

COMPLIANCE WEEK

FIN 48: Modest Change For Large Companies

Early analysis of tax reserves suggests large public companies may only be mildly affected by new rules requiring more candid disclosure about tax uncertainties, but smaller companies may ultimately take a bigger hit.

A study under way for the National Tax Association suggests the top 100 public companies that are not regulated beyond the Securities and Exchange Commission are showing an aggregate reduction of \$2 billion in tax reserves as a result of implementing the controversial Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. FIN 48 requires companies to provide greater, more conservative detail where they may have uncertainty about benefits they are claiming in their tax returns with the Internal Revenue Service.

Lillian Mills, associate professor at the University of Texas at Austin and a co-author of the study, says tax reserves for the companies in the study totaled \$82 billion, or 2 percent of assets. That's the figure companies show for accounting purposes as an amount that might still be accessible to the IRS if agents were to successfully challenge all uncertain tax positions taken on tax returns.

The aggregate change in reserves of \$2 billion represents an increase to stockholder equity, but Mills says overall it doesn't reflect a significant change. "I would have to characterize it as a modest aggregate change," she tells Compliance Week. "In the aggregate, what companies were doing previously is pretty close to what the new standard required. In the economy as a whole, they were getting it pretty close to right."

Mills says the study is still in draft form and is scheduled to be finalized and presented to the NTA in June; data is still outstanding for a few companies in the study group, she says. Mills expects the final results to show that while most companies fell along the average, a few standouts are reporting much bigger swings in tax reserves for both increases and decreases.

A decrease in tax reserves would suggest the company previously was taking a more conservative view of its uncertain positions than even FIN 48 requires, notes Mills. An increase, on the other hand, would suggest the company was taking a more aggressive view or simply faces a good deal more legitimate uncertainty as a result of changes in tax rules.

Mills cites changes in tax law that are just beginning to hit corporate books in 2006 where companies have some uncertainty about how rules and guidance ultimately will play out related to a deduction for domestic production activities. "To be fair, there can be uncertainty that's not related to being aggressive in the sense that the IRS would view it as noncompliant," she says. "The domestic activity deduction is a good example of that. It's such a new law, and the guidance about exactly what the law requires is still very young."

Bill Smith, director of the national tax office at CBIZ Accounting, says he's hearing reports that proportionately the impact on tax reserves flowing through to shareholder equity may be greater for smaller companies than the NTA study is likely to show. Larger companies are more likely to be audited annually and perhaps even have an IRS agent on site.

"You're going to be a little less likely to take aggressive positions, and when you do, they're probably [going to be] a little more carefully thought out and maybe even discussed with the agent," Smith says. "If you don't have an agent on site and you're not under constant audit (as with smaller companies), management has greater freedom to take positions that are not improper but more aggressive. It would make sense that a higher proportion of those positions are at smaller companies that are not under continual audit."