



*Accounting for Income Taxes:
FAS109/FIN 48
and Michigan Business Tax Update*

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Goals for the Session

- General overview of FAS 109
 - Temporary / Deferred Items
 - Permanent items
- Valuation allowances
- F/S Disclosure
- MBT
- FIN 48

Temporary Differences

A temporary difference is the difference between the tax basis of an asset or liability and its reported book basis that will result in taxable amounts or deductible amounts in future years.

Taxable amounts increase taxable income in future years, deductible amounts decrease taxable income in future years.

Permanent Differences

Permanent differences are caused by items that:

- Enter into pretax financial income, but **never** into taxable income (e.g. non-deductible items), or
- Enter into taxable income, but **never** into pretax financial income (e.g. dividends received deduction).

No deferred tax consequences to be recognized on permanent items.

Deferred Tax Asset

A deferred tax asset is the deferred tax consequence attributable to deductible temporary differences.

DTA = **Decrease** taxable income in the future

Generally, if there is a decrease in taxable income in the future it is currently an “unfavorable” M-1.

Example: The increase in an allowance for bad debts.

Deferred Tax Liability

A deferred tax liability is the deferred tax consequence attributable to taxable temporary differences.

DTL = Increase taxable income in the future

If we will increase taxable income in the future, then the item is currently a “favorable” M-1.

Example: Tax depreciation > book depreciation.

Valuation Allowances – Should a DTA be booked??

- A key issue for financial statements – should the deferred tax asset be booked?
- Must meet three conditions:
 - It results from a past transaction.
 - It gives rise to a probable benefit in the future.
 - The entity controls access to the benefit.

If you shouldn't book it...

Create a valuation allowance:

If it is “**more likely than not**” that some portion or all of the deferred tax asset will not be realized, then you must create a valuation allowance.

Allowance is evaluated every year.

Changes in the allowance are then booked.

Considerations

Carryback availability

Existing taxable temporary differences

Do you have significant DTLs that will turn soon?

Future income

Planned event that will create a taxable income/gain

i.e.— Sale of old asset with significant gain...

Tax planning strategies

If booking a VA

Considerations:

Spread of valuation allowance against deferred items whose effect runs through OCI

Future periods...

If increase DTA for NOL, the amortization of goodwill will change and create tax expense.

The increase in the valuation allowance for OCI assets will create tax expense.

Financial Statements

- The Income Statement
 - Income tax payable or refundable (B/S)
 - +/- Change in deferred (B/S)
 - Total income tax expense or benefit (I/S)
- Watch items that flow through Other Comprehensive Income
 - i.e., Pension asset
- All of those items are on statements and explained in the footnotes

Michigan Business Tax – Other State Income Tax Impact on FAS109

- MBT
 - *Income tax component*
 - *Gross receipts component*
- Deferred MBT on inception (2008)
- What does “below the line” mean?
- Calculating a state effective tax rate?

MBT – Modified Gross Receipts

Income tax

Federal Taxable Income
Plus/minus Adjustments
 Taxable Income
Times Apportionment %
 Apportioned income
Less MBT loss carry forward
 MBT Taxable Income
Times tax rate 4.95%
 Income tax

Gross Receipts tax

Gross Receipts
 Less Purchases from other firms:
 Inventory
 Depreciable assets
Materials and supplies
 Modified gross receipts
Times Apportionment %
 Apportioned Gross Receipts
Times Tax rate .8%
 Gross receipts tax

Income tax + Gross Receipts tax
× Surcharge
Less Credits

Michigan Business Tax

MBT

- Both components of the MBT tax, Business Income Tax (BIT) and Modified Gross Receipts Tax (MGRT), are considered income taxes under FAS 109
- Deferred tax must be calculated for the cumulative difference between book and tax basis for all items on the balance sheet
- Applies to all entity taxpayers – C Corporations, S Corporations, Partnerships, LLCs

Deferred MBT Income Tax

Book-tax differences will typically be the same for federal purposes

Some could be different – Bonus depreciation, DPAD, etc.

Accumulated differences are calculated and recorded

Deferred MGRT

Book basis for MGRT and BIT will be the same

Tax basis for MGRT and BIT will be different

Tax basis for the MGRT will be zero for all assets on the books as of any period prior to January 1, 2008

Unitary MBT Filings

- MBT Requires single MBT for common groups
- Tax Sharing Agreement/Tax to each member

What is FIN 48?

An interpretation to FAS 109

Requirement to book a liability for uncertain tax positions

FIN 48

FIN 48 applies to all GAAP financial statements

Any entity that pays tax, including:

- C Corporations
- S Corporations with State & Local Income Taxes
- Other pass-thru entities (partnerships & LLCs)
- Tax exempt with UBIT
- Any entity with International Operations

Effective Date

Interpretation is effective for fiscal years beginning after December 15, 2007. **Extension to after December 15, 2008**

What is a Tax Position

Tax Position:

As used in FIN 48 a position taken on 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.

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.

What is a tax position...

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.

When is a Tax Position Uncertain

1. More-likely-than-not Standard:

A tax position is uncertain when the likelihood (using a threshold of more than 50 percent) that a positive resolution would result for the position taken upon examination by any tax authority, based upon all evidence that the taxing authority (assume taken to the highest court).

When is a Tax Position Uncertain

2. In assessing the more-likely-than-not criterion, you must:

- Presume that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information, and;
- Evaluate based upon the technical merits of a tax position, derived from sources of authorities in the tax law and their applicability to the facts and circumstances of the tax position.
 - Each tax position must be evaluated without consideration of the possibility of offset or aggregation with other positions.

After determining uncertain TP

- Tax position must be more-likely-than-not of being upheld
 - Assuming:
 - The position will be examined
 - The examiner will have full knowledge of all relevant information
 - Evaluation based solely on technical merits
 - No offset or aggregation of positions
 - Resolution to be settled in highest court
- If not more-likely-than-not --must reserve full tax benefit reported
- If more than 50 percent, but less than 100 percent, measurement is required

Documentation

Regardless of the information used to support its position, management's documentation should capture its conclusions on each uncertainty and the documentation should stand on its own.

The documentation should include a description of the uncertain tax position, the tax return treatment, the tax technical merits of the position, and an assessment of the probability that the position will be sustained upon its technical merits or relevant administrative practices (i.e., prior IRS resolutions of like or similar issues).

Disclosure

Annual Reporting

The total amount of unrecognized tax benefits that, if recognized, would affect the effective tax rate

Total amount of interest and penalties recognized in the statement of operations and included in a reserve

Unrecognized tax benefits that may significantly increase or decrease within 12 months of the reporting date

A description of tax years that remain subject to examination by major tax jurisdictions

Michigan Update MBT Matters

- The Budget Battle
 - Changes to DATE
 - Surcharge
 - Sales and Use Tax on Services
 - Doctors Tax
 - Changes to Tax Credits

Michigan Update MBT Update

- New Look at current item
 - Proposed Rules & RAB's
 - Actively Solicits in Michigan
 - Controlled Group defined - RAB
 - Materials and Supplies Defined
 - Industrial Personal Property
 - Order of the Credits

Note: This document is intended for internal training purposes only

Circular 230

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The United States Federal tax advice, if any, contained in this document and its attachments may not be used or referred to in the promoting, marketing, or recommending of any entity, investment plan, or arrangement, nor is such advice intended or written to be used, and may not be used, by a taxpayer for the purposes of avoiding Federal tax penalties.

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“Who Has The First Question?”