McDermott Will & Emery

On the Subject

U.S. & International Tax

September 27, 2010

On September 24, 2010, the IRS issued the final Schedule UTP and instructions that require corporations to report so-called “uncertain tax positions,” or UTPs. In conjunction with finalizing the schedule, the IRS released Announcement 2010-75, explaining the changes it made to the final Schedule UTP from the draft schedule and instructions released April 29, 2010. Additionally, the IRS issued Announcement 2010-76, which details the IRS’s revisions to its policy of restraint with regard to seeking taxpayers’ tax accrual workpapers during audit, as well as an internal directive to the field which outlines the IRS’ plan for treating uncertain tax positions.

IRS Releases Final Schedule UTP and Instructions

In a previous On the Subject, which can be found at http://www.mwe.com/index.cfm/fuseaction/publications.nldetail/object_id/a573efdb-4a2f-4425-90c7-14e35ca06379.cfm, McDermott Will & Emery reported on the release of the Internal Revenue Service’s (IRS) draft schedule and instructions for reporting uncertain tax positions (UTPs). Recently the IRS issued Announcement 2010-75, in which it unveils many important changes to the schedule in response to comments submitted to the IRS.

Who Must File Schedule UTP

The draft UTP instructions required all corporations that file Form 1120, 1120-F, 1120-L or 1120-PC with assets more than $10 million to file Schedule UTP. The IRS rejected the suggestions to exclude CAP taxpayers or CIC taxpayers, but the new instructions temper the reporting requirement by gradually implementing it over a five-year period. Corporations with assets more than $100 million must file the Schedule UTP for tax year 2010. This threshold for filing will be reduced to $50 million in assets in 2012 and $10 million in assets in 2014.

Definition of UTP Modified

The IRS adopted commentators’ suggestions to eliminate the requirement to disclose UTP for which no reserves were taken because the corporation determined it was the IRS’s administrative practice not to raise the issue during exam. The IRS, however, continues to require the disclosure of tax positions for which no reserve was recorded because the corporation expects to litigate the position. The final Schedule UTP instructions clarify that the expectation to litigate does not include positions that are highly certain or immaterial positions under accounting standards. A corporation must report on Schedule UTP a tax position taken on its return for which no reserve for income tax was recorded if the tax position is one that the corporation or a related party determines the probability of settling with the IRS to be less than 50 percent chance and no reserve was recorded because the corporation intends to litigate the tax position and has determined that it is more likely than not to prevail on the merits in the litigation.

Maximum Tax Amount Modified

A major change is the elimination of the maximum tax amount (MTA). The draft Schedule UTP required taxpayers to state the MTA of the liability that would be owed if the UTP were later to be disregarded by the IRS. The final Schedule UTP eliminates the MTA requirement and instead requires all reported positions be ranked according to U.S. federal tax reserve amounts without listing the actual reserve amounts. The corporation must identify “major tax positions,” whose relative size is greater than or equal to 10 percent of the taxpayer’s overall liability, computed by dividing the amount of the major tax position by the sum of all of tax positions, but disregarding the expectation to litigate positions. Transfer pricing positions are included for purposes of determining major tax positions. The corporation can assign any ranking number to expectation to litigate positions.

Description Modified to Conform to Form 8275

The draft instructions required taxpayers to provide the rationale and nature of the uncertainty for any UTP. Many commentators expressed concern that complying with such a requirement might potentially implicate a waiver of privilege regarding confidential communications relating to the UTP. The final schedule addresses this concern by only requiring a concise description of the position without any statement regarding the rationale or nature of the uncertainty. Moreover, the instructions clarify 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. The concise description should not be more than a few sentences and should include a description of the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the secretary of the identity of the position and the nature of the issue.

The concise description is intended to be consistent with the information required to be reported on Form 8275. Accordingly, the final UTP Schedule instructions state that a taxpayer will be treated as filing Form 8275 or Form 8275-R for any tax position that is accurately and completely disclosed on Schedule UTP. Similarly, disclosure on Schedule UTP will satisfy the Internal Revenue Code (IRC) section 6662(i) disclosure requirements. In an effort to avoid duplication of information, the IRS is also considering whether disclosure on Schedule UTP will satisfy the reportable disclosure requirements.

Disclosure to Treaty Partners

Announcement 2010-75 states that the IRS intends to generally refrain from providing Schedule UTP information to other governments. Information obtained through Schedule UTP will not be routinely disclosed to foreign countries, unless there is a reciprocal agreement regarding UTP information. Even then, the IRS will only release information if such a disclosure is warranted under the facts and circumstances, including the relevance of the information to the foreign government.

Modification to IRS Policy of Restraint

The IRS also issued Announcement 2010-76, which modifies the IRS's policy of restraint. Generally, under the policy of restraint, the IRS will not request tax accrual workpapers absent unusual circumstances or when the taxpayer has claimed the benefits of one or more listed transactions. The revised policy of restraint states that a disclosure of issues on Schedule UTP will not affect protections otherwise offered by the existing policy. The revised policy provides that if a document is otherwise privileged under the attorney-client privilege, the IRC section 7525 tax advice or the work product doctrine, and the document was provided to an independent auditor as part of an audit of the taxpayer's financial statements, the IRS will not assert *during* an examination that the privilege was waived by such disclosure. This "no waiver" provision does not apply if the taxpayer has otherwise waived privilege or if a request for tax accrual workpapers is made under IRM 4.10.20.3 because unusual circumstances exist or the taxpayer has claimed the benefits of one or more listed transactions.

The revised policy further provides that a taxpayer may redact its tax reconciliation workpapers to exclude working drafts, revisions or comments concerning the concise descriptions of tax positions reported on Schedule UTP; the amount of any reserve related to a tax position reported on Schedule UTP; and computations determining the ranking of tax positions to be reported on Schedule UTP or the designation of a tax position as a major tax position. The revised policy warns that it is not intended to create or imply the application of the attorney-client privilege, the IRC section 7525 tax advice privilege or the work product doctrine to any document of any taxpayer or party.

IRS Field Directive

Finally, the IRS issued an internal directive to the field that outlines its plan for dealing with the reporting of UTPs. The IRS would like examiners to engage directly with taxpayers early on in the process to eliminate uncertainty. The IRS will, in the near future, conduct special training and will establish a central "triage" team to review and determine the treatment of UTPs.

For more information, please contact your regular McDermott lawyer, or:

Robin L. Greenhouse: +1 202 756 8204 rgreenhouse@mwe.com

Joseph H. Selby: +1 617 535 4066 jselby@mwe.com

Kevin Spencer: +1 202 756 8203 kspencer@mwe.com

Justin Jesse: +1 202 756 8777 jjesse@mwe.com

For more information about McDermott Will & Emery visit: www.mwe.com

McDermott Will & Emery

McDermott Will & Emery

Office Locations

Boston
28 State Street
Boston, MA 02109
USA
Tel: +1 617 535 4000
Fax: +1 617 535 3800

Brussels
Rue Père Eudore Devroye 245
1150 Brussels
Belgium
Tel: +32 2 230 50 59
Fax: +32 2 230 57 13

Chicago
227 West Monroe Street
Chicago, IL 60606
USA
Tel: +1 312 372 2000
Fax: +1 312 984 7700

Düsseldorf
Stadttor 1
40219 Düsseldorf
Germany
Tel: +49 211 30211 0
Fax: +49 211 30211 555

Houston
1000 Louisiana Street, Suite 3900
Houston, TX 77002
USA
Tel: +1 713 653 1700
Fax: +1 713 739 7592

London
7 Bishopsgate
London EC2N 3AR
United Kingdom
Tel: +44 20 7577 6900
Fax: +44 20 7577 6950

Los Angeles
2049 Century Park East, 38th Floor
Los Angeles, CA 90067
USA
Tel: +1 310 277 4110
Fax: +1 310 277 4730

Miami
201 South Biscayne Blvd.
Miami, FL 33131
USA
Tel: +1 305 358 3500
Fax: +1 305 347 6500

Milan
Via A. Albricci, 9
20122 Milan
Italy
Tel: +39 02 89096073
Fax: +39 02 72095111

Munich
Nymphenburger Str. 3
80335 Munich
Germany
Tel: +49 89 12712 0
Fax: +49 89 12712 111

New York
340 Madison Avenue
New York, NY 10173
USA
Tel: +1 212 547 5400
Fax: +1 212 547 5444

Orange County
18191 Von Karman Avenue, Suite 500
Irvine, CA 92612
USA
Tel: +1 949 851 0633
Fax: +1 949 851 9348

Rome
Via Parigi, 11
00185 Rome
Italy
Tel: +39 06 4620241
Fax: +39 0648906285

San Diego
11682 El Camino Real, Ste. 400
San Diego, CA 92130
USA
Tel: +1 858 720 3300
Fax: +1 858 720 7800

Shanghai
MWE China Law Offices
Strategic alliance with
McDermott Will & Emery
28th Floor Jin Mao Building
88 Century Boulevard
Shanghai Pudong New Area
P.R.China 200121
Tel: +86 21 6105 0500
Fax: +86 21 6105 0501

Silicon Valley
275 Middlefield Road, Suite 100
Menlo Park, CA 94025
USA
Tel: +1 650 815 7400
Fax: +1 650 815 7401

Washington, D.C.
600 Thirteenth Street, N.W.
Washington, D.C. 20005
USA
Tel: +1 202 756 8000
Fax: +1 202 756 8087