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More disclosure requirements from your friendly neighborhood IRS - Reporting "uncertain tax positions"

by Albert Y. Lin, LLM, CPA

Continuing a trend towards increasing detailed taxpayer disclosures (which tax-exempt healthcare providers have seen through the recently re-vamped Form 990), the Internal Revenue Service (IRS), in Announcement 2010-9, 2010-7 (Jan. 26, 2010) (Announcement),¹ set forth the IRS's development plans for a new schedule to be attached to certain taxpayers' annual tax returns. The proposed tax form schedule is said to be applicable to "business taxpayers with total assets in excess of \$10 million, if the taxpayer has one or more *uncertain tax positions* of the type required to be reported on the new schedule." The IRS is soliciting comments to this Announcement by March 29, 2010, and the new schedule is anticipated to be required for tax returns filed for the years following the year the actual schedule is finalized. This article identifies the key components of the Announcement that have potential impact on healthcare organizations.

Organizations potentially subject to the new schedule. The Announcement only uses the generic term "business taxpayer with total assets in excess of \$10 million." "Business taxpayer" is undefined, but the tax returns referenced are "Form 1120 . . . or other business tax returns." In final form, this may or may not include tax-exempt organizations. In terms of healthcare organizations, the large, publicly traded organizations and large private hospital systems are clearly impacted. Physician groups, ambulatory surgery centers, and sub-\$10 million real estate ventures will not. Large tax-exempt organizations will want to review developments relating to the Announcement. However, since the revised Form 990 already requires disclosure of FIN 48 footnotes, the author of this article believes it would be overkill for the IRS to further extend this proposed Schedule to Form 990 filers (particularly since the focus on the Announcement is to provide more detailed information on traditional federal income tax abuses).

Disclosure of "uncertain tax positions." The IRS's goal is to "identify quickly and efficiently" significant issues (including uncertain tax positions) underlying the tax return. The significant issues and "uncertain tax positions" requiring disclosure will include:

(1) Positions for which taxpayers are required under Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109*, or other accounting standards to reserve an amount. In the context of for-profit entities, FIN 48 requires consideration of material tax positions and a determination of the position's degree of certainty. A quantitative assessment

Tax Exempt Organizations (cont.)

is made, based on the likelihood of prevailing on a tax position, and a reserve may be required to “hold” a tax benefit required under FIN 48.² Other generally accepted accounting standards, such as International Financial Reporting Standards, may have similar requirements. The IRS intends that the proposed schedule will require (i) 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 (ii) *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).

(2) Any positions related to the determination of any United States federal income tax liability for which a taxpayer or a related entity has not recorded a tax reserve because (i) *the taxpayer expects to litigate the position*, or (ii) *the taxpayer has determined that the IRS has a general administrative practice not to examine the tax position*.

Common examples of tax positions may include ordinary versus capital loss classification, valuation or basis issues, tax credits and carryforwards, employee versus independent contractor positions, non-taxable corporate reorganizations, dividend versus return of capital treatment, and distribution of capital versus disguised compensation. In the context of tax-exempt organizations, classification of income as unrelated business taxable income, transactions potentially subject to intermediate sanctions, private benefit/private inurement issues, and even tax-exempt classification itself may all create uncertain tax positions.

Specific disclosure requirements.

Once the above collective “uncertain tax positions” are established, the IRS will require a concise description of each position in sufficient detail so that the IRS can determine the nature of the issue. Generally, at a minimum, the IRS expects: (1) the actual Internal Revenue Code (Code) provisions at issue; (2) the taxable year or years to which the uncertain tax position relates; (3) a statement that the uncertain tax position involves an item of income, gain, loss, deduction, or credit against tax; (4) a statement that the uncertain tax position involves a permanent inclusion or exclusion of any item, the timing of that item, or both;

(5) a statement whether the uncertain tax position involves a determination of value; (6) a statement as to whether the uncertain tax position involves a computation of basis; and (7) a specification, for each uncertain tax position, of the entire amount of federal income tax that would be due if the position were disallowed entirely upon audit.

Admittedly these requirements, although phrased as “restrained” by the IRS, are quite onerous and mark a significant burden on large corporate organizations. While the Announcement takes care to note that the IRS will not request, in the tax return schedule, the taxpayer's assessment of risk or actual reserve amounts, such restraint provides little comfort. To provide teeth, the IRS expects to publish regulations requiring the schedule, as well as penalty provisions for failure to file the schedule or make adequate disclosures.

Potential impact. The Announcement marks a fundamental change in the philosophy of tax compliance - the IRS has never before required substantial disclosures with respect to decision-making processes in tax departments. It will put *pressure on tax departments, small and large, to expend additional efforts in drafting schedule responses to sensitive matters. Tax counsel may need to be employed to assist in reviewing issues* for which outside return preparers and internal staff cannot adequately assess and disclose exposure or a sufficient legal basis for a position. *Tax-exempt organizations will need to monitor this Announcement to see if it adds an additional complication to an already burdensome revised Form 990, which requires disclosure of only FIN 48-related footnotes.*

This development is not unexpected. Technological advancements and IRS focus on its internal information technology³ have accelerated to the point where the mathematical and data compilation aspects of tax compliance will eventually be so efficient,⁴ the healthcare organization can expect future IRS efforts to be far more focused on legal issues as opposed to calculation problems and/or recordkeeping. ■

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¹ Available at <http://www.irs.gov/irbl>.

² See “IRS FIN 48 Implications - LMSB Field Examiners' Guide,” available at <http://www.irs.gov/businesses/corporations/article/0,,id=171859,00.html>.

³ See “IRS 2009-2013 Strategic Plan,” p. 28, Apr. 2009, available at <http://www.irs.gov/pub/irs-pdf/p3744.pdf>.

⁴ See Randall Stross, “Why Can't the I.R.S. Fill in the Blanks,” N.Y. Times, Jan. 23, 2010, available at <http://www.nytimes.com/2010/01/24/business/24digi.html>.



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