



BDO Seidman, LLP
Accountants and Consultants

February 2007

Subject:

IRS Comments on its Developing Position on Requesting Taxpayer FIN 48 Workpapers

International Tax Alert

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Date/Timing

The Financial Accounting Standards Board's Interpretation No. 48 (FIN 48) is effective for fiscal years beginning after December 15, 2006. Under FIN 48, a US GAAP reporting taxpayer will be required to review its tax positions and determine what tax positions are uncertain tax positions based on a "more-likely-than-not" threshold. Adjustments to financial statements to financial statements may result upon implementation of the new standard.

Affecting

U.S. taxpayers which (1) adhere to U.S. GAAP financial reporting standards and (2) have actual or potential tax liabilities in foreign jurisdictions with which the U.S. has a tax treaty

Background

The U.S. has entered into number of income tax treaties which include articles providing for the exchange of information that is otherwise available under the respective country's tax laws.

Application of FIN 48: Since 1981, the IRS has maintained a voluntary restraint policy under which audit tax accrual workpapers have not been requested unless the taxpayer has either entered into a listed transaction or reported "financial accounting irregularities." While the basis for the policy has been to encourage better communication between the auditor and the client, the Service appears to be modifying its policy.

In December 2006, Frank Ng, newly appointed IRS deputy commissioner (international) speaking at an international tax conference sponsored by the Service and George Washington University, that the Service was still formulating field examination guidelines for using financial disclosures under FIN 48.

More recently, in a Tax Council Policy Institute Symposium, IRS Large and Mid-Size Business Division Deputy Director Elvin Hedgpeth was quoted as stating that, based on his understanding of the treaty exchange provisions, there is no obligation to exchange information contrary to public policy. Mr. Hedgpeth indicated that even if disclosure is warranted, it will occur only after “careful consideration.” At the same meeting, The IRS acknowledged that the IRS does share certain advance pricing agreement information with foreign governments that are treaty partners.

Finally, it was reported that on February 8, 2007, in a meeting of the District of Columbia Bar Taxation Section’s tax audits and litigation committee, Robert Adams, a senior advisor in the Service’s LMSB Division, announced that the Service is planning on providing guidance on tax accrual workpapers in the next three to six months. Additionally, Mr. Adams indicated that the Service is considering following the recent financial accounting trend towards greater transparency by increasing examination of tax accrual workpapers.

Mr. Adams also reportedly commented that the IRS may reopen an audit to inquire about a FIN 48 disclosure. In January at the American Bar Association Section of Taxation Administrative Practice Committee, Mr. Adams reportedly confirmed that the IRS believes Fin 48 workpapers are part of tax accrual workpapers.

Since no FIN 48 disclosures have been furnished to the IRS to date, it remains unclear as to what type of information will be provided. Additionally, if treaty partners requests the IRS to provide FIN 48 information, the information may be shared with treaty partners similar to the sharing of APA information.

Current litigation is in process regarding tax accrual workpapers including *Textron v United States*. *Textron* is a summons enforcement action being heard in the federal district court in Rhode Island, regarding the application of the work product doctrine in the tax accrual workpaper context. Future developments in this case and the IRS finalizing its internal policy on tax accrual workpapers (including FIN 48 workpapers) may ultimately bring some resolution of taxpayers’ and accountants’ legal rights with respect to tax accrual workpapers.

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