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740-10-30EX7 Income Taxes–Initial Measurement–Determining income taxes payable or refundable and current tax expense or benefit.

EXP ¶ 740-10-30EX7 Income Taxes–Initial Measurement–Determining income taxes payable or refundable and current tax expense or benefit.

In order to make an initial or subsequent measurement of a **tax position** that meets the more-likely-than-not threshold for financial reporting purposes, a reporting entity must take into account both of the following:

- The possible tax settlement amounts; and
- The associated probabilities of achieving those amounts if the position is challenged by a tax regulator assumed to have complete information about the position. Those probabilities should be determined by considering all facts, circumstances, and other relevant information available at the reporting date.

(FASB ASC 740-10-30-7)

The amount of the tax position recorded must be the highest amount of tax benefits that is more than 50-percent likely to be achieved in the event that the position is challenged.

(FASB ASC 740-10-30-7)

The term “reporting date” is defined, for purposes of the guidance in Subtopic 740-10, Income Taxes—Overall, as the most recent balance sheet date of the entity.

(FASB ASC 740-10-30-7)

For further guidance on measuring the tax position to recognize in the financial statements and for illustrations of calculating this amount, see Examples 5 through 10 in the Implementation Guidance and Illustrations at **FASB ASC 740-10-55-99 through 55-116**.

(FASB ASC 740-10-30-7)



WG&L Observation: The guidance in **FASB ASC 740-10-30-7** is based on the statistical concept of a “cumulative probability.” One method for calculating a cumulative probability for use in this type of application is as follows:

1. List the possible tax position amounts in descending order;
2. For each position identified in item 1, determine the associated probability that the amount will be upheld if it is reviewed by the tax authority;
3. Beginning at the top of the list and moving downward, accumulate the probabilities as a running total (the dollar amounts of the tax positions are not accumulated); and
4. Choose the largest value of a tax position for which the cumulative probability is greater than 50 percent. If no amount has a greater than 50-percent cumulative probability, then the tax position is not recognized for the current reporting period.

An entity with multiple tax positions must repeat this process for each position.



WG&L Illustration: An entity has taken a position on its tax return of \$100,000 of potential future tax benefits. The tax authority has full knowledge about this position. The management of the entity determines that the key possible outcomes and their associated probabilities in the event that the tax position is examined by the tax authority are:

5% — \$100,000

25% — \$85,000

35% — \$45,000

30% — \$25,000

5% — \$0

The cumulative probabilities are calculated for each outcome by starting with the largest tax position and then accumulating the probability estimates by moving down the list of amounts. The dollar amounts are not accumulated; only the probabilities are accumulated. The possible outcomes and their cumulative probabilities in this example are:

5% — \$100,000

30% — \$85,000

65% — \$45,000


95% — \$25,000


100% — \$0

To determine the amount to recognize in the financial statements, the entity must choose the largest amount that has a greater than 50-percent cumulative probability of occurrence. In this example, the amount is \$45,000. Although \$25,000 and zero dollars both have a higher cumulative probability of occurrence than \$45,000, the reporting entity must recognize the largest outcome with a greater than 50-percent cumulative probability.



WG&L Illustration: A reporting entity has taken two tax positions for \$100,000. Each of those two tax positions has the same fact pattern and cumulative probability distribution as in the prior Illustration. The total amount that the entity must recognize in its financial statements, in this case, is \$90,000, or \$45,000 for each position.

 **WG&L Observation:** Management should keep all relevant supporting documentation for the amounts taken on their tax returns. This includes documentation to support how management determined the amount of the tax benefit that has a greater than 50-percent probability of being realized in the event of an examination. An entity must retain documentation supporting its tax positions for a sufficient period of time to comply with not only the relevant tax laws in the tax jurisdictions to which it is subject, but also any other applicable document-retention requirements that the entity must satisfy such as SEC rules, the Sarbanes-Oxley Act of 2002, or other relevant regulations.

 **WG&L Observation:** Assigning probabilities to the amounts of the tax benefits can be either a relatively easy or relatively complex task, depending on the entity's experience with the tax regulator for similar tax positions or on the entity's knowledge about how the tax regulator has resolved similar positions with other entities.