



IRS releases guidance on Schedule UTP and policy of restraint

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The IRS on March 23 released guidance in the form of answers to several frequently asked questions (FAQs) raised by taxpayers and practitioners with respect to reporting "uncertain tax positions" on the final Schedule UTP and earlier guidance, which the IRS had issued in September 2010. The new guidance addresses two primary areas: issues related to reporting on Schedule UTP and changes to the policy of restraint announced in Announcement 2010-76.

For prior discussion, see WNTS Insight, "[IRS modifies final Schedule UTP and instructions for reporting uncertain tax positions \(UTPs\); expands policy of restraint](#)," September 24, 2010.

Reporting on Schedule UTP

Generally, Schedule UTP requires corporate taxpayers to report a tax position on Schedule UTP if (1) the corporation has taken a tax position on its U.S. federal income tax return for the current or for a prior tax year and (2) the corporation, or a related party, either has recorded a reserve with respect to that position for U.S. federal income tax in audited financial statements or did not record a reserve for the position because the corporation expects to litigate the position.

Observation: The FAQs do not provide additional guidance on the definition of "record a reserve" or clarify what constitutes taking a tax position on a tax return.

Definition of "sufficiently certain"

The instructions to Schedule UTP state that a taxpayer need not disclose a tax position for which no reserve was required because either the amount was immaterial for audited financial statement purposes or the tax position was "sufficiently certain so that no reserve was required." The first FAQ explains that the term "sufficiently certain" in the instructions means the same as "highly certain" within the meaning of FIN 48 for taxpayers issuing financial statements under U.S. GAAP.

Later elimination of reserve

The IRS also addresses situations in which a reserve is recorded in a

year-end audited financial statement and subsequently is eliminated in an interim period financial statement prior to the filing of the respective year's tax return. The second FAQ clarifies that the elimination of a financial statement reserve in a subsequent unaudited interim financial statement issued before the filing of Schedule UTP does not remove the requirement to disclose the position. However, the IRS further provides that a similar elimination in an audited interim financial statement issued prior to the filing of a tax return does remove the Schedule UTP reporting requirement for that position.

Observation: In practice, most interim financial statements are not "audited." Therefore, it is unlikely that a change in a reserve determination for a tax position occurring in an interim reporting period prior to the filing of the respective year's tax return would affect the Schedule UTP reporting requirements for the position.

Transition rules

In a significant clarification of Schedule UTP transition rules, the FAQs provide that uncertain tax positions taken in tax years prior to calendar year 2010 that are embedded in a net operating loss (NOL) or credit carryforward need not be reported on Schedule UTP when the underlying NOL or credit carryforward is used in 2010 or subsequent year. The FAQs do not address disclosure of a tax position on Schedule UTP when a NOL or credit carryforward is utilized that includes a 2010 or post-2010 tax position for which a reserve has been recorded. In the FAQs, the IRS indicates that it intends to issue further guidance regarding the reporting requirements for the use of NOLs and credit carryforwards.

Observation: This FAQ significantly enhances the transition rule provided in the instructions to Schedule UTP and addresses a significant potential issue for taxpayers with uncertain tax positions that are embedded in a NOL or credit carryforward that was not used in a pre-2010 calendar tax year.

Impact of interest and penalties

The FAQs address whether interest and penalties should be included in

the ranking of a tax position on Schedule UTP. The fourth FAQ clarifies that if interest and penalties are not computed on a position-by-position basis for financial reporting purposes, they are not to be included in the ranking of the positions on Schedule UTP.

Changes to the policy of restraint

Background

In Announcement 2010-76, released concurrently with the final Schedule UTP on September 24, 2010, the IRS announced it would forgo seeking certain documents that related to uncertain tax positions and the workpapers that document completion of Schedule UTP.

Specifically, the IRS expanded its policy of restraint by providing that:

- with respect to privileged documents shared with the taxpayer's independent auditor as part of the audit of the taxpayer's financial statements, the IRS generally will not assert during an examination that privilege has been waived by such disclosure; and
- with respect to tax reconciliation workpapers, the taxpayer may redact certain information relating to the preparation of the Schedule UTP from its response.

New guidance

Three of the FAQs released March 23 address the 2010 changes to the policy of restraint. First, the IRS stated that the changes apply to any document request during the administrative process of determining the correct tax liability, including Appeals.

Observation: This clarification eliminates uncertainty regarding whether the changes to the policy of restraint apply only to examinations.

Expanding beyond the administrative determination process, the second policy of restraint FAQ states that in Tax Court litigation, an IRS Counsel attorney ordinarily would not issue discovery requests for documents or information the IRS would not seek under the policy of restraint. The

FAQ provides that application of the policy of restraint to actions by Counsel in Tax Court litigation will be addressed in a revision to the Chief Counsel Directives Manual.

Finally, the FAQs clarify the effective date of Announcement 2010-76. The IRS states that the changes to the policy of restraint apply to any request for documents outstanding on or made after September 24, 2010, in any open examination.

Final Observations

When it released the FAQs on March 23, the IRS explained that the new guidance addresses some questions that have been raised regarding Schedule UTP and stated that additional FAQs may be forthcoming to address other issues. Given the many questions that still remain, such additional guidance will be welcomed.

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