Financial Accounting for State and Local Taxes

Policy Position

Position: *The various financial accounting rules under which businesses operate are to provide stakeholders in the financial marketplace with clear, consistent, and necessary information for evaluating the strength and future of a business. Thus, financial accounting rules for taxes must be in furtherance of providing such information to the financial marketplace and not for other regulatory or political goals. Such rules must also be carefully drafted to actually accomplish the goal of providing stakeholders with necessary information without imposing a disproportionate burden on the business. Regulatory bodies involved in financial accounting issues must recognize the unique issues and disproportionate impact accounting rules have on state tax issues due to the sheer number of taxing jurisdictions, types of taxes, and varying laws and interpretations. Unlike federal law, many state and local tax issues hinge on constitutional questions not subject to straightforward determination. Thus, such regulatory bodies must always solicit meaningful comments specifically on state and local tax issues from the affected community and such regulatory bodies must ensure themselves that they understand these issues and how their decision on financial accounting issues will affect state and local tax practices. Finally, tax disclosure rules should not put businesses at a disadvantage regarding disclosure of information to outside parties.*

Explanation: New accounting rules and new interpretations of existing rules are proliferating, and the level of scrutiny on a business's application of these rules has increased exponentially. This scrutiny is coming from multiple sources, including the financial marketplace, government regulatory authorities, and corporate outside auditors.

As long as financial accounting rules actually lead to the provision of necessary information to the stakeholders in the financial marketplace of business' financial strength and future, such rules are an important part of our system. However, such rules risk becoming counter-productive and an actual drain on our system when the rules: a) become so administratively burdensome or expensive to implement that the incremental knowledge to the financial markets is outweighed by the cost of implementation; b) require such detailed information that the general investor or lender would find it difficult to understand the implications of such information, c) provide information so voluminous as to make actual analysis unreasonable; or d) provide information as to strategy analysis, cost/benefit considerations, or other business decisions that are not necessary for the stakeholders' evaluation but puts the business at a disadvantage in the financial marketplace which ultimately negatively affects stakeholders.

State and local tax issues bear a disproportionate impact of changes in financial accounting rules interpretation or overly burdensome documentation or due diligence requirements. This disproportionate impact results from the sheer number of jurisdictions (as many as 7,500 jurisdictions depending on the tax at issue), types of taxes (income, franchise, sales, gross receipts, etc), and varying laws and interpretations. As an example, the Financial Accounting Standards Board's adoption in 2006 of Interpretation 48, "Accounting for Uncertainty in Income Taxes" (now ASC 740), has created extreme pressure and confusion for state and local tax professionals. While at the federal level, on any one issue there is only one taxing jurisdiction and one body of relevant legal precedent, at the state level there could be as many positions as there are jurisdictions imposing the tax. Further, the guidance at the state level, as compared to the federal level, is in many situations minimal, nonexistent, or contradictory (at least among the states but sometimes even within a state). Thus, application of a financial accounting standard that may be challenging but useful at the federal level could become misleading and useless at the state level if the accounting rules are not crafted with the unique issues in state and local tax in mind.

Thus, in order to accomplish the goal of providing necessary information to stakeholders in the financial marketplace, rules regarding accounting for taxes should:

- Specifically consider the unique issues arising at the state and local level;
- Adopt an easily understood and consistent format with realistic examples of application to state and local tax issues;
- Provide an appropriate time frame so that the information is received in time to be properly used but the information is not required to be disclosed until the reporting business could be expected to have all relevant data;
- Require information at a level necessary to the financial markets—not too granular, excessive, or in a format that could foster misunderstanding;
- Balance the cost in resources of providing the information against the benefits to the market in receiving such information;
- Enhance the consistency and rationality of our financial markets in general by avoiding “rules for rules sake”—clarity and bright line standards should be favored; and
- Above all, avoid specific disclosure of a business’s subjective analysis of its tax risk tolerance, its settlement thresholds, or other business concerns affecting the strategy, not the legitimacy, behind a tax position.