



BDO Seidman, LLP
Accountants and Consultants

July 2006

Subject:

FASB Interpretation No. 48 (“FIN 48” or “the interpretation”): Accounting for Uncertainty in Income Taxes

Federal Tax Alert

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Affecting/Timing

FIN 48 applies to all enterprises following US GAAP for fiscal years beginning after December 15, 2006. Earlier application of the interpretation is encouraged if the enterprise has not yet issued financial statements (including interim financial statements) in the period the interpretation is adopted.

Overview

The interpretation is intended to reduce inconsistencies and increase relevance and comparability in the application of the accounting rules related to income tax contingencies.

Two-Step Approach

The interpretation applies to all tax positions accounted for in accordance with FASB Statement No. 109 (income taxes and guidance for associated penalties and interest). The interpretation requires an evaluation of a tax position using a two-step process, recognition and measurement.

Recognition

The first step is recognition: The reporting enterprise determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The evaluation of whether a tax position has met the more-likely-than-not recognition threshold should presume that the position will be examined by the appropriate taxing authority that would have full knowledge of all relevant information.

Measurement

Once it is determined that a benefit for a tax position may be recognized because it meets the more-likely-than-not recognition threshold, the amount of the position must be measured and a determination made of the amount of benefit to be recognized in the financial statements. That amount is the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement of the tax position. (For example, if a company believes that its position would be sustained upon litigation but typically settles with the taxing jurisdiction to avoid the expense and hazards of litigation, the company would record the largest amount of the benefit which has a greater than 50 percent likelihood of being realized upon settlement with taxing authorities.)

Subsequent Recognition, Derecognition and Measurement

The interpretation requires ongoing evaluation of tax positions. Those tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Any previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

Subsequent recognition, derecognition, and measurement are based on management's best judgment based upon facts, circumstances, and information available at the reporting date. However, subsequent changes in that 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 interpretation of the information that was available in previous financial reporting periods.

Interest and Penalties

A company should accrue interest on liabilities for tax positions that are not recognized because they do not meet the more-likely-than-not recognition threshold or the measurement guidance. In addition, a company should accrue penalties if a tax position does not meet the statutory threshold to avoid penalties. Each company should make an accounting policy decision whether to record interest and penalties in the provision for income taxes or as interest and other expense, respectively.

Disclosure

The interpretation has added financial disclosure requirements including a tabular rollforward analysis of unrecognized tax benefits, their impact on the effective tax rate if recognized, the accounting policy for the classification of interest and penalties, and the total amount of interest and penalties recognized in the income statement and balance sheet. In addition, the interpretation requires certain disclosure for tax positions for which it is reasonably possible that the amount of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date.

Effective Date and Transition

The interpretation is effective for fiscal years beginning after December 15, 2006; early adoption is encouraged if the enterprise has not yet issued financial statements (including interim financial statements) in the period the interpretation is adopted. The provisions of the interpretation are required to be applied to all tax positions in all open tax years. Only positions that meet the more-likely-than-not threshold on the date of adoption will be recognized or will continue to be recognized. In other words, all tax positions for all open years must be reevaluated applying this new interpretation. The cumulative effect of applying the provisions of the interpretation will be reported as an adjustment to beginning retained earnings in the year the interpretation is adopted.

Recommended Action

The interpretation will be effective at the beginning of 2007 for calendar year end companies. Income tax contingency accounting practices that companies have employed have been varied and many companies may find that all the information regarding the tax positions reported on tax returns is not readily available. Existing tax contingency evaluation methodologies and contingency reserve balances will likely differ from those that are determined pursuant to the interpretation. Any difference (the cumulative effect) will need to be recorded as an adjustment to beginning retained earnings in the year the interpretation is adopted as noted above.

Companies that report quarterly earnings will need to reflect the change in the first quarter of the year of adoption. Companies, therefore, should quickly inventory the tax positions taken in all open years and evaluate which positions will require significant analysis to substantiate the level of confidence that a position will be sustained as well as the measurement of benefit to be recorded for those positions considered more likely than not of being sustained. Many companies may find that their existing tax analysis and documentation is insufficient to evaluate the GAAP consequences of this proposed interpretation.

How BDO Seidman May Assist

BDO Seidman tax professionals can evaluate the tax positions that the company reported in its tax filings and assist with the evaluation of the potential tax consequences of those positions. Typically, the types of tax analysis that support the evaluation of accounting for uncertain tax positions include: preparing tax opinions, research credit and other credit studies, transfer pricing studies, permanent establishment analysis, Sub Part F analysis, loss limitation analysis, and methods of accounting studies. BDO Seidman can provide these services as well as a full range of tax services.

Under certain circumstances, BDO Seidman could also assist the company in analyzing the implications of this interpretation on the financial statements.

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