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A New IRS Form Brings New Risks

By Katie Wagner May 2, 2011

Large public companies may be boosting their risk exposure this year by complying with the **Internal Revenue Service**'s new Schedule UTP, which requires them to disclose more information about their uncertain tax positions. An uncertain tax position is any in which a company considers itself to be paying less than it may ultimately owe the IRS.

For years, FIN48 has required U.S. companies to disclose the estimated value of uncertain tax positions — or a reserve for those positions — in their 10-Ks. Now, companies with assets of $100 million or more that file audited financial statements must list each individual uncertain tax position in a new form, Schedule UTP, to be filed with their 2010 income tax returns. Specifically, they must report all positions for which the corporation or a related party has recorded a reserve in audited financial statements. They must also report any uncertain position for which they did not record a reserve because the corporation expects to challenge it.

Some examples of uncertain tax positions include claiming tax-free treatment for a spin-off transaction, or splitting a percentage of profit with an affiliated foreign distributor.

Experts say the requirement provides a road map for an IRS audit. And they think it will lead to more exposure to tax and other risks.

"With Schedule UTP, the IRS will now have a list of the controversial issues the company has already identified, described at a high level and ranked by the size of the issue," says **Scott Knott**, a partner with the **Ferraro Law Firm**, which represents IRS tax whistle-blowers.

"As a result of this, I think the IRS will spend less time on issues that don't matter and will be more focused on the large-dollar issues," Knott adds. "In the past, you could count on them spinning wheels to look at transactions that you knew weren't issues."

Schedule UTP has already significantly affected audit committees, increasing the complexity of their risk oversight role and adding to their plate the responsibility of determining just how much detail to disclose in the new form.

Question Your Tax Pros

Tax risk has a way of bringing other risks in its wake, experts say. Besides potentially losing income to additional taxes, a company that underestimates the value of its uncertain tax positions might have to restate earnings. It might run the risk of needing costly litigation to fight the IRS. Any of these risks can damage a company's reputation.

Even if the IRS doesn't question a company's uncertain tax positions, the general public may look unfavorably on them. Just look at the outrage directed at General Electric since word got out that it paid no taxes for 2010 — the result of taking billions of dollars' worth of uncertain tax positions.

Milt Walters, who chairs the audit committees at **Frederick's of Hollywood Group** and **Sun Healthcare Group**, is concerned about how the new requirement will affect a company's ability to fight the IRS in court.

"By filling out this form, you have identified areas of uncertainty," he says, "and because you have done that, you may sacrifice your litigating position. It's very possible that just the form could be the foundation of the litigation," adds Walters."

So how can a board help its company manage all of these additional risks?

To start, the audit committee, risk committee or whichever entity is responsible should ask more questions about taxes.

"Audit committees need to be questioning their [company's] tax department as well as the tax department's outside advisors," says Knott. "The audit committees should also be questioning the financial auditors who are reviewing their company's tax positions and the external auditors, because they are attesting to their company's financials in reviewing their FIN48 disclosures."

Annual reviews of the estimates and judgments used to determine a company's tax positions probably won't be sufficient, he suggests.

Boards also need to look at the big picture, making sure they understand their companies' overall tax postures.

"Taxpayers run the gamut from conservative to moderate to aggressive," says **Pamela Packard**, a retired vice chairman of **BDO USA** who serves on the audit committee of a private board. "If you're an aggressive taxpayer, you would be the most likely to be impacted by [Schedule UTP].

"What the existence of the schedule UTP does is require a company to take a second look at the likelihood of IRS disagreeing with it," she says. "There may be no change, or a company may decide that it needs to increase reserves, because there is a higher likelihood that IRS will discover and disagree with the positions taken and ultimately prevail."

What to Disclose?

One chore for audit committees and other risk managers will be figuring out exactly what to disclose on Schedule UTP. The requirement — like so many IRS rules — isn't crystal clear.

For example, a company could describe an uncertain tax position as transfer pricing related to a foreign distributor, without describing in detail the methodology it used to determine its reserve for the position.

A company can also list an individual position on Schedule UTP without describing exactly which transaction or situation it's based on, or suggesting why the position might be questionable. "If you do a lot of spin-offs, for example, maybe you don't want to state for which spin-off you are taking an uncertain tax position," says Knott.

Other useful approaches might include overwhelming the IRS with details about your positions or being excessively vague.

Viva Hammer, a partner at **KPMG** in Washington who spent six years at the Office of Tax Policy at the **Treasury Department**, recommends that audit committees seek input from their company's public relations staff on what to include on the new form for "damage control" purposes, even though the public generally doesn't see corporate tax returns.

"This is going to cause a lot of heartburn for corporate taxpayers," Hammer says. "There is a lot of uncertainty as to what taxpayers are going to be able to divulge in this form without giving away all their secrets, so to speak."

Not all directors agree. "At my audit committee meetings... I haven't heard too much concern that goes beyond the already existing requirement to disclose uncertain tax positions under generally accepted accounting principles" says **Denny Beresford**, chairman of the audit committees at **Fannie Mae**, **Kimberly-Clark** and **Legg Mason**.

And **Mike Losh**, who chairs **Aon**'s and **TRW Automotive Holdings**' audit committees, says he doesn't expect Schedule UTP to provide the IRS with significant new information.

"This is just asking companies to share something with the IRS that they have already [disclosed]," says Losh. "If you are doing it right, there's nothing to change."