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Effects of FIN 48 on Private Clubs

By Christopher W. Casini, CPA – Partner, and Garrett M. Higgins, CPA – Senior Tax Manager, O'Connor Davies Munns & Dobbins, LLP

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With the end of the calendar year approaching quickly, it is time for private clubs and other not-for-profit entities to begin researching the effects and start the implementation of FASB Interpretation No. 48 (FIN 48) Accounting for Uncertainty in Income Taxes.

For nonpublic entities, including private clubs and other not-for-profits, FIN 48 is applicable for years beginning after Dec. 15, 2008. This means that for clubs with calendar year-ends, FIN 48 will apply to the Dec. 31, 2009, financial statements. It is here and it is here to stay.

FIN 48 requires clubs to evaluate measures and disclose uncertain tax positions in their financial statements. Additionally, they are required to include the same wording from their footnote disclosure in IRS Form 990. These disclosure requirements essentially put red flags in the financial statements allowing taxing authorities to use them as road maps in event of an audit.

While most private clubs qualify as tax exempt under IRS code 501(c)(7), this does not mean they would not have uncertain tax positions. Uncertain tax positions can arise in a number of ways.

First, clubs should review their tax-exempt status. Are they still operating as originally intended? Are they involved in any activities that could jeopardize their tax-exempt status? This could be done by reviewing their articles of incorporation, bylaws, minutes of board meetings, correspondence with taxing authorities and their original applications for tax-exempt status.

Second, clubs must look at their “unrelated business income” (UBI), which they report to the IRS on Form 990-T. Are all sources of UBI being reported on the form? Are the expenses reasonable and allocable as deductions against UBI, and are they being properly reported? Does the club have net operating losses that it is deducting, and have these losses been calculated correctly? Is there too much UBI, which could possibly jeopardize the club’s tax-exempt status?

Additionally, clubs’ state tax status needs to be reviewed. Are they qualified as exempt for state tax purposes? Is their UBI subject to tax in states where they reside? Are they filing all of the appropriate state returns?

Clubs should look at their tax positions as if all of their income tax returns were being audited by the IRS as well as other tax authorities in their resident states. They should assume these taxing authorities would have complete knowledge of all of the information surrounding the club’s tax returns, including uncertain positions taken. Clubs must then consider the likelihood of being assessed additional tax based on this review. If there is a greater than 50 percent chance of additional tax being assessed upon audit by the taxing authorities, a liability should be measured and accrued and applicable disclosures made in the notes to the financial statements. Penalties and interest should also be accrued when applicable.

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Some steps clubs can take prior to year-end to prepare for possible accruals and disclosures are:

- Determine what their open tax years are for federal and state taxes
- Review documentation used to prepare and support their tax returns
- Review documentation and prepare schedules of tax positions taken
- Determine the likelihood of possible reversal of these tax positions upon audit
- Record accruals and draft footnote disclosures when appropriate

These schedules of tax positions should be maintained throughout the year, kept current and rolled forward to subsequent financial reporting periods.

It should be noted that FIN 48 does not apply to non-income tax items such as payroll, property or sales tax.

The FASB recently eliminated some of the onerous quantitative disclosures about unrecognized tax benefits; however, entities will still need to make disclosures in their financial statements about the following:

- Interest and penalties related to uncertain tax positions recognized in the financial statements
- Description and estimate of uncertain tax positions for where it is reasonably possible that amounts will change in the next year, and
- A description of open tax years that remain subject to examination by major jurisdiction

Clubs should work with their independent audit firms to determine the extent of the required disclosures. The auditors will more than likely require the club to provide them with management's assessment of the tax positions and risks related to them.

While this may seem like a voluminous task, remember, you are not alone. Most of your fellow clubs will also be embarking on this challenge for the first time. Together, along with the help of colleagues and an audit firm, you will be able to assess the requirements of FIN 48 and record the required disclosure.

National Club Association | 1201 15th Street NW, Suite 450 | Washington, DC 20005 | TEL: (202) 822-9822 | FAX: (202) 822-9808

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