

PHARMA TAX NEWS

Vol. 5, No. 7

August 2006

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

Accounting for Uncertainty in Income Taxes, FASB Interpretation No. 48 from a 482 Perspective

FASB Interpretation 48 (FIN 48), governing the review of tax provisions with respect to “uncertain tax positions,” is among the most significant developments to affect corporate tax departments in recent years. Because transfer pricing is among the most common sources of uncertainty in tax reporting, FIN 48 is likely to apply in a great many instances to issues under Section 482. Because the text of FIN 48 refers explicitly to transfer pricing as a source of tax uncertainty, FIN 48 is of particular interest to Pharma companies.

The key element of FIN 48 is that for all fiscal years beginning after December 15, 2006, companies will need to estimate their potential exposures with respect to all open uncertain tax positions. Thus, the estimation is retrospective as well as prospective.

Ascertaining “Cumulative Probability”

With respect to positions such as those related to transfer pricing for which there is a continuous range of possible results, FIN 48 permits the reporting of financial benefits based on a concept of “cumulative probability.” Specifically, companies are to book the greatest benefit for which there is at least a 50 percent likelihood of a favorable outcome. For example, assume a company estimates that the probability that a tax authority will sustain a benefit worth at least \$100 million is 25%, the chance of sustention of a benefit worth at least \$50 million is 50%, and the chance of sustention of a benefit worth at least \$25 million is 75%. The company can record a benefit of \$50 million. The “cumulative probability” approach replaces a wide range of approaches that have been applied in the past to uncertain positions falling along a possible spectrum of results.

To reach the “more likely than not” comfort level, companies must presume the tax position will be examined by a tax authority with all relevant information. In addition, the technical merits of a tax position are

derived from multiple sources including legislation and intent, regulations, rulings, and case law as well as in many cases, past administrative practices and precedents. Finally, each tax position must be evaluated on its own merit without the consideration of offsets or aggregations.

FIN 48 devotes considerable attention to the transitional issues—and particularly the income adjustments—that are very likely to arise the first year that the new rules are implemented.

Clearly, complying with FIN 48 will require very detailed attention, with careful judgment applied to all significant potential transfer pricing exposures. All corporate personnel with responsibility for transfer pricing should become thoroughly familiar with FIN 48 and should be planning now for an efficient approach to compliance.

For more information, contact:

Michael Swanick, Partner
michael.f.swanick@us.pwc.com
 + 1-267-330-6060

John Kelly, Partner
john.m.kelly@ie.pwc.com
 + 353-1-662-6307

Visit our website at: www.pwc.com/pharma

Pharma Tax News is provided by PricewaterhouseCoopers LLP for general guidance only, and does not constitute the provision of legal advice, accounting services, investment advice, written tax advice under Circular 230 or professional advice of any kind. The information provided herein should not be used as a substitute for consultation with professional tax, accounting, legal, or other competent advisers. Before making any decision or taking any action, you should consult with a professional adviser who has been provided with all pertinent facts relevant to your particular situation. The information is provided ‘as is’ with no assurance or guarantee of completeness, accuracy, or timeliness of the information, and without warranty of any kind, express or implied, including but not limited to warranties or performance, merchantability, and fitness for a particular purpose.