

IRS releases final schedule to report uncertain tax positions

On April 19, 2010, the IRS released a draft of Schedule UTP, Uncertain Tax Position Statement, and requested public comments on the draft form and instructions. The IRS received a large number of comments on the overall proposal, including concerns on how the IRS would use the reported information, the additional reporting burden on taxpayers, and the IRS's authority to require reporting of uncertain tax positions with the corporation's tax return. The final schedule and instructions were released by the IRS on September 24, 2010.

Major changes to the draft schedule and instructions

In response to concerns expressed by commentators on the draft proposal, the final Schedule UTP and instructions contain a number of significant changes, which include the following:

- > Five-year phase-in of the reporting requirement based on a corporation's asset size;
- > Taxpayers must specifically identify transfer pricing adjustments and any position that exceeds 10 percent of the total amount of all the reserves on the schedule;
- > 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.

The final schedule and instructions generally retain the previously announced filing requirements regarding types of corporations required to complete Schedule UTP for 2010 tax years. This includes all public or privately held corporations that issue or are included in **audited** financial statements and that file a 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.

Corporations without audited financial statements are not required to file Schedule UTP regardless of their size. An audited financial statement is defined as one on which an independent auditor expresses an opinion; compilations or reviewed financial statements do not subject a taxpayer to the Schedule UTP reporting requirements.

Phase-in of reporting

The initial proposal by the IRS required the reporting of uncertain tax positions by business taxpayers with total assets of at least \$10 million. In response to comments, the IRS has implemented a five-year phase-in of Schedule UTP for corporations with total assets under \$100 million. Corporations that have total worldwide assets equal to or exceeding \$100 million must file Schedule UTP beginning with 2010 tax years. The total asset threshold will be reduced to \$50 million beginning with 2012 tax years and to \$10 million beginning with 2014 tax years. The IRS is also considering the extension of Schedule UTP reporting to other taxpayers for 2011 or later years, such as pass-through entities or tax-exempt organizations.

Tax positions to be reported on Schedule UTP

Schedule UTP requires the reporting of each U.S. federal income tax position taken by the corporation on its U.S. federal income tax return. This includes any tax position that would result in an adjustment to a line item on that tax return (or would be included in a section 481(a) adjustment) if the position is not sustained. In other words, an uncertain tax position is any tax position that doesn't meet the "more likely than not" standard. The "more likely than not" standard is met if a tax position has a greater than 50 percent likelihood that a position will be sustained on its merits. Uncertain tax positions must be reported on Schedule UTP if:

- > The corporation has taken a tax position on its U.S. federal income tax return for the current tax year or a prior tax year; and
- > Either a reserve has been recorded with respect to that tax position in audited financial statements, or a reserve was not recorded for the tax position because the corporation expects to litigate the position.

Consistency between Schedule UTP reporting and financial statement reserve decisions

The final instructions for Schedule UTP clarify that the schedule seeks the reporting of tax positions consistent with the reserve decisions made by the corporation for audited financial statement purposes. Corporations are not required to report tax positions that are either

immaterial under applicable financial reporting standards or are sufficiently certain so that no reserve is required under those standards. Only 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 must be reported on Schedule UTP.

Additional areas of clarification

Based on commentary received on the draft proposal, the IRS made additional clarifications with the final Schedule UTP and instructions, some of which include the following:

- > Schedule UTP requires the reporting of U.S. federal income tax positions only; it does not require the reporting of foreign or state positions (a corporation is required to report a U.S. 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 U.S. federal income tax was recorded to reflect that uncertainty);
- > 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;
- > Corporations are to report their own tax positions on Schedule UTP and not the tax positions of a related party;
- > Tax positions taken in years prior to 2010 do not need to be reported in 2010 or a later year, even if a reserve is recorded in audited financial statements issued in 2010 or later; and
- > Schedule UTP does not need to be filed for short tax years ending in 2010.

The final instructions do not provide specific guidance regarding penalties. The IRS stated that it does intend to review compliance with Schedule UTP and will take appropriate enforcement action in 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.

The IRS will also create a working group to study and revise Schedule M-3, Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More, to reduce duplicate reporting. The IRS believes that the implementation of Schedule UTP is likely to reduce the need for some of the information currently reported on Schedule M-3. The working group is expected to begin its review in 2011 and external stakeholders will be involved to develop the appropriate revisions.

What can taxpayers do now to prepare for Schedule UTP?

Taxpayers that will be required to file Schedule UTP for the 2010 tax year should begin evaluating uncertain tax positions that will be included in the 2010 audited financial statements. For each uncertain tax position, the following must be disclosed:

- > Ranking of the tax position – Each tax position must be ranked by size. The size of each tax position is determined on an annual basis and is the amount of U.S. federal income tax reserve that is recorded for that position;
- > Major tax positions – Taxpayers must indicate if a tax position is a “major tax position,” i.e., tax positions for which the relative size of the tax position is greater than or equal to 10% of the total reserve recorded for all uncertain tax positions included on Schedule UTP; and
- > Concise description – For each tax position, a concise description including relevant facts affecting the tax treatment of the position and information that can reasonably be expected to apprise the IRS of the identity of the tax position and nature of the issue must be disclosed on Schedule UTP. “Available upon request” is not an adequate disclosure for purposes of Schedule UTP.

Access the final **Schedule UTP** and **instructions** on the **IRS Web site** for additional detail.

If you have any questions regarding the additional reporting requirements, please contact your Baker Tilly advisor or send an e-mail to tax@bakertilly.com.