

Transparency of Uncertain Tax Positions: The IRS Vision

The IRS recently announced a plan to bring transparency to uncertain tax positions within a federal income tax return. The stated goal is to allow the IRS to focus its resources on positions of particular interest or magnitude, but the benefit to the taxpayer remains unclear.

The Internal Revenue Service (IRS) issued Announcement 2010-9 on January 26, 2010, to introduce transparency of uncertain tax positions into a taxpayer's federal income tax return. According to the IRS, this information will allow it to focus "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 examinations teams to identify all of the issues underlying the tax returns more quickly and efficiently."

Taxpayers have been provided a comment period on the IRS proposal. The initial comment period set forth by Announcement 2010-9 ended on March 29, 2010, and it included several items of particular interest to the Service for commenting. The March 29 deadline was extended to June 1, 2010, when the IRS issued Announcement 2010-17 (March 5, 2010),

which added a few more items for commenting. The purpose of this article, therefore, is to examine the IRS vision on transparency.

What are the basics of the transparency proposal? The concept being advanced is that certain taxpayers would be required to file a schedule (currently being developed) with their Form 1120, Corporate Income Tax Return, or other business tax returns. Two pieces of information would be provided on the schedule: (1) a concise description of each uncertain tax position and (2) the maximum amount of potential federal income tax liability attributable to each position. Taxpayers will be happy to know that the IRS won't require them to provide any risk analysis regarding the likelihood of prevailing on the merits of the tax position.

The Service went on to clarify what's meant by providing a concise description. Specifically, the Service is looking for sufficient detail so that it can determine the nature of the issue. Sufficient detail, of course, depends on the transaction itself. As for the description, taxpayers will be required to include the rationale for the position they have taken

and a concise statement of the reasons for determining that the position is uncertain. You might wonder why the Service hasn't required that the maximum tax liability amount be included with the submitted schedule. Then the taxpayer could apply for a refund. In addition, the taxpayer must provide the applicable Code sections and tax years, as well as the type of item (i.e., income, gain, loss, deduction, or credit), whether the item is a permanent inclusion or exclusion, timing issue or both, whether the position involves the value of any property or rights, and whether the position involves a computation of basis.

What if a taxpayer fails to make adequate disclosure of an uncertain item? The Service has indicated that it is evaluating additional options for penalties or sanctions for such unacceptable behavior. In fact, the Service stated in the Announcement that one option being considered is to seek legislation imposing a penalty for failure to file the schedule or to make adequate disclosure. Yet the IRS intends to retain the existing policy of restraint for requesting tax accrual workpapers during the course of examinations described

in Internal Revenue Manual Section 4.10.20.

Who is subject to this proposed provision?

Not everyone is subject to this provision. The new schedule is intended for taxpayers with total assets in excess of \$10 million who have one or more uncertain tax positions. This includes taxpayers who prepare financial statements—if the taxpayer or related entity determines its federal income tax reserves under FIN 48 (FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes”) or other accounting standards related to uncertain tax positions involving federal income tax.

But the IRS went on to say that uncertain tax positions for which a taxpayer or a related entity hasn’t recorded a tax reserve include *any position* for which the taxpayer expects to litigate the position or has determined that the Service has a general administrative practice not to examine the position. Wow, this is an interesting expansion of the scope by including items that weren’t likely to be examined (but could be likely soon)!

What comments are of interest to the IRS? Announcement 2010-9 provides eight areas of comments that are of particular interest:

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

issue would allow the IRS to identify the relative importance of the uncertain tax positions;

3. 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;
4. How the related entity rules should be applied;
5. Whether the scope of the Announcement should be modified regarding the uncertain tax positions for which information is required to be reported (e.g., positions for which no tax reserve has been established because the taxpayer determined the IRS has a general administrative practice not to examine the position);
6. 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);
7. How the new schedule should address taxpayers who initially didn’t record a reserve for an issue but did so in later years; and
8. 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.

As already mentioned, Announcement 2010-17 extended the

comment period to June 1, 2010, and expanded the list of eight areas of interest by three. The additional areas are:

1. Do the disclosures required by the new schedule duplicate those required by other forms, thus making certain forms, such as Form 8275 and 8275-R, unnecessary or redundant in some circumstances;
2. What type of uncertain tax positions should be reported by pass-through entities and tax-exempt entities; and
3. How should uncertain tax positions be reported in various related-entity contexts, such as how should members of a consolidated group for financial statement or tax return purposes or entities that are disregarded for federal tax purposes report uncertain tax positions?

A draft of the schedule was released on April 20, 2010, as Announcement 2010-30. The IRS purports the draft clarifies some of the issues that have already been submitted and that other issues will be resolved by the time taxpayers are required to comply with the new ruling.

When does the new ruling apply?

At the moment, the new reporting requirement is scheduled to apply to taxpayers filing a 2010 calendar-year tax return and to taxpayers whose fiscal year begins in 2010. The new filing schedule, therefore, isn’t applicable to 2009 tax returns filed in 2010.

Final Thoughts

Although the proposed reporting

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requirement may be beneficial to the IRS for reducing audit time, focusing its audit areas of particular interest, and increasing revenue collections, it appears on the surface to be less than beneficial to the taxpayer. As a result of this new proposal, taxpayers save resources currently needed for lengthy audits. But they now incur new costs for time spent determining “uncertain tax positions,” the reporting of those positions, and so forth. A possible uncertain tax liability is more than likely to become a certain tax liability. In fact, issues that currently aren’t of interest and thus not a tax liability may become tomorrow’s item of interest because of the potential magnitude of tax revenues.

On another front, state revenue departments may see a new opportunity for revenue with little cost to them. Now taxpayers could be required to provide states with uncertain state tax positions, especially in the area of multistate tax issues.

Finally, could this proposal simply be a way for Congress to increase tax revenues without taking credit for the tax assessment? No, that’s just my overactive imagination. So are you going to respond to the Service’s request to comment on this idea? **SF**

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