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IRS Plans To Ask For An Auditing Road Map

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In another sign of the increasingly aggressive efforts by the IRS to target “large” business taxpayers, the IRS is planning on requiring a new schedule to be filed with the business tax return of any company whose total assets exceed \$10 million. The IRS is using the “efficiency of resources” justification to require companies to disclose, on a soon-to-be-released schedule, the following:

A concise description of each uncertain tax position for which the taxpayer or a related entity has recorded a reserve in its financial statements; and

The maximum amount of potential federal tax liability attributable to each uncertain tax position (determined without regard to the taxpayer’s risk analysis regarding its likelihood of prevailing on the merits).

The description must include the rationale for the position and the reasons why the position taken is uncertain. In addition, the description must be sufficient enough to allow the IRS to determine the nature of the issue, which is inherently based on the taxpayer’s facts and circumstances, and it must contain, at a minimum, the following:

The Code sections potentially implicated by the position;

A description of the taxable year or years to which the position relates;

A statement that the position involves an item of income, gain, loss, deduction, or credit against tax;

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A statement that the position involves a permanent inclusion or exclusion of any item, the timing of that item, or both;

A statement whether the position involves a determination of the value of any property or right; and

A statement whether the position involves a computation of basis.

The schedule will be required not only when a reserve is recorded in the taxpayer's (or of certain related parties') financial statements (whether pursuant to FIN 48, International Financial Reporting Standards, or country-specific GAAP provisions) but also when a reserve has not been booked because either the taxpayer expects to litigate the position or the taxpayer has determined that the IRS has a general administrative practice not to examine the position in question.

Manatt, Phelps & Phillips, LLP's tax attorneys are closely monitoring these developments. In addition, the IRS will be accepting comments until March 29, 2010, and is particularly interested in the following areas:

How the maximum tax adjustment should be reflected on the schedule so that it provides the IRS with an objective and quantifiable measure of each reported tax position (e.g., specific dollar amount or by appropriate dollar ranges);

What alternative methods of disclosure of the amount at issue would allow the IRS to identify the relative importance of the uncertain tax positions;

Whether the calculation of the maximum tax adjustment should relate solely to the tax period for which the return is filed or to all tax periods to which the position relates, and whether net operating losses or excess credits should be taken into account in determining the maximum tax adjustment;

How the related entity rules should be applied;

Whether the scope of the Announcement should be modified regarding the uncertain tax positions for which information is required to be reported (e.g., positions for which no tax reserve has been established because the taxpayer determined the IRS has a general administrative practice not to examine the position);

Whether transition rules should be used or criteria modified to either include or exclude certain business taxpayers (e.g., the proposed threshold of \$10 million total assets);

How the new schedule should address taxpayers that initially did not record a reserve for an issue, but in later years do record a reserve; and

Whether the list of information proposed to be included should be modified, including whether certain information should be requested in some circumstances upon examination rather than with the tax return.

If you have any questions regarding the planned new schedule or are interested in submitting a comment, please contact one of the authors listed below.

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