

IRS requirements for disclosure of uncertain tax positions

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Background

On 26 January 2010, the Internal Revenue Service ("IRS") announced its intention to require certain business taxpayers to disclose their uncertain tax positions ("UTP") as part of their US tax filing requirements. The new disclosure requirements will require US federal tax filers with assets over \$10m to report their uncertain tax positions together with an estimate of the maximum potential tax exposure. The IRS has issued a draft schedule ("Schedule UTP") and instructions/guidance for its completion. The new schedule will apply prospectively (i.e. for 2010 onwards).

This represents a shift in the way that taxpayers interact with the IRS. For example, the IRS have argued that this proposal is part of its ongoing effort to "improve transparency regarding material tax issues" and have stated that this move will reduce the time it takes for the IRS to complete a tax audit. However, this new requirement will add to the tax compliance burden of groups with a US federal tax filing obligation, actual or contingent.

The requirement is consistent with global trends in respect of tax collection and compliance where we have seen an increased focus on compliance and enforcement as well as shifts towards promoting taxpayers' self-reporting in a bid to increase tax revenues. It is anticipated that other tax authorities in OECD countries primarily will be watching closely to evaluate the application of a similar requirement in their countries.

Who is impacted?

In simple terms, anyone with an entity within its group with a US federal tax filing obligation needs to consider the impact of the requirement. For example, a Russian or CIS head quartered group with a US tax presence (meeting the \$10m asset test in the rules) would have to file a Schedule UTP. In addition, a multinational group with a US tax filing requirement where a non US entity within the group has a US permanent establishment or another US tax liability would also have to disclose this position together with filing Form 1120-F. However, based on the draft instructions issued by the IRS, pass-through entities and tax exempt organizations will not be required to file a Schedule UTP in respect of 2010. This position is expected to change in respect of the 2011 tax filing requirements.

What is to be disclosed?

For the purposes of the Schedule UTP, uncertain tax positions will include the positions taken by the corporation or a related party for which:

- ▶ a tax reserve must be established under FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, or other accounting standards (e.g. IFRS or local standards);
- ▶ a decision was made by the corporation not to record a reserve based on an expectation to litigate or based on established IRS practice.

It is noted that the entity with the filing requirement will not simply be able to take their FIN48 analysis or IFRS reserve and report this to the IRS in order to meet the new filing requirements. Additional analysis would need to be performed (e.g. calculation of the maximum exposure).

Non-Compliance

The IRS confirmed in their webcast on 28 April 2010 that they are not considering imposition of any new penalties and sanctions if a taxpayer fails to adequately disclose their uncertain tax positions.

Steps to prepare

We believe the following steps should be taken by any group subject to the regulations described above in order to prepare themselves for the forthcoming changes:

- ▶ Identify uncertain tax positions that would meet the threshold for disclosure. For calendar year filers, the 2009 US federal tax return due by September 15, 2010 should provide the basis for such a review. EY Moscow has US tax experts in its Moscow office and we will be happy to assist in such a review.

Special attention should be paid to financial materiality for new tax positions and items with no reserve that are required to be disclosed on Schedule UTP. For foreign tax filers, we expect that additional hot topics will be relevant such as transfer pricing issues, income tax withholding issues (including FIRPTA and other types of withholding) and valuation of uncertain positions in light of the requirement of the new schedule.

- ▶ Identify tax positions for which uncertainty can be reduced or which can be resolved;
- ▶ Identify and utilize options for reducing uncertainty, such as:
 - ▶ Obtain rulings and other clarifications from tax authorities;
 - ▶ Adopt alternative tax accounting methods;
 - ▶ Change filing positions.
- ▶ Prepare draft Schedule UTP.

Ernst & Young Moscow is best positioned to assist Russian based companies with this issue as well as other Tax accounting and International tax issues, given the blend of expertise we have in these areas locally and combined with the very strong international networks and integration of Ernst & Young professionals.

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