

# Insight

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compliance.”*

## Valuation Plays Key Role in FIN 48 Compliance

FASB Interpretation (FIN) 48 requires companies to assess their tax positions and set aside reserves for any amount which do not meet the recognition threshold and thus may result in tax assessments upon audit. FIN 48 applies to all tax positions within the scope of Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes, regardless of their level of uncertainty or the nature of the position. The FASB issued FIN 48 in an effort to minimize diversity in accounting for uncertainty in income taxes and to enhance transparency in financial reporting.

Generally, a tax position is defined as something that can result in a permanent reduction of income taxes payable, a deferral of income taxes, or a change in realization of deferred tax assets. Examples would include the following:

- A decision not to file a tax return
- An allocation of a shift in income between jurisdictions
- Characterization of income or a decision to exclude reportable taxable income in a return
- A decision to classify a transaction, entity, or other position in a tax return as tax exempt

## DEFERRAL FOR PRIVATE COMPANIES

FIN 48 took effect for public companies for years beginning after Dec. 15, 2006, but at the time the effective date for private companies was still being debated. On Oct. 15, the FASB decided, for the second time in two years, to defer FIN 48 for private companies. For nonpublic companies, implementation will be for fiscal years beginning after December 15, 2008.

The implementation date has been delayed for the most part because of the lack of clarity regarding pass-through entities. The FASB plans to issue a FASB staff position (FSP), in which it will propose implementation guidance for pass-through entities. The FSP will ask for input as to the accounting issues pertaining to pass-through entities under FIN 48. The Board will then develop guidance based on the input it receives.

## DISCLOSURES

Many companies have already adopted FIN 48 and have turned their attention to the annual disclosure requirements. Under FIN 48, a company must include a number of disclosures including the following:

- Tabular reconciliation of the total aggregate amount of the unrecognized tax benefit at the beginning and end of the period including the following:
  - The effects of the positions taken during the year
  - Changes in assessments of prior-period positions
  - The impact of settlements with taxing authorities
- The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate (ETR).
- The total amount of interest and penalties recognized in the financial statements.

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- Potential significant increases/decreases to the total unrecognized tax benefit that could occur within the next 12 months, including the following:
  - Nature of uncertainty
  - Nature of event that might trigger the change
- A description of tax years that remain subject to examination by major tax jurisdictions.

Valuation services are often required for FIN 48 compliance. The following case studies represent examples of how we could help support the FIN 48 analysis which must be undertaken by companies as part of their quarterly and annual financial statement processes.

### CASE STUDIES

1) A private manufacturer and distributor of automobile components has plans to go public in the near term. The company has subsidiaries in Canada, China, Germany and Mexico. The Canadian operations have lost money for a number of years and in 2007 the US parent took a worthless stock deduction on its US income tax return. In preparing the financial statement to be included in the public filing, the company evaluated its tax positions under FIN 48. In reviewing the documentation related to the worthless stock deduction, the company concludes that the worthless stock deduction was based on the book balance sheet. In order to document the worthlessness of the entity and support that no reserve is required for FIN 48 purposes, VRC could assist by performing a valuation of the company. A valuation which supports that the company was insolvent would be helpful in concluding that the company would not be required to establish a FIN 48 reserve related to this issue.

2) A multinational public company engaged in the consumer goods industry acquired another US multinational group in the same business in 2008. The acquired company has two subsidiaries located outside the United States, in the United Kingdom and in Italy. The Italian subsidiary had been acquired by the target in 2006 and the target had made a Section 338 election to step up the basis in the Italian subsidiaries' assets for US tax purposes. The Italian subsidiary generates Subpart F income annually. There had not been a valuation supporting the purchase price allocation related to the acquisition of the Italian subsidiary. Accordingly, the earnings and profits calculation supporting the Subpart F determination was estimated. VRC would be available to perform a purchase price allocation related to the acquisition of the Italian subsidiary in support of the earnings and profits computation and the related Subpart F income amount, thus assisting in the determination of the need for a FIN 48 reserve.

### DOCUMENTATION

Companies must identify and document new uncertain tax positions that arise during the past year. Sarbanes-Oxley also calls for companies to review tax positions on a quarterly basis. For more information regarding FIN 48, contact your VRC representative.

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