

## FIN 48 Shocker

What if you feared the Internal Revenue Service and ended up in trouble with Congress instead?

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After complaining bitterly that a new accounting rule — FIN 48 — would expose them to greater IRS scrutiny, Corporate America got an unpleasant surprise: their financial statement disclosures were also drawing scrutiny from Senate investigators. In August, investigators solicited details about corporate tax positions from at least 30 companies, noted a report in the *Wall Street Journal*. "I thought the [Internal Revenue Service] would use FIN 48 as a roadmap, but was shocked to find out that Congress is using it," Lehman Brothers tax expert Robert Willens told CFO.com.

"No one anticipated Congress jumping into the fray and putting bloodhounds on the tax shelter scent," adds Bill Smith, a tax attorney and national tax director at CBIZ Inc., an accounting and tax advisory firm.

FIN 48 dictates how companies should account for uncertain tax positions. It requires that corporations disclose how much they have kept in reserve to cover the possibility that the IRS or state tax officials might disallow certain tax treatments, such as a company's claim for credits and deductions, exclusions of certain revenue from taxable income, or, say, the decision that a merger or other transaction can be considered tax-free. It's a tricky calculation. Companies must start by assuming their tax positions will be audited — a departure from typical accounting philosophy. They then must try, with the help of attorneys and accountants, to handicap the likelihood that their tax decision would survive an audit.

Prior to FIN 48, which went into affect in 2006, companies kept those opinions, and other calculations, assumptions, and estimates related to the reserves, under wraps, for fear of tipping off the IRS or competitors. Exposing a possible weakness in a tax position or tax shelter could even put the company at a disadvantage in a court case, as the opposing side would be able to prove that the company had reservations.

The big, fear, of course, was that FIN 48 would provide the IRS with clues about what to look for. Now, however, it is the Senate's Permanent Subcommittee on Investigations, led by Michigan Democrat Senator Carl Levin, that is using the FIN 48 disclosures to investigate companies that disclosed large tax reserves. According to a report in BNA's August 28, *Daily Tax Report*, Levin's subcommittee is asking companies to hand over details related to tax transactions that account for 5 percent or more of their total tax reserve, as well as transactions in which the company paid tax advisors at least \$1 million for their services.

Reportedly, the Senators want to companies to submit the total amount of unrecognized tax benefits, as well as a break out of penalty and interest projections (which must be accrued under FIN 48), and information related to tax periods and foreign jurisdictions. The subcommittee seems to be asking for the data used to develop the proprietary documents known as tax accrual work papers, rather than the work papers specifically. Companies "will definitely have to scrub the data before sending it to Congress," says Smith, who says corporate legal and tax teams likely will get involved with the preparation of the material.

Companies will "feel squeamish" about giving Congress the work papers tied to their most aggressive tax transactions without having the legal team review the documents, adds Smith, noting releasing the too much information could hobble the corporation's defense of its tax position. The worse case scenario, says Smith, is if Congress pushes the IRS to change its policy of restraint regarding tax accrual work papers. Currently, the IRS has determined that work papers are privileged information and do not need to be disclosed. However, the agency is reviewing the status of the documents in light of FIN 48.

If the Senators believes that corporations are pushing the tax envelope too hard, says Smith, "they will get their congressional hackles up and push the IRS to change its policy. "Congress is absolutely being more aggressive than the IRS," adds Willens, who says that the initial investigations could just be the "tip of the iceberg."

The senators are likely targeting large tax shelters and focusing on multinational corporations that garner tax benefits from shifting income offshore and through shelter structures, speculates Smith. Levin's press officer declined to comment on the nature of the investigation. However, two years ago, Levin wrote a six-page letter to the Financial Accounting Standards Board in support of FIN 48, outlining several "dubious" tax shelters and championing the change as a way to "eliminate . . . approaches that undermine the federal tax system."

Levin's fervor is probably the result of the subcommittee's earlier probes into abusive tax shelters. Those included Enron's so-called "Slapshot" shelter, which was supposed to help the now defunct energy company inflate earning over five years by a total of \$65 million, and KPMG's sale of questionable tax shelters to 50 small private companies.

But some observers think the latest effort goes far beyond the original scope of investigations into abusive tax shelters. "I don't think the potential here is for uncovering those types of very aggressive tax shelter transactions," says David Sheckman, an attorney with the business tax group of Drinker Biddle & Reath LLP. Instead, he says, Congress's latest query "gets into bread and butter tax planning that all of our corporate clients do."

But Smith also points out that the new investigations "play well politically," because they take aim at big numbers. Indeed,

the *Journal* named Merck & Co., Johnson & Johnson, and Wyeth as being among the companies to receive subcommittee letters. Earlier in the year the newspaper cited a Credit Suisse report that identified Merck & Co. as having the highest tax reserve — \$7.4 billion — of any U.S. company. Other companies topping the tax reserve list included: General Electric (\$6.8 billion), AT&T (6.3 billion), J.P. Morgan Chase (\$4.7 billion), and Pfizer (\$4.6 billion).

"The way I'm reading it, Congress is viewing unrecognized tax positions as evidence of wrongdoing," says Lehman's Willens. "But unrecognized positions can arise from legitimate tax planning." Unrecognized positions are common, he explains, and corporations "confront them every day." The reason such positions continue to be labeled "uncertain" or "unrecognized" is because they have not yet been the subject of a tax court decision or IRS rule. "That these transactions could all be tarred with the same brush is really frightening for a tax advisor," says Willens.

"I think [the investigations] will really heighten sensitivities beyond the tax group to the CFO and CEO level in terms of what's going on in terms of tax reserves," says Drinker Biddle's Shechtman. He says that the Congressional inquiry could have a chilling effect on legitimate transactions with unclear tax consequences. "If you show a substantial FIN 48 tax reserve, now you not only face more chance of an audit, but you also might be called on the carpet before Congress," he says. "That's obviously something any company would like to avoid."