

## Part IV - Items of General Interest

### Reporting of Uncertain Tax Positions

#### Announcement 2010-75

In a series of Announcements the Internal Revenue Service announced that it was developing a schedule requiring certain business taxpayers to report uncertain tax positions on their tax returns and requested comments both on the proposal and on a draft schedule and instructions. Announcement 2010-9, 2010-7 I.R.B. 408; Announcement 2010-17, 2010-13 I.R.B. 515; Announcement 2010-30, I.R.B. 2010-19. The Service also stated in Announcement 2010-9 that it would issue a Notice of Proposed Rulemaking (NPRM) to provide that corporations would be required to file a schedule disclosing uncertain tax positions. The NPRM was published on September 9, 2010, and sets out a proposed rule explicitly authorizing the Service to require the filing of Schedule UTP. Requirement of a Statement Disclosing Uncertain Tax Positions, 75 Fed. Reg. 54802 (proposed Sept. 9, 2010). The Service expects a final rule will be promulgated by the end of the year.

The Service received a large number of comments on the overall proposal, including whether and how the Service should implement the requirement to file a schedule reporting uncertain tax positions, as well as the draft schedule and instructions released for comment on April 19, 2010. Many of the comments expressed concerns regarding how the Service would use the reported information, the interaction of the new reporting requirement with the existing policy of restraint, the additional burden the

reporting requirement would place on affected corporations, and the impact the reporting requirement would have on the relationship between the corporation and the Service or the corporation and its advisors or independent auditors. Some commentators questioned the Service's authority to require reporting of uncertain tax positions with the corporation's tax return.

All of these comments have been carefully considered in developing the final schedule and instructions, which require certain corporations with audited financial statements to file Schedule UTP, Uncertain Tax Position Statement, beginning with the 2010 tax year. A final schedule and instructions are being released contemporaneously with this Announcement. In addition, a Directive regarding implementation of Schedule UTP and related matters, and a separate announcement regarding modifications that will be made to the existing Policy of Restraint in conjunction with implementation of Schedule UTP, are being released contemporaneously with this Announcement.

#### Overview of major changes to the draft schedule and instructions

The final schedule and instructions make a number of significant changes to the April draft in order to address burden and other concerns expressed by commentators. 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*

In Announcement 2010-9, the Service proposed that the reporting requirement apply to business taxpayers with total assets of at least \$10 million. The Service requested comments on whether transition rules should be used or criteria modified to either include or exclude certain business taxpayers, and the type of uncertain tax positions that should be reported by pass-through entities and tax-exempt entities.

In Announcement 2010-30, the Service announced that the types of corporations required to file the schedule initially would be limited to corporations that issue audited financial statements (or that have tax positions for which a related party records a reserve in an audited financial statement) and file Form 1120, U.S. Corporation Income Tax Return; Form 1120-F, U.S. Income Tax Return of a Foreign Corporation; Form 1120-L, U.S. Life Insurance Company Income Tax Return; or Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return.

A number of commentators recommended that the Service either increase the \$10 million total asset threshold permanently or during a transition period to allow many organizations additional time to implement the reporting requirement. Some commentators recommended that taxpayers in the Compliance Assurance Program (CAP) and taxpayers under continuous audit (CIC taxpayers) be excluded from the reporting requirement. Although a few comments recommended that the reporting requirement also apply to pass-through entities and tax-exempt entities, many suggested that the reporting requirements should be delayed or eliminated for these entities.

The final schedule and instructions generally retain the previously announced filing requirements regarding types of corporations required to complete the schedule for 2010 tax years. Accordingly, public or privately held corporations that issue or are included in audited financial statements and that file a Form 1120, Form 1120-F, Form 1120-L, or Form 1120-PC must report their uncertain tax positions on Schedule UTP if they satisfy the total asset threshold. In response to comments, however, the Service has 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 2010 tax years. The total asset threshold will be reduced to \$50 million starting with 2012 tax years and to \$10 million starting with 2014 tax years. 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.

The final instructions do not exclude CAP or CIC taxpayers from the reporting requirement. With respect to CAP, the Service will address Schedule UTP compliance in upcoming CAP permanence guidance that is expected to be released shortly.

*No reporting of maximum tax adjustment*

The draft schedule and instructions proposed that the corporation report a maximum tax adjustment for each tax position listed on the schedule, other than transfer pricing and other valuation positions. The maximum tax adjustment was defined in the draft instructions as the maximum United States federal income tax liability for the tax position if the position were not sustained upon examination by the Service. The draft instructions also provided the corporation 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 were not sustained.

Many of the comments recommended eliminating entirely or modifying the proposed requirement to report the maximum tax adjustment for each tax position. Many comments expressed concern that this amount would be unduly burdensome to compute, would provide the Service with misleading information about the riskiness of the position and its magnitude, and would not be a meaningful basis upon which to determine the issues or returns to examine. Some commentators recommended that no information be provided on the schedule regarding the materiality of the tax position. Some commentators expressed a preference for a measure that relied on information already available to the corporation to minimize the burden associated with completing the schedule. Many commentators suggested various alternative measures of magnitude including the following:

- ranges or baskets based on the maximum tax adjustment, a reasonable estimate of the federal income tax benefit, or the reserve for the tax positions;
- ranges or baskets based on a percentage of gross income, revenue, expenses, or reserves;
- ranking of all issues as proposed in the draft instructions for transfer pricing and other valuation issues;
- ranking of all issues based on magnitude, such as reserves for uncertain tax positions;

- disclosure of only those tax positions for which the tax reserve exceeds a percentage of the tabular roll-forward in the annual financial statement footnote disclosures;<sup>1</sup>
- disclosure of the maximum tax adjustment only if it exceeds \$500,000; and
- disclosure of the aggregate reserve for uncertain tax positions.

After considering the comments and the suggested alternatives, the Service has removed the proposed requirement to report the maximum tax adjustment. Instead, the final schedule and instructions require a corporation to rank all of the reported tax positions (including transfer pricing and other valuation positions) based on the United States 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 percent of the aggregate amount of the reserves for all of the tax positions reported on the schedule. This ranking method is expected to allow the Service to more accurately evaluate the materiality of the issues reported on the schedule and to impose less burden on corporations than would have been the case under the maximum tax adjustment proposal. 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.

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<sup>1</sup> Public companies are required to disclose a tabular reconciliation of unrecognized tax benefits at the beginning and end of the reporting period in their annual financial statements. FASB ASC Topic 740-10 Income Taxes. Income Taxes, Accounting Standards Codification Subtopic 740-10-5015A (Fin. Accounting Standards Bd. 2010).

In addition, commentators noted the difficulty of computing the maximum tax adjustment for tax positions for which no reserve was created based on an expectation to litigate the position. The instructions address this concern by providing that no size needs to be determined with respect to these tax positions and that these positions can be assigned any rank by the corporation.

*Removal of requirement to include rationale and nature of uncertainty in concise description of the position*

A number of commentators expressed concern about the requirement that the rationale for an uncertain tax position, as well the nature of the uncertainty, be disclosed as part of the concise description. Commentators stated that these disclosures are not required by FIN 48 and asserted that they conflict with both the Service's policy of restraint and the Service's stated objective not to require that taxpayers disclose their assessment of the strength or weakness of their positions. Other commentators pointed out that the examples in the draft instructions did not provide this information. As an alternative, several commentators suggested that the requirements for a concise description be similar to the information required to be disclosed in conjunction with the filing of a Form 8275, Disclosure Statement.

In response to these comments, the proposed requirement to include the rationale and nature of the uncertainty in the concise description has been eliminated. The instructions now require a concise description of the tax position, including a description of the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the Service of the identity of the tax position and the nature of the issue. This is based upon and consistent with the

information required to be reported on Form 8275. 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 proposal required 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. Many commentators recommended elimination of this requirement because it would be unduly burdensome for corporations to identify, describe, and quantify these positions, and would provide the Service very little useful information.

After reviewing the comments, the Service determined that the concerns about the administrability of this requirement outweighed the value of the information that may be included. Therefore, the Service has eliminated the proposed requirement to report tax positions for which no reserve was created due to a widely-understood administrative practice, but will continue to explore ways to assess the impact of these tax positions on overall tax compliance.

*Consistency between Schedule UTP reporting and financial statement reserve decisions*

Some commentators opposed the proposal because of their understanding that it required a corporation to report tax positions for which no reserve was recorded in the corporation's financial statements (including expectation-to-litigate positions) either because the position was highly certain or was immaterial in the context of the audited financial statements. Other commentators recommended that the instructions clearly



state that highly certain and immaterial tax positions not be required to be reported on the schedule.

The final instructions address these comments by clarifying that the schedule seeks the reporting of tax positions consistent with the reserve decisions made by the corporation for audited financial statement purposes. The instructions 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.

A number of commentators requested that the instructions regarding unit of account be clarified to more closely align the term with its meaning in FIN 48. The final instructions add an example to emphasize that the definition of unit account should be applied consistently with the guidance in FIN 48. Some commentators stated that the draft instructions provided inadequate guidance regarding the treatment of a unit of account for reporting tax positions by corporations using IFRS. The final instructions continue to provide that a corporation that uses its entire tax year as a unit of account under IFRS or another method of accounting may not do so for Schedule UTP reporting, but must identify a unit of account based on FIN 48 principles or by using any other level of detail that is consistently applied if that identification is reasonably

expected to apprise the Service of the identity and nature of the issue underlying a tax position taken in the tax return.

*Additional areas of clarification*

Many of the commentators provided specific comments on the language in the draft instructions, either asking for clarification of the language or suggesting changes to the language. In response, the following changes were made to the instructions:

- 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 United States 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 United States 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 the fact 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 United States 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.

*Privilege, work product doctrine, subject matter waiver, and policy of restraint*  
*comments*

A number of commentators asked that the proposal be withdrawn on the basis that the requirement to identify tax positions along with the taxpayer's views and assessments of those positions is inconsistent with the attorney-client privilege, the

work product doctrine, and the tax practitioner privilege, because it may require disclosure of information that is based upon the advice of counsel and tax return preparers and may require the sharing of the mental impressions of these advisers. Many of these commentators were also concerned that disclosure of tax positions on Schedule UTP could enable adversaries to raise questions about subject-matter waiver with respect to confidential communications related to the disclosed tax positions. Other commentators asked that the Service confirm that claims of privilege may continue to be asserted to the same extent permitted under current law.

As set out above, the instructions no longer require the rationale and nature of the uncertainty to be included in the schedule's concise description and further explain that the concise description should not include information related to the corporation's assessment of the hazards of a tax position or an analysis of the support for or against the tax position.

Many commentators raised issues about the effect of Schedule UTP's reporting requirements on the Service's policy of restraint. Some saw Schedule UTP as inconsistent with the policy of restraint, while others asked that the policy of restraint be expanded to cover documents used to prepare Schedule UTP. The Service is releasing, contemporaneously with the release of this announcement, Announcement 2010-76, which modifies the policy of restraint in response to these concerns.

*Other comments - exclude certain tax positions and expectation to litigate*

Various commentators suggested excluding certain types of tax positions from Schedule UTP reporting, including:

- all transfer pricing positions;

- temporary differences;
- correlative effects of foreign tax positions (e.g., effect of foreign tax positions on U.S. earnings and profits or foreign tax credits); and
- specified transactions or issues, such as permanent establishment, debt-equity, tax-free combinations, or issues the Service has conceded in an audit of the reporting corporation during the prior five years, which should be included in an “angel list.”

The final schedule and instructions do not incorporate any of the recommended exclusions. The Service believes that excluding these types of tax positions from Schedule UTP reporting would be inconsistent with the purpose and objectives underlying the new reporting requirement and that it is important to obtain reporting of all types of uncertain tax positions.

The proposal required a corporation to report a tax position taken in a return for which no reserve was recorded based on the corporation's expectation to litigate the position. A number of commentators suggested eliminating this requirement, either because it would be unduly burdensome to identify, describe, and quantify these positions, or because requiring reporting of these positions on Schedule UTP departs from the Service's stated objective of consistency with financial accounting standards. Many commentators recommended clarifying the scope of tax positions required to be reported as expectation-to-litigate positions. Some commentators expressed concern that this requirement would require corporations to reassess at the time of preparing Schedule UTP all tax positions taken in the current-year return for which no reserve was previously recorded and report on the schedule each tax position the corporation might

litigate if it had to do so in order to sustain the issue. A few commentators requested guidance on how the corporation documents an expectation-to-litigate position.

The final schedule and instructions retain the requirement to report tax positions taken in a return for which no reserve was recorded because of an expectation to litigate the position and incorporate revised instructions to clarify the meaning of expectation to litigate. The final instructions clarify that a corporation may rely on the reserve decisions it made for financial statement purposes to complete Schedule UTP and thus is not expected to reassess at the time the schedule is completed those reserve decisions previously made for financial statement purposes. The final instructions do not provide guidance on how a corporation documents an expectation to litigate position. The Service expects that a corporation would continue to document its decision in the same way as it substantiates any decision not to record a reserve in its financial statements.

#### Internal Directive and related changes

The Service is issuing contemporaneously with this Announcement a Directive concerning the use of Schedule UTP by the Service and its examination and research personnel. The Directive outlines the various uses for the information reported on the schedule and indicates that initial processing of Schedule UTP information will be centralized to ensure appropriate review to identify trends and areas requiring further guidance to address uncertainty in the law.

In addition, the Service will create a working group to study and revise the Schedule M-3, Net Income (Loss) Reconciliation for Corporations with Total Assets of \$10 Million or More, to reduce duplicate reporting. The Service believes that the

implementation of Schedule UTP is likely to reduce the need for some of the information currently reported on the Schedule M-3. The working group will begin its work in 2011 and will work with external stakeholders to develop appropriate revisions to the Schedule M-3.

The Service also will be expanding the Compliance Assurance Program (CAP) and making it permanent. The Service intends that the permanent CAP will consist of three phases: pre-CAP, which will allow a taxpayer to become current on the audit cycle while demonstrating the requisite transparency needed to be eligible for CAP; CAP, which will resemble the existing CAP pilot program; and CAP maintenance, which will call for the reduction of resources and taxpayer contact for those taxpayers in this phase as appropriate. Details will be contained in the upcoming CAP permanence guidance that is expected to be released shortly.

#### *Exchange of information with foreign governments*

Concerns have been raised that the Service will automatically disclose information reported on the Schedule UTP to foreign governments. The Service intends to generally refrain from providing Schedule UTP information to other governments except in those circumstances in which there is a reciprocal arrangement with the foreign government regarding uncertain-tax-position information, such as where the foreign government collects similar information for its own tax administration purposes and agrees to make this information available to the Service in a similar manner. In addition, even if reciprocity did exist, 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.

### *Future guidance and changes*

While the instructions provide initial guidance concerning filing of Schedule UTP, the Service recognizes that they do not address every issue raised by commentators. For example, the instructions do not address issues related to the reporting of tax positions in the year in which a corporation is acquired or disposed of. As another example, a number of commentators recommended the instructions address the level or type of due diligence required to obtain reserve information from a related party or information from a pass-through entity relating to a corporation's uncertain tax position involving the pass-through entity. Other issues will arise as the Service and corporations gain experience with the schedule. The Service will continue to consider these issues and how best to provide further guidance.

In addition, the Service will review the completeness and utility of Schedule UTPs filed by corporations, beginning with 2010 tax years, and modify the schedule and instructions as appropriate. For example, the Service will review the reporting of transfer pricing positions on Schedule UTP and consider whether additional information, such as the specific country, character of income, or other facts are necessary to provide sufficient information regarding the identity and nature of those tax positions.

### *Penalties*

A number of commentators recommended that the Service expressly state that penalties will not be imposed, either permanently or during a transition period, for reporting failures regarding Schedule UTP. The final instructions do not provide specific instructions regarding penalties. The Service intends to review compliance regarding how the schedule is completed by corporations and to take appropriate enforcement



action, including the possibility of opening an examination or making another type of taxpayer contact, in those instances in which there appears to be a failure to complete the schedule or a failure to report whether the corporation is required to complete the schedule.

#### *Coordination with Forms 8275 and 8886*

Some commentators suggested the Service provide that in certain circumstances a corporation need not file Form 8886, Reportable Transaction Disclosure Statement, if a reportable transaction is disclosed on Schedule UTP. A number of commentators recommended that the Service expressly provide that disclosure of a tax position on Schedule UTP constitutes disclosure of the position to avoid penalties under sections 6662(b)(6) and 6662(i) involving an underpayment due to a claimed tax benefit because of a transaction lacking economic substance.

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 regarding the tax position and that a separate Form 8275 or 8275-R need not be filed to avoid certain accuracy-related penalties with respect to that tax position. Consistent with Notice 2010-62, issued September 13, 2010, 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). 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.

The principal author of this announcement is Kathryn Zuba of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this Announcement contact Kathryn Zuba at (202) 622-3400 (not a toll-free call). For questions relating to Schedule UTP and instructions contact Deborah Palacheck at (202) 283-8710 (not a toll-free call).