

Financial Interpretation No. 48

The U.S. Financial Accounting Standards Board ("FASB") recently issued Financial Interpretation No. 48 ("FIN 48"). The purpose of FIN 48 is to achieve increased standardization of financial reporting of uncertain tax positions. Under FIN 48, taxes will attract increased scrutiny and be subject to explicit disclosures for financial reporting purposes, including a detailed roll forward of those tax positions that do not qualify for financial statement benefits. FIN 48 applies for fiscal years beginning after 15 December 2006.

Who is affected? FIN 48 applies to companies using U.S. GAAP.

General Requirements: Companies are required to have processes, procedures and controls in place to ensure that all material *uncertain* tax positions are identified. Once identified, each uncertain tax position must first pass a *recognition* standard (see below) and is then subject to a defined *measurement* process. Finally, specific *disclosure* requirements apply with respect to book – tax differences.

Uncertain tax positions. All positions other than those that are highly certain (i.e., where there is clear and unambiguous supporting tax law) are *uncertain* and thus subject to the *recognition*, *measurement* and possible *disclosure* requirements. Tax positions thus include: deductions, shifting of income between jurisdictions, the characterization of an entity or transaction (e.g., hybrid structures), and the decision to report (or not) in a particular jurisdiction.

Recognition. To recognize any tax benefit, it must be more likely than not that the tax position will be sustained on its technical merits, assuming resolution in a court of last resort. The likelihood that the position will not be audited can not be taken into consideration, and a company's history of favorable resolution of the same or similar matters in prior audits is not relevant. Rather, a pure technical analysis of the matter must conclude that it is more likely than not that the tax position will be sustained on its merits. For highly technical matters, auditors will likely seek documentation supporting the taxpayer's conclusions. Tax opinions from qualified experts are not necessarily required, but in appropriate instances may be desired to substantiate a position. If third party advice is provided to an auditor, steps should be taken to protect applicable privileges, if any.

Measurement. For those positions that meet the recognition threshold, the next step is to determine the financial statement benefit. Companies may only recognize that amount of the benefit that is greater than 50% likely of being realized upon ultimate settlement. To accomplish the measurement, the highest possible outcome with respect to a tax position is evaluated to determine whether there is a greater than 50% likelihood that the outcome would be sustained. If so, the full amount of the related tax benefit should be reflected on the financial statements. If not, the next highest possible outcome is considered. This process is repeated until the probability of occurrence for a specific amount is higher than 50%. That amount gets recognized as a tax benefit on the financial statements. This step, unlike the recognition standard, is highly judgmental and does take into account specific facts, circumstances, and taxpayer's history of favorable resolution.

Disclosure. FIN 48 requires substantial disclosure, including: open tax years by major jurisdiction; interest and penalties (assumed imposed on difference between amount reported under FIN 48 and amount reported on tax returns); quantitative and



qualitative description of positions that have a reasonable possibility of changing; a tabular roll-forward of unrecognized tax benefits; and if reasonably possible that an unrecognized benefit will significantly change in 12 months, then the nature of uncertainty and the event that would cause the change and estimate of change. There is some anticipation that tax authorities may use these disclosures to identify taxpayers engaged in aggressive tax planning.

Common Instances where FIN 48 May Apply in International Context:

- A U.S. parent or U.S. subsidiary reports in GAAP.
- A non-U.S. company is listed on a U.S. exchange or is otherwise subject to U.S. financial reporting.
- A GAAP reporting company acquires a target company with tax attributes, such as net operating losses. Attributes of the target must be tested under FIN 48 for post-acquisition reporting.
- Inter-company transfer pricing, hybrid entities and instruments, permanent establishment exposure issues, and tax nexus with certain U.S. states.

How we can assist:

- Advice regarding requirements and applicability of FIN 48 to particular clients / situations.
- Identification: Identify the uncertain tax positions for open tax periods (generally 3 years, but may be longer).
- Recognition: We provide clients with advice regarding likely U.S. tax treatment for purposes of recognition, including written support to document the analysis and conclusion upon financial statement audit.
- Measurement: Establish appropriate measurement of benefit.
- Disclosure: Assist company and auditors prepare appropriate disclosure language.

Contact Persons:

David M. Neuenhaus, WTS US LLC
Karsten Gnuschke and Monika Ullrich, WTS AG Munich / Düsseldorf

Editors:

World Tax Service US LLC
Rockefeller Plaza – 7th Floor
1230 6th Avenue
New York, NY 10020
USA

WTS Aktiengesellschaft
Steuerberatungsgesellschaft
Thomas-Wimmer-Ring 3
80539 Munich
Germany

Telephone: +1 212 618 6306
Telefax: +1 480 247 4487

Telephone: +49 89 28 646 139
Telefax: +49 89 28 646 111

E-Mail: dneuenhaus@wtsus.com
Homepage: www.wtsus.com

E-Mail: karsten.gnuschke@wts.de
Homepage: www.wts.de

This information is intended to provide general guidance with respect to the subject matter. This general guidance should not be relied on as a basis for undertaking any transaction or business decision, but rather the advice of a qualified tax professional should be obtained based on a taxpayer's individual circumstances. Although our Info Letters are carefully reviewed, we accept no responsibility in the event of any inaccuracy or omission. For further information please refer to WTS US and WTS AG.