



Disclosure of uncertain tax positions

The US Internal Revenue Service recently announced that it is developing a schedule on which business taxpayers with total assets exceeding \$10m will be required to disclose uncertain US federal tax positions for which they establish a tax reserve on their financial statements, as well as certain other positions. The schedule will require a description of each uncertain tax position, providing sufficient detail for the Service to determine the nature of the issue, as well as disclosure of the maximum US federal income tax liability attributable to each uncertain tax position if the position was disallowed entirely.

The US Internal Revenue Service recently announced that it is developing a schedule on which many business taxpayers with total assets exceeding \$10m will be required to disclose their uncertain US federal tax positions. The new disclosures will be in addition to disclosures of tax shelter transactions already required by current law.

Proposed US disclosure requirement

The schedule will require disclosure of all positions for which the taxpayer must establish a tax reserve under Financial Accounting Standards Board (FASB) Interpretation No. 48 (Accounting for uncertainty in income taxes, an interpretation of FASB Statement No. 109 (FIN 48)) or another applicable accounting standard (such as International Financial Reporting Standards or country-specific generally accepted accounting standards). Disclosure will also be required for uncertain tax positions for which no reserve is recorded because the taxpayer expects to litigate the position or the taxpayer has determined that the Service has a general administrative practice not to examine the position.

The schedule will require:

- a description of each uncertain tax position providing sufficient detail for the Service to determine the nature of the issue; and
- disclosure of the maximum US federal income tax liability attributable to each uncertain tax position if the position was disallowed entirely.

While a taxpayer will not be required to disclose either its risk analysis regarding the likelihood of prevailing on the merits of a position or the individual tax reserve amounts, it must, as part of the description, disclose the rationale for each position and explain its reasons for determining that the position is an uncertain tax position. To be compliant, each description must:

- list the statutory provisions potentially implicated by the position;
- describe the tax year(s) affected;
- state whether the position involves an item of income, gain, loss, deduction or credit;
- state whether the position involves a permanent inclusion or exclusion of an item, the timing of an item, or both;
- state whether the position involves the valuation of any property or right; and
- state whether the position involves the computation of basis.

The Service intends to issue a notice of proposed rulemaking requiring affected business taxpayers to file the new schedule with their US federal income tax returns. It is also considering whether to seek legislation imposing a penalty for failure to file the schedule or make adequate disclosure.

The Service requested comments on the proposal by March 29, 2010. Disclosure of uncertain tax positions will be required with returns filed after release of the schedule. (See Announcement 2010-9 (January 26, 2010).)

Part of a larger US trend towards transparency

The proposed requirement to disclose uncertain tax positions is the latest manifestation of a trend in which the Service has been seeking ever greater transparency with respect to the tax affairs of large business taxpayers in an effort to focus audits on issues of particular interest or items of significant magnitude. Over the last decade, this trend has included the introduction of new tax return schedules requiring large business taxpayers to reconcile book-tax differences, as well as a shift in policy on government access to tax accrual workpapers developed by taxpayers in connection with establishing reserves for financial accounting purposes. During the same period, all taxpayers have been required specifically to disclose their involvement in reportable tax shelter transactions.

While the Service has long taken the position that it can require disclosure of tax accrual workpapers under the Internal Revenue Code and *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984), it has traditionally exercised a “policy of restraint” under which it only seeks tax accrual workpapers in unusual circumstances. Since 2002, however, the Service’s policy has been to request tax accrual workpapers in its examination of any tax return claiming tax benefits from a transaction listed by the Service as an abusive tax shelter.¹ If a taxpayer fails to disclose a listed transaction, the Service may request all tax accrual workpapers relating to the return. Affected taxpayers have sought to invoke the protection of the work product privilege, which protects documents prepared in anticipation of litigation or for trial. An August 2009 judgment in *United States v. Textron*, 104 AFTR 2d 2009-5719 (1st Cir. 2009), however, held that this privilege does not extend to tax accrual workpapers. The taxpayer’s petition for review of the judgment is currently pending before the US Supreme Court.

While the recent announcement states that the Service will continue its policy of restraint with respect to tax accrual workpapers, introduction of the new schedule will require taxpayers to make unprecedented amounts of information regarding their tax positions and reserves available to

the Service on a routine basis. By providing access to detailed information on positions that are not related to identified tax shelters, the announcement continues the trend towards ever greater transparency. Whether the US Supreme Court will enter the fray remains to be seen.

Related international developments

In recent years, a number of European jurisdictions have considered introducing disclosure requirements for reportable tax shelter transactions, and the UK has established a special regime requiring taxpayers and advisers to disclose details of schemes bearing certain “hallmarks” that have a main purpose of securing a UK tax advantage. Disclosure requirements similar to the schedule of uncertain tax positions just proposed by the US authorities, however, have not yet been introduced. UK companies are required to prepare their statutory accounts under International Financial Reporting Standards or UK generally accepted accounting principles, and disclosure of uncertain tax positions on their financial statements is not necessary. This may change in the future. An exposure draft published by the International Accounting Standards Board (IASB) in March 2009 would require disclosure of “major sources of estimation uncertainties” relating to tax, including a description of the uncertainty.

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¹ Ann. 2002-63, 2002-2 C.B. 72.