

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2009-06
September 2009

Income Taxes (Topic 740)

Implementation Guidance on Accounting for
Uncertainty in Income Taxes and Disclosure
Amendments for Nonpublic Entities

An Amendment of the *FASB Accounting Standards Codification*[™]

Financial Accounting Standards Board
of the Financial Accounting Foundation

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing this Update to address the need for additional implementation guidance on accounting for uncertainty in income taxes. The guidance answers the following questions:

1. Is the income tax paid by the entity attributable to the entity or its owners?
2. What constitutes a tax position for a pass-through entity or a tax-exempt not-for-profit entity?
3. How should accounting for uncertainty in income taxes be applied when a group of related entities comprise both taxable and nontaxable entities?

In addition, after consulting with constituents including the FASB's Private Company Financial Reporting Committee (PCFRC) and others, the Board decided to eliminate the disclosures required by paragraph 740-10-50-15(a) through (b) for nonpublic entities.

Who Is Affected by the Amendments in This Update?

The implementation guidance will apply to financial statements of nongovernmental entities that are presented in conformity with U.S. generally accepted accounting principles (GAAP).

The disclosure amendments will apply only to nonpublic entities as defined in Section 740-10-20.

What Are the Key Provisions?

The amendments to the *FASB Accounting Standards Codification*[™] in this Update provide implementation guidance, through examples, to answer the three questions mentioned above about how to apply the standards for uncertainty in income taxes.

1. If income taxes paid by the entity are attributable to the entity, the transaction should be accounted for consistent with the guidance for uncertainty in income taxes in Topic 740. If income taxes paid by the entity are attributable to the owners, the transaction should be recorded as a transaction with owners. The determination of attribution should be made for each jurisdiction where the entity is subject to income taxes

- and is determined on the basis of laws and regulations of the jurisdiction.
2. The amendments clarify that management's determination of the taxable status of the entity, including its status as a pass-through entity or tax-exempt not-for-profit entity, is a tax position subject to the standards required for accounting for uncertainty in income taxes.
 3. A reporting entity must consider the tax positions of all entities within a related group of entities regardless of the tax status of the reporting entity.

In addition, the amendments eliminate the disclosures required by paragraph 740-10-50-15(a) through (b) for nonpublic entities. Paragraph 740-10-50-15(a) requires a tabular reconciliation of the total amount of unrecognized tax benefits at the beginning and end of the periods presented. Paragraph 740-10-50-15(b) requires the disclosure of the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate.

How Are the Key Provisions Different from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments eliminate the disclosures required by paragraph 740-10-50-15(a) through (b) for nonpublic entities. Users of private company financial statements have indicated that the disclosures required by that paragraph do not provide decision-useful information. Therefore, the amendments reduce the cost of preparing private company financial statements without eliminating the decision-useful information needed by the users of those statements. The amendments do not alter the disclosure requirements for public companies. Users of public company financial statements have indicated that the information in paragraph 740-10-50-15(a) through (b) is useful.

The additional implementation guidance improves current accounting by helping to achieve consistent application of accounting for uncertainty in income taxes. The guidance is not intended to change practice. It has been issued to provide additional implementation guidance on accounting for uncertainty in income taxes and does not change other requirements of Topic 740.

Although the guidance is not intended to change practice, there may be instances in which practice does change. In those situations, disclosures shall be made in accordance with Section 250-10-50.

When Will the Amendments Be Effective?

For entities that are currently applying the standards for accounting for uncertainty in income taxes, the guidance and disclosure amendments are effective for financial statements issued for interim and annual periods ending after September 15, 2009. For those entities that have deferred the application of accounting for uncertainty in income taxes in accordance with paragraph 740-10-65-1(e), the guidance and disclosure amendments are effective upon adoption of those standards. The amendments in this Update do not affect the effective date guidance for certain nonpublic entities in paragraph 740-10-65-1.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

The amendments in this Update provide guidance on accounting for uncertainty in income taxes. This Update also amends disclosure requirements for nonpublic entities for unrecognized tax benefits. As of the issuance date of this Update, IFRS do not specifically address accounting for uncertainties in income taxes; instead, the general guidance for contingencies is applied to uncertain tax positions. The current IFRS approach to contingencies is similar to accounting for loss contingencies described in paragraph 450-20-25-2.

Amendments to the *FASB Accounting Standards Codification*TM

Introduction

1. The following are amendments to the Accounting Standards Codification as a result of this Update. In some cases, not only are the amended paragraphs shown but the preceding and following paragraphs also are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck-out~~.

Amendment to Master Glossary

2. Amend the Master Glossary term “Tax Position,” with a link to transition paragraph 740-10-65-2, as follows:

Tax Position

A position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities for interim or annual periods. 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 term tax position also encompasses, but is not limited to:

- a. A decision not to file a tax return
- b. An allocation or a shift of income between jurisdictions
- c. The characterization of income or a decision to exclude reporting taxable income in a tax return
- d. A decision to classify a transaction, entity, or other position in a tax return as tax ~~exempt~~exempt
- e. An entity's status, including its status as a pass-through entity or a tax-exempt not-for-profit entity.

Amendments to Subtopic 740-10

3. Add paragraph 740-10-15-2AA, with a link to transition paragraph 740-10-65-2, as follows:

740-10-15-2AA The Sections of this Subtopic relating to accounting for uncertain tax positions are applicable to all entities, including tax-exempt not-for-profit entities, pass-through entities, and entities that are taxed in a manner similar to pass-through entities such as real estate investment trusts and registered investment companies.

4. Amend paragraph 740-10-50-15, with a link to transition paragraph 740-10-65-2, as follows:

> Unrecognized Tax Benefit Related Disclosures

740-10-50-15 ~~An entity~~All entities shall disclose all of the following at the end of each annual reporting period presented:

- a. ~~Subparagraph superseded by Accounting Standards Update 2009-06. 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. ~~Subparagraph superseded by Accounting Standards Update 2009-06. The gross amounts of the increases and decreases in unrecognized tax benefits as a result of tax positions taken during a prior period~~
 2. ~~Subparagraph superseded by Accounting Standards Update 2009-06. The gross amounts of increases and decreases in unrecognized tax benefits as a result of tax positions taken during the current period~~
 3. ~~Subparagraph superseded by Accounting Standards Update 2009-06. The amounts of decreases in the unrecognized tax benefits relating to settlements with taxing authorities~~
 4. ~~Subparagraph superseded by Accounting Standards Update 2009-06. Reductions to unrecognized tax benefits as a result of a lapse of the applicable statute of limitations.~~
- b. ~~Subparagraph superseded by Accounting Standards Update 2009-06. 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.

See Example 30 (paragraph 740-10-55-217) for an illustration of disclosure about uncertainty in income taxes.

- 5. Add paragraph 740-10-50-15A, with a link to transition paragraph 740-10-65-2, as follows:

740-10-50-15A Public entities shall disclose both of 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:
 - 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.

See Example 30 (paragraph 740-10-55-217) for an illustration of disclosures about uncertainty in income taxes.

- 6. Add paragraphs 740-10-55-223 through 55-229 and related headings, with a link to transition paragraph 740-10-65-2, as follows:

> > Example 32: Definition of a Tax Position

740-10-55-223 Entity A has sales in Jurisdiction S but no physical presence. Management has reviewed the nexus rules for filing a return in Jurisdiction S and must determine whether filing a tax return in Jurisdiction S is required. In evaluating the tax position to file a tax return, management should consider all relevant sources of tax law. The evaluation of nexus has to be made for all jurisdictions where Entity A might be subject to income taxes. Each of these evaluations is a separate tax position that is subject to the recognition, measurement, and disclosure requirements of this Subtopic.

> > Example 33: Definition of a Tax Position

740-10-55-224 Entity S converted to an S Corporation from a C Corporation effective January 1, 20X0. In 20X7, Entity S disposed of assets subject to built-in gains and reported a tax liability on its 20X7 tax returns. Tax positions to consider related to the built-in gains tax include, but are not limited to:

- a. Whether other assets were sold subject to the built-in gains tax
- b. Whether the income associated with the calculation of the taxable amount of the built-in gains is correct
- c. Whether the basis associated with the built-in gains calculation is correct.

It should be noted that whether or not Entity S is subject to the built-in gains tax also is a tax position subject to the provisions of this Subtopic.

> > Example 34: Definition of a Tax Position

740-10-55-225 Entity N, a tax-exempt not-for-profit entity, enters into transactions that may be subject to income tax on unrelated business income. Tax positions to consider include but are not limited to:

- a. Entity N's characterization of its activities as related or unrelated to its exempt purpose
- b. Entity N's allocation of revenue between activities that relate to its exempt purpose and those that are allocated to unrelated business income
- c. The allocation of Entity N's expenses between activities that relate to its exempt purpose and those that are allocated to unrelated business activities.

Even if Entity N were not subject to income taxes on unrelated business income, it still has a tax position of whether it qualifies as a tax-exempt not-for-profit entity.

> > Example 35: Attribution of Income Taxes to the Entity or Its Owners

740-10-55-226 Entity A, a partnership with two partners—Partner 1 and Partner 2—has nexus in Jurisdiction J. Jurisdiction J assesses an income tax on Entity A and allows Partners 1 and 2 to file a tax return and use their pro rata share of Entity A's income tax payment as a credit (that is, payment against the tax liability of the owners). Because the owners may file a tax return and utilize Entity A's payment as a payment against their personal income tax, the income tax would be attributed to the owners by Jurisdiction J's laws whether or not the owners file an income tax return. Because the income tax has been attributed to the owners, payments to Jurisdiction J for income taxes should be treated as a transaction with the owners. The result would not change even if there were an

agreement between Entity A and its two partners requiring Entity A to reimburse Partners 1 and 2 for any taxes the partners may owe to Jurisdiction J. This is because attribution is based on the laws and regulations of the taxing authority rather than on obligations imposed by agreements between an entity and its owners.

> > Example 36: Attribution of Income Taxes to the Entity or Its Owners

740-10-55-227 If the fact pattern in paragraph 740-10-55-226 changed such that Jurisdiction J has no provision for the owners to file tax returns and the laws and regulations of Jurisdiction J do not indicate that the payments are made on behalf of Partners 1 and 2, income taxes are attributed to Entity A on the basis of Jurisdiction J's laws and are accounted for based on the guidance in this Subtopic.

> > Example 37: Attribution of Income Taxes to the Entity or Its Owners

740-10-55-228 Entity S, an S Corporation, files a tax return in Jurisdiction J. An analysis of the laws and regulations of Jurisdiction J indicates that Jurisdiction J can hold Entity S and its owners jointly and severally liable for payment of income taxes. The laws and regulations also indicate that if payment is made by Entity S, the payments are made on behalf of the owners. Because the laws and regulations attribute the income tax to the owners regardless of who pays the tax, any payments to Jurisdiction J for income taxes should be treated as a transaction with its owners.

> > Example 38: Financial Statements of a Group of Related Entities

740-10-55-229 Entity A, a partnership with 2 partners, owns a 100 percent interest in Entity B and is required to issue consolidated financial statements. Entity B is a taxable entity that has unrecognized tax positions and a related liability for unrecognized tax benefits. Because entities within a consolidated or combined group should consider the tax positions of all entities within the group regardless of the tax status of the reporting entity, Entity A should include in its financial statements the assets, liabilities, income, and expenses of both Entity A and Entity B, including those relating to the implementation of this Subtopic to Entity B. This is required even though Entity A is a pass-through entity.

7. Add paragraph 740-10-65-2 and related heading as follows:

> Transition Related to Accounting Standards Update 2009-06

740-10-65-2 The following represents the transition and effective date information related to Accounting Standards Update 2009-06.

- a. For entities that are currently applying the standards for accounting for uncertainty in income taxes, the pending content that links to this

paragraph shall be effective for interim and annual periods ending after September 15, 2009.

- b. For those entities that have deferred the application of accounting for uncertainty in income taxes in accordance with paragraph 740-10-65-1(e), the pending content that links to this paragraph shall be effective upon adoption of those standards.
- c. The effective date guidance in 740-10-65-2(a) does not affect the effective date guidance for certain nonpublic entities in paragraph 740-10-65-1.

8. Amend paragraph 740-10-00-1 as follows:

Paragraph Number	Action	Accounting Standards Update	Date
Tax Position	Amended	2009-06	09/02/2009
740-10-15-2AA	Added	2009-06	09/02/2009
740-10-50-15	Amended	2009-06	09/02/2009
740-10-50-15A	Added	2009-06	09/02/2009
740-10-55-223	Added	2009-06	09/02/2009
740-10-55-224	Added	2009-06	09/02/2009
740-10-55-225	Added	2009-06	09/02/2009
740-10-55-226	Added	2009-06	09/02/2009
740-10-55-227	Added	2009-06	09/02/2009
740-10-55-228	Added	2009-06	09/02/2009
740-10-55-229	Added	2009-06	09/02/2009
740-10-65-2	Added	2009-06	09/02/2009

The amendments in this Update were adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
 Thomas J. Linsmeier
 Leslie F. Seidman
 Marc A. Siegel
 Lawrence W. Smith

Background Information and Basis for Conclusions

BC1. This section summarizes considerations that Board members deemed significant in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (now included in Subtopic 740-10), was issued in June 2006 and was effective for fiscal years beginning after December 15, 2006. Early adoption was permitted as of the beginning of an entity's fiscal year provided that the entity had not issued financial statements, including financial statements for any interim period, for that fiscal year. Paragraph 1 of Interpretation 48 states:

This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. . . . the requirements of this Interpretation apply to not-for-profit organizations. This Interpretation also applies to pass-through entities and entities whose tax liability is subject to 100 percent credit for dividends paid (for example, real estate investment trusts and registered investment companies) that are potentially subject to income taxes.

BC3. Interpretation 48 did not provide examples of how it applies to not-for-profit entities or pass-through entities, such as S Corporations or partnerships.

BC4. The Board issued FSP FIN 48-2, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, in February 2008 to defer the effective date of Interpretation 48 for nonpublic entities as defined in Statement 109 until annual financial statements for fiscal years beginning after December 15, 2007, unless the nonpublic entity is a consolidated entity of a public entity that applies U.S. GAAP or has issued a full set of U.S. GAAP annual financial statements before the issuance of FSP FIN 48-2 using the recognition, measurement, and disclosure requirements of Interpretation 48. The Board concluded that the deferral would give nonpublic entities the necessary time to implement Interpretation 48.

BC5. After the issuance of FSP FIN 48-2, the PCFRC and other constituents observed that questions remain about how to apply Interpretation 48 to pass-through entities and not-for-profit entities. In response to those concerns, the Board issued FSP FIN 48-3, *Effective Date of FASB Interpretation No. 48 for*

Certain Nonpublic Enterprises (also now included in Subtopic 740-10), in December 2008. That FSP extended the deferral of the effective date of Interpretation 48 to annual financial statements for fiscal years beginning after December 15, 2008. The Board concluded that the effective date deferral provided by FSP FIN 48-3 would give the Board the time necessary to develop guidance on the implementation of Interpretation 48 to pass-through entities and tax-exempt not-for-profit entities.

BC6. The proposed FSP of FSP FIN 48-3 asked that respondents identify specific examples of problems that private entities and not-for-profit entities would encounter in applying Interpretation 48. Respondents identified more than 20 issues. The comments and questions identified specific facts and circumstances relating to income taxes that might be paid by pass-through entities to federal, state, local, and foreign jurisdictions. Several comments addressed tax-exempt not-for-profit entities.

BC7. The Board identified four common issues among the comments and questions. The four issues are:

- a. Definition of an income tax
- b. Definition of a tax position
- c. Attribution of income taxes to the entity or its owners
- d. Financial statements of a group of related entities.

BC8. The Board decided not to address whether a particular tax is an income tax because the Board believes the determination of whether a tax is an income tax goes beyond the scope of this project. The purpose of this project is to provide guidance on how the guidance on accounting for uncertainty in income taxes applies to pass-through entities and not-for-profit entities. The issue of whether a tax is an income tax is discussed in the Income Taxes Topic (Topic 740) and applies to all entities—both public and nonpublic—whether or not they are pass-through entities or not-for-profit entities. This issue is not new to guidance related to uncertain tax positions.

BC9. The PCFRC also asserted that certain disclosures about uncertain tax positions were not useful to users of private company financial statements. Some Board members and staff met with users of private company financial statements from the PCFRC and others to discuss the disclosure requirements of Interpretation 48. After confirming that view with users, the Board decided to amend the disclosure requirements for nonpublic entities to eliminate the disclosures required by paragraph 740-10-50-15(a) through (b).

BC10. In May 2009, the Board issued proposed FSP FIN 48-d, *Application Guidance for Pass-through Entities and Tax-Exempt Not-for-Profit Entities and Disclosure Modifications for Nonpublic Entities*, for a 30-day comment period. The Board identified the following issues for consideration among the 14 comment letters received:

- a. Definition of an income tax
- b. Interaction of the proposed FSP with other income tax guidance
- c. Disclosures
- d. Effective date and transition guidance
- e. Scope considerations.

BC11. The Board affirmed its decision that the issue of whether or not a tax is an income tax goes beyond the scope of this project. The Board reached this decision because this issue applies to all entities—both public and nonpublic—regardless of whether they are pass-through entities or not-for-profit entities.

BC12. A respondent suggested clarifying whether the proposed guidance on attribution of an income tax to the entity or its owners conflicts with other guidance such as paragraph 740-10-15-4(b). The Board concluded, however, that the proposed guidance is not in conflict with the guidance found in paragraph 740-10-15-4(b) because both indicate that a payment by an entity that the owners may apply toward their personal income tax should be recorded as a transaction with owners and not as an income tax of the entity.

BC13. The Board received feedback from several respondents stating that if the disclosure requirements of paragraph 740-10-50-15(a) through (b) are eliminated for nonpublic entities, the proposed guidance should require the disclosure of the total unrecognized tax benefits at the balance sheet dates. They stated that the remaining disclosures within paragraph 740-10-50-15 would not be relevant without knowing the total unrecognized tax benefits. The Board concluded that the disclosure requirements in paragraph 740-10-50-15(c) through (e) still provide value for users of nonpublic entity financial statements even without the disclosure of total unrecognized tax benefits. As a result, the Board decided not to require nonpublic entities to disclose total unrecognized tax benefits at the balance sheet dates.

BC14. One respondent asked if a disclosure would be required if management determines that there are no unrecognized tax benefits to record. The Board concluded that such a disclosure would not be required because it will set a precedent for requiring a similar disclosure for all accounting standards for which there was no material effect on the financial statements.

BC15. A respondent suggested that the Board avoid using the term *credit* in paragraph 740-10-55-226 because *credit* has a broader meaning than how it is used in proposed FSP FIN 48-d. That respondent stated that using the term *credit* could create confusion in applying the concept in this example. The respondent suggested substituting a description such as *a payment used against the tax liability of the owners* rather than the term *credit*. The Board agreed with the respondent's request because it believes that description does not alter the intent or meaning of paragraph 740-10-15-226 and it may help to avoid

unintended consequences due to the broader meaning of the term *credit*. As a result, the Board parenthetically noted this distinction within paragraph 740-10-55-226.

BC16. Several respondents suggested that the scope of Subtopic 740-10 relating to uncertain tax positions exclude public tax-exempt not-for-profit entities. They referred to tax-exempt not-for-profit entities that are deemed “public” because they are conduit bond obligors for conduit debt securities that are traded in a public market. The Board decided that this comment relates to whether an entity is considered a public or nonpublic entity because of conduit debt and is an issue that is not unique to tax-exempt entities. As a result, the Board concluded that this issue is beyond the scope of this project and should not be addressed at this time.

BC17. The Board received feedback that an “SFAS 5 approach” to evaluating uncertain tax positions is a better alternative for nonpublic entities than the guidance in Subtopic 740-10 relating to accounting for uncertainty in income taxes. Because many nonpublic entities are pass-through entities, the Board decided that nonpublic entities should not be excluded from the scope of Subtopic 740-10 relating to accounting for uncertainty in income taxes because to exempt nonpublic entities would eliminate the requirement of management to evaluate whether or not they are in fact pass-through entities or tax-exempt not-for-profit entities. The Board decided that an entity’s status is the most significant position taken by many nonpublic entities and should not be ignored.

BC18. To allow sufficient time for entities that are currently applying Subtopic 740-10 relating to accounting for uncertainty in income taxes to apply this guidance properly, the Board concluded that for those entities, the guidance and disclosure amendments to the U.S. GAAP resulting from the amendments in this Update should be effective for financial statements issued for interim and annual periods ending after September 15, 2009. For those entities that have deferred the application of accounting for uncertainty in income taxes in accordance with paragraph 740-10-65-1(e), the guidance and disclosure amendments to the U.S. GAAP should be effective upon adoption of Subtopic 740-10 relating to accounting for uncertainty in income taxes. Those amendments do not affect the effective date guidance for certain nonpublic entities described in paragraph 740-10-65-1.

Amendments to the XBRL Taxonomy

There are no additional XBRL elements as a result of the amendments in this Update.