

PRACTICE FOCUS

PROPOSED SCHEDULE TARGETS UNCERTAIN TAX POSITIONS

BY JOSH O. UNGERMAN

The Internal Revenue Service is expanding mandatory disclosures for companies with more than \$10 million in assets. On Jan. 26, the IRS proposed a new schedule that in-house lawyers need to consider carefully and on which they should consider submitting comments to protect their businesses' interests. Once the proposed schedule becomes final, in-house attorneys will need to review their companies' tax policies and ensure retraining of employees regarding the new requirement.

Currently, all taxpayers must disclose participation in one of 34 expressly prohibited "listed transactions," as noted in the Recognized Abusive and Listed Transactions - LMSB Tier I Issues section on the IRS Web site. These include sale-in lease-out transactions as discussed in IRS Notice 2005-13 and distressed asset trust transactions as discussed in IRS Notice 2008-34.

For taxpayers with assets in excess of \$10 million, additional levels of potential scrutiny and disclosure exist. They must file a Schedule M-3 showing detail on the major differences between the books of the business and the tax return of the

business. They are subject to examination by the IRS Large & Mid-Size Business Division and may be subject to a new "holistic" audit program by the division. Additionally, these taxpayers may be required to fill out a new proposed schedule disclosing uncertain tax positions.

On Jan. 26, the IRS issued Announcement 2010-9, titled Uncertain Tax Positions - Policy of Restraint. The announcement proposes a mandatory schedule to disclose the existence and magnitude of uncertain tax positions on tax returns of taxpayers with assets in excess of \$10 million. The announcement is the latest move in the IRS' ongoing effort to discover uncertain tax positions through the tax accrual work papers of a taxpayer. Such work papers may become much less relevant if the IRS can gather some of the same type of information with the new schedule.

In a nutshell, the schedule will require business taxpayers to describe concisely uncertain tax positions reported on their financial statements as well as the maximum amount of potential federal tax liability attributable to each uncertain



tax position. The IRS is quick to point out that the proposal does not require the taxpayer to disclose the taxpayer's risk assessment or tax reserve amounts. Nonetheless, the IRS warned in the announcement that it could compel the production of the same information through a summons, based on the 1984 U.S. Supreme Court case *United States v. Arthur Young*. The IRS reiterates in the announcement that it is proposing to retain the existing policy of restraint on requesting accrual work papers.

Currently, tax returns do not require taxpayers to disclose uncertain tax positions underlying a tax return. As a result of the adoption

of Financial Accounting Standards Board Interpretation (FIN) No. 48 in July 2006, many taxpayers have had to identify and quantify uncertain tax positions taken in their audited financial statements that must be reserved.

FIN 48 tax reserves and reporting apply to 1. the taxpayer's books and records or financial statements and 2. those 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, such as Generally Accepted Accounting Standards and International Financial Reporting Standards. The IRS considers this type of information highly relevant in examining a taxpayer's tax liability in accordance with *Arthur Young*.

The new schedule expands beyond disclosures required by FIN 48 and other accounting standards to include amounts not reserved by a taxpayer due to an expectation of litigation or lack of discovery by the IRS caused by poor audit coverage.

WHAT TO DO

To highlight the information on uncertain tax positions, the new schedule requires a concise description of each uncertain tax position the taxpayer (including a related entity) reserves on its financial statements and a quantification of the tax liability attributable to each uncertain tax position.

The "concise description" required is not so concise. It includes identification of:

1. the Internal Revenue Code sections, tax year involved and the amount of tax involved;

2. whether the position involves an item of income, gain, loss, deduction, basis computation or tax credit;

3. whether the position involves a permanent inclusion or exclusion of any item, the timing of that item or both; and

4. whether the position involves a determination of the value of any property or right.

The new schedule applies to business taxpayers with total assets in excess of \$10 million with at least one uncertain tax position. Taxpayers with uncertain positions who prepare financial statements and taxpayers included in the financial statements of a related entity that prepares financial statements must also comply with the new schedule. Additionally, the IRS is considering asking Congress to enact legislation imposing a penalty for failure to file the schedule or make adequate disclosure.

The IRS indicates it intends to continue the existing policy of restraint for requesting tax accrual work papers during the course of examinations, according to Internal Revenue Manual §4.10.20. But it is entirely possible that the proposed schedule could eliminate some or all of the need for the tax accrual work papers in the first place. The preparation of the new schedule is expected to evoke meaningful analysis by taxpayers and their advisers surrounding the language to be included on the schedule and

related issues concerning taxpayer protection of privilege and work product.

In-house counsel and general counsel need to review the proposed schedule and provide feedback to their tax professionals to forward to the IRS regarding any aspect of the schedule that will cause problems in its implementation. Next, as companies participate in current tax planning, lawyers must make them aware that the IRS is pushing forward the new schedule and that it will most likely become a reality in its current or a modified form.

The IRS has requested comments on the proposed new schedule and may change the requirements based on comments from tax lawyers and certified public accountants. What will not change, however, is the IRS' desire for taxpayers to expand these types of self-disclosures in an effort to provide transparency and ease of examinations for the IRS. Accordingly, if the proposed new schedule is modified or even canceled, expect the IRS to continue pressing taxpayers to disclose more and more on tax returns each year. **U H T**

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