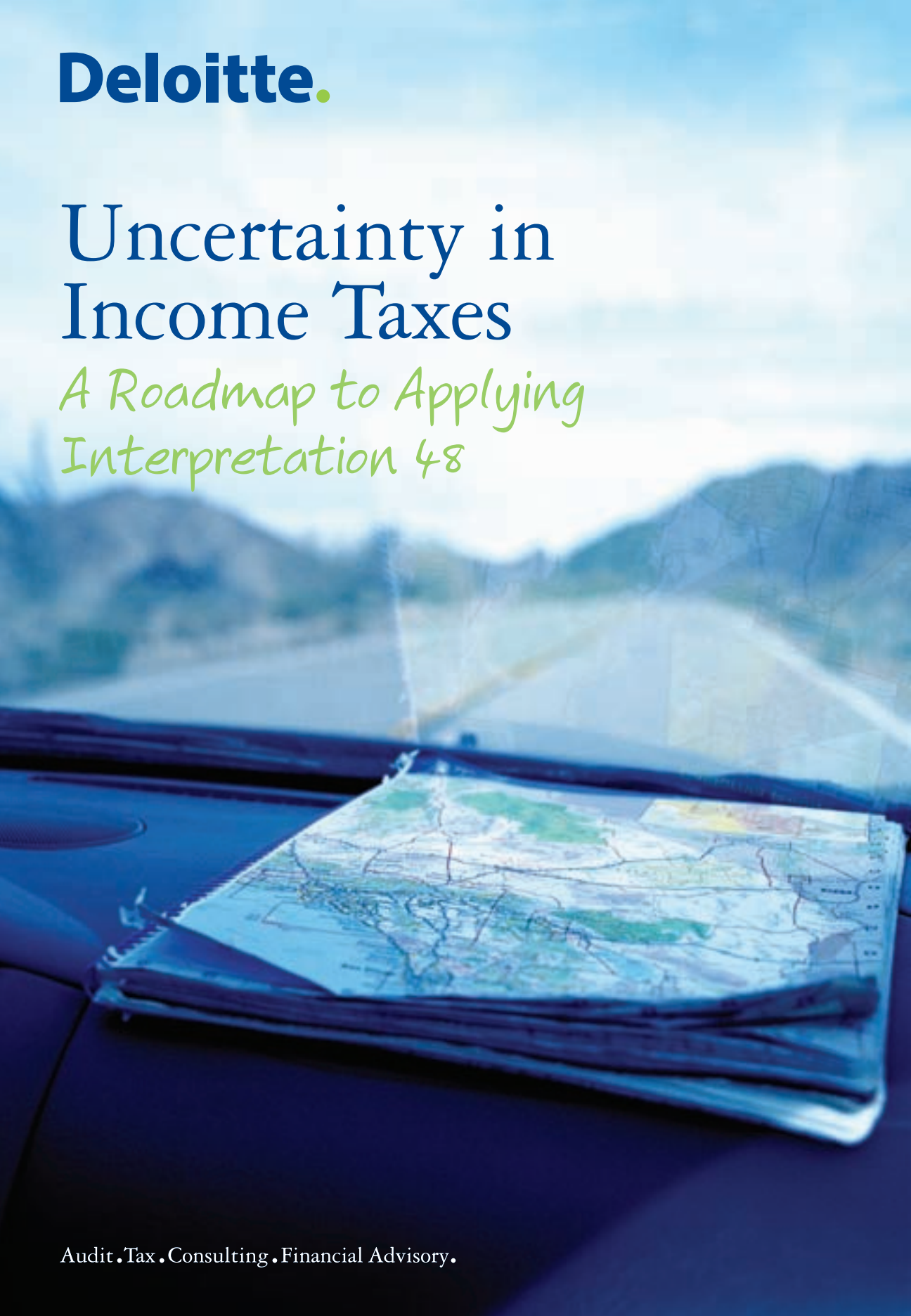


**Deloitte.**

# Uncertainty in Income Taxes

*A Roadmap to Applying  
Interpretation 48*







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# Executive Summary

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* — an interpretation of FASB Statement No. 109 (“Interpretation 48” or the “Interpretation”). The Interpretation, which is effective for fiscal years beginning after December 15, 2006, introduces a new approach that significantly changes how enterprises recognize and measure tax benefits associated with tax positions and disclose uncertainties related to income tax positions in their financial statements. Enterprises will need to develop a comprehensive work plan to identify and assign responsibilities for the many steps that must be performed to ensure a proper and timely adoption of the Interpretation.

Why was this Interpretation issued? Although the validity of an enterprise’s tax position is a matter of tax law, in certain cases, the law is subject to significant and varied interpretation. As a result, an enterprise may be uncertain about whether a tax position would ultimately be sustained as filed in its tax return. FASB Statement No. 109, *Accounting for Income Taxes*, does not provide specific guidance on how such uncertainties should be reflected in an enterprise’s financial statements. This lack of guidance has resulted in diversity in how enterprises recognize, derecognize, and measure potential tax benefits associated with tax positions. The FASB believes that Interpretation 48 will increase comparability in financial reporting of income taxes.

The Interpretation applies to all tax positions within the scope of Statement 109 and establishes a single approach in which a recognition and measurement threshold is used to determine the amount of tax benefit that should be recognized in the financial statements. Interpretation 48 also provides guidance on (1) the recognition, derecognition, and measurement of uncertain tax positions in a period subsequent to that in which the tax position is taken; (2) the accounting for interest and penalties; (3) the presentation and classification of recorded amounts in the financial statements; and (4) disclosure requirements.

Generally, a tax position is a filing position that an enterprise has taken or expects to take on its tax return. Examples of tax positions that are subject to the Interpretation include a decision not to file a return, an allocation of income between jurisdictions, and a decision to exclude income from a tax return. For each material tax position identified, an enterprise must determine the level at which the tax position will be evaluated (i.e., unit of account). The determination is based, in part, on (1) the manner in which the enterprise supports and documents its income tax return and (2) the approach the enterprise expects the taxing authorities will take during an examination of the enterprise's tax filings.

Under Interpretation 48, an enterprise cannot recognize a tax benefit in its financial statements unless it concludes that it is "more likely than not" that the benefit will be sustained on audit by the taxing authority based solely on the technical merits of the associated tax position. In this evaluation, an enterprise must assume that the position (1) will be examined by a taxing authority that has full knowledge of all relevant information and (2) will be resolved in the court of last resort. If the recognition threshold is not met, no benefit can be recognized, even when the enterprise believes some amount of benefit will ultimately be realized. This approach will most likely result in an enterprise's recording liabilities that it will never have to pay.

The one exception to the more-likely-than-not recognition threshold is the reliance on past administrative practices and precedents of the taxing authority. This exception addresses the limited instances in which a taxing authority with full knowledge of all relevant facts will accept a position as filed even though the position technically violates the law. In this situation, although a tax position would not be sustained at the court of last resort on the basis of its technical merits, an enterprise would still recognize the associated tax benefit in its financial statements.

If the recognition threshold is met, the tax benefit recognized is measured at the largest amount of the tax benefit that, in the enterprise's judgment, is greater than 50 percent likely to be realized. The analysis should be based on the amount the taxpayer would ultimately accept in a negotiated settlement with the taxing authority. To compute the amount that is greater than 50 percent likely to be realized, an enterprise must perform a cumulative-probability assessment of the possible outcome(s). Assigning probabilities in measuring a recognized tax position requires a high degree of judgment and should be based on all relevant facts, circumstances, and information.



The Interpretation requires enterprises to recognize interest expense if the tax law requires interest to be paid on an underpayment of income taxes. Interpretation 48 also requires an enterprise to recognize penalty expense if a tax position does not meet the minimum statutory threshold to avoid payment of penalties in the period in which the enterprise claims or expects to claim the position in the tax return.

Under Interpretation 48, an enterprise must make extensive disclosures about tax positions, including a detailed reconciliation of tax benefits taken in its tax return that do not qualify for financial statement recognition. The reconciliation of the amount of unrecognized tax benefit is one of the Interpretation's most controversial requirements. Some constituents were concerned that the disclosure would provide a "roadmap" to the taxing authorities. The Board concluded that requiring the disclosure at an aggregate level would not reveal information about individual tax positions that is necessary for a roadmap. The Interpretation also requires certain other quantitative and qualitative disclosures of the unrealized tax benefit and the related interest and penalties.

The complexity of the Interpretation has led to many questions regarding its application. This publication responds to these questions and includes a detailed six-step approach that will help with successful implementation.

This publication reflects the Deloitte U.S. Firms' current understanding of the Interpretation's provisions, some of which is based on discussions with the FASB and Securities and Exchange Commission (SEC) staffs. As practice continues to develop, look for additional guidance.



# Introduction and Scope

## Introduction

The issuance of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ("Interpretation 48" or the "Interpretation"), dramatically changes an enterprise's accounting for and reporting of its income tax uncertainties. Diverse accounting practices had developed in the accounting for uncertainties in income taxes because FASB Statement No. 109, *Accounting for Income Taxes*, does not provide specific guidance on how uncertainties should be reflected in an enterprise's financial statements.

This lack of guidance has resulted in diversity in how enterprises recognize, derecognize, and measure potential tax benefits associated with tax positions, and the disclosure of income tax uncertainties rarely occurred. The FASB's objective in issuing this Interpretation is to increase comparability in financial reporting of income taxes. The Interpretation is effective for fiscal years beginning after December 15, 2006.

The Interpretation will have significant consequences for many enterprises, most notably increased financial statement disclosure of uncertain tax positions. This is one of the more controversial requirements of the Interpretation because many believe that the increased disclosure will provide a "roadmap" for taxing authorities. The FASB rejected this argument and decided to require a tabular reconciliation of the amounts of unrecognized tax benefits from the beginning to the end of the period, in addition to other disclosures.

Successfully implementing — and ensuring ongoing compliance with — Interpretation 48 is time-consuming, requiring the efforts of an enterprise's tax and accounting professionals and, in many cases, the assistance of external advisers. Enterprises should develop a comprehensive work plan to identify and assign responsibility for the many steps that must be performed to ensure a proper and timely adoption of the Interpretation. Management must ensure that the appropriate policies and controls are in place to properly adopt and apply the Interpretation and that those policies are communicated to and applied by the tax and accounting departments within the organization. The enterprise's management team should discuss the plan with audit committee members.

Furthermore, because the Interpretation requires increased disclosures, management should be prepared to answer financial statement users' questions about income tax uncertainties.

Prior to the issuance of Interpretation 48, many enterprises applied FASB Statement No. 5, *Accounting for Contingencies*, in assessing uncertainty of income tax positions and the need for an accrual for the exposure to additional income tax assessments as a result of positions taken in income tax returns. Because Statement 5 does not specifically address the recognition, measurement, and disclosure of potential tax contingencies, enterprises were accounting for income tax contingencies in different ways. Some enterprises were recording accruals for only those tax contingencies meeting the Statement 5 threshold of being probable that a liability had been incurred in an amount that is reasonably estimable, a threshold thought by some to result in delayed recognition of a liability until the issues are agreed to by the taxpayer and the taxing authority. Other enterprises accounted for tax contingencies by recording an accrual for each identified uncertain tax position at the amount expected to be required to settle each issue. Moreover, some enterprises accounted for tax positions only if a probability threshold was achieved while some enterprises estimated the amount to be accrued without using a specific methodology. Although the Interpretation provides a consistent methodology to use in the accounting for uncertainty in income taxes, a significant amount of judgment is still required in applying its provisions.

Interpretation 48 establishes (1) a recognition threshold — a likelihood of more than 50 percent ("more-likely-than-not") that the tax position taken will be sustained upon examination — and (2) a measurement standard — the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the taxing authority — to be applied in determining the amount of tax benefit to recognize in the financial statements for each tax position meeting the recognition threshold. An enterprise cannot recognize a tax benefit in its financial statements for a tax position that does not meet the recognition threshold.

Differences between a tax position taken or expected to be taken in a tax return and the benefit recognized and measured pursuant to the Interpretation are referred to as "unrecognized tax benefits." A liability is recognized (or the amount of a net operating loss carryforward or amount refundable is reduced) for an unrecognized tax benefit because it represents an enterprise's potential future obligation to the taxing authority for a tax position that was not recognized as a result of applying the Interpretation. A tax benefit recognized in the financial statements as a result of applying the Interpretation

may change or create a temporary difference. An unrecognized tax benefit should not be classified as a deferred tax liability or reduce a deferred tax asset unless it relates to a taxable or deductible temporary difference.

Interpretation 48 also provides guidance on (1) the recognition, derecognition, and measurement of uncertain tax positions in a period subsequent to that in which the tax position is taken; (2) the accounting for interest and penalties; and (3) the presentation and classification of recorded amounts in the financial statements. Moreover, the Interpretation includes several new disclosure requirements for annual financial statements.

Discussions with the FASB and SEC staffs regarding the application of the Interpretation are ongoing. These discussions will most likely lead to the issuance of additional interpretive guidance, some of which may amend existing guidance. Any new guidance will be available on Technical Library: The Deloitte Accounting Research Tool at [www.deloitte.com/us/dart](http://www.deloitte.com/us/dart).

## **Scope**

The Interpretation uses the term “enterprise” throughout because accounting for income taxes is primarily an issue for business enterprises. However, tax-exempt and not-for-profit enterprises are also within the scope of Interpretation 48, since the decision that some or all of an enterprise’s activities are not subject to income taxes is itself a tax position for which the Interpretation requires evaluation. The Interpretation also applies to other types of enterprises, including the following: (1) pass-through enterprises, such as real estate investment trusts and registered investment companies, that are potentially subject to income taxes but whose taxable income is reduced to zero by dividends paid; and (2) non-U.S.-based enterprises that issue financial statements based on, or reconciled to, U.S. generally accepted accounting principles (GAAP).

Interpretation 48 applies to all tax positions accounted for in an enterprise’s financial statements in accordance with Statement 109, including positions taken in a previously filed tax return or expected to be taken in a future tax return. A tax position can result in a permanent reduction of income taxes payable, a deferral of income taxes otherwise currently payable to future years, or a change in the expected realizability of deferred tax assets. The following are examples of tax positions that are within the scope of Interpretation 48:

- A decision not to file a tax return (e.g., a decision not to file a specific state tax return because nexus was not established).

- An allocation or shift of income between jurisdictions (e.g., transfer pricing).
- The characterization of income as, or decision to exclude, taxable income in a tax return (e.g., interest income earned on municipal bonds).
- Classification of a transaction, enterprise, or other position in a tax return as tax exempt (e.g., decision not to include a foreign enterprise in the U.S. federal tax return).

Tax positions not within the scope of Statement 109, such as taxes based on gross receipts, revenue, or capital, should not be accounted for under Interpretation 48 but under other applicable literature such as Statement 5.

Furthermore, an enterprise should not record liabilities relating to uncertain income tax positions beyond those that are required by Interpretation 48. Interpretation 48 amends Statement 5 to eliminate its applicability to income taxes.

### **Subsidiary Financial Statements**

Paragraph 40 of Statement 109 requires that the consolidated amount of current and deferred tax expense for a group that files a consolidated tax return be allocated among the members of the group. When those members issue separate financial statements, income tax expense is to be allocated in a systematic and rational method that is consistent with the broad principles established by Statement 109. One systematic and rational method is the separate return method. Although Interpretation 48 does not specifically address stand-alone financial statements, under the principles of Statement 109, the accounting for uncertain tax positions that originate at the member level of a consolidated group that uses the separate return method to allocate the consolidated amount of current and deferred tax expense should be reflected in the separate financial statements of the member (subsidiary) in accordance with the provisions of Interpretation 48 for the subsidiary as a stand-alone entity. The financial statements of the subsidiary should include the disclosures required by Interpretation 48.

# Internal Control Considerations

An enterprise's internal control processes relating to income tax accounting will likely take on increased importance as a result of the issuance of Interpretation 48. Enterprises subject to the internal control reporting requirements of Section 404 of the Sarbanes-Oxley Act of 2002 (the "Act") should already have documented the processes and procedures they use in accounting for income taxes and tax contingencies.

To ensure compliance with the Act and Interpretation 48, an enterprise should review its policies, procedures, and documentation and, where necessary, revise its documentation to include a thorough description of the internal controls involved in the identification, evaluation, and reporting of all material tax positions. This review should focus on the control processes and procedures surrounding uncertain tax positions. Enterprises not subject to the requirements of the Act will also need to review and document, to the extent management considers appropriate, their procedures for the identification and analysis of tax positions to comply with Interpretation 48. The nature and extent of the review may depend on the size and complexity of the enterprise, its tax filings, and the tax positions it has taken. If necessary, professional advisers should be engaged to assist with the analysis.

Enterprises should, at a minimum, develop and document the control processes and procedures that, in management's judgment, will achieve the following control objectives (with a focus on uncertain tax positions):

- All material tax positions taken or expected to be taken in tax returns are identified.
- The appropriate unit of account is determined for each material tax position.
- Only tax positions that meet the more-likely-than-not recognition threshold are recognized.
- All tax positions that meet the more-likely-than-not recognition threshold are recognized.

- All previously unrecognized tax positions that subsequently meet the more-likely-than-not recognition threshold are recognized in the first interim period in which the recognition threshold is met.
- All previously recognized tax positions that subsequently fail to meet the more-likely-than-not recognition threshold are derecognized in the first interim period in which the recognition threshold is no longer met.
- The amount of benefit recognized for each tax position is the largest amount that is greater than 50 percent likely to be realized.
- New information — such as new tax laws, regulations, and court cases — that affects the recognition and measurement of the benefits of a tax position is identified in a timely manner and properly evaluated.
- The recognition and measurement of the benefits of a tax position reflect all information available to management at the reporting date and do not take into account facts and circumstances and developments occurring after the reporting date but before the issuance of the financial statements.
- Interest and penalties are properly measured and recorded for all uncertain tax positions.
- Amounts recorded for unrecognized tax benefits, including interest and penalties, are properly presented, classified, and disclosed in the financial statements.

Enterprises should assign one group, usually the enterprise's tax professionals (internal personnel, external advisers, or both), the primary responsibility for identifying and evaluating all material tax positions. In addition, enterprises must establish the level of involvement or oversight by (1) the controller or chief accounting officer; (2) senior management (e.g., CEO, CFO); (3) the audit committee; and (4) the disclosure committee, if applicable.

In addition, management should establish the nature and extent of the evidence supporting each material tax position, as well as how the opinions of external advisers are to be weighted (i.e., whether or when they are required or simply encouraged). All relevant information should be considered in this evaluation, including, but not limited to, the nature and complexity of each issue involved, the magnitude of the potential exposures, the state of the applicable tax law (well-developed or evolving), and the availability or lack of analogous tax law or court cases.



The extent of documentation needed to support an enterprise's Interpretation 48 analysis will often depend on the level of uncertainty of a tax position and its size. For example, a highly certain tax position that is routine in nature and for which the tax law is clear and unambiguous and, in turn, the deduction is highly certain, will require significantly less documentation than an uncertain tax position. Effective internal control processes can help reduce the documentation effort. In addition, an enterprise should determine whether it is appropriate to document tax positions by category or transaction class as opposed to individual tax positions.

Furthermore, the Interpretation indicates that a legal tax opinion received from a third party is not necessary to demonstrate that the more-likely-than-not recognition threshold is met. Management should decide whether to obtain a tax opinion after evaluating all available evidence and the uncertainties surrounding the relevant statutes or case law. How much evidence is needed in addition to, or in lieu of, a tax opinion, to demonstrate the more-likely-than-not recognition threshold is a matter of judgment.

Management should consider providing the following documentation for each material uncertain tax position (by individual tax position, category, or transaction class):

- Identification of the tax year and tax jurisdiction.
- Unit of account selected and the supporting rationale.
- If the more-likely-than-not recognition threshold is met, support for that conclusion, including references to tax opinions, case law, rules, regulations, and prior settlements or agreements with the taxing authorities. If the recognition threshold is not met, support for that conclusion and discussion of the exposure to penalties for taking the position in the tax return.
- The amount included in or excluded from the tax return, as filed.
- The amount recognized in determining book tax expense, and the supporting rationale for the amount recorded in the current year and in the prior periods.
- The amount recorded in the balance sheet at the reporting date as a current tax liability, noncurrent tax liability, and deferred tax asset or liability.
- The amount of the adjustment in the current period, if any, recorded to the balance sheet liability or deferred tax account for unrecognized tax benefits at the reporting date.

- The amount recorded in the results of operations in the current period — and where that amount is classified for interest and penalties — and the supporting computations and rationale.
- The amount of interest and penalties recorded in the statement of financial position at the reporting date.

In addition, management should document the nature and extent of controls and processes for the identification and evaluation of material tax positions.

The frequency and timing of the enterprise's evaluation of its uncertain tax positions depend on the complexity of its tax filing situation and the number of tax positions taken in its tax returns. Some enterprises will perform a rigorous analysis of uncertain tax positions once a year, usually in connection with the preparation of their financial statements, and throughout the year will monitor developments that could necessitate an interim adjustment of recorded amounts. Enterprises with large, complex tax reporting situations may find it necessary to evaluate their tax positions rigorously throughout the year.

There is no "one size fits all" approach to an enterprise's achieving compliance with Interpretation 48. Nevertheless, every enterprise's management team should do the following: (1) evaluate the relevant facts and circumstances carefully, (2) implement processes and procedures to help meet the requirements of the Interpretation cost-effectively, and (3) ensure that those processes and procedures have been documented properly. An enterprise should consult with its external auditor regarding its implementation of Interpretation 48.

# Identifying Tax Positions

The first step in applying Interpretation 48 is the identification of all material tax positions, in all taxing jurisdictions, for all open tax years. The following are sources of information to consider when identifying tax positions that may require analysis under the Interpretation:

- An organization chart of all domestic and foreign entities for each open tax year. The chart should indicate the legal and tax form of each enterprise and summarize changes in the organizational structure during the period covered by all open tax years.
- A schedule of all jurisdictions (state, local, and foreign) in which the enterprise or its subsidiaries have employees or own assets, or in which the enterprise's employees or agents perform services, identifying the jurisdictions for which no returns are currently filed.
- Reconciliations of book and taxable income for each jurisdiction for all open tax years.
- A listing of all material federal, state, local, and foreign tax elections and other required tax return disclosures.
- Reports of questionable transactions previously disclosed to taxing authorities (for example, on federal Form 8886, "Reportable Transaction Disclosure Statement").
- Tax holiday agreements with significant jurisdictions.
- Federal, state, local, and foreign revenue agent reports, including detailed explanations of all audit adjustments.
- Settlement or closing agreements executed by the enterprise or its subsidiaries with federal, state, local, and foreign taxing authorities for transactions in any open tax years, including consideration of carryovers.
- Notices of assessment or proposed assessment received from taxing authorities.
- Status reports of any pending federal, state, local, and foreign tax examinations and any correspondence in which an enterprise's tax positions are questioned (and related responses to those questions) or in which extensions of the statute of limitations are requested.

- Tax rulings or ruling requests and requests for changes in accounting methods for all open tax years.
- A schedule of state apportionment factors (including property, payroll, and sales factors) for each enterprise for all open tax years.
- Correspondence from taxing authorities that questions the activities of the enterprise in any tax jurisdiction, and related responses, for all open tax years.
- A description of all significant intercompany related-party transactions (including transactions with shareholders) and transactions structured to achieve a desired tax position.
- Copies of any transfer pricing studies and advance pricing agreements entered into with taxing authorities for all open tax years.
- All copies of federal Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations," filed with respect to the enterprise's foreign subsidiaries for all open tax years.
- Analysis of any tax contingency reserves or deficiency in tax accounts recognized in all open tax years.
- Tax opinions, correspondence, and memoranda from third-party service providers and studies prepared by the enterprise or its subsidiaries concerning significant tax exposures.

Special consideration must be given to those taxing jurisdictions in which an enterprise conducts revenue-generating activities for which a decision has been reached that a tax return is not required by law, since in most taxing jurisdictions, any statute of limitations does not begin to run until a tax return is filed. In such cases, the tax liability owed to that jurisdiction could accumulate indefinitely, along with any applicable interest and penalties.

### **Determining the Unit of Account**

After identifying all of the material tax positions it has taken, the enterprise must determine the level at which each tax position will be analyzed and subjected to the more-likely-than-not recognition threshold (i.e., determining the "unit of account"). The unit of account is determined by evaluating the facts and circumstances of that position. Every tax position (e.g., transaction, portion of transaction, election, decision) for which a tax reporting consequence is accounted for in financial statements under Statement 109

is within the scope of Interpretation 48 and is, therefore, a possible unit of account to which Interpretation 48 applies.

A tax return position may represent the accumulation of data from multiple reporting units, divisions, subsidiaries, etc. Some tax positions are evaluated at the transaction level (e.g., the acquisition of a business or the sale of a subsidiary); other tax positions are evaluated at the tax return line item level (e.g., foreign tax credits, research and experimentation credits) or, more likely, at a subset of the tax return line item such as by project, location, subsidiary, or some combination of those components. The enterprise must decide the appropriate level at which to apply the provisions of Interpretation 48.

Paragraph 5 of the Interpretation states that the determination of the appropriate unit of account at which its provisions should be applied is “a matter of judgment based on the individual facts and circumstances” and involves consideration of (1) the manner in which the enterprise supports and documents its income tax return and (2) the approach the enterprise expects the taxing authorities will take during an examination of the enterprise’s tax filings.

A common source of income tax uncertainty involves the pricing of transactions between related parties that cross between two or more jurisdictions, often referred to as “transfer pricing” issues. In identifying the appropriate unit of account, an enterprise needs to understand the types of transactions occurring between the members of the larger enterprise that cross multiple jurisdictions (e.g., payments made for services received, tangible property acquired, or use of intangible property). Each underlying transaction may have unique characteristics related to its transfer price, which may affect the determination of the appropriate unit of account. Enterprises should also consider how the transfer pricing information will be provided to the relevant taxing authorities and how the taxing authorities will examine it.

Paragraphs A5–A7 of the Interpretation provide an example of determining the unit of account for a research and experimentation credit taken on a tax return. In the example, the enterprise has four projects of equal expenditures that make up the total credit of \$1 million. In evaluating the unit of account, the enterprise considered the level at which it accumulates information to support the tax return and the level at which it anticipates addressing the issue with taxing authorities. The enterprise concluded that the taxing authority would address the issue on examination at the individual project level because of the magnitude of the expenditures in each project. Other units of account that the enterprise might consider are the entire credit taken in the return or individual expenditures within individual projects.

When determining the relevant unit of account, an enterprise may also consider the following:

- Composition of the position — whether the position is made up of multiple transactions that could be individually challenged by the taxing authority.
- Statutory documentation requirements.
- Nature and content of tax opinions.
- Prior history of the enterprise (or reliable information about other enterprises' histories) with the relevant taxing authority on similar positions.

Once a unit of account for a given tax position has been determined, it should be consistently applied to that position and similar positions from period to period, unless changes in facts and circumstances indicate that a different unit of account is appropriate. Changes in facts and circumstances that could cause management to reassess its determination of the unit of account may include significant changes in organizational structure, recent experience with a taxing authority, and changes in the regulatory environment within a jurisdiction. Although the Interpretation acknowledges that changes in the unit of account may occur, such changes are expected to be infrequent. Furthermore, if a change in unit of account is caused by something other than a change in facts and circumstances, this may indicate that Interpretation 48 was applied incorrectly in prior periods.

# Recognition

Interpretation 48 establishes a two-step process for the recognition and measurement of the amount of benefit to be recorded in the financial statements for tax positions taken or expected to be taken in a tax return. This process requires the enterprise first to determine whether it is more likely than not that the tax position taken will be sustained upon examination by the taxing authority, including resolution of any appeals or litigation, on the basis of the technical merits of the position.

The enterprise must presume that the tax position will be examined by a taxing authority with full knowledge of all the facts and circumstances concerning the position taken and that any dispute would be taken to the court of last resort. The more-likely-than-not recognition threshold means that no amount of tax benefit may be recognized for a tax position without a greater than 50 percent likelihood that it will be sustained upon examination by the taxing authority.

## **Administrative Practices and Precedents**

Some tax positions technically do not comply with the tax law but are nevertheless widely accepted by the taxing authorities (in accordance with “administrative practices and precedents”) and thus may meet the recognition threshold. In this situation, although a tax position is a violation of the tax law, because the taxing authority is aware of the violation and has taken no action in the past, an enterprise may still recognize the associated tax benefit in its financial statements. Paragraph 7(b) of the Interpretation states:

Technical merits of a tax position derive from sources of authorities in the tax law (legislation and statutes, legislative intent, regulations, rulings, and case law) and their applicability to the facts and circumstances of the tax position. When the past administrative practices and precedents of the taxing authority in its dealings with the enterprise or similar enterprises are widely understood, those practices and precedents shall be taken into account.

According to the Interpretation, a common application of this concept is the immediate deduction for acquired assets whose cost is below a reasonable dollar threshold. For example, an enterprise has a policy under which all fixed asset purchases under \$1,000 are immediately

charged to expense. Although this policy has no basis in U.S. tax law, it is known to be widely accepted by the taxing authority. Therefore, the enterprise may conclude that the tax position meets the more-likely-than-not recognition threshold.

The Interpretation does not provide guidance on when an administrative practice and precedent exists or when it should be considered “widely understood.” Evidence that an administrative practice and precedent is widely understood may include an enterprise’s reliable knowledge of the taxing authority’s past dealings with the same enterprise or other enterprises on the same tax matter with similar facts and circumstances.

### **Impact of Past Examinations on the Recognition Threshold**

A completed examination of a tax year does not necessarily mean that a tax position taken and not disputed by the taxing authority meets the more-likely-than-not recognition threshold. An enterprise cannot assert that a tax position will be sustained on the basis of its technical merits simply because the taxing authority did not dispute or disallow the position; the lack of a dispute or disallowance may be due to the taxing authority’s overlooking of the position.

An enterprise generally should not use the fact that a tax position was not disputed or disallowed during an examination in a particular tax year as a basis for determining whether a tax position taken in a different tax year meets the more-likely-than-not recognition threshold. However, if the taxing authority explicitly agrees with a filing position, the enterprise may be able to conclude, in certain instances, that a similar position taken in a future year will, more likely than not, be sustained. An explicit agreement may take the form of a formal closing agreement with the taxing authority that covers tax positions previously taken.

### **Highly Certain Tax Positions**

A “highly certain” tax position is a tax position that an enterprise believes will be sustained because it is based on clear and unambiguous tax law. One might expect that many, if not most, of the “ordinary and necessary” business expenses that an enterprise incurs would qualify as highly certain tax positions. Whether a tax position is highly certain will often depend on the nature of the tax position and the level of aggregation at which the tax position is evaluated (i.e., unit of account). An evaluation of a tax position performed at an aggregated level may result in greater uncertainty than an evaluation performed at a disaggregated level. For example, an enterprise that evaluates salary expense at an aggregated level may not be able to conclude that the tax position is highly certain because certain salary expenses may not be deductible.



Material tax positions should be evaluated to determine whether they are highly certain. If so, the recognition threshold is met and an enterprise should determine whether circumstances exist that could result in the enterprise's ultimately accepting less than the full amount of the benefit in a negotiated settlement with the taxing authority. For example, repair and maintenance expense should be reviewed for capitalizable amounts; interest expense on bank borrowings may be challenged if tax-exempt securities are owned; and otherwise deductible costs may require capitalization if incurred in the construction of capital assets. Notwithstanding the need to perform an evaluation in accordance with the Interpretation, a tax position that is routine in nature and for which the tax law is clear and unambiguous and, in turn, the deduction is highly certain, will require significantly less documentation than an uncertain tax position.

Paragraphs A19 and A20 of the Interpretation describe a highly certain tax position that is based on clear and unambiguous tax law; it concerns the deduction claimed for salaries and benefits paid to employees. In this example, the salaries claimed are not subject to any limitation (e.g., no salaries in excess of \$1 million per executive) and are not required to be capitalized (e.g., under the uniform capitalization regulations), and amounts accrued at period end were or will be paid within the required time frame subsequent to year-end. Since management is confident that if challenged the deduction will be sustained in its entirety, the full amount of the benefit is recorded. Note that in this example, the FASB was cautious in indicating that the salary expense in question did not include any uncertain characteristics. Management should be similarly cautious when designating a tax position as highly certain.

### **Deferred Tax Consequences of Unrecognized Tax Benefits**

The recognition of a liability for an unrecognized tax benefit may indirectly affect deferred taxes. For example, a deferred tax asset for a federal benefit could be created if the unrecognized tax benefit relates to a state tax position. If an evaluation of the tax position results in the enterprise's increasing its state tax liability, an enterprise should record a deferred tax asset for the corresponding federal benefit.

To illustrate, assume that (1) an enterprise records a liability for an unrecognized tax benefit relating to a position taken in a state tax return of \$1,000 and (2) the enterprise's federal tax rate is 35 percent. The additional state income tax liability resulting from the unrecognized state tax deduction results in a state income tax deduction on the federal tax return, resulting in the recognition of a deferred tax asset. As such, the enterprise should record a deferred tax asset for the federal benefit of \$350 ( $\$1,000 \times 35\%$ ).



# Measurement

Interpretation 48 requires that an enterprise measure the amount of the recognizable tax benefit for each tax position meeting the recognition threshold as the largest amount that is greater than 50 percent likely to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. The measurement process requires the determination, for each material tax position that meets the more-likely-than-not recognition threshold, of the range of possible settlement amounts and the probability of achieving each of the possible settlements.

As paragraph 8 of the Interpretation states, “Measurement of a tax position that meets the more-likely-than-not recognition threshold shall consider the amounts and probabilities of the outcomes that could be realized upon ultimate settlement” with the taxing authority. Measuring the recognizable tax benefit for each of the many tax positions taken by an enterprise raises a host of implementation issues, many of which are discussed in the remainder of this section.

## **Assumptions and Information Used in Recognition and Measurement**

Applying the two-step process in Interpretation 48 to determine the amount of tax benefit to be recognized requires different assumptions and information to be used in the recognition and measurement phase. Certain assumptions and information used in determining whether a tax benefit should be recognized (step 1) differ from those used in measuring the amount of the tax benefit to recognize (step 2).

The following table summarizes the similarities and differences when applying steps 1 and 2:

Step 1 — Recognition	Step 2 — Measurement
The position will be examined	Same
The examiner will have full knowledge of all relevant information	Same
No consideration should be given to offsetting or aggregating tax positions	Same

*continued*

The evaluation should be based solely on the technical merits of the tax position	The evaluation should be based on all relevant facts, circumstances, and information available at the reporting date
Conclusion should be based on resolution in the court of last resort	The conclusion should be based on the amount the taxpayer would ultimately accept in a negotiated settlement with the taxing authority

To illustrate the differences, consider an example in which an enterprise took a tax position on a prior-year tax return that resulted in a \$100 tax benefit. The taxing authority challenged that tax position, and the enterprise negotiated a settlement and ultimately received a \$60 tax benefit. The technical merits of the tax position were not affected by the settlement. In the current year, the enterprise takes the same tax position on its tax return and it results in a \$100 tax benefit. In determining whether the tax position meets the recognition threshold, the enterprise may not use the fact that it settled a similar tax position with the taxing authority in the prior year since that settlement did not affect the technical merits of the tax position. However, if the enterprise determines that the recognition threshold is met, it should consider the outcome of the previous settlement in determining the appropriate tax benefit to recognize in its financial statements. The enterprise would likely assign a high probability to a potential outcome of \$60 in measuring the tax benefit.

**Aggregation and Offsetting in Measuring Tax Positions**

When measuring the benefit associated with a tax position, an enterprise may not employ aggregation or offsetting of multiple tax positions. Each tax position (unit of account) must be considered and measured independently, regardless of whether the related benefit is expected to be negotiated with the taxing authority as part of a broader settlement involving multiple tax positions.

**Measuring a Tax Position — Assigning Probabilities in a Cumulative-Probability Assessment**

In applying the measurement criterion of Interpretation 48, the enterprise must perform a cumulative-probability assessment of the possible outcomes. Assigning probabilities in measuring a recognized tax position is a highly judgmental process. Because the Interpretation does not prescribe how to assign or analyze the probabilities of individual outcomes, the enterprise must have a reasonable, supportable basis for developing the range of possible settlements and the probability of achieving each possible settlement by taking into account all relevant facts and circumstances surrounding the tax position.

Factors to consider in assigning probabilities include, but are not limited to, the amount reflected (or expected to be reflected) in the tax return, the enterprise’s past experience

with similar tax positions, information obtained during the examination process, closing and other agreements, and the advice of experts. Management may wish to consult with its third-party advisers in developing the range and amounts of possible outcomes, especially in the following situations:

- The tax position results in a large tax benefit.
- The tax position relies on an interpretation of law in which the enterprise lacks expertise.
- The tax position arises in connection with an unusual nonrecurring transaction or event.
- The range of potential sustainable benefits is widely dispersed.
- The tax position is not addressed specifically in the tax law and requires significant judgment and interpretation.

Although paragraph A1 of the Interpretation indicates that the FASB did not “intend to imply a documentation requirement” by including cumulative-probability tables in its illustrative guidance, a cumulative-probability table is one documentation tool that can help management assess the levels of uncertainty related to the outcomes of various tax positions and demonstrate that the amount of tax benefit recognized complies with paragraph 8 of the Interpretation.

### **Weighting of Information**

The amount of tax benefit to recognize in financial statements should be based on reasonable and supportable assumptions. Some information used to determine the amount of tax benefit to be recognized in financial statements (amounts and probabilities of the outcomes that could be realized upon ultimate settlement) will be more subjective than other information. The weight given to the information should be commensurate with the extent to which the information can be objectively verified. Examples of objectively determined information include the amount of deduction reported in an enterprise’s as-filed tax return or the amount of deduction for a similar tax position examined in the past by the taxing authority or sustained in settlement in the past with the taxing authority.

### **Cumulative-Probability Approach Versus Best Estimate**

Using the cumulative-probability measurement approach required by the Interpretation, the enterprise should record the largest amount of tax benefit that is greater than 50 percent likely to be realized upon ultimate settlement with a taxing authority. That amount may not equal the “best estimate” (i.e., the single expected outcome that is more probable than all other possible outcomes). The following table illustrates this difference:

Possible Estimated Outcome (\$)	Individual Probability of Occurring (%)	Cumulative Probability of Occurring (%)
40	31	31
30	20	51
20	20	71
10	20	91
0	9	100

Under the cumulative-probability approach, the largest amount of tax benefit that is more than 50 percent likely to be realized is \$30, while the enterprise's best estimate is \$40 (the most probable outcome at 31 percent probability). The enterprise must use the cumulative-probability approach in measuring the amount of tax benefit to record under the Interpretation. In instances in which the probability of one outcome is greater than 50 percent likely to occur, the "best estimate" and the cumulative-probability amount will be the same.

### Uncertainty in Deduction Timing

If the benefits of an entire tax position are certain and the only uncertainty is the timing of the deduction, the Interpretation's recognition threshold is satisfied and the uncertainty in the appropriate timing of the deduction should be considered in determining the measurement of the associated tax benefit in each period. Consider the following example:

- An enterprise purchases equipment for \$1,000 in 2007.
- Company earnings before interest, depreciation, and taxes are \$1,200 in years 2007 to 2011.
- For book purposes, the equipment is depreciated over five years.
- For tax purposes, the enterprise deducts the entire \$1,000 in its 2007 tax return.
- The enterprise has a 40 percent tax rate and is taxable in only one jurisdiction.
- There is no half-year depreciation rule for accounting or tax purposes.
- The interest and penalties on tax deficiencies are ignored.

In applying the recognition provision of Interpretation 48, the enterprise has concluded that it is certain that the \$1,000 equipment acquisition cost is ultimately deductible under the tax law. Because it is certain that the asset acquired is ultimately deductible, the tax deduction of the tax basis of the acquired asset would satisfy the Interpretation 48 recognition threshold. In applying the measurement step, the enterprise concludes that the largest amount that is more than 50 percent likely to be realized in a negotiated settlement with the taxing authority is \$200 per year for five years. Exclusive of interest and penalties, the enterprise's current-year tax provision is unaffected because the benefit taken in the tax return, in contrast to the benefit recognized in the financial statements, is a temporary difference.

However, the Interpretation requires interest and penalties to be recognized based on the provisions of the relevant tax law. Although interest and penalties are ignored in this example for simplicity, they cannot be ignored when applying Interpretation 48. In this example, the enterprise would begin accruing interest in 2008. Therefore, notwithstanding that this is a timing difference, the accrual of interest (and penalties, if applicable) will have an impact on the income tax provision.

The 2007 tax return reflects a \$400 reduction in the current tax liability for the \$1,000 deduction claimed. For book purposes, the enterprise will recognize a balance sheet credit of \$320  $[(\$1,000 - \$200) \times 40\%]$  for unrecognized tax benefits associated with the deduction claimed in year one. The Interpretation 48 credit will be extinguished over the next four years at \$80  $(\$200 \times 40\%)$  per year.

The journal entries, excluding interest and penalties, recording the tax effects of the purchased equipment are illustrated below:

	2007	2008	2009	2010	2011	Totals
<b>EBITDA</b>	\$1,200	\$1,200	\$1,200	\$1,200	\$1,200	\$6,000
Depreciation	(200)	(200)	(200)	(200)	(200)	(1,000)
Interest	—	—	—	—	—	—
<b>Net income before tax</b>	<u>\$1,000</u>	<u>\$1,000</u>	<u>\$1,000</u>	<u>\$1,000</u>	<u>\$1,000</u>	<u>\$5,000</u>
Adjust for tax depreciation as filed	<u>(800)</u>	<u>200</u>	<u>200</u>	<u>200</u>	<u>200</u>	<u>—</u>
<b>Taxable income</b>	<u>\$ 200</u>	<u>\$1,200</u>	<u>\$1,200</u>	<u>\$1,200</u>	<u>\$1,200</u>	<u>\$5,000</u>
Current tax provision	80	480	480	480	480	2,000
Interpretation 48 tax provision	320	(80)	(80)	(80)	(80)	—
Deferred tax provision	—	—	—	—	—	—
Interest and penalties	—	—	—	—	—	—
Total tax provision	<u>400</u>	<u>400</u>	<u>400</u>	<u>400</u>	<u>400</u>	<u>2,000</u>
<b>Net income</b>	<u>\$ 600</u>	<u>\$ 600</u>	<u>\$ 600</u>	<u>\$ 600</u>	<u>\$ 600</u>	<u>\$3,000</u>
<b>Effective tax rate</b>	40.0%	40.0%	40.0%	40.0%	40.0%	40.0%
Taxable income — as filed	\$ 200	\$1,200	\$1,200	\$1,200	\$1,200	\$5,000
Taxable income — Interpretation 48 tax return	1,000	1,000	1,000	1,000	1,000	5,000
Current tax liability — as filed	80	480	480	480	480	—
Current tax liability — Interpretation 48	400	400	400	400	400	—
Underpayment (repayment) of tax	320	(80)	(80)	(80)	(80)	—

Journal Entries	2007	2008	2009	2010	2011
Current tax provision	\$ 80	\$ 480	\$ 480	\$ 480	\$ 480
Cash or current tax liability	(80)	(480)	(480)	(480)	(480)
Interpretation 48 tax provision	320	—	—	—	—
Current Interpretation 48 tax liability	(80)	—	—	—	—
Long-term Interpretation 48 tax liability	(240)	—	—	—	—
Current Interpretation 48 tax liability	—	80	80	80	80
Cash or increase in current tax liability	—	(80)	(80)	(80)	(80)
Cash or reduction in current tax liability	—	80	80	80	80
Interpretation 48 tax provision	—	(80)	(80)	(80)	(80)
Long-term Interpretation 48 tax liability	—	80	80	80	—
Current Interpretation 48 tax liability	—	(80)	(80)	(80)	—

Supplemental Cash Flows Statement Disclosure	2007	2008	2009	2010	2011
Income taxes paid	\$ 80	\$ 480	\$ 480	\$ 480	\$ 480
<b>Unrecognized Tax Benefits (UTBs)</b>					
Beginning of year	\$ —	\$(320)	\$(240)	\$(160)	\$ (80)
Gross increases — prior-year positions	—	—	—	—	—
Gross decreases — prior-year positions	—	—	—	—	—
Increases in UTBs — current-year positions	(320)	—	—	—	—
Settlements with taxing authorities	—	80	80	80	80
Reductions due to statute lapse	—	—	—	—	—
<b>End of year</b>	<u>\$(320)</u>	<u>\$(240)</u>	<u>\$(160)</u>	<u>\$(80)</u>	<u>\$ —</u>

At the end of each year, the enterprise, if an SEC registrant, would include its total Interpretation 48 liabilities in the tabular disclosure of contractual obligations required by SEC Regulation S-K, Item 303(a)(5), "Management's Discussion and Analysis of Financial Condition and Results of Operations," under the table heading "Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet Under GAAP." In that table, allocation of the total Interpretation 48 liabilities to "Payments Due by Period" would be based on the scheduled repayments as illustrated above (\$80 per year for the next four years).



### **Consideration of a Tax-Planning Strategy**

Paragraph 21 of Statement 109 states, in part, that the “[f]uture realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback, carryforward period available under the tax law.” Tax-planning strategies (as defined in Statement 109) are one of four possible sources of taxable income that may be available under the tax law to realize such a tax benefit.

The Interpretation acknowledges that, as long as its recognition and measurement requirements are met, tax-planning strategies may be considered a source of future taxable income to support the realizability of a deferred tax asset under Statement 109. Accordingly, to be contemplated as a possible source of future taxable income, a tax-planning strategy (and its associated taxable income) must meet the more-likely-than-not recognition threshold and be measured as the largest amount of benefit that is more likely than not to be realized in a negotiated settlement with the taxing authority.



# Changes in Subsequent Periods

Subsequent changes in judgment that lead to changes in recognition, derecognition, and measurement should result from the evaluation of new information and not from a new evaluation or a new interpretation of information that was available in a previous financial reporting period.

## Subsequent Recognition

If the more-likely-than-not recognition threshold is not met in the period in which a tax position is taken or expected to be taken, the enterprise should recognize the benefit for that tax position in the first interim period in which any of the following conditions are met:

- The more-likely-than-not recognition threshold is met by the reporting date.
- The tax position is ultimately settled through negotiation or litigation.
- The applicable statute of limitations for the taxing authority to examine and challenge the tax position has expired.

An enterprise that has taken a tax position that previously did not meet the more-likely-than-not recognition threshold can subsequently recognize the benefit associated with that tax position only if new information changes the technical merits of the position (in the absence of the settlement of the tax position or the expiration of the statute of limitations). New information may include, but is not limited to, developments in case law, changes in tax law and regulations, and rulings by the taxing authority.

## Subsequent Measurement

An enterprise that has taken a tax position that previously met the more-likely-than-not recognition threshold may subsequently remeasure the benefit associated with the tax position without the new information changing the technical merits of the position.

### Example 1

Assume that an enterprise takes the same tax position on its tax return every year and has previously concluded that the tax position meets the more-likely-than-not recognition threshold. In addition, the enterprise concludes that the largest amount of tax benefit that is greater than 50 percent likely to be realized upon ultimate settlement is something

less than the full benefit. Assume that the taxing authority recently completed a prior-year audit of the enterprise in which the taxing authority examined and explicitly agreed with the as-filed tax position. The enterprise may use that information in remeasuring the tax benefit associated with the current-year tax position.

### **Subsequent Derecognition**

A previously recognized tax position that is determined to no longer meet the more-likely-than-not recognition threshold should be derecognized in the first interim period in which the new conclusion is reached. Establishing a valuation allowance in lieu of derecognizing the previously recorded tax benefit is not permitted.

### **Change in Judgment Resulting From New Information Obtained in the Audit or Appeals Process**

In determining whether “new information” obtained through interactions with the taxing authority during the audit or appeals process is sufficient to support a change in recognition, the enterprise should consider whether (1) the tax position has been ultimately settled with the taxing authority or (2) the taxing authority provided a greater understanding of the appropriate interpretation of the relevant tax law that would change the enterprise’s conclusion about the more-likely-than-not standard for recognition. The mere closing of an audit or an appeals process by the taxing authority would not, in and of itself, affect an enterprise’s evaluation of the technical merits of a tax position.

At the January 17, 2007, FASB meeting, the Board discussed issuing guidance relating to the meaning of the term “ultimately settled,” as used in paragraph 10(b) of Interpretation 48. Specifically, the FASB will consider whether a tax position is ultimately settled if the taxing authority can reopen an examination after an audit has been completed. This guidance is expected to be issued in the form of a FASB Staff Position (FSP). As of the date this publication was issued, the FASB had not yet issued its guidance. Deloitte & Touche LLP will provide guidance upon issuance of the FSP.

### **Reporting Changes in Recognition in Interim Financial Statements**

A change in judgment over a tax position taken or expected to be taken in the current year is accounted for differently than a change in judgment applied to a tax position taken in a prior fiscal year. Consistent with the requirements of FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*, and APB Opinion No. 28, *Interim Financial Reporting*, Interpretation 48 requires that the effect of a change in judgment concerning a tax position taken in a prior interim period in the same fiscal year be recognized partially in the quarter the judgment changes, with the remainder recognized over the remaining interim periods by incorporation into the annual estimated effective tax rate (ETR); however, the effect of a

change in judgment concerning a tax position taken in a prior fiscal year is recorded entirely in the interim period the judgment changes (similar to taxes on an unusual, infrequently occurring, or extraordinary item).

The following examples compare changes in judgment regarding current-year (Example 1) and prior-year (Example 2) tax positions, pursuant to the requirements of the Interpretation:

#### Example 1

#### Changes in Judgment Over a Current-Year Tax Position

In the first quarter of 2007, an enterprise:

- Estimates its ordinary income — i.e., its income (or loss) from continuing operations before income taxes (or benefits), excluding significant unusual or infrequently occurring items. For fiscal year 2007, this will be \$4,000 (\$1,000 per quarter). Assume a tax rate of 40 percent.
- Enters into a transaction that is expected to permanently reduce its 2007 taxable income by \$1,000; thus, its total tax expense for the year is expected to be \$1,200. Assume that the transaction meets the recognition threshold and that the full \$400 will be recognized under Interpretation 48. The following table summarizes the ETR calculation:

Estimated pre-tax book income for 2007	\$4,000
Less: tax deduction	<u>1,000</u>
Taxable income	<u>\$3,000</u>
Estimated income tax expense for 2007 (includes the \$400 tax benefit)	\$1,200
Estimated annual ETR	30%

Accordingly, for each quarter in 2007, ordinary income and income tax expense are expected to be \$1,000 and \$300, respectively.

During the second quarter of 2007, the enterprise receives new information indicating that the tax position relating to the \$1,000 deduction no longer meets the more-likely-than-not recognition threshold. Accordingly, in preparing its second-quarter financial statements, the enterprise updates its estimate of the annual ETR as follows:

Estimated pre-tax book and taxable income for 2007 (\$1,000 per quarter)	\$4,000
Estimated income tax expense for 2007 (excludes the \$400 tax benefit)	\$1,600
Estimated annual ETR	40%

On the basis of new information received in the second quarter, ordinary income and income tax expense for each quarter during 2007 should be reported as follows:

	Ordinary Income for the Quarter	Year to Date	Estimated Annual ETR	Tax Year to Date	Less Previously Provided	For the Quarter
Quarter 1	\$1,000	\$1,000	30%	\$ 300	–	\$ 300
Quarter 2	1,000	2,000	40	800	\$ 300	500
Quarter 3	1,000	3,000	40	1,200	800	400
Quarter 4	<u>1,000</u>	4,000	40	1,600	1,200	<u>400</u>
	<u>\$4,000</u>					<u>\$1,600</u>

The effect of the change in judgment over a tax position taken in the current fiscal year is recognized by changing the estimated annual ETR to 40 percent, which does not reflect a benefit for the tax position. Of the \$400 total change representing the loss of the tax benefit previously thought to be more-likely-than-not, \$200 is recognized in the second quarter and the remaining \$200 is recognized evenly in the third and fourth quarters.

**Example 2**  
**Changes in Judgment Over a Prior-Year Tax Position**

In the first quarter of 2007, an enterprise estimates that its annual ETR for the year will be 30 percent. In the second quarter of 2007, the enterprise receives new information indicating that a tax position taken or expected to be taken in its 2006 income tax return no longer meets the more-likely-than-not recognition threshold. The benefit recognized for that tax position in the 2006 financial statements was \$400. No similar tax positions have been taken or are expected to be taken in 2007.

	Ordinary Income	Tax Applicable to Ordinary Income	Applicable to Change in Judgement Over Prior-Year Tax Position	Total
Quarter 1	\$1,000	\$ 300	–	\$ 300
Quarter 2	1,000	300	\$400	700
Quarter 3	1,000	300	–	300
Quarter 4	<u>1,000</u>	<u>300</u>	<u>–</u>	<u>300</u>
	<u>\$4,000</u>	<u>\$1,200</u>	<u>\$400</u>	<u>\$1,600</u>

Assuming that ordinary income for each of the quarters is \$1,000 per quarter, income tax expense in each of the quarters in 2007 is determined as in the above table. The effect of the change in judgment over the tax position taken or expected to be taken in 2006 is recorded entirely as a discrete item in the second quarter of 2007, the period in which the enterprise's judgment changed, and does not affect the ETR to be applied to 2007 income.

### New Information Obtained After the Balance Sheet Date

Under Interpretation 48, new information received after the balance sheet date but not available at the balance sheet date should not be considered when evaluating a tax position at the balance sheet date. Consider the following examples:

#### Example 1

At the balance sheet date, an enterprise believes that it is more likely than not that a tax position will be sustained. Before the issuance of the financial statements, management becomes aware of a recent court ruling occurring after the balance sheet date that disallowed a similar tax position taken by another taxpayer. Because the court ruling occurred after the balance sheet date, the enterprise should reflect any change in its assessment of recognition and measurement that resulted from the new information in the first interim period after the balance sheet date.

#### Example 2

Assume that an enterprise finalizes a tax litigation settlement with the taxing authority after the balance sheet date but before the issuance of its financial statements and that the events that gave rise to the litigation had taken place before the balance sheet date. According to the Interpretation, the enterprise should not adjust its financial statements to reflect the settlement; however, the enterprise should disclose the subsequent settlement and the effect on the financial statements in the notes to the financial statements.

The current accounting requirements for subsequent events are contained in AICPA *Professional Standards*, AU Section 560, "Subsequent Events." The guidance in Interpretation 48 applies only to the application of Interpretation 48 and is not analogous to other situations covered by AU Section 560. AU Section 560 prescribes the accounting requirements for two types of subsequent events: the first type (Type I) consists of those events that provide additional evidence about conditions that existed at the balance sheet date and that require adjustment of previously unissued financial statements, and the second type (Type II) consists of those events that provide evidence of conditions that did not exist at the balance sheet date but arose after that date and that require disclosure only.





# Interest and Penalties

Many taxing jurisdictions require the payment of interest on an underpayment of income taxes and may impose penalties when a taxpayer does not have an appropriate basis or threshold of authority for a particular transaction or with respect to a substantial underpayment of income taxes. Before the issuance of Interpretation 48, practices concerning the accrual of interest and penalties varied widely. Many enterprises did not accrue interest and penalties because they believed that the requirements of Statement 5 to support such an accrual (i.e., it was probable that the liability had been incurred and the amount was reasonably estimable) were not met. In addition, no consistent method was used to calculate the amount of interest to record on tax contingencies because the settlement processes did not distinguish between additional taxes, interest, or penalties.

## Interest

For jurisdictions in which the tax law requires the payment of interest on an underpayment of income taxes, Interpretation 48 requires an enterprise to recognize interest expense on the amount of underpaid taxes associated with its tax positions, beginning in the first period in which interest starts accruing under the tax law and continuing until the tax positions are settled. The amount of interest expense to be recognized is computed by applying the statutory interest rate to the difference between the amount of the tax benefit taken or expected to be taken in the tax return and the amount of benefit recognized pursuant to the requirements of the Interpretation.

The interest expense recognized on the estimated liability for uncertain tax positions is not eligible for capitalization under FASB Statement No. 34, *Capitalization of Interest Cost*. In the basis for conclusions to Statement 34, the Board concluded that the amount of interest cost to be capitalized is the amount that theoretically could have been avoided if expenditures for the asset had not been made. The Board envisioned an enterprise with two alternatives: (1) repaying the borrowing or (2) investing in an asset. The enterprise could avoid interest cost by choosing to repay a borrowing instead of investing in an asset. The Board indicated that once the decision to invest in the asset is made, the relationship between the investment in the asset and the incurrence of interest cost makes the interest cost analogous to a direct cost in the asset. The Board's intent was to link the alternatives.

The liability recognized under Interpretation 48 does not result from the investment alternatives above but from a difference in the amount of benefit recognized in the financial statements compared with the amount taken, or expected to be taken, in a tax return. The liability is not a borrowing as contemplated in Statement 34 and should not be considered a financing activity. Therefore, the relating interest expense should not be capitalized; rather, it should be expensed as incurred.

### **Recognizing Interest Expense for Interim-Period Reporting When Interest Is Classified as Income Tax Expense**

Enterprises that report interim-period financial information are required to apply the provisions of Opinion 28, which require that income taxes for interim reporting periods be recognized using an estimated annual ETR. Paragraph 19 of Interpretation 48 indicates that interest recognized for the underpayment of income taxes can be classified in the statement of operations as either income tax or interest expense, “based on the accounting policy election of the enterprise.” However, an enterprise whose accounting policy includes interest expense for the underpayment of income taxes as a component of income taxes should not recognize interest expense through the estimated annual ETR for interim reporting purposes. Rather, interest expense should be accrued over time as incurred. This conclusion is based on the fact that the interest expense relates to prior years’ unrecognized tax benefits and is not based on taxes for current-year income and expense amounts.

In addition, including interest expense with income tax expense may create unexpected results in an enterprise’s tax rate. For example, in a period in which an enterprise sustains a loss, tax expense may be zero; however, an enterprise that records interest expense as a component of income taxes would show tax expense. Likewise, in the period an enterprise sustains a loss, it may record a tax benefit for the reversal of interest expense associated with an unrecognized tax benefit that is subsequently recognized as a result of the expiration of the statute of limitations associated with the tax position. Disclosing the components of the tax provision would help the user of the financial statements understand the effect of interest expense in the tax provision.

### **Interest Income**

Although Interpretation 48 does not specifically discuss the recognition and measurement of interest income on uncertain tax positions, an enterprise should recognize and measure interest income to be received on an overpayment of income taxes in the first period the interest would begin accruing according to the provisions of the relevant tax law.

It is preferable for a public enterprise to present interest income attributable to an overpayment of income taxes as an element of non-operating income, separately stated in the income statement or in a note to the financial statements as *interest on refund claims due from taxing authorities*. This presentation is consistent with SEC Regulation S-X, Rule 5-03(b)(7), "Income Statements."

On the basis of informal discussions with the SEC staff, at present, the SEC staff does not have a view on this matter and may not object to an enterprise's including interest income attributable to overpayment of income taxes as an element of its provision for income taxes. Accordingly, if an enterprise's accounting policy is to include interest income attributable to overpayment of income taxes within the provision for income taxes, the SEC staff has advised us that this policy must be prominently disclosed and transparent to users of the financial statements.

## Disclosure

The SEC staff indicated they believe a public enterprise that has an accounting policy to include interest income or expense on overpayments and underpayments of income taxes should consistently display such amounts as income tax in the balance sheets, statements of operations, statements of cash flows, and other supplemental disclosures. Specifically, public enterprises should disclose the components of income tax provision either on the face of the statements of operations or in a note to the financial statements, as follows:

Current tax expense (benefit)	\$XXX
Tax expense (benefit) recognized for Interpretation 48 uncertainties in the income statement	XXX
Interest expense, gross of related tax effects	XXX
Interest income, gross of related tax effects	XXX
Penalties, gross of related tax effects	XXX
Deferred tax expense (benefit)	XXX
Tax benefits recognized as a reduction of intangible assets	XXX
Tax benefits charged or credited to additional paid-in capital	<u>XXX</u>
<b>Total tax provision</b>	<u><u>\$XXX</u></u>

This disclosure is also recommended for nonpublic enterprises to help financial statement users understand the effect of interest expense and income. The tax effects of accrued interest expense, interest income, and penalties should be included as part of deferred tax expense (benefit).

All enterprises must disclose their accounting policy for classification of interest income, as well as interest expense, in accordance with paragraph 19 of Interpretation 48. The accounting policy election for interest income need not be consistent with the enterprise's policy election for interest expense. Public companies should be aware that the SEC staff may formulate a different view than the one presented herein.

## **Penalties**

In many jurisdictions, penalties may be imposed when a specified threshold of support for a tax position taken is not met. In the United States, some penalties are transaction-specific (i.e., not based on taxable income) and others, such as penalties for substantial underpayment of taxes, are based on the amount of additional taxes due on ultimate settlement with the taxing authority.

If a tax position taken does not meet the minimum statutory threshold to avoid the payment of a penalty (e.g., the position lacks substantial authority or was not properly disclosed in the tax return), an accrual for the amount of the penalty that may be imposed under the tax law should be recorded. Paragraph 16 of Interpretation 48 indicates that an enterprise must recognize an expense for the amount of a statutory penalty in the period in which the tax position has been taken or is expected to be taken in the tax return.

# Financial Statement Presentation

The application of Interpretation 48 may result in amounts of tax benefits recognized in the financial statements that differ from the amounts taken or expected to be taken in a tax return for the current year. A liability is recognized (or the amount of a net operating loss carryforward or amount refundable is reduced) for the amount of the unrecognized tax benefit because it represents an enterprise's potential future obligation to the taxing authority for the benefit taken in the tax return that was not recognized pursuant to the requirements of Interpretation 48.

An enterprise that presents a classified balance sheet should classify a liability associated with an unrecognized tax benefit as a current liability (or the enterprise should reduce the amount of a net operating loss carryforward or amount refundable) to the extent that the enterprise anticipates payment (or receipt) of cash within one year or the operating cycle, if longer. That being said, a liability associated with an unrecognized tax benefit will generally be classified as a noncurrent liability because there will usually be a period of several years between the filing of the tax return and the final resolution of an uncertain tax position with the taxing authority. Only those cash payments that management anticipates making within the next 12 months (or the operating cycle, if longer) to settle liabilities for unrecognized tax benefits should be classified as a current liability.

A reclassification from noncurrent to current should only occur when a change in the balance of a liability is expected to result from a payment of cash. For example, the portion of the Interpretation 48 liability that is expected to reverse because of the expiration of the statute of limitations in the next 12 months would not be reclassified as a current liability. In situations in which a reclassification occurs, the enterprise should consider supplementing the required disclosures to describe the circumstances and amount of the reclassification. In addition, the liability associated with the difference between the as-filed tax position and the amount of the tax benefit recognized in the financial statements as a result of applying Interpretation 48 should not be considered a deferred tax liability unless that liability arises from a taxable temporary difference.

## **Gross Versus Net Presentation**

An enterprise may take a tax position in its tax return that, upon its disallowance, would allow the enterprise to realize a deferred tax asset. For example, an enterprise may be able to utilize a net operating loss carryforward to reduce a prior-year's taxable income if a tax deduction taken in the prior year is disallowed. If the enterprise recognizes an Interpretation 48 liability as a result of taking that tax position, the enterprise should present that liability in the financial statements on a gross basis and not as a reduction of the deferred tax asset.

### **Example**

Assume that an enterprise has a \$1,000 deferred tax asset related to a prior-year net operating loss. In the current year, the enterprise takes a tax position that results in the recording of a \$400 liability for an unrecognized tax benefit in accordance with Interpretation 48. Further assume that the tax position, if disallowed, is of the appropriate character to allow use of a portion of the prior-period net operating loss. The enterprise would present the \$400 liability and the \$1,000 deferred tax asset on a gross basis in its financial statements.

## **Interest and Penalties**

The Interpretation permits interest to be classified in the financial statements as either income taxes or interest expense and permits penalties to be classified in the financial statements as either income taxes or another expense classification, based on the accounting policy election of the enterprise. An enterprise may adopt an accounting policy for the classification of interest that differs from its policy for the classification of penalties. For example, interest on uncertain tax positions may be recorded below the line in income tax expense while penalties may be recorded above the line in other expenses. However, the balance sheet classification of the related accruals should be consistent with the income statement classification. An enterprise that classifies interest as a component of interest expense should classify the related accrual for interest as a component of accrued expense. Likewise, an enterprise that classifies interest as a component of income tax expense should classify the related accrual for interest as a component of the Interpretation 48 liability.

## **Changes in the Classification of Interest and Penalties**

Upon adoption of Interpretation 48, an enterprise is permitted to change its accounting policy regarding the income statement classification of interest, penalties, or both without establishing preferability. After the adoption of Interpretation 48, an enterprise would be required to establish preferability for changes. The SEC staff

has stated that its registrants are not required to submit a preferability letter for changes in the income statement classification of interest or penalties upon the adoption of Interpretation 48 because the accounting model for income tax contingencies and interest was fundamentally changed by Interpretation 48. The staff also noted that a preferability letter is required for classification changes made after the adoption of Interpretation 48.





# Disclosures

The Interpretation's most controversial requirement may be that relating to an enterprise's disclosure of the amounts that make up an enterprise's unrecognized tax benefits. Before the issuance of the Interpretation, Statement 5 and AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, were believed to address the requirements for disclosure of income tax uncertainties adequately. However, disclosure of income tax uncertainties rarely occurred.

In considering whether this Interpretation should require additional disclosures, the Board contemplated what information is decision-useful to users of financial statements. The Board selected a tabular reconciliation of the amounts of unrecognized tax benefits at the beginning and end of the period, believing that it would provide users with valuable information about a significant and sensitive estimate and changes in that estimate that are subject to significant measurement judgment. During deliberations, some constituents asserted that requiring a tabular reconciliation is not appropriate because it would inappropriately provide a "roadmap" for taxing authorities. The Board concluded that requiring disclosures at the aggregate level does not reveal information about individual tax positions, yet it provides information that users indicated would be decision-useful.

The Board decided that an enterprise must disclose the following in its financial statements (paragraphs 20 and 21 of Interpretation 48): (1) the policy for classification of interest and penalties and (2) a tabular reconciliation of the beginning and ending balances of the recorded liability for unrecognized tax benefits.

In addition, the following should be disclosed for each annual period presented:

- The total amount of unrecognized tax benefits that, if recognized, would affect the ETR.
- The total amounts of interest and penalties recognized in the statement of operations and in the statement of financial position.
- For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:

1. The nature of the uncertainty.
  2. The nature of the event that could occur in the next 12 months that would cause the change.
  3. An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made.
- A description of the tax years that remain subject to examination by major tax jurisdictions.

**Tabular Reconciliation of Unrecognized Tax Benefits**

The tabular reconciliation of the total amount recorded for unrecognized tax benefits at the beginning and end of each annual period must, at a minimum, include:

1. The gross amounts of increases in unrecognized tax benefits as a result of tax positions taken during a prior period (resulting from changes in recognition or measurement).
2. The gross amounts of increases in unrecognized tax benefits as a result of tax positions taken during the current period.
3. The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities.
4. Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations.

The following is an example of the tabular reconciliation required by paragraph 21(a) of the Interpretation:

<b>Unrecognized Tax Benefits — Opening Balance</b>	<b>\$250,000</b>
Gross increases — tax positions in prior period	5,000
Gross decreases — tax positions in prior period	(12,000)
Gross increases — current-period tax positions	2,000
Settlements	(6,000)
Lapse of statute of limitations	<u>(40,000)</u>
<b>Unrecognized Tax Benefits — Ending Balance</b>	<b><u>\$199,000</u></b>

The beginning and ending balances of the reconciliation may not equal the liability recorded on the balance sheet because the reconciliation includes all unrecognized tax benefits that are reflected in the balance sheet, not just the amount that is classified

as a liability. The reconciliation should include the amount recorded as a liability for unrecognized tax benefits, amounts recorded as a reduction in a deferred tax asset or an increase in a deferred tax liability, and amounts recorded as components of other equity or net asset amounts in the balance sheet.

With respect to a specific tax position, increases and decreases in the estimate that occur in the same (current) year can be reflected on a net basis in the tabular reconciliation. However, if these changes are significant, it may be appropriate to disclose them on a gross basis elsewhere in the footnotes to the financial statements. For example, if the enterprise did not recognize any benefit of a tax position taken in the second quarter (and therefore recognized a liability for the unrecognized tax benefit), but subsequently recognizes the full benefit in the fourth quarter (and therefore derecognizes the previously recorded liability), this should be disclosed in the notes to the financial statements.

The recording of an unrecognized tax benefit resulting from a state or local income tax position may result in the recognition of a deferred tax asset for the corresponding federal tax benefit. In this situation, for purposes of the tabular reconciliation, the unrecognized tax benefit relating to the state or local tax position should be presented on a gross basis.

**Example**

Assume that (1) an enterprise records a liability for an unrecognized tax benefit relating to a position taken in a state tax return of \$1,000 and (2) the enterprise's federal tax rate is 35 percent. The additional state income tax liability associated with the unrecognized state tax deduction results in a state income tax deduction on the federal tax return, creating a federal benefit in the amount of \$350 ( $\$1,000 \times 35\%$ ). The enterprise would only include the gross \$1,000 unrecognized state tax benefit in the tabular reconciliation. However, in accordance with paragraph 21(b), the enterprise would include \$650 in the amount of unrecognized tax benefits that, if recognized, would affect the ETR.

**Disclosure of the Settlement of a Tax Position**

The settlement amount of a tax position will usually differ from the recorded amount of the unrecognized tax benefit related to that position. This is primarily due to the method used to measure the unrecognized benefit under the Interpretation and the nature of the settlement negotiation process. In preparing the tabular reconciliation of the total amount of unrecognized tax benefits as of the beginning and end of the year, an enterprise should disclose the difference between the unrecognized tax benefit and

the settlement in the reconciliation as a gross amount of increase or decrease in unrecognized tax benefits related to tax positions taken in prior periods (paragraph 21(a)(1)). The settlement amount should be disclosed in the reconciliation as the amount of decrease in unrecognized tax benefits related to settlements with taxing authorities (paragraph 21(a)(3)).

**Example**

An enterprise has recorded a liability for an unrecognized tax benefit of \$1,000 as of December 31, 2007 (its fiscal year-end). During the fourth quarter of fiscal year 2008, the tax position is settled with the taxing authority for \$800 (recognizing a \$200 benefit). The enterprise's tabular reconciliation disclosure as of December 31, 2008, would show a decrease in unrecognized tax benefits from prior periods of \$200 and a decrease in unrecognized tax benefits related to settlements of \$800. A "current taxes payable" for the settlement amount of \$800 should be recorded until that amount is paid to the taxing authority.

**Disclosure of Unrecognized Tax Benefits That, If Recognized, Would Affect the Effective Tax Rate**

Paragraph 21(b) of the Interpretation requires that an enterprise disclose, for each annual reporting period presented, "the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate." However, it is not clear what is meant by the "effective tax rate."

The disclosure specified in paragraph 21(b) is required if recognition of the tax benefit would affect the ETR from "continuing operations" determined in accordance with the requirements of Statement 109. However, the enterprise should provide supplemental disclosure of amounts that significantly affect other items outside of income from continuing operations (e.g., goodwill or discontinued operations).

The following are examples of unrecognized tax benefits that, if recognized, would not affect the enterprise's ETR.

**Example 1**

An enterprise expenses \$10,000 of repair and maintenance costs for book and tax purposes in the current year. After analyzing the tax position, the enterprise believes, on the basis of the technical merits, that the IRS will more-likely-than-not require the enterprise to capitalize and depreciate the cost over five years. The enterprise has a 40 percent applicable tax rate. The application of Interpretation 48 would create a \$3,200 ( $\$8,000 \times 40\%$ ) deferred tax asset for repair cost not allowable in the current period (\$2,000 would be allowable in the current period for depreciation expense) and a liability

for the unrecognized tax benefit. Because of the impact of deferred tax accounting, the disallowance of the shorter deductibility period would not affect the ETR but would accelerate the payment of cash to the taxing authority to an earlier period. In accordance with the Interpretation, the enterprise recognizes a liability for an unrecognized tax benefit and a deferred tax asset, both affecting the balance sheet, with no net impact on overall tax expense. Thus, the amount of the unrecognized tax benefit for this item is not included in the amounts for the paragraph 21(b) disclosure. However, it may be necessary for the enterprise to provide supplemental disclosure if the amount is considered significant.

**Example 2**

An enterprise acquires a third party ("acquiree") in a business combination. The acquiree adopted Interpretation 48 before the date of the business combination and recognized a liability for an unrecognized tax benefit in the amount of \$10,000. That liability continues to be recorded on the acquiree's balance sheet after the business combination. Sometime after the business combination, new information becomes available that affects the measurement of the Interpretation 48 liability. In light of this new information, the enterprise asserts that the liability should be decreased to \$8,000. According to Interpretation 48, the acquiree would decrease goodwill and the Interpretation 48 liability by \$2,000, with no net impact on overall tax expense. Thus, the amount of the unrecognized tax benefit for this item is not included in the amounts for the paragraph 21(b) disclosure. However, it may be necessary for the enterprise to provide supplemental disclosure if the amount is considered significant.

**Disclosure of the Effects of the Expiration of the Statute of Limitations or Other Events**

The expiration of the statute of limitations or the occurrence of other events, such as the closure of a tax examination within the next 12 months, could have a significant effect on unrecognized tax benefits. Therefore, the FASB decided to require, in accordance with paragraph 21(d) of Interpretation 48, that an enterprise disclose certain information relating to amounts recognized "[f]or positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date." Events expected to occur within 12 months of the date of the financial statements, such as the expiration of the statute of limitations relating to an open tax year for which significant unrecognized tax benefits have been recorded, could result in the type of significant change contemplated in paragraph 21(d).

If the statute of limitations is scheduled to expire or any other event is expected to occur within 12 months of the date of the financial statements and management believes that it is reasonably possible that the expiration of the statute or that another event will cause

the total amount of the enterprise's unrecognized tax benefits to increase or decrease significantly, then the enterprise should disclose the following information according to paragraph 21(d):

- (1) The nature of the uncertainty.
- (2) The nature of the event that could occur in the next 12 months that would cause the change.
- (3) An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made.

### **Disclosures Required Before the Adoption of Interpretation 48**

Interpretation 48 does not have specific disclosure requirements applicable to financial statements issued after its release but before adoption. However, public companies must comply with the guidance in SEC Staff Accounting Bulletin (SAB) No. 74, codified as SAB Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period." SAB 74 requires disclosure of (1) a brief description of Interpretation 48, its effective date, and the date the registrant plans to adopt the Interpretation; and (2) the expected impact of adopting Interpretation 48 on the registrant's financial statements. The SEC staff expects robust disclosures in calendar-year-reporting registrants' 2006 Forms 10-K, since the filing deadline is after the date of initial application of the Interpretation.

The disclosure requirements of SAB 74 apply to interim and annual financial statements filed before the adoption of the Interpretation. The objectives of these disclosures are to (1) notify the reader about the issuance of a standard that registrants will be required to adopt in the future and (2) help the reader assess the standard's impact on the financial statements of the registrant when it is adopted.

The following SAB 74 disclosures should generally be considered:

- A brief description of the new standard, the date by which adoption is required, and the date on which the registrant plans to adopt, if earlier.
- The methods of adoption allowed by the standard and the method the registrant is expected to use, if determined.

- The impact that adoption of the standard is expected to have on the financial statements of the registrant, unless unknown or not reasonably estimable, in which case this should be stated.
- The potential impact of other significant matters that the registrant believes might result from the adoption of the standard (e.g., technical violations of debt covenant agreements, planned or intended changes in business practices).

### **Interim Disclosures Required in Form 10-Q**

Historically, the SEC staff has required that interim-period financial statements filed on Form 10-Q that include the adoption of a new accounting standard in that interim period present all disclosures required by the new standard. The staff has also previously required that those disclosures continue to be provided in the interim-period financial statements filed on Form 10-Q subsequent to the quarter of adoption until the first annual financial statements that contain the required disclosures are filed on Form 10-K after adoption. Paragraphs 20 and 21 of Interpretation 48 establish a number of disclosures that are required annually.

The AICPA SEC Regulations Committee met with the SEC staff in September 2006 to discuss the disclosures required (1) as of the date of adoption (e.g., January 1, 2007, for calendar year-end enterprises) and (2) for activity during the current and year-to-date interim periods subsequent to the date of adoption. The staff indicated that it will not require that the full disclosures under paragraphs 20 and 21 of Interpretation 48 be included in interim financial statements after the date of adoption. However, interim financial statements should present those disclosures as of the date of adoption in the first interim period that includes the date of adoption. The “date of adoption” disclosures should be included in each set of interim financial statements during the year of adoption until the annual disclosures are required to be included in Form 10-K. The staff also indicated that interim financial statements post-adoption should disclose any material changes. Enterprises should also consider the disclosure requirements under SOP 94-6 for all interim and annual financial statements.

The SEC staff stated that the following approach to disclosure in the period of adoption and subsequent interim periods, proposed by the AICPA SEC Regulations Committee, is reasonable:

Interpretation 48 Disclosures (Paragraph)	Disclosure as of Date of Adoption <sup>1</sup>	Disclosure as to Interim Periods Post-Adoption <sup>2</sup>
20. An enterprise shall disclose its policy on classification of interest and penalties in accordance with paragraph 19 of this Interpretation in the footnotes to the financial statements.	Yes <sup>3</sup>	Disclose any change in classification <sup>4</sup>
21. An enterprise shall disclose the following at the end of each annual reporting period presented:		
a. A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum:	Total amount of unrecognized tax benefits as of date of adoption	Tabular reconciliation not required for interim periods
(1) The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period	N/A	Disclose any material changes
(2) The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period	N/A	Disclose any material changes <sup>5</sup>
(3) The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities	N/A	Disclose any material changes <sup>5</sup>
(4) Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations	N/A	Disclose any material changes <sup>5</sup>
b. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate	Yes, amount as of date of adoption	Disclose any material changes
c. The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position	Total amount of accrued interest and penalties as of date of adoption	Disclose any material changes <sup>5</sup>
d. For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:	Yes, amount as of date of adoption	Disclose any material changes <sup>6</sup>
(1) The nature of the uncertainty	Yes, as of date of adoption	Disclose any material changes



*continued*

(2) The nature of the event that could occur in the next 12 months that would cause the change	Yes, as of date of adoption	Disclose any material changes
(3) An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made	Yes, estimate as of date of adoption	Disclose any material changes
e. A description of tax years that remain subject to examination by major tax jurisdictions.	Yes, as of date of adoption	Disclose any material changes

<sup>1</sup> Disclose date of adoption information. For example, disclose information as of January 1, 2007, for calendar year-end filers in all interim financial statements during 2007. The information should not be updated; however, material changes since the date of adoption should be disclosed.

<sup>2</sup> This column refers to interim balances or activity during the current and year-to-date interim periods and takes into account the interim period of adoption. For example, March 31, 2007, for calendar year-end filers.

<sup>3</sup> If, upon adoption of Interpretation 48, a registrant changes its financial statement classification of interest and penalties, it should disclose that it made a change in accounting principle and disclose its new policy for classification of interest and penalties. Financial statements presented prior to adoption of Interpretation 48 should not be retroactively restated or reclassified to conform to the newly adopted accounting policy.

<sup>4</sup> If, after the first quarter of the year of adoption of Interpretation 48, a registrant changes its financial statement classification of interest and penalties, it should provide the disclosures specified by paragraphs 17 and 18 of FASB Statement No. 154, *Accounting Changes and Error Corrections*, and file a preferability letter (post-adoption). This change in accounting principle would be retrospectively applied to the first interim period in which Interpretation 48 was applied.

<sup>5</sup> If material amounts are recognized or derecognized during the quarter, disclosure in management's discussion and analysis may be required.

<sup>6</sup> If material amounts are updated during the quarter disclosure in management's discussion and analysis may be required and critical accounting policies may need to be updated.



# Effective Date and Transition

The provisions of Interpretation 48 are effective for fiscal years beginning after December 15, 2006, and must be adopted as of the beginning of the enterprise's fiscal year (e.g., January 1, 2007, for calendar-year-reporting enterprises). Early adoption of the Interpretation is permitted (as of the first day of the first quarter of the enterprise's fiscal year) only if the enterprise has not yet issued any interim or annual financial statements for that fiscal year.

Accordingly, a public enterprise with a calendar year-end generally may not early adopt the provisions of Interpretation 48 since that enterprise will probably have already issued interim financial statements covering periods in 2006. The following are examples of the application of the effective date of the Interpretation.

## **Example 1**

A public enterprise with a December 31 fiscal year-end is required to adopt Interpretation 48 effective January 1, 2007, since that is the beginning of its fiscal year beginning after December 15, 2006. A nonpublic enterprise with a December 31 fiscal year-end would be able to early adopt Interpretation 48 as of the beginning of 2006 (i.e., January 1, 2006) only if it had not already issued any interim or annual financial statements for that fiscal year.

## **Example 2**

An enterprise with a November 30 fiscal year-end is not required to adopt Interpretation 48 until December 1, 2007, since that would be the beginning of its first fiscal year beginning after December 15, 2006. However, that enterprise may early adopt the provisions of Interpretation 48 as of December 1, 2005, or December 1, 2006, as long as it has not issued any interim or annual financial statements for that fiscal year.

## **Example 3**

An enterprise with a March 31 fiscal year-end is not required to adopt Interpretation 48 until April 1, 2007, the beginning of its first fiscal year beginning after December 15, 2006. However, that same enterprise may early adopt the provisions of Interpretation 48 as of April 1, 2006, as long as it has not issued any interim or annual financial statements for that fiscal year.

## **Early Adoption by Foreign Filers**

A calendar year-end foreign registrant that only issues U.S. GAAP financial statements at year-end may early adopt the provisions of Interpretation 48 in its December 31, 2006, U.S. GAAP financial statements provided that the foreign registrant did not reconcile its local GAAP amounts to U.S. GAAP amounts in its interim local GAAP financial statements. If such a reconciliation was provided, early adoption in its December 31, 2006, financial statements is not permitted and the foreign registrant should adopt the Interpretation beginning January 1, 2007.

## **Transition**

Before initially applying Interpretation 48, an enterprise must continue to apply its existing accounting policies to its tax contingencies. The cumulative effect of adopting the provisions of the Interpretation is the difference between the amount of the enterprise's net assets (or net liabilities) recognized in its balance sheet just before applying the Interpretation and the amount of net assets (or net liabilities) recognized and measured pursuant to the Interpretation's provisions (including interest and penalties). The amount of the cumulative-effect adjustment recorded in opening retained earnings should not include any amounts that would not be recognized in the enterprise's results of operations (such as the effect of applying the requirements of the Interpretation to tax positions related to prior business combinations) and must be reported separately as an adjustment of opening retained earnings of the fiscal year of initial application.

The cumulative effect on retained earnings upon adoption of Interpretation 48 will generally only result from changes in recognition and measurement of permanent items and interest. Changes in taxable temporary differences resulting from the adoption of Interpretation 48, excluding the impact of interest and penalties, generally lead to a reclassification from a deferred asset or liability to a liability for unrecognized tax benefits.

## **No Retrospective Application Upon Adoption**

Paragraph 23 of Interpretation 48 requires that the cumulative effect of applying the provisions of the Interpretation be reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) in the year of adoption. The Board considered and ultimately rejected retrospective application during its original deliberations on the Interpretation. Paragraph B71 of Interpretation 48 states, in part:

The Board rejected retrospective application as a transition alternative because of the many significant changes that have occurred in the business environment and regulatory tax environment in recent years. The Board also was concerned about the ability to identify in a retrospective application a discrete period in which a change in the perceived sustainability of a tax position may have occurred.

The Board's prohibition of retrospective application also applies to changes in classification of interest, penalties, or both upon the adoption of Interpretation 48.

### **Applying the Subsequent-Event Guidance Upon Adoption**

Before adopting Interpretation 48, some enterprises treated the favorable resolution of an uncertainty associated with an income tax position as a gain contingency. These enterprises did not reflect the resolution of the uncertainty in the financial statements until the period in which the contingent gain was realized. Therefore, the contingent gain was not recognized until the period in which information indicating that the gain had been realized was made available.

Other enterprises treated the favorable or unfavorable resolution of an uncertainty associated with an income tax position as additional evidence of conditions that existed at the balance sheet date, and thereby as clarifying their measurement of a contingent loss. Accordingly, these enterprises reflected the resolution of the uncertainty as an adjustment to their financial statements (i.e., a Type I subsequent event as contemplated in AU Section 560). These enterprises have questioned how information that becomes available after the adoption date of Interpretation 48 should be reflected in the financial statements upon transition.

For example, assume information becomes available to a calendar year-end enterprise on January 5, 2007, that affects the recognition and measurement of an income tax uncertainty. According to discussions with the FASB and SEC staffs, provided that it is appropriate for the enterprise to conclude that the information made available on January 5, 2007, constitutes a Type I subsequent event (under the enterprise's policy for distinguishing between Type I and Type II subsequent events), there are two acceptable approaches for reflecting Type I subsequent events upon adoption of Interpretation 48.

Under the first approach, the enterprise uses the information made available on January 5, 2007, to adjust the recognized amount of the contingent loss associated with the uncertain tax position that is reflected in its December 31, 2006, financial statements.

Because the adjustment to the contingent liability was made as of December 31, 2006, that same adjustment would not be reversed when determining the cumulative-effect adjustment to record on January 1, 2007, since it would only be reestablished on January 5, 2007. To the extent recognized in the December 31, 2006, financial statements, the income statement for the three months ended March 31, 2007, would not reflect the effect of the information because it has already been reflected in the enterprise's prior-period financial statements.

Under the second approach, effective January 1, 2007, the enterprise no longer recognizes a difference between Type I and Type II subsequent events when accounting for income tax uncertainties. Therefore, the information made available on January 5, 2007, is not reflected in the enterprise's December 31, 2006, financial statements or the cumulative-effect adjustment recorded on January 1, 2007. The effect of the change in judgment that results from the information that becomes available on January 5, 2007, is reflected in the enterprise's income statement in the three months ended March 31, 2007.

If the impact of the approach selected is significant to an enterprise's financial statements, the approach selected and its effects should be disclosed in the enterprise's notes to the financial statements.

### **Foreign Currency Translation and the Cumulative-Effect Adjustment**

In recording the cumulative-effect adjustment upon adoption of Interpretation 48 in the consolidated financial statements, an enterprise should apply the exchange rate as of the adoption date to all components of the cumulative-effect adjustment related to a foreign subsidiary's tax positions regardless of the tax return year to which they relate. The portion of the cumulative-effect adjustment relating to items that would be recognized in earnings (i.e., net debit or net credit) should be recorded in its entirety in opening retained earnings.

For example, Enterprise B (B) has a 100 percent wholly owned foreign subsidiary, S. Enterprise B's reporting currency is the U.S. dollar. Subsidiary S's functional currency is the euro. To prepare its consolidated financial statements, B translates S's assets and liabilities into U.S. dollars using the exchange rate at the balance sheet date. Revenues, expenses, gains, and losses are translated using the rates on the dates on which those elements are recognized during the period. Resulting translation adjustments are reported in other comprehensive income. At the adoption date of Interpretation 48, B records a cumulative-effect adjustment in its consolidated

financial statements, of which a portion relates to S's income tax positions and related accrued interest and penalties. The exchange rate as of the Interpretation 48 adoption date should be applied to all components of the cumulative-effect adjustment related to S's tax positions regardless of the tax return year to which they relate. The portion of the cumulative-effect adjustment relating to items that would be recognized in earnings (either a net debit or net credit) should be recorded in its entirety in opening retaining earnings. Enterprise B should consider what impact the adjustments to S's assets and liabilities, recorded as part of the Interpretation 48 cumulative-effect adjustment, would have on the amount of deferred taxes, if any, recognized on the difference between the adjusted carrying value for financial reporting purposes and the tax basis of its investment in S, upon adoption.





# Business Combinations

Interpretation 48 does not affect the consensus reached in EITF Issue No. 93-7, “Uncertainties Related to Income Taxes in a Purchase Business Combination,” that all income tax uncertainties that exist at the time of or arise in connection with a purchase business combination should be accounted for pursuant to Statement 109 rather than FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises* (the guidance on preacquisition contingencies from Statement 38 was incorporated into paragraph 40 of FASB Statement No. 141, *Business Combinations*, without reconsideration).

Accordingly, the “allocation period,” as defined in paragraph F1 of Statement 141, is not relevant for determining the acquired and assumed amounts for current, deferred, and Interpretation 48 income tax assets and liabilities, at the acquisition date.

The Task Force observed that the consensus in Issue 93-7 does not apply to changes in judgment about the realization of deferred tax assets because paragraphs 26 and 30 of Statement 109 provide guidance on changes in valuation allowance related to an acquired deductible difference or carryforward. However, Interpretation 48 amends the EITF 93-7 Discussion section of Issue 93-7 to reflect that the Interpretation now applies to recognition and measurement of uncertainty in income taxes recognized in accordance with Statement 109. Therefore, the amounts of acquired and assumed current, deferred, and Interpretation 48 income tax assets and liabilities of the acquired entity recognized by the acquirer as of the acquisition date should be based on the provisions of Interpretation 48. That is, as of the acquisition date, tax benefits are recognized if they meet the more-likely-than-not recognition threshold and are measured at the largest amount of benefit that is greater than 50 percent likely to be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information.

Interpretation 48 does not affect the guidance in Issue 93-7 or in Question 17 of FASB Staff Implementation Guide (Statement 109), “A Guide to Implementation of Statement 109 on Accounting for Income Taxes: Questions and Answers,” regarding accounting for the effects of adjustments to current, deferred, and Interpretation 48 income tax assets

and liabilities after the acquisition date. That is, the effect of adjustments to those income tax assets and liabilities should be applied to increase or decrease the remaining balance of goodwill attributable to that acquisition. If goodwill is reduced to zero, the remaining portion of that adjustment should be applied initially to reduce to zero other noncurrent intangible assets related to that acquisition. Any remaining benefits should be recognized in income.

Paragraphs 10–12 of Interpretation 48 provide guidance on when to account for subsequent changes in judgment over recognition and measurement of tax positions.

### **Income Tax Indemnifications in a Business Combination**

Enterprises should not continue to apply the provisions of Interpretation 48 to previously taken tax positions of a subsidiary after the sale of the subsidiary. For example, Company A (A) enters into a sales agreement to sell 100 percent of the outstanding stock in its wholly owned subsidiary to Company B (B). Before the sale, the subsidiary filed a separate tax return and recognized an Interpretation 48 liability for an uncertain tax position. This liability continued to be recognized by B after the sale. As part of the sales agreement, A indemnifies B for any claims made by the taxing authority subsequent to the sale date for the uncertain tax position taken by the subsidiary in its prior tax return.

By providing B with an indemnification for tax positions of the subsidiary, A has entered into a guarantee contract that is subject to the accounting requirements of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*.

Paragraph 3(c) of Interpretation 45 indicates that indemnification agreements that contingently require the indemnifying party (guarantor) to make payments to the indemnified party as a result of imposition of additional taxes, owing to either a change in the tax law or an adverse interpretation of the tax law, are under the scope of Interpretation 45. Therefore, in accordance with Interpretation 45, A should recognize a liability at the sale date for the fair value of the indemnification, representing the fair value of its stand-ready to perform the obligation. Company A would recognize a liability for its former subsidiary's potential cash payment under the indemnification in accordance with Statement 5 when such payment becomes "probable of occurring" and the amount is reasonably estimable.

# Comparison of U.S. GAAP and IFRS Accounting

While convergence of U.S. GAAP and International Financial Reporting Standards (IFRSs) is a high priority of both U.S. and International standard setters, the requirements of Interpretation 48 differ in several respects from those of the corresponding International Accounting Standard (IAS). The following is a comparison of the requirements of Interpretation 48 and IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

## IFRS Accounting

IAS 37 requires a one-step approach to recognizing a provision when (1) an enterprise has a present obligation as a result of a past event, (2) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and (3) a reliable estimate can be made of the amount of the obligation. The term “probable” is defined in IAS 37 as “more likely than not.” If these conditions are not met, no provision is recognized.

According to paragraph 39 of IAS 37, “Uncertainties surrounding the amount to be recognized as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is ‘expected value.’” Paragraph 39 of IAS 37 goes on to explain that “[w]here there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.” Furthermore, paragraph 40 states that “[w]here a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the enterprise considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.”

## **Comparison of U.S. GAAP and IFRS — Recognition**

As discussed earlier, under Interpretation 48, a tax position must meet the more-likely-than-not recognition threshold for the associated tax benefit to be recognized in an enterprise's financial statements. If a tax position does not meet the recognition threshold, a liability or other adjustment would be recognized for the full amount of the tax benefit. IAS 37, however, does not include a separate recognition threshold; rather, it provides a single threshold for the recognition and measurement of a provision. Therefore, the liability recognized under IAS 37 may or may not be the same amount as that recognized under Interpretation 48.

For example, assume an enterprise takes a deduction of \$100 on its tax return (resulting in a \$40 tax benefit) and concludes that it is not more likely than not that the deduction would be sustained upon examination by the taxing authority. Under Interpretation 48, the enterprise would recognize a liability or other adjustment for an unrecognized tax benefit for the full amount of the tax benefit (\$40) in its financial statements. Under IAS 37, the enterprise would recognize the most reliable estimate that can be made of the amount of the obligation. That amount probably would be less than the full amount.

## **Comparison of U.S. GAAP and IFRS — Measurement**

As discussed earlier, under Interpretation 48, a tax position that meets the more-likely-than-not recognition threshold is measured as the largest amount of benefit that is greater than 50 percent likely to be realized upon ultimate settlement (the "cumulative-probability" approach). The enterprise would recognize a liability for an unrecognized tax benefit for the difference between the full amount of the benefit and the largest amount of the benefit that is greater than 50 percent likely to be realized. IAS 37 does not include a separate measurement threshold; rather, it provides a threshold for the recognition and measurement of the provision. Under IAS 37, the enterprise would recognize the most reliable estimate that can be made of the amount of the obligation.

For example, assume an enterprise takes a deduction of \$100 on its tax return (resulting in a \$40 tax benefit) and concludes that it is more likely than not that the deduction would be sustained upon examination by the taxing authority. Under Interpretation 48, the enterprise would measure the associated tax benefit at the largest amount of benefit that is greater than 50 percent likely to be realized upon ultimate settlement. The enterprise concludes that the following table of values accounts for all possible outcomes and probabilities:

Possible Estimated Outcome (\$)	Individual Probability of Occurring (%)	Cumulative Probability of Occurring (%)
40	31	31
30	20	51
20	20	71
10	20	91
0	9	100

Under Interpretation 48, the enterprise should recognize a tax benefit of \$30 because this is the largest benefit with a cumulative probability of greater than 50 percent. Accordingly, the enterprise should record a \$10 income tax liability (assuming the tax position does not affect deferred taxes).

IAS 37 does not provide explicit guidance on which method to use in determining the best estimate of the liability to recognize. There are many acceptable methods. Applying any of these methods may or may not result in a difference in the amount of recognized liability as compared with Interpretation 48. One acceptable method would be a weighted-average method that results in a \$16 liability in accordance with the example above, since the weighted average of all possible outcomes is \$24.

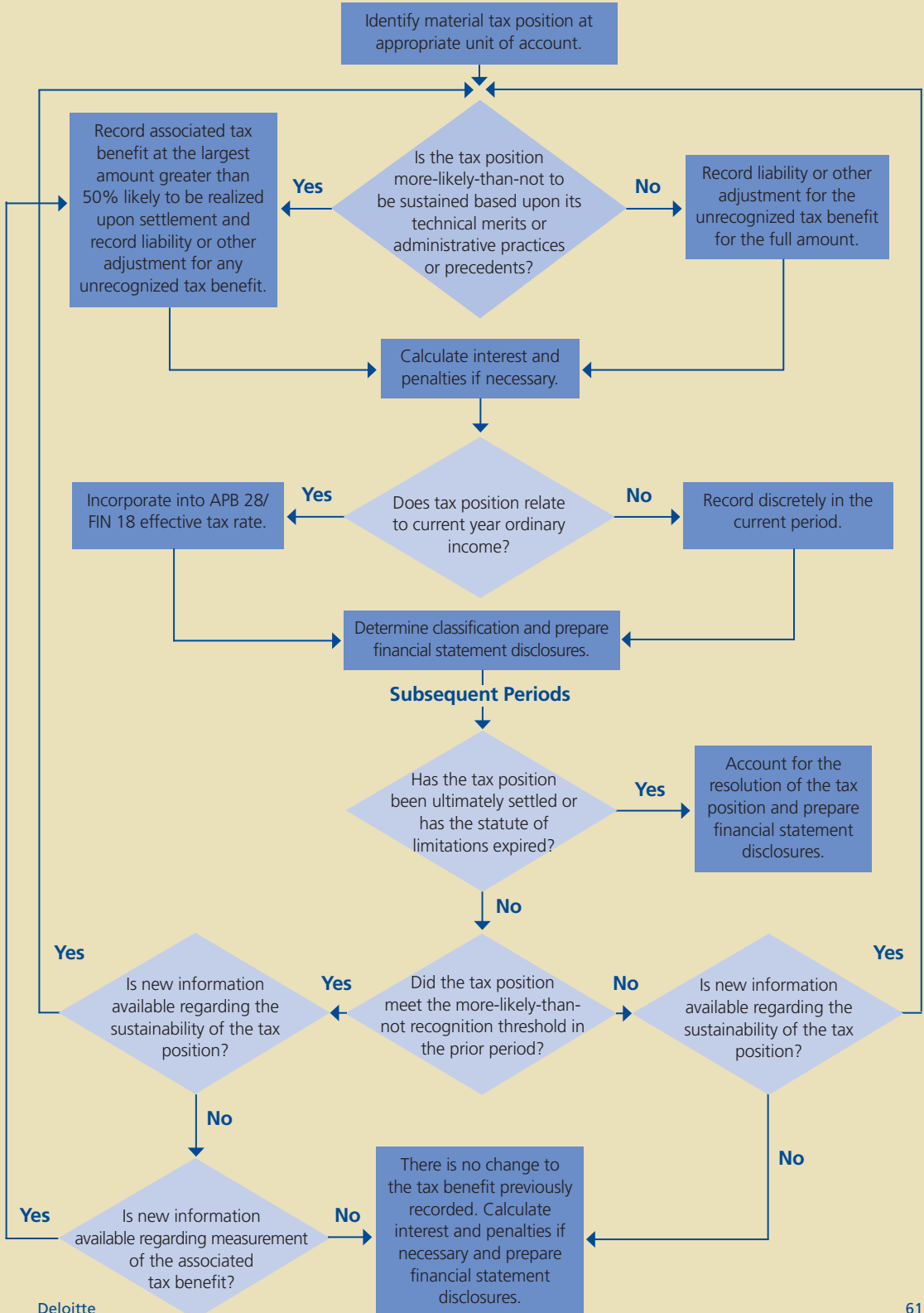
### Other Differences

Interpretation 48 also provides guidance on subsequent recognition, derecognition, measurement, recognition of interest and penalties, classification, and disclosure. This guidance will probably create additional differences between U.S. GAAP and IFRS.

# Appendices:

- A — Interpretation 48 Decision Tree
- B — Steps to Implement Interpretation 48
- C — Interpretation 48 GAAP Checklist

# Interpretation 48 Decision Tree



# Steps to Implement Interpretation 48

## Comprehensive Approach and Scope

Phase 1	Phase 2	Phase 3		Phase 4		
	STEP 1	STEP 2	STEP 3	STEP 4	STEP 5	STEP 6
Planning	Identify tax positions at the appropriate unit of account	Evaluate tax position for recognition	Measure benefit to be recognized	Determine classification	Accrue interest and penalties	Prepare disclosures
<ul style="list-style-type: none"> <li>Assess existing FAS 5 processes and 404 controls</li> <li>Establish project scope and protocols</li> <li>Assemble project team and external resources</li> <li>Determine training needs</li> <li>Establish criteria for determining documentation needs</li> <li>Establish key steps, timeliness, responsibilities, and communication protocols</li> </ul>	<ul style="list-style-type: none"> <li>Execute a process for identifying highly certain and uncertain positions by jurisdiction</li> <li>Determine unit of account for each position</li> <li>Segregate positions between highly certain and uncertain</li> <li>Review positions identified for completeness</li> <li>Establish documentation requirements for tax positions identified</li> <li>Review positions and expected documentation with external auditor</li> </ul>	<ul style="list-style-type: none"> <li>Analyze and document uncertain tax positions</li> <li>Segregate tax positions that meet MLTN recognition threshold and those that do not</li> <li>Review conclusions regarding recognition with external auditors</li> </ul>	<ul style="list-style-type: none"> <li>Determine Enterprise's policy regarding settlements with tax authorities</li> <li>Assess Enterprise's tax examination and settlement history</li> <li>Prepare cumulative probability assessments</li> <li>Reevaluate deferred tax assets, valuation allowances, tax return elections, and other decisions impacted by FIN 48</li> </ul>	<ul style="list-style-type: none"> <li>Determine whether tax positions are permanent or temporary</li> <li>Assess whether adjustments will be paid in cash in 12 months</li> <li>Determine presentation in the balance sheet</li> <li>Prepare adjusting entries</li> </ul>	<ul style="list-style-type: none"> <li>Determine accounting policies on accrual of interest and penalties</li> <li>Calculate and record accrued interest</li> <li>Determine and record accrued penalties, if applicable</li> </ul>	<ul style="list-style-type: none"> <li>Prepare required disclosures including tabular roll forward</li> <li>Disclose amount of unrecognized benefits that would impact effective rate</li> <li>Disclose classification and amount of interest and penalties</li> <li>Disclose positions that could change in next 12 months</li> <li>Disclose open tax years by jurisdiction</li> <li>Determine quarterly reporting requirements</li> </ul>



# Interpretation 48 GAAP Checklist

The following checklist should be used to ensure that the provisions of Interpretation 48 have been applied correctly:

## In the year of initial adoption:

1. Has the cumulative effect of applying the Interpretation been reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately? Does the cumulative-effect adjustment not include items that would not be recognized in earnings? [\[Interpretation 48.23\]](#)
2. Has the enterprise disclosed the cumulative effect of the change on retained earnings in the statement of financial position as of the date of adoption? [\[Interpretation 48.24\]](#)

## In the year of initial adoption and thereafter:

3. If the enterprise presents a classified statement of financial position, did it classify a liability associated with an unrecognized tax benefit as a current liability (or the amount of a net operating loss carryforward or amount refundable is reduced) to the extent the enterprise anticipates payment (or receipt) of cash within one year or the operating cycle, if longer? [\[Interpretation 48.17\]](#)
4. Did the enterprise not combine the liability for unrecognized tax benefits (or reduction in amounts refundable) with deferred tax liabilities or assets? [\[Interpretation 48.17\]](#)
5. Are liabilities recognized as a result of applying the Interpretation not classified as a deferred tax liability unless they arose from a taxable temporary difference? [\[Interpretation 48.18\]](#)
6. Has the enterprise consistently classified the interest recognized in the financial statements as either income taxes or interest expense, based on the accounting policy election of the enterprise? [\[Interpretation 48.19\]](#)
7. Has the enterprise consistently classified penalties recognized in the financial statements as either income taxes or another expense classification, based on the accounting policy election of the enterprise? [\[Interpretation 48.19\]](#)

8. Has the enterprise disclosed its policy on classification of interest and penalties in the footnotes to the financial statements? **[Interpretation 48.20]**
9. Has the enterprise disclosed at the end of its annual reporting period the following:
  - a. A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the period, which shall include at a minimum:
    - (1) The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period?
    - (2) The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period?
    - (3) The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities?
    - (4) Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations?
  - b. The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate?
  - c. The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position?
  - d. For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:
    - (1) The nature of the uncertainty?
    - (2) The nature of the event that could occur in the next 12 months that would cause the change?
    - (3) An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made?
  - e. A description of tax years that remain subject to examination by major tax jurisdictions? **[Interpretation 48.21]**

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