

Client Alert

Tax Department

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IRS Modifies Proposed Tax Disclosures of Uncertain Tax Positions

The Internal Revenue Service (the “Service”) now requires large corporations filing audited financial statements to provide a tax schedule of the taxpayer’s “uncertain tax positions” (Schedule UTP) beginning in tax year 2010.

The Service recently announced major changes to its draft Schedule UTP reflecting the large number of public comments received in response to its proposed schedule. The Service also announced that it is expanding its policy of restraint and, accordingly, will forgo seeking particular documents that relate to uncertain tax positions and the workpapers that document the completion of Schedule UTP.

Some of the major changes include:

- a five-year phase-in of the reporting requirement based on a corporation’s asset size;
- no reporting of a maximum tax adjustment;
- no reporting of the rationale and nature of uncertainty in the concise description of the position; and
- no reporting of administrative practice tax positions.

Five-year phase-in period

The Service had proposed that the reporting requirement apply to corporations (public or private) that issue audited financial statements (or that have tax positions for which a related party records a reserve in an audited financial statement), if the corporation has total assets of at least \$10 million.

The Service has now implemented a five-year phase-in of the Schedule UTP for corporations with total assets under \$100 million. Corporations that have total assets equal to or exceeding \$100 million must file Schedule UTP starting with tax year 2010. The total asset threshold will be reduced to \$50 million starting with the 2012 tax year and to \$10 million starting with the 2014 tax year. The Service will consider whether to extend all or a portion of Schedule UTP reporting to other taxpayers for 2011 or later tax years, such as pass-through entities and tax-exempt entities.

No reporting of maximum tax adjustment

The draft Schedule UTP would have required a corporation to report a maximum tax adjustment for each tax position listed on the schedule, other than transfer pricing and other valuation positions. The draft instructions provided a choice of ranking transfer pricing and other valuation positions based on the federal income tax reserve or an estimate of the adjustment to federal income tax that would result if the position was not sustained.

The Service has removed the proposed requirement to report the maximum tax adjustment. Instead, a corporation that is required to file Schedule UTP will be required to rank all of the reported tax positions (including transfer pricing and other valuation positions) based on the federal income tax reserve (including interest and penalties) recorded for the position taken in the return, and to designate those tax positions for which the reserve exceeds 10% of the aggregate amount of the reserves for all of the tax positions reported on such schedule. This method relies on the reserve computations that corporations perform for audited financial statement purposes, but does not require disclosure of the actual amounts of the tax reserves.

No reporting of rationale and nature of uncertainty in concise description of the position

The Service has eliminated the proposed requirement to include the rationale and nature of the uncertainty in the concise description. The instructions now require a concise description of the tax position, including (1) a description of the relevant facts affecting the tax treatment of the position, (2) information that reasonably can be expected to apprise the Service of the identity of the tax position and (3) the nature of the issue. This is based upon and consistent with the information required to be reported on the Form 8275 Disclosure Statement. In addition, the final instructions expressly state that a corporation is not required to include an assessment of the hazards of a tax position or an analysis of the support for or against the tax position.

No reporting of administrative practice tax positions

The Service has eliminated the proposal that a corporation report on Schedule UTP tax positions for which no reserve was recorded because the corporation determined it was the Service's administrative practice not to raise the issue during an examination.

Consistency between Schedule UTP reporting and financial statement reserve decisions

Tax positions reported on Schedule UTP will be consistent with the reserve decisions made by the corporation for audited financial statement purposes. The instructions to Schedule UTP clarify that corporations are not required to report tax positions that are either immaterial under applicable financial accounting standards or are sufficiently certain so that no reserve is required under those standards. A tax position that a corporation would litigate, if challenged, but that is clear and unambiguous or is immaterial is therefore not required to be reported on Schedule UTP. The instructions require reporting of tax positions taken in a return for which reserves were created under applicable financial accounting standards or for which no reserve was created because of an expectation to litigate. The final instructions add an example to emphasize that the definition of unit account should be applied consistently with the guidance in FIN 48.

Additional areas of clarification

The following changes were made to the instructions to Schedule UTP:

- The instructions clarify that Schedule UTP requires the reporting of U.S. federal income tax positions but not foreign or state tax positions. Under the general reporting instructions, however, a corporation is required to report a U.S. federal income tax position taken in a return that arises out of uncertainty with regard to a foreign tax position (e.g., foreign tax credits) if a reserve for U.S. federal income tax was recorded to reflect that uncertainty.
- The instructions clarify that a tax position is reported on Schedule UTP once (1) a reserve for a tax position is recorded, and (2) a tax position is taken on a return regardless of the order in which those two events occur.
- The instructions clarify that corporations report their own tax positions on Schedule UTP and do not report the tax positions of a related party.
- The instructions clarify that tax positions taken in years before 2010 need not be reported in 2010 or a later year even if a reserve is recorded in audited financial statements issued in 2010 or later.
- The instructions clarify the reporting of recurring tax positions taken in multiple years.
- The instructions were revised to reflect that Schedule UTP need not be filed for short tax years ending in 2010.
- The instructions clarify that worldwide assets are used to determine whether a corporation that files a Form 1120-F (including a protective return) must file Schedule UTP.
- The definition of “audited financial statement” was revised to clarify that an audited financial statement is one on which an independent auditor expresses an opinion and that compiled or reviewed financial statements are excluded from the definition of audited financial statement.
- The definition of “record a reserve” was revised to clarify that it includes the recording of a reserve for U.S. federal income tax, interest, or penalties and to reinforce that temporary differences must be reported on Schedule UTP.
- The instructions clarify for corporations included in multiple audited financial statements that the recording of a reserve in any audited financial statement in which the corporation is included triggers reporting of the tax position if the tax position is taken on a return filed by the reporting corporation.

Exchange of information with foreign governments

The Service generally intends to refrain from providing Schedule UTP information to other governments except in those circumstances in which there is a reciprocal arrangement with the foreign government. In addition, even if reciprocity exists, the Service would consider other factors in determining whether to disclose the information, including the relevance of the information to the foreign government, which in many cases would not be present.

Coordination with other disclosures

The final Schedule UTP instructions state that a complete and accurate disclosure of a tax position on the appropriate year's Schedule UTP will be treated as if the corporation filed a Form 8275 or Form 8275-R. In the case of a transaction that is not a reportable transaction, the Service will treat a complete and accurate disclosure of a tax position on Schedule UTP as satisfying the disclosure requirements of Section 6662(i) of the Internal Revenue Code. The Service is studying other ways to reduce duplicate reporting and is considering whether complete and accurate disclosure on Schedule UTP would also, in appropriate circumstances, provide the information necessary to satisfy the reportable transaction disclosure requirements.

For further information, please contact Nina Krauthamer of Olshan's Tax Department or any partner with whom you work.

Nina Krauthamer
nkrauthamer@olshanlaw.com
212.451.2242

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