Perspective

Procedure

In 2009, private companies are required to adopt Financial Accounting Standards Board Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes. In this article, authors Douglas M. Sayuk, Matthew H. Fricke, and Shamen R. Dugger, of Clifton Douglas LLP, review the FIN 48 requirements and discuss why, for private companies, multistate issues may often trump federal and international issues. The authors also address four key areas giving rise to multistate income tax issues, delineating aspects of risk and providing guidance for FIN 48 analysis.

Private Company FIN 48 Adoption: Multistate Tax Positions May Prove Difficult to Defend in Today's Strapped Economy

By Douglas M. Sayuk, Matthew H. Fricke,
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INTRODUCTION

With the adoption of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48)[1] now a requirement for private companies during 2009, a review for uncertainty of income tax positions taken or expected to be taken by private companies on their income tax returns is imminent. Due to the lagging economy and resulting aggressiveness of states attempting to rejuvenate their financial status, multistate tax positions likely will prove particularly arduous for private companies becoming FIN 48 compliant. State tax positions generally will require thorough analyses and supporting documentation to meet FIN 48's ''more-likely-than-not'' threshold for financial statement recognition in the current economic environment. Common state income tax positions that are likely to receive the most scrutiny from state taxing authorities are as follows:

- decisions not to file a state income tax return;
- apportionment percentages;
- separate versus combined/consolidated filing methods, as well as water's edge elections; and
- tax attributes, including net operating loss and credit carryforwards.

Per FIN 48 guidelines, ''in assessing recognition it shall be presumed that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information.''[2] The American Institute of Certified Public Accountants (AICPA) provides further guidance that:

> The determination of what constitutes an individual tax position (the unit of account) may directly affect the assessment of the uncertain tax position and is a matter of professional judgment. In making that determination, the financial statement preparer should

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[1] Guidance regarding accounting for income tax uncertainties was previously found within FASB Interpretation No. 48 (FIN 48), but no longer for financial statements issued for interim and annual periods ending after Sept. 15, 2009. At that time, all nongovernmental entities will be required to use the FASB Accounting Standards Codification (ASC), which will be the sole source of authoritative U.S. accounting and reporting standards, in addition to guidance issued by the Securities and Exchange Commission (SEC). FIN 48 is referenced as FASB ASC 740-10 under the new codification system. FASB Statement No. 109, *Accounting for Income Taxes*, (FAS 109) is referenced as FASB ASC 740.

[2] FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, ¶ 7(a).

consider . . . the level at which it expects tax authorities to address the issues during an examination.[3]

Therefore, although it must be assumed that all multistate tax positions will be examined by state taxing authorities, the level at which those tax positions are examined should be considered in light of the current challenging economic climate and increased aggressiveness of state tax authorities. Simply stated, in identifying FIN 48 uncertain tax positions, companies should expect state audits and prepare for them with the understanding that state deficits are on the line.

Once multistate tax positions have been identified, they must be analyzed for recognition in the financial statements (*i.e.*, more–likely-than-not to be sustained on audit) and subsequently measured applying FIN 48's cumulative probability analysis to determine how much of the tax benefit and/or liability may be recognized. For those tax positions meeting the recognition threshold, the current challenging economic environment will add complexity to measurement because no objective standards for assigning probabilities have been established. During 2007, public companies made a good faith effort to apply reasonable probability assessments to varying levels of tax position sustention based on prior audit experience, available primary and secondary authority, and administrative practices and standards. Private companies adopting during 2009 must take into account all factors considered by public companies, in addition to heightened scrutiny of state income tax positions as jurisdictions react to budgetary pressures.

In this article, we will review the requirements of FIN 48 in light of private company adoption, highlighting differences as well as synergies with public company adoption and discussing why multistate issues may often trump federal and international issues from a private company perspective. We will then address each of the four key areas giving rise to multistate income tax issues, as noted above, delineating aspects of risk and providing guidance for FIN 48 analysis. Finally, we will outline the anticipated financial statement multistate impacts resulting from private company FIN 48 adoption.

BACKGROUND

On July 13, 2006, the Financial Accounting Standards Board issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, effective for fiscal years beginning after Dec. 15, 2006.[4] This interpretation is intended to clarify 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*, by prescribing a more-likely-than-not threshold to recognize any benefit of a tax position taken or expected to be taken in a tax return. Tax positions that meet the recognition threshold are reported at the largest amount that is more-likely-than-not to be realized. Public companies were generally required to adopt FIN 48 during 2007, whereas most private companies were granted an adoption deferral due to a consensus that additional time was necessary for private company adoption. The deferral ended for tax years beginning after Dec. 15, 2008. Therefore, most private companies will adopt FIN 48 for fiscal years ended during 2009.

Although there are some additional, potentially significant, considerations that should be taken into account by private companies before adopting FIN 48 during 2009, we do not believe these considerations will materially impact the 2009 adoption process.[5] Therefore, private companies should leverage FIN 48 adoption processes of their public counterparts as foundations, while incorporating general concerns germane to the private sector.[6]

One of the key adoption areas private companies can leverage from their public counterparts relates to multistate tax positions, barring one important consideration: the economic climate during 2009 is significantly different from that of 2007 when public companies adopted FIN 48. Private companies may apply the same public company multistate tax position adoption analyses, but should account for the potentially heightened scrutiny of state taxing authorities in terms of tax position identification (*i.e.*, unit of account assessment), recognition, and measurement.

Private companies may apply the same public company multistate tax position adoption analyses, but should account for the potentially heightened scrutiny of state taxing authorities.

According to a *Wall Street Journal* article dated June 3, 2009,[7]

[3] American Institute of Certified Public Accountants (AICPA), *Practice Guide on Accounting for Uncertain Tax Positions under FIN 48,* Nov. 29, 2006.

[4] Uncertain tax positions were previously accounted for under Financial Accounting Standard No. 5 (FAS 5), *Accounting for Contingencies*. Under this guidance, the evaluation of tax positions by a company was typically limited to positions judged to be uncertain. The company did not evaluate tax positions judged not to be uncertain, and the benefits of these positions were recognized in the financial statements.

[5] The International Accounting Standards Board (IASB) proposed changes to FIN 48 (Exposure Draft/2009/2 Income Tax) could be significant, but approval is highly improbable during calendar year 2009 and FASB adoption is speculative at best. Although the ASC codification is effective during 2009, likely the only impact to private company FIN 48 adoption is a change to referencing in required financial statement disclosures. Finally, based on our discussions with FASB's Private Company Financial Reporting Group, no other variances between private company and public company FIN 48 disclosures are anticipated outside of those noted in Accounting Standards Update No. 2009-06. Therefore, barring these considerations, private company FIN 48 adoption should mirror public company FIN 48 adoption in most respects.

[6] Among other differences, private companies often have limited tax personnel, few internal controls as they are not subject to the Sarbanes-Oxley Act (SOX 404), little or no audit history with taxing authorities due to their smaller size, and less documentation to support tax positions. These factors could increase the complexity associated with private company adoption relative to their public counterparts.

[7] Amy Merrick, ''States' Budget Woes are Poised to Worsen,'' *The Wall Street Journal*, June 3, 2009.

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states face aggregate budget shortfalls of at least $230 billion from fiscal 2009 through fiscal 2011. For most states, that covers the period from July 1, 2008 to June 30, 2011. That aggregate figure is nearly double the roughly $130 billion in federal stimulus funds that states can use flexibly over three years. When today's federal assistance peters out, a number of state budget officers don't expect new tax revenue to replace it. As the recession grinds on, states are posting significant declines in revenue from their three major sources: sales, personal income, and corporate taxes.

Per the following data (*see table next page*) prepared by the Center on Budget and Policy Priorities (CBPP) and updated as of Sept. 3, 2009,[8] the majority of states and the District of Columbia faced a budget deficit in the fiscal year ended June 30, 2009. California had the largest deficit ($37 billion), followed by New York ($7 billion), New Jersey ($6 billion), Florida ($5.7 billion), and Massachusetts ($5.2 billion). Many state budget gaps are expected to continue through fiscal year ending June 30, 2011, with at least 48 states addressing or facing shortfalls. Because states cannot borrow easily, many will be required to find other sources of revenue from reserves, cutting expenditures, raising taxes, and becoming generally more aggressive with respect to state audits.

State taxing authorities eager to replenish their dwindling coffers likely will be more aggressive with respect to all material state tax positions.

From a practical perspective, this data suggests state taxing authorities eager to replenish their dwindling coffers likely will be more aggressive with respect to all material state tax positions such as nexus (*i.e.*, requirements to file corporate income tax returns), apportionment, filing methods (*i.e.*, separate versus combined/consolidated reporting), and tax attributes. From a FIN 48 perspective, as discussed above, this data indicates tax position identification (*i.e.*, unit of account assessment), recognition, and measurement all must be considered relative to how a company expects state tax authorities to address the issues during an examination, *i.e.*, state income tax uncertainties must be considered in light of state taxing authorities' fiscal motives. Specifically, in our current challenging economy, states are more likely to:

- require extensive support for tax positions taken on a state income tax return;
- lower monetary assessment thresholds for triggering an audit;
- review existing tax statutes for revenue generation opportunities and submit notices of proposed adjustments (NOPA) and questionnaires where potential revenue exists; and
- interpret statutes, regulations, and case law strictly and to the taxing authorities' advantage.

In the following section we will address each of these material state tax positions in light of FIN 48 guidelines and the general assumption that, practically speaking, all state taxing authorities will be increasingly aggressive with respect to reviewing and auditing open tax years.

KEY MULTISTATE TAX POSITIONS

State Tax Nexus

With respect to state tax nexus, the primary FIN 48 issues relate to whether a state income tax filing requirement exists. Over the years states have become increasingly aggressive in this area, finding nexus with the slightest connection.

Initially state income tax nexus was established primarily through a physical presence.[11] However, the courts have increasingly de-emphasized physical presence in favor of economic presence, beginning with the landmark case *Quill Corp. v. North Dakota*.[12] In that case, the U.S. Supreme Court provides ''within the context of contemporary society and commercial practice, we conclude that the concept of nexus encompasses more than mere physical presence within the State, and that the determination of nexus should take into consideration all connections between the out–of–state seller and the state, all benefits and opportunities provided by the State, and should stress economic realities rather than artificial benchmarks.'' The South Carolina Supreme Court further applied *Quill* concepts of state nexus in *Geoffrey Inc. v. South Carolina Tax Comn.*,[13] wherein state nexus was found to exist via a slight physical presence and a significant economic presence derived from licensing intangibles.

The potential for state income tax nexus should be evaluated in conjunction with audit expectations.

Since these landmark cases were decided and despite Pub. L. No. 86-272,[14] states have found nexus to

[8] The Center on Budget and Policy Priorities is one of the nation's premier policy organizations working at the federal and state levels on fiscal policy and public programs. Among other objectives, the CBPP examines the short- and long-term impacts of proposed policies on the health of the economy and the soundness of federal and state budgets. The CBPP explores whether federal and state governments are fiscally sound and have sufficient revenue to address critical priorities, both for low-income populations and for the nation as a whole.

[11] *National Bellas Hess Inc. v. Illinois Dept. of Rev.*, 386 U.S. 753 (1967).

[12] *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992).

[13] *Geoffrey Inc. v. South Carolina Tax Comn.*, 437 S.E.2d 13 (1993).

[14] Pub. L. No. 86-272 provides federal legislation which prohibits a state from imposing an income tax (directly or indirectly) upon a taxpayer whose only activity within the state is ''solicitation'' of orders for the sale of tangible personal property, where the orders are sent outside the state for approval and, if approved, are filled and delivered from a stock of goods located outside the state. Pub. L. No. 86-272 is applicable only to direct or indirect state income taxes, and only to businesses which derive their income from the sale of tangible personal property. A company that derives income in the state from

other than the sale of tangible personal property may not be protected.

exist with even the slightest presence (be it physical or economic) via licensing of intangibles, agency relationships, and even an employee's personal residence, to highlight a few examples. State budget shortfalls are

CBPP Projected State Budget Deficits 2009 to 2011

State	FY 2009 Actual Budget Deficit[9]	FY 2010 Projected Deficit	FY 2011 Projected Deficit[10]
Alabama	$1.1 billion	$1.2 billion	N/A
Alaska	$360 million	$1.3 billion	$677 million
Arizona	$3.7 billion	$4 billion	$2.6 billion
Arkansas	$107 million	$146 million	ND
California	$37.1 billion	$45.5 billion	$15 billion
Colorado	$1.1 billion	$1.4 billion	$1.3 billion
Connecticut	$2.7 billion	$4.2 billion	$4.4 billion
Delaware	$443 million	$557 million	ND
District of Columbia	$679 million	$800 million	ND
Florida	$5.7 billion	$5.9 billion	$5 billion
Georgia	$2.4 billion	$4.1 billion	$1.3 billion
Hawaii	$417 million	$978 million	$320 million
Idaho	$452 million	$411 million	ND
Illinois	$4.3 billion	$13.2 billion	$10.4 billion
Indiana	$1.2 billion	$1.1 billion	$316 million
Iowa	$484 million	$779 million	N/A
Kansas	$186 million	$1.6 billion	$412 million
Kentucky	$722 million	$1.1 billion	$598 million
Louisiana	$341 million	$1.8 billion	ND
Maine	$265 million	$640 million	ND
Maryland	$1.5 billion	$2.6 billion	$1.2 billion
Massachusetts	$5.2 billion	$5 billion	N/A
Michigan	$2 billion	$2.8 billion	$2.7 billion
Minnesota	$1.6 billion	$3.2 billion	ND
Mississippi	$453 million	$480 million	$544 million
Missouri	$542 million	$923 million	ND
Nebraska	ND	$150 million	$150 million
Nevada	$1.6 billion	$1.2 billion	ND
New Hampshire	$250 million	$250 million	$250 million
New Jersey	$6.1 billion	$8.8 billion	$6 billion
New Mexico	$454 million	$777.6 million	$318 million
New York	$7.4 billion	$20 billion	$4.6 billion
North Carolina	$3.2 billion	$4.6 billion	$4.4 billion
Ohio	$2.6 billion	$3.3 billion	$1.1 billion
Oklahoma	$114 million	$777 million	$725 million
Oregon	$442 million	Included w/ FYE 2011	$4.2 billion
Pennsylvania	$3.2 billion	$4.8 billion	$4.1 billion
Rhode Island	$872 million	$655 million	$197 million
South Carolina	$1.1 billion	$725 million	ND
South Dakota	$27 million	$32 million	ND
Tennessee	$1.5 billion	$1 billion	ND
Texas	ND	$3.5 billion	ND
Utah	$620 million	$1 billion	$700 million
Vermont	$141 million	$306 million	$82 million
Virginia	$2.3 billion	$3.3 billion	N/A
Washington	$1.3 billion	$3.6 billion	N/A
West Virginia	ND	$184 million	$243 million
Wisconsin	$1.7 billion	$3.2 billion	N/A
Wyoming	$119 million	$32 million	$147 million
Total	***$109.9 billion***	***$167.6 billion***	***$73.9 billion***

[9] ND indicates no state deficit was recorded for FY 2009. In most cases these shortfalls have already been addressed.
[10] ND indicates no state deficit was projected for FY 2011. N/A indicates data was not available.

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likely to exacerbate this trend as taxing authorities attempt to alleviate the fiscal strain. From a FIN 48 perspective, this means uncertainty with respect to a company's state income tax filings is at an all-time high and illustrative examples provided by the FIN 48 pronouncement should be evaluated for guidance.

FIN 48 ¶ A14 describes a situation in which a company has filed state tax returns for each year that it believes business has been conducted, but is uncertain of the exact date it began doing business or first had nexus. Upon adoption, FIN 48 requires a review of all open tax years and provides guidance in terms of assessing which years are open to audit in ¶ A15. This paragraph suggests the company should rely on its familiarity with the administrative practices and precedents of jurisdictions, specifically statutes of limitation, in determining whether it is more-likely-than-not that a tax return is not required to be filed at an earlier date. Therefore, it would appear that although current state budget deficits and assessment proclivity should be a consideration with respect to nexus uncertainty, past practices and precedents are equally reliable in assessing FIN 48 exposure.

In order to thoroughly address this uncertainty, we recommend listing all states in which your company has the slightest physical and/or economic presence, noting all state activities, including those where the perception could exist that your company is availing itself of some benefit (be it monetary or otherwise), potentially giving rise to state income tax nexus and a resulting state filing requirement. That being said, the potential for state income tax nexus should be evaluated in conjunction with audit expectations. Even though nexus may exist from a FIN 48 perspective, the corresponding potential tax exposure may fall below audit thresholds of materiality for fair, accurate, objective, and impartial accounting and financial reporting. This result is especially possible in the case of private companies that have generated losses since inception, wherein state income tax nexus would result in no tax liability or only minimum taxes due.

Apportionment

State apportionment is another area ripe for FIN 48 uncertainty within the current challenging economic climate. As with state income tax nexus, over the years, states have become increasingly aggressive extending their reach as far as possible to increase apportioned state income, as well as modifying state apportionment rules to their benefit.

Once a company is determined to have nexus with a state, it must apportion taxable income to that state based on the state's requisite apportionment factor. The traditional formula[15] of allocation and apportionment of operating income and losses—the three factors of property, payroll, and sales[16]—appears equitable and rather straightforward in a perfect world where all payroll, property, and sales are clearly sourced within one state. The difficulty arises in the real world where companies employ workers operating in several states, own or rent property in transit across multiple states, and make sales to destination states where no nexus exists. In this convoluted real world, apportionment becomes an exercise in ambiguity and, more importantly for FIN 48 purposes, an opportunity for states to assess additional income tax.

Apportionment becomes an exercise in ambiguity and, more importantly for FIN 48 purposes, an opportunity for states to assess additional income tax.

For example, New Jersey requires 100 percent apportionment to their state if the taxpayer cannot prove it maintained a regular place of business outside New Jersey. In this case, sales that should properly be sourced to a destination state where nexus exists must be included in New Jersey apportionment, unless evidence supporting a regular place of business outside New Jersey is available. In addition, the generic ''three-factor apportionment formula'' is being modified in various states to include a double-weighted sales factor or minimized entirely to a single sales factor apportionment formula, both changes with the jurisdictional intention of incentivizing certain in-state activities over other out-of-state activities. These apportionment factor changes could be overlooked, creating further FIN 48 exposure.

In order to thoroughly address this uncertainty, we recommend listing all states where your company has been filing income tax returns along with the corresponding income apportionment percentages. Those states with material jurisdictional apportionment percentages should be analyzed thoroughly to ensure the percentage is accurate. But even those states with low apportionment may require review depending on your company's tax status. As with state nexus, the corresponding tax exposure should be evaluated in conjunction with audit expectations. Even though apportionment uncertainty may exist from a FIN 48 perspective, the corresponding potential tax exposure may fall below audit thresholds of materiality for fair, accurate, objective, and impartial accounting and financial reporting. This result is especially possible in the case of private companies that have generated losses since inception, wherein modified state apportionment would

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[15] Each factor is expressed as a fraction the numerator of which is the taxpayer's property (or payroll or sales) within the state and the denominator of which is the taxpayer's property (or payroll or sales) everywhere. The average of the three factors (usually converted from a fraction to a percentage and called the ''apportionment percentage'') is then applied to the apportionment base (the total business income of the unitary business) to determine the amount of income of the multistate business that is taxable by the state in question.

[16] The U.S. Supreme Court has said the three-factor formula has become ''something of a benchmark against which other apportionment formulas are judged.'' *Container Corp. of America v. California Franch. Tax Board,* 463 U.S. 159 (1983), *reh'g denied*, 464 U.S. 909 (1983). More recently, the court approved this same formula for apportionment of the tax base under a value-added tax. *Trinova Corp. v. Michigan Dept. of Treas.*, 498 U.S. 358 (1991).

result in no additional tax liability or only minimum taxes due.

Filing Methods

Approximately half of states require separate reporting, so assuming your company is filing accurate separate returns in these jurisdictions, filing methods for these states should not be a material FIN 48 issue. It is the other half, the half that either allows or mandates combined or consolidated reporting, that is problematic and may result in FIN 48 uncertainty due to the potentially very different tax liabilities associated with application of these three methods, *i.e.*, separate, combined, or consolidated reporting.

If your company is operating at a loss with respect to all its entities, then the issue of filing methods may fall below audit thresholds of materiality.

Combined returns are filed for corporate groups conducting a unitary business. The determination of ''unity'' generally rests on a highly subjective facts and circumstances test as to whether related companies demonstrate common ownership and economic interdependencies such as centralized management, functional integration, and economies of scale. Consolidated returns are filed for affiliated corporations meeting common ownership requirements. Generally an affiliated group is a group of corporations with a common parent that owns at least 80 percent of the voting stock and value of all the stock of at least one member corporation. Combined and consolidated reporting generally expands a state's tax base making it less susceptible to manipulation.

In today's strapped economy, states are becoming more aggressive with respect to contending whichever filing method results in the greatest state income tax liability is accurate. The subjective unitary rules allow states to be aggressive, which means a company must document its rationale for filing positions if some form of combined filing exists within a state (be it water's edge or otherwise). Similar to the considerations noted above, if your company is operating at a loss with respect to all its entities, then the issue of filing methods may fall below audit thresholds of materiality for fair, accurate, objective, and impartial accounting and financial reporting. However, companies with some entity profit should review their current filing methods for key states ensuring adequate support exists for such methods.

Tax Attributes

Tax attributes are a direct offset to state taxable income (most commonly in the case of net operating loss deductions) and state income tax liabilities (most commonly in the case of income tax credits). Proportionately, tax attributes generally offer the greatest potential revenue benefit relative to expended audit costs. Therefore, they are high on state tax authorities' radars for review and potential disallowance if qualifying criteria are not met and/or adequate supporting documentation does not exist.

The primary areas of uncertainty with respect to state net operating loss deductions are whether:

- any ownership change limitations exist per the federal I.R.C. §382 limitation, and
- any limitations exist with respect to utilizing pre-acquisition net operating losses against post-acquisition taxable income.

Section 382 limitations apply when a company experiences a greater than 50 percent ownership change over a three-year period, either by an acquisition, disposition, or shift in equity ownership. This section and related regulations limit the amount of post-change taxable income that may be reduced by pre-change tax attributes such as net operating losses. In addition, net operating loss utilization may be limited if the losses were generated by another company subsequently acquired by the taxpayer. States vary significantly in their allowance of these pre-acquisition losses against post-acquisition separate or combined/consolidated taxable income. Some states allow loss utilization without restriction, some deny utilization completely, and others apply a hybrid approach where typically only a portion of the pre-acquisition losses may be utilized to offset post-acquisition income.

The primary areas of uncertainty with respect to state income tax credits are whether:

- the company has met all requirements for qualification,
- the company has maintained adequate support to sustain the credits on audit,
- any ownership change limitations exist per the federal I.R.C. §383 limitation, and
- any limitations exist with respect to utilizing pre-acquisition income tax credits against post-acquisition income tax.

Although there are a variety of state income tax credits, most companies claim the following three types of credits: research credits, investment credits, and/or hiring credits. Very specific tax laws, regulations, and case law, as well as applicable secondary sources, must be applied in claiming these credits. Oftentimes this task is not easy because the guidelines can be ambiguous and subjective requiring extensive analyses for qualification. In addition, extensive contemporaneous documentation is generally required to sustain these credits on audit for all open tax years in which a credit has been claimed. Similar to net operating loss deductions, there also exist potential limitations on the utilization of credits due to ownership changes and restrictions against post-acquisition usage of pre-acquisition credits.

Proportionately, tax attributes generally offer the greatest potential revenue benefit relative to expended audit costs. Therefore, they are high on state tax authorities' radars for review.

In order to address these uncertainties, we recommend that your company first assess its tax status for open tax years. If your company has consistently generated losses thereby calling into question whether tax at-

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tributes will be utilized before expiration, then a detailed analysis of all areas of uncertainty discussed above may not be warranted at adoption time. Gathering sufficient data to meet the recognition threshold may suffice. However, if your company is currently utilizing tax attributes or anticipates utilization in the near future, then a detailed analysis of these areas of uncertainty is required.

These detailed analyses generally take the form of ''studies'' performed in-house or out-sourced, which involve intricate reviews of qualifying criteria, extensive assembling of supporting data, and limitation calculations. Costs for these studies vary depending on many factors, including number of open tax years, size of the company, amount of the tax attribute, and the extent of supporting data already assembled. Again, even though tax attribute uncertainty may exist from a FIN 48 perspective, the corresponding potential tax exposure may fall below audit thresholds of materiality for fair, accurate, objective, and impartial accounting and financial reporting. It is, therefore, prudent to consult your independent auditing firm before undertaking the often-times extensive effort to complete a thorough and accurate study.

FINANCIAL STATEMENT IMPACTS OF MULTISTATE TAX POSITIONS

With respect to financial statement impacts, private company FIN 48 adoption will be somewhat different from public company FIN 48 adoption, particularly with respect to requisite disclosures. Disclosures required by paragraphs ASC 740-10-50-15 (a) through (b) for public entities are eliminated for nonpublic entities. This means a tabular reconciliation of the total amount of unrecognized tax benefits at the beginning and end of the periods presented as well as disclosure of the total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate are not required for private company FIN 48 disclosures.[17] In addition, because private company financial statements do not contain a ''Management's Discussion and Analysis'' (MD&A) section, the pronouncement adoption will likely appear within the income taxes and recent accounting pronouncements sections of the ''Summary of Significant Accounting Policies.''

Outside of FIN 48 disclosures, there could be balance sheet and/or income statement impacts from adoption depending on the company's tax status and FIN 48 analyses, such as reductions to deferred tax assets, establishment of FIN 48 liabilities, and/or adjustments to retained earnings.

Loss Company

In adopting FIN 48, multistate tax positions likely will impact loss companies with a full valuation allowance only from a disclosure perspective. If the company has generated losses since inception and operates primarily in one state jurisdiction, it is likely the only two material tax positions requiring FIN 48 analysis are state net operating losses and tax credits. Assuming these tax positions meet the requisite recognition threshold and are measured at 100 percent sustention, no FIN 48 adjustments are required. However, in the more likely instance that the tax positions meet the recognition threshold but are measured at an amount less than 100 percent, deferred tax assets disclosed in the financial statement footnotes should be reduced accordingly. The result is simply a disclosure without impacting the balance sheet and/or income statement, since these deferred tax assets are fully offset by valuation allowance.

Profitable Company

In adopting FIN 48 for a profitable, more complex company operating in multiple jurisdictions and without offsetting valuation allowance against deferred tax assets, there likely will be more than two material tax positions related to net operating losses and tax credits. The other three common multistate tax issues discussed above (*i.e.*, nexus, apportionment, and filing methods) likely will need to be addressed under FIN 48 guidelines. In this case, there may be insufficient support to meet the recognition threshold, thereby resulting in no tax benefit recognized in the financial statements and the recordation of a corresponding FIN 48 liability. It may be that the tax position meets the recognition threshold, but is measured at something less than 100 percent. In this case, if the underlying tax attribute has been utilized and no offsetting valuation allowance exists, then a mere reduction to deferred tax assets will not suffice. Rather, a FIN 48 liability must be established and penalties and interest disclosed.

CONCLUSION

The current challenging economic environment and generally more aggressive state taxing authorities will add complexity to addressing multistate tax positions as part of private company FIN 48 adoption during 2009. However, this complexity may be mitigated by leveraging public company adoption analyses for multistate tax positions and evaluating your company's tax positions in terms of the most common areas for exposure, i.e., nexus, apportionment, filing methods, and tax attributes. In addition, considering these common areas of multistate tax exposure in light of your company's tax status will assist in streamlining this part of the FIN 48 adoption process. Private loss companies with a full valuation allowance may have multistate tax issues, but in such minute amounts as to make them immaterial requiring less analysis and documentation. Profitable and complex private companies without full valuation allowances, on the other hand, may require intricate ''studies'' related to their multistate tax positions to become FIN 48 compliant. Regardless, all private companies adopting FIN 48 should consult their independent auditing firm before taking action with respect to potential FIN 48 tax exposure.

[17] Accounting Standards Update No. 2009-06, *Income Taxes (Topic 740), Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities.*