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IRS Demands Taxpayers' "Help" in Applying Complex Internal Revenue Code

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On January 26, 2010, the Internal Revenue Service ("IRS") published Announcement 2010-9 (the "Announcement") addressing proposed reporting requirements with respect to uncertain tax positions of certain business taxpayers. According to the Announcement, the IRS is in the process of developing a schedule – to be filed with the annual U.S. federal income tax return – on which certain business taxpayers will be required to disclose their uncertain tax positions affecting their U.S. federal income tax liability. The proposed effective date for the new schedule is for returns filed after its release. The IRS will also issue proposed regulations and is seeking public comments. The new schedule was announced yesterday by IRS Commissioner Douglas Schulman at a luncheon meeting of the New York State Bar Tax Section in New York City. Schulman started his remarks with discussing the complexity of the tax law and gradually progressed towards arguing in favor of more taxpayer transparency regarding material tax issues in order to help the IRS.

According to the Announcement, the IRS is proposing that every business taxpayer with total assets in excess of \$10 million that has one or more "uncertain tax positions" will be required to file the new schedule with its annual U.S. federal income tax return. "Uncertain tax positions" include positions for which (i) a tax reserve under FIN 48 or other accounting standards must be established, or (ii) the taxpayer or a related entity has not established a tax reserve because the taxpayer (a) expects to litigate the position, or (b) has determined that the IRS has a general administrative practice not to examine the position.

The new schedule will require the taxpayer to include a concise description of each uncertain tax position and the maximum amount of potential U.S. federal tax liability attributable to each uncertain tax position. The concise description must include the rationale for the position taken by the taxpayer and a general statement of the reasons why the position is an uncertain tax position. In particular, the description must include the following:

1. The Internal Revenue Code sections implicated by the position;
2. The taxable year(s) to which the position relates;
3. Whether the position involves an item of income, gain, loss, deduction, or credit;
4. Whether the position involves a permanent inclusion or exclusion of any item and/or the timing of that item;
5. Whether the position involves a determination of the value of any property or right; and
6. Whether the position involves a computation of basis.

The new schedule is the latest volley in the long-running battle between taxpayers and the IRS over "tax accrual workpapers." It is not clear from the Announcement whether the description's request for a rationale and statement of reasons implicates privileged or otherwise protected legal analysis. The request for a rationale regarding positions the taxpayer expects to litigate seems at least to directly implicate protected work product. Textron Inc. is currently seeking Supreme Court review of a recent First Circuit en banc decision rejecting the taxpayer's attempt to protect its internal tax workpaper analysis based on the work product doctrine. If the Supreme Court reverses the First Circuit and agrees that such analysis is protected work product, this could provide an

additional basis for limiting the information provided to the IRS on the new proposed schedule. It is well-established that the IRS's summons power is subject to traditional privileges and, therefore, depending on the outcome of Textron's appeal, the IRS may not be able to force a taxpayer to disclose privileged or protected information on the new schedule.

The Announcement further states that the IRS's current policy of restraint regarding requests for tax accrual workpapers is not being changed. However, the IRS notes that modifications to that policy could be made "to ensure it obtains complete and accurate information regarding a taxpayer's uncertain tax positions on a timely basis."

The IRS is contemplating seeking legislation that would impose penalties or other sanctions when a taxpayer fails to adequately disclose the required information with respect to its uncertain tax positions. In addition, the IRS invites comments from the public by March 31, 2010, with respect to the proposal described in the Announcement.