

Internal Revenue Service Announces Schedule for "Uncertain Tax Positions" to be Filed By Certain Corporate Taxpayers for the 2010 Taxable Year

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Overview & Summary

On April 20, 2010, the Internal Revenue Service issued Announcement 2010-30 (the "Announcement"), along with a draft of new "Schedule UTP - Uncertain Tax Position Statement" and related instructions. As proposed, Schedule UTP will require certain large corporate taxpayers to disclose "uncertain tax positions" reflected on their financial statements, which includes issues where the result under current U.S. tax law is unclear, regardless of whether the taxpayer believes it would ultimately prevail in litigation.

Schedule UTP is the culmination of a series of IRS announcements stating the Treasury Department's intent to issue proposed regulations requiring certain business taxpayers to describe and quantify "uncertain tax positions" on their annual U.S. federal tax return, and announcing the IRS's intent to issue a related new schedule. These announcements stated the general intention of the Treasury Department and the IRS to link these new filing requirements to the treatment of "uncertain tax positions" under FASB 109 and FIN 48.

The Announcement states that Schedule UTP generally must be filed for 2010 taxable years by a taxpayer with more than \$10 million in assets and uncertain tax positions, if the taxpayer is:

- A domestic corporation that files Form 1120 *other than* a RIC or a REIT;
- A life insurance or property and casualty insurance company that files Form 1120-L or 1120-PC; or
- A foreign corporation that files Form 1120-F.

Other taxpayers (e.g., partnerships, trusts, RICs and REITs) are not required to file Schedule UTP presently, but the IRS is considering requiring others to file Schedule UTP in the future. The Announcement also discusses certain related matters the IRS is considering in connection with Schedule UTP. A public comment period on all of these matters is open until June 1, 2010, and on April 28, an IRS official publicly urged interested taxpayers to comment, stating that the IRS is open to considering changes to Schedule UTP.

Taxpayers required to file Schedule UTP for the 2010 taxable year should consider how this will interact with their current FIN 48 compliance procedures, whether they wish to comment on Schedule UTP and what "related parties" must be reflected on their Schedule UTP filings.

A discussion of the background and the specific requirements of Schedule UTP follows. If you have any questions, you may contact any member of the Tax Group at Proskauer to discuss any of the issues raised by Schedule UTP or the U.S. federal income tax reporting of uncertain tax positions generally.

Background

In the first quarter of 2010, the IRS issued two announcements^{[\[1\]](#)} describing the Treasury Department's intention to issue proposed regulations that would require certain business taxpayers to describe and quantify "uncertain tax positions" on their annual U.S. federal tax return, and also the IRS's intent to issue a related new disclosure schedule. These announcements stated a general intention to require disclosure of "uncertain tax positions" for which taxpayers have recorded a reserve pursuant to FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* ("FIN 48"). Pursuant to FIN 48, taxpayers that follow United States GAAP are generally required to identify and quantify "uncertain tax positions" taken on a tax return, and are required under certain conditions to take a reserve against the resulting potential tax liability.

In Announcement 2010-9, the IRS stated their view that disclosing uncertain tax positions on a return would help identify transactions “of particular interest or of sufficient magnitude” to warrant audit scrutiny. The IRS stated that information developed in complying with FIN 48 is relevant to a taxpayer's tax positions and the positions’ effect on tax liability. The IRS appears to assert that “uncertain tax positions” are within the purview of its examination authority.[\[2\]](#)

The IRS stated that they did not intend to seek a taxpayer’s risk analysis regarding the likelihood of prevailing on the merits or the actual amount of the reserve, and professed the intent to retain a policy of “restraint” for requesting tax accrual workpapers in connection with an audit, pursuant to the policy in the current Internal Revenue Manual. [\[3\]](#) However, the IRS intends to review and consider modifications to that policy if appropriate or necessary to obtain complete and accurate information regarding a taxpayer's uncertain tax positions on a timely basis.[\[4\]](#)

The IRS acknowledged that this proposal raises many areas of discussion, and requested comments generally, but especially with respect to:

- whether the potential adjustment should be for a fixed dollar amount or a range (since a potential adjustment might relate to several variables);
- whether there were potential alternative methods of disclosure;
- whether the disclosure should relate to a single taxable year or multiple years, and how then to account for loss carryforwards and carrybacks or excess credits;
- how the related entity rules should be applied;
- whether the scope of disclosure should be limited (*e.g.*, for positions where no reserve has been established because the IRS has a general practice not to audit such positions);
- whether transition rules are needed or certain business taxpayers should be included or excluded;
- how the new schedule should address taxpayers that recorded a reserve in a year after the position was taken; and
- whether the information proposed to be included should be modified, including whether certain information should be requested in some circumstances upon examination rather than in a schedule filed with the tax return.

Announcement 2010-19 amplified and clarified certain parts of Announcement 2010-17, including that disclosure would be required for taxpayers beginning with the 2010 taxable year (rather than for 2009 tax returns due in 2010), and also requested comments on additional issues, including:

- whether the new schedule would duplicate disclosure required by other current forms, rendering existing forms unnecessary or redundant in some circumstances;
- what types of uncertain tax positions should be reported by pass-through entities and tax-exempt entities; and
- how uncertain tax positions should be reported in various related entity contexts, such as entities consolidated for either financial statement or tax return purposes and entities disregarded from their owner for U.S. federal tax purposes.

Schedule UTP and the draft instructions as published in the Announcement address some, but not all, of the issues identified in these announcements.

Announcement 2010-9 stated that the Treasury Department is expected to propose regulations providing the IRS with express regulatory authority relating to the disclosure of uncertain tax positions, but to date no such regulations have been proposed.

Schedule UTP

In the Announcement, the IRS released a draft of Schedule UTP, as well as draft instructions. A summary of the most important considerations follows.

Taxpayers Who Must File Schedule UTP

As drafted, Schedule UTP is to be filed for the 2010 taxable year by a taxpayer that:

- has at least \$10 million in assets;[\[5\]](#)
- has itself, or a related party has, “uncertain tax positions;” and
- is one of the following:
 - a corporation that files a U.S. corporation income tax return on Form 1120;
 - an insurance company that files on either Form 1120-L or Form 1120-PC; or
 - a foreign corporation that files on Form 1120-F.

A “related party” is defined very broadly for this purpose.[\[6\]](#) A corporation filing “protective” returns is not exempt from filing Schedule UTP.

After considering comments, the IRS expects to announce when other taxpayers will be required to file Schedule UTP, but the Announcement states that the IRS will not require a Schedule UTP from other corporate filers (such as real estate investment trusts or regulated investment companies), pass-through entities (such as partnerships or grantor trusts) or tax-exempt organizations for the 2010 taxable year.

A domestic corporation that is “related to” a foreign corporation within the meaning of the relevant Code sections will have to report positions relating to that foreign corporation, even if the foreign corporation itself is not required to file a Form 1120-F. Left unresolved is whether and how a corporation that for this purpose is “related” to either its third-party shareholders or to entities (such as a hedge fund) in which the taxpayer has made a passive investment would know of and report uncertain tax positions relating to such a shareholder or entity.

If an affiliated group of corporations is eligible to file a consolidated return, a single Schedule UTP is to be filed for the entire affiliated group, and does not require identification of the group member(s) to which the tax position(s) relates or that recorded the relevant reserve(s). However, an affiliated corporation that files separately (such as a deconsolidated foreign subsidiary) may have to file a Schedule UTP setting forth its own tax positions (if it otherwise meets the filing criteria).

Tax Positions Required to be Reported on Schedule UTP

If a corporation is required to file Schedule UTP, the corporation must report federal income tax positions taken in the current or any prior taxable year, if at least 60 days before filing the return the corporation or a related party has either recorded a reserve in an audited financial statement^[7] for such a position, or a reserve has not been recorded by the corporation or a related party based on an IRS administrative practice or the corporation’s expectation of litigation. The latter two categories significantly expands the scope of required disclosure beyond the requirements of FIN 48, which only establishes a recognition threshold and measurement guidance for determining whether or not a reserve must be taken on financial statements.^[8]

The draft instructions define certain key terms for this purpose:

- A “tax position” is based on the unit of account in the audited financial statements in which the reserve is recorded, and a tax position is treated as “reflected” on a tax return if an adjustment to a line item on the return would result if the position is not sustained.^[9]

- A corporation is treated as “recording a reserve” for a tax position in either or both of two situations:
 - where the corporation records an increase in a liability for income taxes payable or a reduction of an income tax refund receivable with respect to the tax position; and
 - where the corporation records a reduction in a deferred tax asset or an increase in a deferred tax liability with respect to the tax position.

Importantly, the draft instructions provide that the initial recording of a tax position will trigger a Schedule UTP reporting requirement, but subsequent increases or decreases to a reserve amount will not.[\[10\]](#)

Tax positions taken by the corporation on its return for the current taxable year will be reported separately from positions taken on tax returns for prior taxable years, and tax positions taken in a prior tax year are not reportable if the corporation reported the tax position on a Schedule UTP in a prior year.

Where a transaction results in a tax position reportable on Schedule UTP, and that position is reflected on more than one taxpayer’s tax return subject to the requirement to file Schedule UTP, the draft instructions state that the tax position is to be disclosed by each affected taxpayer; *i.e.*, the fact that a transaction results in a disclosure of an position on one tax return does not shield other corporations from disclosing the position on their tax returns. However, no position needs to be disclosed prior to the tax year in which such tax position is reflected on a filed tax return.

How a Tax Position is to be Reflected on Schedule UTP

With respect to each tax position that a filer must report, the following line-item information with respect to the position is required:

- the primary Code section or sections (up to three) implicated;
- whether the timing of the position results in a temporary or permanent difference, or both;[\[11\]](#)
- the EIN of a “pass-through entity” to which the position relates;[\[12\]](#)
- whether the corporation has determined the position is not subject to challenge based on IRS administrative practice;[\[13\]](#)
- the “maximum tax adjustment” (MTA) related to the position;
- the year the tax position was taken; and
- a “concise description” of each tax position.

A “concise description” will need to include information that “reasonably can be expected to apprise the IRS of the identity of the tax position and the nature of the uncertainty.” While the draft instructions suggest that no more than a few sentences will be required, it is clear that the “concise description” will require a disclosure of whether the position relates to an item of income, gain, loss, deduction or credit; whether the position relates to valuation or basis determinations, and a brief summary of the nature of the uncertainty. It is clear from the examples in the draft instructions that the required “concise description” will need to be sufficient to guide the examiner to the issue in an audit.

Maximum Tax Adjustment

The draft instructions explain that the MTA for a position is an estimate of the maximum amount of potential U.S. federal income tax liability associated with the position in a taxable year. The MTA for a position depends on whether the position relates to valuation, transfer pricing or neither. A position’s MTA must be determined in dollars, and on an annual basis.

The rules for determining the MTA for a position are mechanical:

- If the position relates to items of income, gain, loss, or deduction, the MTA is the total amount of the item multiplied by 35 percent; if the position relates to a credit, the MTA is total amount of the credit.
- If a position relates to multiple items of income, gain, loss, deduction or credit, the MTA is determined for each item, and then all of the items are added together to determine the position’s overall MTA; however, a corporation is precluded from netting positive and negative reserves for different positions to determine the MTA of any given position.
- State, local, and foreign taxes, as well as interest or penalties imposed by the Code, are disregarded in determining an MTA.
- The MTA for a tax position of an affiliated group is determined at the group level, taking into account all items of income, gain, loss, deduction, or credit relating to the position for all members of the group.
- The draft instructions do not require a corporation to determine a specific MTA for valuation or transfer pricing tax positions. Instead, the corporation must “rank” each valuation and transfer pricing tax position based on either the amount reserved for the position, or the estimated adjustment to U.S. federal income tax that would result if the position were not sustained.[\[14\]](#)

Transition Rules and Method of Filing

The instructions provide that no reporting is required in respect of taxable years beginning before December 15, 2009, or short taxable years beginning on or after December 15, 2009 and ending before January 1, 2010; for most taxpayers, this means the requirement will commence with their tax return for calendar or fiscal year 2010. This transition rule is applied regardless of whether or when a reserve was recorded with respect to a tax position.

In an effort to reduce redundant filings, the draft instructions provide that a corporation will be treated as having filed a *Form 8275 – Disclosure Statement* or *Form 8275-R – Regulation Disclosure Statement* for tax positions that are properly reported on Schedule UTP. The IRS has specifically reserved in the draft instructions on whether and how Schedule UTP is to be filed electronically. Schedule UTP must be filed with the corporation’s federal tax return, and is not to be filed separately.

Penalties for Failure to File or Failure to Disclose Positions on Schedule UTP.

The draft instructions specifically reserve on penalties for either a failure to file or a failure to disclose an “uncertain tax position” on Schedule UTP. However, taxpayer’s should note that there is no “materiality” threshold described in the instructions to Schedule UTP that would expand the scope of the general standard for materiality of “uncertain tax positions” described in FIN 48.

To ensure compliance with requirements imposed by U.S. Treasury Regulations, we inform you that any U.S. tax advice contained in this communication (including any attachments or enclosures hereto) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.

[\[1\]](#) See Announcement 2010-9, 2010-7 I.R.B. 408 (Jan. 26, 2010) and Announcement 2010-17, 2010-13 I.R.B. 515 (Mar. 5, 2010).

[\[2\]](#) Announcement 2010-9 cites to *United States v. Arthur Young*, 465 U.S. 805 (1984), for this proposition. We note that the scope of what tax accrual workpapers are or are not subject to protection from discovery by the IRS remains a subject of significant litigation. See *Textron, Inc. v. United States*, 560 F.3d 513 (1st Cir., Jan. 21, 2009), *rev’d en banc*, 577 F.3d 21 (1st Cir., Aug. 13, 2009), *pet. cert.* U.S., No. 09A361, filed Dec. 24, 2009.

[3] See Ann. 2002-63, 2002-2 C.B. 72, and I.R.M. Sec. 4.10.20.

[4] *United States v. Arthur Young*, 465 U.S., at 815.

[5] The “\$10 million in assets” requirement is determined for a domestic corporation based on the amount reported as “Total Assets” on Form 1120 in Part I, Box D, and determined based on the higher of the beginning or end of year total assets reported on Schedule L for other types of corporations subject to the Schedule UTP filing requirement.

[6] A “related party” for this purpose will include entities related within the meaning of Sections 267(b), 318(a) or 707(b) of the Internal Revenue Code of 1986, as amended (“Code”).

[7] The draft instructions require reporting of such tax positions regardless of the corporation’s system of accounting for financial statement purposes (e.g., GAAP, “modified GAAP,” IFRS or a country-specific method of accounting).

[8] See FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109, pp. 1-2, 5.

[9] For situations where a line item on a tax return is affected by multiple units of account, the draft instructions would require each unit of account to be reported separately on Schedule UTP.

[10] An important issue left unresolved by the draft instructions is whether a change in the amount reserved for a tax position that was initially reserved in a pre-2010 taxable year would trigger a Schedule UTP reporting requirement for the 2010 taxable year.

[11] Whether a difference is temporary or permanent must be determined consistently with the corporation’s method of accounting.

[12] A “pass-through” entity for purposes of draft Schedule UTP is defined in Section 1(h)(10), and thus includes REITs, RICs, S corporations, partnerships, estates, trusts, common trust funds, and passive foreign investment corporations (PFIC) for which a qualified electing fund (QEF) election has been made. If the pass-through entity is foreign, the position must still be reported as related to the pass-through entity on Schedule UTP. Based on the draft instructions, the “pass-through” entity for this purpose does not have to be a related party to the corporation – only that the tax position relate to an investment in, or transaction with, a pass-through entity. A controlled foreign corporation (CFC) is not a pass-through entity for this purpose, but may nevertheless be “related” to the corporation filing Schedule UTP by virtue of Section 267(b), 318(a) or 707(b).

[\[13\]](#) In a public appearance on April 28, 2010, a senior IRS official stated that it was intentional that Schedule UTP does not require a taxpayer disclose whether or not they expect to litigate an uncertain tax position. See “Official Says IRS Purposely Did Not Put Litigation Check Box on UTP Draft Form,” BNA Daily Tax Report, 81 DTR G-3, April 29, 2010.

[\[14\]](#) The corporation may choose either method and is not required to describe the method chosen or report the reserve or adjustment amounts for the reported position, but the draft instructions provide that the method selected must be consistently applied to all valuation positions and to all transfer pricing positions reported on a single Schedule UTP.

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