private company that files generally accepted accounting principles (GAAP) financial statements will be impacted by FIN 48 means that such entities — even those without interim FIN 48 reporting — should begin taking implementation steps now.

SAB 74 disclosures, which report on the impact of adopting new accounting standards, noted that for numerous public companies at the close of 2006, FIN 48 implementation was still in process and adjustments could not be quantified. This underscores the fact that the adoption process can be long and arduous.

Issues to Address During FIN 48 Implementation

■ *Recognition.* Identify and document each income tax position at the unit-of-account level, along with the relevant income tax law. Tax positions of a private company may include the treatment of personal expenses of the owners that are paid by the company, treating an entity such as an S corporation as exempt from federal taxation, or the decision not to file income tax returns in jurisdictions where the company may have taxable activities.

Document management's determination of whether "more likely than not" is sustainable upon examination, including the basis for the determination. Private companies may have limited tax authority audit history on which to base many of their conclusions, but must keep in mind that FIN 48 requires the assumption that the tax position is subject to examination.

Monitor for new information that may cause a change in the recognition conclusion of a tax position. Private companies may need to implement new processes to track tax law or court decisions affecting their tax positions.

■ *Measurement.* Document management's determination of potential outcomes and related probabilities of a position. As noted above, private companies will need to assess the likely outcomes of their tax positions under an assumed examination of the position, and new resources may be required to help management determine the level of likelihood of various settlement scenarios.

As in the recognition step, private companies will need to implement processes by which they are able to remain up-to-date on tax legislation, court decisions or other rulings that may impact their conclusions on the amount of a tax position presumed to be sustained under examination.

■ *Classification and Disclosures.* FIN 48 adds additional complexity to the financial statement disclosure of current and noncurrent taxes payable/receivable and deferred tax assets/liabilities, the netting of assets and liabilities, the recording of valuation allowances and the classification of interest and penalties on assumed examination adjustments.

It also requires more robust income tax disclosures in the footnotes to the financial statements. These rules may be of particular significance when performing debt covenant calculations and explaining the results of FIN 48 implementation to shareholders, bankers or other parties who rely on the company's financial statements.

The processes and procedures noted above are among those that private companies should pay close attention to in their adoption of FIN 48. Outsourcing has proven effective for those that lack a full-time, in-house tax department. However, management remains responsible for any and all amounts and disclosures included in financial statements.

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