Uncertain Tax Positions: An Update of Reporting Requirements Since 2008
Ian J. Redpath, Thomas J. Vogel and George F. Kermis

From 2006 to 2008, the accounting profession experienced substantial changes in the reporting of uncertain tax positions and potential preparer penalties resulting from these positions. Prior research provides an extensive review of the changes from FIN 48, IRC Penalty Disclosure, and Circular 230. Over the past few years, the reporting rules have been further studied, and in some cases, modified. From a financial reporting perspective, the Financial Accounting Foundation used the controversial disclosure requirements of FIN 48 to conduct its first “Post-Implementation Review” of an accounting standard. In its report, the FAF concludes that FIN 48 provided relevant information to the users of financial statements. From a taxation perspective, the IRS revised its penalty provisions and developed a self-reporting requirement that forces certain taxpayers with a FIN 48 position to disclose the position to the IRS when filing tax returns. In this paper we summarize these recent developments, and discuss how the accounting profession will be impacted in subsequent years.

Keywords: uncertain tax positions, FIN 48, tax preparer penalties, Schedule UTP

1. Introduction

In the post-Sarbanes-Oxley era, the reporting of uncertain tax positions has undergone major changes, both in financial reporting and taxation. In financial reporting, the emphasis evolved because prior guidance resulted in inconsistent measurement and disclosure of the positions. In taxation, the changes were prompted by the desire of the IRS to reduce/eliminate the use of illegal tax shelters.
Redpath, Vogel, and Kermis (2010) provides a discussion of the new requirements for financial reporting (FASB Interpretation 48 or FIN 48), and taxpayer/preparer responsibilities (IRC §§ 6662 and 6694). This paper emphasized the struggles that the profession would face when dealing with both standards. The purpose of both was to increase transparency, but the standards contained significant differences.

Both standards have received their share of criticism since their implementation. In this paper, we provide an update on events/changes that have occurred over the past few years in the reporting of uncertain tax positions. The Financial Accounting Foundation chose FIN 48 as its initial standard to undergo a “Post Implementation Review.” Of primary note, the study found that controversial disclosures related to uncertain tax positions provided users of the financial statements with relevant information that is used in investment decisions. In taxation, the IRS now requires some companies to complete Schedule UTP (Uncertain Tax Positions) when material tax positions are in place. We discuss these recent events and the impact that each will have on today’s accountants and tax preparers.

2. BACKGROUND AND LITERATURE REVIEW

2.1 Uncertain Tax Positions and FIN 48

After the implementation of the Sarbanes-Oxley Act (SOX) in 2002, a number of internal control deficiencies in financial reporting came to light. One of the most problematic areas was the reporting of income taxes. Specifically, the reporting of uncertain tax positions (UTPs) was inconsistent, and in some cases, used to manage earnings. In addition, very little disclosure was provided to end users regarding these UTPs.

In response, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, “Accounting for Uncertainty in Income Taxes: An Interpretation of FASB Statement No. 109” (FIN 48), in June 2006. FIN 48 improved consistency in the reporting of UTPs by specifying rules to determine the related contingent liability. Perhaps more important, however, FIN 48 required companies to disclose additional information
about UTPs such as the amount of the liability, and the changes in tax benefits resulting from tax positions taken in the current year.

Concurrent with these events in financial reporting, Congress took initiatives to help prevent tax loopholes and the under-reporting of income. In 2007, Congress, at the behest of the Internal Revenue Service, expanded the preparer penalties in IRC§6694 that are applicable to positions taken on a return. In addition the Internal Revenue Service amended Circular 230 and the Due Diligence standards for taking a tax position.

These changes in the reporting of UTPs incorporated new responsibilities on the accounting profession. Unfortunately for accountants and tax preparers, the standards contained significant differences. Redpath, et al (2010) contains a detailed discussion of the standards and the challenges faced by the accounting profession during implementation.

Since the implementation of these standards, the reporting of UTPs has remained a controversial topic. It is argued by some that the disclosure of UTPs in the financial report provides the IRS with a roadmap in planning which companies to audit. As a result, companies may be less willing to structure a transaction with an aggressive tax position.

Mills, Robinson, and Sansing (2012) model the potential economic effect resulting from FIN 48. They argue that taxpayers are not necessarily harmed by the standard. Firms with strong tax positions will receive higher “payoffs” from investor confidence and the lower likelihood of a tax audit. In addition, firms with weaker tax positions may not suffer a financial impact because the IRS cannot extract sufficient information to collect tax and/or impose a penalty without a costly audit, settlement, and collection process.

While the above study documents a potential positive outcome from FIN 48, most recent studies have documented the negative impacts of the standard. Firms are reluctant to provide the required disclosures, and there is evidence that the disclosures will create financial hardships for firms that commit to an aggressive tax position. Some evidence of the negative consequences documented in current literature includes the following studies:
Katz (2008) discusses how companies are reluctant to disclose the “look forward” provision (i.e. tax positions that will significantly change in the next twelve months). In a study of the first reporting period after the implementation of FIN 48, 72 out of 601 companies did not provide the required information. Another 198 companies claimed the information was not material, and 76 companies reported that a reasonable estimate could not be reached. Stuart E. Seigel, former Internal Revenue Service chief counsel, is quoted in the study saying the “look forward” disclosure is “the greatest single area of non-compliance with FIN 48 disclosure requirements.” It appears that firms are indeed reluctant to provide this essential piece of the roadmap for the IRS.

Kern and Luttman (2011) find that state and local disclosures are less frequent than U.S. or international jurisdictions. As a result they are even less helpful to these taxing authorities.

Tomohara, Lee, and Lee (2012) finds that U.S. companies experienced a higher tax burden after the implementation of FIN 48. When evaluating the impact on small and large companies, the higher tax burden is concentrated in the group of large firms. This is consistent with the premise that large companies have more resources available to structure transactions that make use of aggressive tax positions. As a result, they conclude that FIN 48 has a greater impact on larger firms than small firms.

Leone (2007) notes that Congress is using FIN 48 disclosures as well as the IRS. In August 2007, Senate investigators solicited details about FIN 48 disclosures from at least 30 companies as first reported in the Wall Street Journal.

It appears that the implementation of FIN 48 did have a substantial impact on both financial and taxation reporting. But it did not provide a perfect roadmap for the IRS and other taxing jurisdictions. Firms are reluctant to disclose all relevant information and taxing authorities still incur substantial costs to locate and collect from those positions where the UTP has weak support.
2.2 Recent Developments
In recent years, the disclosure requirements of FIN 48 have been further studied and modified by authorities in both financial reporting (FASB) and taxation (IRS). We summarize these developments in the following sections.

In Section 3, we evaluate recent developments in financial reporting. In 2012, a Post-Implementation Review on FIN 48 was issued by the Financial Accounting Foundation. We discuss the findings from this review and implications on the accounting profession. The study found that FIN 48 accomplished its objectives, and despite numerous criticisms of the standard, the Financial Accounting Standards Board concluded no changes in the standard would be considered at this time.

In Section 4, we discuss changes in taxation reporting which are even more controversial. In September 2010, the IRS unveiled a new form for reporting more information on UTPs within the tax return itself. It created Schedule UTP, *Uncertain Tax Position Statement*, for this specific purpose. We discuss the requirements of this new schedule and the issues relating to protection of accountants’ work papers, as well as the additional requirements/burdens placed on today’s accountants and tax preparers.

3. Financial Reporting Update

3.1 What is a Post-Implementation Review?
In August 2008, the Advisory Committee on Improvements to Financial Reporting of the Securities and Exchange Commission recommended that a formalized post- adoption review should be completed for significant new standards. In response to this recommendation, the Financial Accounting Foundation (“FAF”) announced on November 18, 2010 that a new process was being developed to conduct Post Implementation Reviews (“PIR”) of recently issued accounting standards. In discussing the purpose of PIRs, the FAF states:

*The post-implementation review process is a tool to help the Trustees with their ongoing efforts to evaluate the effectiveness*
of accounting standards as well as the standard-setting process. The Trustees considered whether the Standards Boards should have responsibility for conducting the Review process rather than having it as part of the Trustees’ oversight responsibilities. Because the independence of post-implementation reviews was of paramount importance to the Trustees, they decided that the Review process should be an FAF function that is independent of the Standards Boards. Separating the standard-setting process from the review process makes the review process independent of standard setting in fact and in appearance.

The FAF determined three primary objectives for PIRs. First, the PIR should determine whether a standard is accomplishing its stated purpose. Second, the PIR should evaluate the standard’s implementation costs and related benefits. Finally, the PIR should provide recommendations to improve the standard-setting process (as opposed to recommending standard-setting actions).

In determining which accounting standards to review, a number of factors are considered including:

- Whether significant post-implementation guidance has been requested
- Whether there has been a significant number of financial statement restatements
- Whether the standard is or was controversial to stakeholders
- Whether the standard required significant costs to implement or significant systems changes and maintenance
- Whether other standard setters are reviewing the standard

The FAF determined that its first PIR would be on the implementation FIN 48. FIN 48 was developed to help curb earnings management opportunities related to the estimation of tax expense. It became a very controversial topic, mainly because of its disclosure requirements where companies were required to disclose potential tax liabilities resulting from uncertain tax positions. As noted by the FAF:
FIN 48 was selected as the initial post-implementation review standard because it made an important change in accounting and reporting, but it was not so transforming and controversial that it would overwhelm PIR team resources.

The criteria and procedures for reviewing FIN 48 were extensive. The PIR team reviewed academic publications and footnote disclosures and other public information for selected public companies. In addition, surveys were sent to numerous stakeholders to obtain a variety of perspectives on the standard. The survey process yielded a total of 199 responses of which 45% came from users, 29% from preparers, 18% from accounting practitioners, and 8% from academics.

3.2 PIR on FIN 48

The PIR for FIN 48 was released in January 2012, and discusses each of the primary objectives. The PIR team concluded that FIN 48 did accomplish its stated purpose. The conclusion is based on five areas of research:

1. Underlying need for the statement – Prior to the issuance of FIN 48, there were inconsistencies in the measurement of tax uncertainties, very few companies disclosed information on tax uncertainties, and users were unable to include tax reserve information in investment decisions. Since the implementation of FIN 48, feedback from users indicates that investors are using FIN 48 disclosures to assist in estimates of cash flows and assess the aggressiveness of management in company income tax strategies. In addition, FIN 48 provides a consistent methodology for companies to follow in estimating the potential impact of uncertain tax positions. It appears that FIN 48 does satisfy the underlying needs that resulted in its issuance.

2. Decision-Useful Information – As noted above, feedback received from investors and other financial statement users indicates that FIN 48 disclosures are incorporated in investment decisions, although some feedback indicated that users question the reliability and verifiability of the estimates. Preparers, however, do
not believe FIN 48 provides decision-useful information. They believe the judgments involved in measuring income tax uncertainties result in information that is not comparable, and may not represent amounts expected to be settled. Finally, a review of academic research indicated that the usefulness of the disclosure may vary depending on entity size and sensitivity to tax authority settlement implications. Based on all the information received, the PIR team concluded that “on balance” FIN 48 disclosures do provide decision-useful information.

3. Standard should be operational – Feedback from preparers suggests that they generally understand the standard’s requirements, and are generally able to apply FIN 48’s provisions. They do note difficulties that result from attempting to apply probabilities to complex and vague tax practices. Preparers and practitioners believe that FIN 48 disclosures reveal sensitive information to taxing authorities. This sensitivity can lead to ambiguous disclosures, which in turn reduce the reliability of the disclosures. Furthermore, the implementation of FIN 48 required professionals to seek (and they continue to seek) post-implementation guidance from a variety of sources.

4. Unexpected Changes in Practice – Research conducted by the PIR team indicates that most of the resulting changes in practice were anticipated. The most prevalent change was the coordination of tax and other functions. Some research suggests that preparers and practitioners became more conservative in tax strategies after FIN 48 was introduced, but some of this change in behavior may have resulted from increased IRS and Congressional focus on tax shelters. Preparers expressed further concern that the IRS Schedule UTP introduced in 2010 could lead to adverse audit and settlement consequences. PIR research, however, did not detect any changes in taxing authority behavior in selecting entities for audit or settling a tax dispute.

5. Economic Consequences – PIR team research did not document any significant economic consequences such as stock price volatility or
other market effects directly attributable to FIN 48’s recognition, measurement, and disclosure. The PIR does note, however, that it is too early to determine if any economic consequences will result from the implementation of IRS Schedule UTP.

Overall, the PIR team concludes that FIN 48 did accomplish its stated purpose – i.e. there is more consistency in measuring uncertain tax positions and more information provided to users about these positions. Users appear to use the information in investing decisions. But concerns remain regarding the use of judgment and the resulting lack of comparability that may result.

Regarding the second major objective of the PIR, the team concludes that the benefits associated with FIN 48 (improved consistency and reporting of uncertain tax positions) outweigh the costs. This belief is related to feedback received from the users. These stakeholders say the information is useful, and the PIR team notes that most preparers indicate that they did not incur significant FIN 48 implementation and compliance costs. Preparers and practitioners, however, believe that FIN 48 does not resolve important issues. While the standard does introduce a consistent methodology for measuring the uncertain tax positions, the use of judgment required creates an environment where estimates remain incomparable. As a result, these stakeholders claim the costs incurred do not generate substantial benefit.

Finally, regarding the third objective, the PIR on FIN 48 includes a few recommendations for the standard setting process. Of particular note, the PIR team suggests that subsequent standards provide benchmarks for determining the usefulness of information required by the standard. This recommendation outlines the issues that resulted for the team in determining whether or not FIN 48 disclosures provided meaningful and useful information to users.

A second “gray” area of concern became apparent to the team when attempting to address the second objective – cost-benefit tradeoff. The team recommends that FASB include in each subsequent standard a
discussion of the anticipated costs and benefits, as well as suggested methods for measuring these costs and benefits.

On March 20, 2012, FASB released its formal response to the PIR on FIN48. FASB believes that the PIR supports the premise that FIN 48 achieves its desired results while acknowledging some reporting issues remain. Excerpts from this response include:

We believe that the PIR Report findings affirm the overall effectiveness of FIN 48. In particular, the stakeholder feedback indicates that (a) FIN 48 achieves its objective of more consistent recognition and measurement of uncertain tax positions; (b) reported information about income tax uncertainties is more relevant since FIN 48 was issued, and (c) most preparers did not incur significant incremental implementation and continuing compliance costs.

Notwithstanding these overall positive findings, the PIR Report relays concerns expressed by some preparers and practitioners about certain technical provisions that are central to FIN 48. In particular, some preparers and practitioners expressed concerns that the judgments required to recognize and measure income tax uncertainties under FIN 48 result in information that is not comparable and reported liabilities that may be larger than settled amounts because the risk of examination for tax uncertainties by authorities (so-called examination risk) is not considered and the selected recognition threshold. As set forth in its Rules of Procedure, the Board evaluates whether those concerns provide information about circumstances that were new or not adequately considered at the time FIN 48 was developed.

The Board appreciates that there are different points of view about these issues and that some might have weighed the elements of this decision differently. However, the Board believes that the concerns discussed above were carefully considered during the development of FIN 48. The PIR Report was also discussed informally with several stakeholders, including members of FASB advisory groups. On the basis of those procedures, the Board has concluded that the criteria for a review or reconsideration of these fundamental aspects of FIN 48 are not met, and no discrete standards-setting action will be undertaken at this time.
4. **INTERNAL REVENUE SERVICE DISCLOSURE REQUIREMENTS:**

4.1 **Schedule UTP Disclosure:**
For tax years beginning in 2010 the IRS has added a new disclosure “Schedule UTP” to compliment the financial reporting for uncertain tax positions under FIN 48 (Exhibit 1). This will serve as the disclosure for penalties and substitute for Form 8275 and 8275-R, discussed later. The tax adjustment is broader than FIN 48 and applies any time:

1. “The corporation has taken a tax position on its U.S. federal income tax return for the current tax year or for a prior tax year and
2. Either the corporation or a related party has recorded a reserve with respect to that tax position for U.S. federal income tax in audited financial statements, or the corporation or related party did not record a reserve for that tax position because the corporation expects to litigate the position”. (Instructions).

It only applies to corporations filing 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) whose assets equal or exceed $100 million or the corporation, or a related party, issued audited financial statements reporting all or a portion of the corporation’s operations for all or a portion of the corporation’s tax year; and the corporation has one or more tax positions that must be reported on Schedule UTP (Instructions). The Service points out that Blank Schedule UTPs should not be filed (Instructions). To determine the corporation’s assets, the amount reported on as total year end assets on the Form 1120, or the higher of the beginning or end of year total assets reported on the balance sheet. Note that this is phased-in over 5 years and will be reduced to $10 million when fully phased-in.

A tax position for which a reserve was recorded or not recorded because of an expectation to litigate, must be disclosed on Schedule
**EXHIBIT 1. Schedule UTP.**

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<th>UTP No.</th>
<th>Primary IRC Section (e.g., “61”, “106”, etc.)</th>
<th>Timing Code (check if Permanent, Temporary, or both)</th>
<th>Pass-Through Entity EIN</th>
<th>Major Tax Position</th>
<th>Ranking of Tax Position</th>
<th>Reserved for Future Use</th>
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This Part I, Schedule UTP (Form 1120) is page ___ of ___ Part I pages.

**Part I** Uncertain Tax Positions for the Current Tax Year. See instructions for how to complete columns (a) through (g). Enter, in Part III, a description for each uncertain tax position (UTP).

Check this box if the corporation was unable to obtain information from related parties sufficient to determine whether a tax position is a UTP (see instructions).
**Exhibit 1. continued**

**Part II Uncertain Tax Positions for Prior Tax Years.**

See instructions for how to complete columns (a) through (h). Enter, in Part III, a description for each uncertain tax position (UTP).

<table>
<thead>
<tr>
<th>(a) UTP No.</th>
<th>(b) Primary IRC Section (e.g., &quot;61&quot;, &quot;1098&quot;, etc.)</th>
<th>(c) Timing Code (check if permanent, temporary, or both)</th>
<th>(d) Pass-Through Entity EIN</th>
<th>(e) Major Tax (f) Ranking of Tax Position</th>
<th>(g) Reserved for Future Use</th>
<th>(h) Year of Tax Position</th>
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EXHIBIT 1. concluded

Schedule UTP (Form 1120) 2011

<table>
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<th>Name of entity as shown on page 1 of tax return</th>
<th>EIN of entity</th>
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This Part III Schedule UTP (Form 1120) is page of Part III pages.

### Part III

**Concise Descriptions of UTPs.** Indicate the corresponding UTP number from Parts I and II, column (a). Use as many Part III pages as necessary (see instructions).

<table>
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<th>UTP No.</th>
<th>Concise Description of Uncertain Tax Positions</th>
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Uncertain Tax Positions Update

UTP regardless of whether the audited financial statements are prepared based on U.S. generally accepted accounting principles (GAAP), International Financial Reporting Standards (IFRS), or other country-specific accounting standards. This includes a modified version of any of those standards. However, if the corporation reconsiders it position on the reserve in an interim audited financial statement issued before the tax position is taken in a return, the corporation need not report the tax position to which the reserve relates on Schedule UTP (Instructions).

The positions that need to be reported are only those that require a reserve determination. It is not important how the position is reported on the financial statement by the corporation or a related party. It is considered recorded anytime an uncertain tax position or a FIN 48 liability is stated anywhere in a corporation’s or related party’s financial statements. This would include footnotes or other types of accounting journal entries. It may be a combination of journal entries that may indicate a reserve such as: “an increase in a current or non-current liability for income taxes, interest or penalties payable, or a reduction of a current or non-current receivable for income taxes and/or interest with respect to the tax position; or a reduction in a deferred tax asset or an increase in a deferred tax liability with respect to the tax position” (FAQ #6). While the initial recording of a reserve will trigger reporting, subsequent adjustments to the reserve will not. If a corporation is included in multiple audited financial statements, it must file Schedule UTP if a reserve was recorded in any of those audited financial statements. (Instructions)

In determining if a reserve has been recorded for purposes of Schedule UTP, reference is made to the decisions made by the corporation or a related party for audited financial statement purposes. If it has determined under financial accounting rules such as FIN 48 that no reserve is required, then the position need not be disclosed on Schedule UTP. Although the use of a NOL or a credit carryforward is a tax position taken on a tax return, it does not have to be disclosed on Schedule UTP.

A unit of account is the level of detail used in analyzing a tax position. It takes into account what the taxpayer uses to prepare and support the tax return and the level at which the taxpayer anticipates addressing
the issue with the IRS. The unit of account used by a GAAP or modified GAAP taxpayer for reporting a tax position on Schedule UTP must be the same unit of account used by the taxpayer for GAAP or modified GAAP. If GAAP is not used, the corporation must identify a unit of account based on similar principles or use any other level of detail that is consistently applied and that will apprise the IRS of the identity and nature of the issue underlying the tax position taken. For example, the unit of account for a research credit could be driven down to the particular research project or could be the total functional expenditures. Either could be a unit of account if used consistently.

Part I of the form is for reporting Positions for the Current Year. Part II is for prior years but not before 1/1/2010. If a position is reported for a current year, it does not also have to be reported in future years as a prior year position.

Part II of the Form is the most controversial. It requires a concise Description of the UTPs. This includes the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the IRS of the identity and nature of the tax position. Generally it should not exceed a few sentences and should not include an assessment of the hazards of a tax position or an analysis of the support for or against the tax position (Announcement 2010-75).

The extent of the disclosure and the ability of the government to access the accountant’s work papers has been a matter of great concern. Generally the accountant’s workpapers will be used in determining the existence of an uncertain tax position. Generally “work product” prepared “in anticipation of litigation” is protected from disclosure. (Hickman and FRCP 26(b)(3) ). There are two tests for anticipation of litigation: the majority applies the “because of” test and the minority the “primary purpose”. The “because of” test looks to see if the workpapers were prepared because of prospective litigation (Sealed). The “primary purpose” test makes inquiry as to whether the “primary purpose” of preparing the workpapers was to aid future litigation (United States v Davis).

There have been two major cases dealing with work production protection for accountant’s workpapers. The first case, Textron, was a
major defeat for accountants. In a split decision (3-2) the First Circuit Court of Appeals allowed the Service to obtain in-house tax accrual workpapers finding that they had no relevancy to litigation. Jude Torruella in the dissent made a strong argument for such workpapers having a dual purpose that included defending a position in possible litigation with the Service (*United States v Textron*). The Second case was decided in 2010 involving the Service’s attempt to require disclosure of workpapers prepared for Dow Chemical by its independent auditors, Deloitte, LLP. (*United States v Deloitte*). In 2010, the Court of Appeals for the District of Columbia held that the workpapers of independent auditors can be protected as “work product” and that the workpapers contained thoughts and opinions developed in anticipation of possible litigation with the government. While the case was remanded for more evidence, the court indicated that the fact that the workpapers were generated to satisfy a regulatory requirement does not mean they cannot have another purpose because the nature of workpapers is such that they contemplate a challenge by the government.

The IRS issued Announcement 2010-76 to provide guidance on the issue of a Policy of Restraint as it relates to Schedule UTP. This should be looked at in light of Deloitte. The Policy of Restraint is a self-imposed Policy the IRS has during audit to try to avoid requesting documents that may violate privileges or protections. The IRS will not ask the taxpayer to explain their rationale for determining that the issue was uncertain, or for information about the hazards of the position or an analysis of support for or against the tax position. It cannot ask why a Schedule UTP issue is uncertain, nor ask for copies of workpapers used to prepare Schedule UTP, any Tax Accrual Workpapers, or for any documents privileged under the modified policy of restraint. Further, the fact an issue disclosed on the Schedule UTP was present on a prior year audit is not sufficient to automatically roll over an issue from one year to the next.

The Modified Policy provides in part:

“Under current procedures, examiners request tax reconciliation workpapers as a matter of course. (IRM 4.10.20.3). The taxpayer may redact the following information from any copies of tax
reconciliation workpapers relating to the preparation of Schedule UTP it is asked to produce during an examination:

(a) working drafts, revisions, or comments concerning the concise description of tax positions reported on Schedule UTP;
(b) the amount of any reserve related to a tax position reported on Schedule UTP; and
(c) 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.

Other than requiring the disclosure of the information on the schedule, the requirement to file Schedule UTP does not affect the policy of restraint.”

4.2 Taxpayer and Preparer Penalties:
Taxpayers and preparers have long been subjected to penalties for understatement of their tax liability and improper positions taken on returns. The penalties on the preparer and taxpayer are cumulative in nature.

IRC§6662 sets for the penalties on taxpayers. It is a standard of “substantial authority” for a position on a return or any claim made to the Internal Revenue Service. This means that if a taxpayer has “substantial authority” for a position it may be taken without further disclosure. Commentators have generally viewed this as a 40% chance of being sustained on audit. This is an objective standard applied by taking into account the weight of authority both supporting and opposing a position.

Treasury Regulation §1.6662-4 provides:

“The weight accorded an authority depends on its relevance and persuasiveness, and the type of document providing the authority. For example, a case or revenue ruling having some facts in common with the tax treatment at issue is not particularly relevant if the authority is materially distinguishable on its facts, or is otherwise inapplicable to the tax treatment at issue. An authority that merely states a conclusion ordinarily is less persuasive than one that reaches its conclusion by cogently relating the applicable law to pertinent facts. The weight of an authority from which information
has been deleted, such as a private letter ruling, is diminished to the extent that the deleted information may have affected the authority’s conclusions. The type of document also must be considered. For example, a revenue ruling is accorded greater weight than a private letter ruling addressing the same issue. An older private letter ruling, technical advice memorandum, general counsel memorandum or action on decision generally must be accorded less weight than a more recent one. Any document described in the preceding sentence that is more than 10 years old generally is accorded very little weight. However, the persuasiveness and relevance of a document, viewed in light of subsequent developments, should be taken into account along with the age of the document. There may be substantial authority for the tax treatment of an item despite the absence of certain types of authority. Thus, a taxpayer may have substantial authority for a position that is supported only by a well-reasoned construction of the applicable statutory provision.”

The regulations provide an exhaustive list of authorities that are considered to provide “substantial authority”. Interestingly, treatises and articles are not among those listed.

The substantial authority standard means that no further disclosures are needed to avoid penalties. If this standard is not met, penalties may still be avoided by disclosing the position taken. If the position is frivolous, then disclosure will not avoid penalties. (IRC §6662). Frivolous means that the chance of being sustained in audit is 5-10% or less. The disclosure is made by completing Form 8275 or Form 8275-R if the position is contrary to a regulation. The UTP Schedule replaces the Forms matters covered by the UTP.

In 2007, Congress made sweeping changes to the penalties applicable to tax preparers. Amended IRC§6694 adopted a return position disclosure that mirrored FIN 48 with a “more likely than not” (MLTN) standard. In May of 2007 Congress imposed a duty to disclose if the position does not meet the MLTN standard. The tax MLTN standard requires the preparer to have a reasonable belief that the supporting authority provides a more than 50% chance of success if audited. This brought the standard for preparers more in line with FIN 48, but greater than the taxpayer.
The frivolous standard has been replaced with a “reasonable basis” standard for preparers. Thus the preparer may not take a position, even if disclosed, for which there is not a “reasonable basis” that the position will be sustained on audit. (IRC 6694) A “reasonable basis” is a lesser standard than a “realistic possibility” but a higher standard than “non-frivolous”. The standard is somewhere around a 15% chance of being sustained on its merits. Thus the preparer may not take a position if the position does not have a “reasonable basis” for being sustained on its merits.

This changed again in October of 2008. Congress again revised the preparer penalties and adopted the “substantial authority” standard for preparers. This standard is the same as that of the taxpayer but is less than the MLTN standard of FIN 48. **Exhibit 2 summarizes the disclosure requirements for preparers.**

<table>
<thead>
<tr>
<th>Taxpayer Confidence</th>
<th>Probability of Success of Position Taken</th>
<th>§6694</th>
<th>Circular 230</th>
</tr>
</thead>
<tbody>
<tr>
<td>Will</td>
<td>(&gt;90%) Virtual Certainty</td>
<td>ND</td>
<td>ND</td>
</tr>
<tr>
<td>Should</td>
<td>(&gt;70%) Preponderance and weight favorable</td>
<td>ND</td>
<td>ND</td>
</tr>
<tr>
<td>More Likely Than Not</td>
<td>(&gt;50%) Greater than fifty percent the position will prevail</td>
<td>ND</td>
<td>ND</td>
</tr>
<tr>
<td>Substantial Authority</td>
<td>(&gt;40%) Authorities in support outweigh Authorities against</td>
<td>ND</td>
<td>ND</td>
</tr>
<tr>
<td>Realistic Possibility</td>
<td>(&gt;33%) Well-informed reasonable position by tax authority</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td>Reasonable Basis</td>
<td>(&gt;15%) One or more Authorities support the position</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td>Non-frivolous</td>
<td>(&gt;10%) Some merit exists for position taken</td>
<td>P</td>
<td>P</td>
</tr>
<tr>
<td>Frivolous</td>
<td>(&lt;10%) No merit for position</td>
<td>P</td>
<td>P</td>
</tr>
</tbody>
</table>

ND: No Disclosure Needed
D: Disclose To Avoid Possible Penalty
P: Penalty Applied
5. Conclusions

As we discuss above, the reporting of uncertain tax positions is continuing to evolve. While criticisms persist regarding required disclosures, the changes are suggesting that more information will be required in future years rather than less. The increased disclosure requirements of Schedule UTP are now directly linked to financial statement disclosures. The financial statement disclosures have been conceptually supported by the FAF’s Post Implementation Review that concludes the disclosures provide useful information for users making investment decisions. It should be noted, however, that the survey results discussed in the Post Implementation Review were not provided in the report. Further, the FAF has refused to provide us with a copy of the survey results upon request. Our review of the PIR in Section 2 is based solely of the FAF’s interpretation of the survey results.
WORKS CITED

10. Internal Revenue Manual (IRM).
11. Instructions: Schedule UTP.


20. *United States v Textron Inc. and Subsidiaries*, 577 F. 3rd. 21, (1St Cir. 2009).