

IRS TO REQUIRE REPORTING OF UNCERTAIN TAX POSITIONS

February 2010

The IRS is developing a schedule to require certain business taxpayers to report uncertain tax positions on their tax returns. The announcement discusses the potential content of such a schedule and invites public comment on the proposed approach. IRS Commissioner Doug Shulman commented on the proposal in prepared remarks to the New York State Bar Association Taxation Section Annual Meeting in New York City, Jan. 26, 2010 appearing in a news release.

As explained below, the schedule will require the annual disclosure of uncertain tax positions in the form of a concise description of those positions and information about their magnitude. The taxpayer will not have to disclose its risk assessment or tax reserve amounts, even though under *U.S. v. Young & Co*, Arthur, (1984, S Ct) 53 AFTR 2d 84-866, IRS can compel the production of this information through a summons.

Notwithstanding the proposal, IRS plans to otherwise retain its existing policy of restraint as described in Ann. 2002-63, 2002-2 CB 72 (see Weekly Alert ¶ 3 06/20/2002). IRS says, however, it will continue to review the policy and to consider additional modifications as appropriate or necessary to ensure it obtains complete and accurate information regarding a taxpayer's uncertain tax positions on a timely basis.

UNCERTAIN TAX POSITIONS. The income tax system relies on taxpayers to make a self-assessment of tax and to file the appropriate form of return that shows the

facts upon which tax liability may be determined and assessed. To discharge its obligation to fairly and uniformly administer the tax laws, IRS must be able to identify quickly and efficiently significant issues (including uncertain tax positions) underlying the tax return. Existing business tax returns do not currently require that taxpayers identify and explain uncertain tax positions underlying their returns.

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Many taxpayers are required by FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48) to identify and quantify uncertain tax positions taken in the return for financial accounting purposes. That is, taxpayers must identify and quantify for financial accounting purposes a tax position relating to a specific Federal tax return for which a taxpayer is required to reserve an amount under FIN 48.

For background on FIN 48 see Weekly Alert ¶ 1 07/05/2007, discussing IRS guidance to its auditors on how to handle FIN 48 issues. A taxpayer's tax reserves and reporting regarding its uncertain tax positions may be reflected in its own books and records or financial statements, or in the books and records or financial statements of a related domestic or foreign entity. Taxpayers not subject to FIN 48 may be subject to other requirements regarding accounting for uncertain tax positions. For example, taxpayers may be subject to other generally accepted accounting standards.

The information developed in the course of complying with FIN 48 or other accounting standards is highly relevant to understanding the taxpayer's tax positions and assessing how they affect its tax liability. That information also would aid IRS in focusing its examination resources on returns that contain specific uncertain tax positions that are of particular interest or of sufficient magnitude to warrant IRS inquiry, as well as allowing examination teams to identify all of the issues underlying the tax returns more quickly and efficiently.

NEW SCHEDULE. IRS is developing a schedule that will require certain filers to provide information about their uncertain tax positions that affect their income tax liability. It will be filed with the Form 1120, U.S. Corporation Income Tax Return or other business returns. The schedule will require (i) a concise description of each uncertain tax position for which the taxpayer or a related entity has recorded a reserve in its financial statements and (ii) the maximum amount of potential Federal tax liability attributable to each uncertain tax position (determined without regard to the taxpayer's risk analysis regarding its likelihood of prevailing on the merits).

In addition to those positions for which a tax reserve must be established under FIN 48 or other accounting standards, uncertain tax positions will include any position related to the determination of any U.S. Federal income tax liability for which a taxpayer or a related entity has not recorded a tax reserve because (i) the taxpayer expects to litigate the position, or (ii) the taxpayer has determined that IRS has a general administrative practice not to examine the position.

The schedule will require a concise description of each uncertain tax position in sufficient detail so that IRS

could determine the nature of the issue. To be sufficient, the description will have to contain:

- (1) The Code sections potentially implicated by the position;
- (2) A description of the tax year or years to which the position relates;
- (3) A statement that the position involves an item of income, gain, loss, deduction, or credit against tax;
- (4) A statement that the position involves a permanent

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- inclusion or exclusion of any item, the timing of that item, or both;
- (5) A statement whether the position involves a determination of the value of any property or right; and
- (6) A statement whether the position involves a computation of basis.

In addition, the schedule will require a taxpayer to specify for each uncertain tax position the entire amount of U.S. Federal income tax that would be due if the position were disallowed in its entirety on audit. This amount is the maximum tax adjustment for the position reflecting all changes to items of income, gain, loss, deduction, or credit if the position is not sustained.

AFFECTED TAXPAYERS. IRS intends the new schedule to be filed by a business taxpayer with total assets in excess of \$10 million if the taxpayer has one or more uncertain tax positions of the type required to be reported on the new schedule. This includes a taxpayer who prepares financial statements, or is included in the financial statements of a related entity that prepares financial statements, if that taxpayer or related entity determines its U.S. Federal income tax reserves under FIN 48, or other accounting standards relating to uncertain tax positions involving United States Federal income tax.

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REQUEST FOR COMMENTS. Given the importance of these issues to both IRS and taxpayers, **IRS says it intends to publish the new schedule as quickly as possible and therefore invites the public to submit comments on the proposal by Mar. 29, 2010.** IRS intends to mandate that the new schedule for uncertain tax positions be filed with returns filed after the schedule's release. IRS is particularly interested in comments regarding:

... How the maximum tax adjustment should be reflected on the schedule so that it provides IRS with an objective and quantifiable measure of each reported tax position (e.g., specific dollar amount or by appropriate dollar ranges);

... What alternative methods of disclosure of the amount at issue would allow the IRS to identify the relative importance of the uncertain tax positions;

... Whether the calculation of the maximum tax adjustment should relate solely to the tax period for which the return is filed or to all tax periods to which the position relates, and whether net operating losses or excess credits should be taken into account in determining the maximum tax adjustment;

... How the related entity rules should be applied;

... Whether there should be a change to the uncertain tax positions for which information will be required to be reported;

... Whether transition rules should be used or criteria modified to either include or exclude certain businesses taxpayers (e.g., the proposed threshold of \$10 million total assets);

... How the new schedule should address taxpayers that initially did not record a reserve for an issue, but in later years do record a reserve; and

... Whether the list of information proposed to be included should be modified, including whether certain information should be requested in some circumstances upon examination rather than with tax return.

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