

Titus Tax Alert

IRS Announces New Broad Disclosure Requirements for Uncertain Tax Positions

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The Internal Revenue Service (IRS) recently announced that it will require large corporations and certain partnerships that are covered by shareholder-transparency rules and that have assets over \$10 million to file a list of uncertain tax positions along with their annual federal income tax return. This new disclosure requirement is set forth in Announcement 2010-9, and is a significant departure from the IRS' prior policy of seeking information such as that contained in tax accrual work papers in limited circumstances. The plan, which is designed to give the IRS a roadmap to detect tax avoidance, was outlined by IRS Commissioner, Douglas Shulman, in a speech to the New York Bar Association. Commissioner Shulman described the proposal as “a major step toward transparency” and said that the proposal is intended to help the IRS determine the “nature and materiality of a taxpayer’s uncertain tax positions, which will cut down the time it takes [the IRS] to find issues and complete an audit ... and to help [the IRS] prioritize selection of issues and taxpayers for examination.” The IRS intends to mandate that taxpayers disclose these uncertain tax positions on a newly created schedule that is filed with the taxpayer’s annual federal income tax return.

Contents of Proposed Schedule

The new schedule requiring disclosure of uncertain tax positions will call for:

- (1) A concise description (i.e., a few sentences that inform the IRS of the nature of the issue) of each uncertain tax position for which the taxpayer (or a related entity) has recorded a tax reserve under FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, in its financial statements, and
- (2) The maximum amount of potential federal tax liability attributable to each uncertain tax position if the position is not sustained (determined without regard to the taxpayer’s risk analysis regarding the likelihood of prevailing on the merits).

In addition, taxpayers would be required to disclose any position related to the determination of any United States federal income tax liability for which a taxpayer (or related entity) has not recorded a tax reserve because (i) the taxpayer expects to litigate the position, or (ii) the taxpayer has determined that the IRS has a general administrative practice not to examine the position.

To be sufficient, the disclosure of each uncertain tax position must contain:

- (1) The Internal Revenue Code sections implicated by the position;
- (2) A description of the taxable 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 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.

Commissioner Shulman stated that the new reporting requirements “would not require that taxpayers disclose how strong or weak they regard their tax positions or report [to the IRS] the amounts they reserved on the books regarding those positions.” However, the proposed schedule would require a taxpayer to specify for each uncertain tax position the entire amount of United States federal income tax that would be due if the position were disallowed in its entirety in an IRS examination. This amount would include the maximum tax adjustment for the position reflecting all changes to items of income, gain, loss, deduction or credit if the position were not sustained.

Tax Accrual Work Papers

Under FIN 48, a company’s financial statements must reflect the company’s reserves or accruals for its potential exposure relating to items that, if identified and challenged by the IRS, may result in the additional assessment of federal income taxes. A disclosure pursuant to FIN 48 generally does not identify the specific tax positions for which the company has reserved, but rather reflects only the total amount of reserves related to all uncertain tax positions.

To calculate the total amount of tax reserves, the company prepares so-called “tax accrual work papers,” which may include a position-by-position analysis of vulnerable positions taken on the company’s tax return. Tax accrual work papers may include legal opinions and other analysis, including the estimated dollar amount of potential exposure and the company’s percentage estimate of successfully defending each position.

IRS’ Prior Policy of Restraint

Prior to the issuance of Announcement 2010-9, taxpayers were not required to provide the IRS any information regarding their uncertain tax positions with their income tax returns.

Moreover, although the IRS has the power to access a taxpayer's tax accrual work papers under *United States v. Arthur Young*, 465 U.S. 805, 815 (1984), the IRS' official policy has been to request the production of tax accrual work papers only in three limited circumstances: (1) if the IRS determines that the taxpayer participated in listed transactions, (2) in cases being investigated by the IRS Criminal Investigation Division or in other broadly defined "unusual circumstances" set forth in the Internal Revenue Manual, or (3) in litigation of a tax dispute.

Taxpayers have historically resisted IRS attempts to obtain tax accrual work papers by claiming that such work papers are protected by the work product doctrine. Recently, the First Circuit Court of Appeals determined that work product protection only prevents discovery of documents prepared "for use in possible litigation." *United States v. Textron Inc.*, 577 F.3d 21, 27 (1st Cir. 2009). The First Circuit determined that Textron's tax accrual work papers were not work product because they were prepared to quantify its tax reserves and obtain a clean opinion from its auditors regarding the company's financial statements, rather than "for use in possible litigation." Textron has petitioned the United States Supreme Court for a writ of certiorari.

As a result of the government's victory in *Textron*, IRS Chief Counsel William Wilkins announced that the IRS planned to develop a new approach to obtaining taxpayer information about uncertain tax positions. Announcement 2010-9 ensued, and represents a significant departure from the prior policy of restraint.

IRS Requests Comments

Announcement 2010-9 states that the IRS will publish a notice of proposed rulemaking regarding the disclosure requirements and will publish the schedule to be used for such disclosures. The IRS also stated that business taxpayers would be required to include the new schedule regarding uncertain tax positions with their income tax returns filed after the IRS releases the schedule. Furthermore, the IRS is evaluating various options, including legislation, for penalties or sanctions to be imposed on a taxpayer that fails to make adequate disclosure of the required information about its uncertain tax positions.

The proposed disclosure requirements have not been finalized, and the IRS has requested public comments on the proposal be submitted by March 29, 2010.

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