

[CC-2004-010]

January 22, 2004

Subject: Requests for Tax Accrual
Workpapers

Cancel Date: Upon incorporation
into CCDM

Purpose

This Notice supplements CC-2003-012, "Obtaining Tax Accrual Workpapers" with respect to clarifying the definition of tax accrual workpapers.

Background

The term "tax accrual workpapers" means those audit workpapers relating to the tax reserve for current, deferred and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to footnotes disclosing those tax liabilities appearing on audited financial statements. The Supreme Court upheld the Service's authority, under section 7602, to summon tax accrual workpapers. *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984). Subsequent to the *Arthur Young* opinion, however, the Service announced that it would continue its policy of not routinely requesting tax accrual workpapers during examinations. Announcement 84-46, 1984-18 I.R.B. 18. In 2002, the Service announced that it was modifying its policy with respect to tax accrual workpapers. In general, the modified policy applies to returns filed by taxpayers who failed to disclose their involvement in listed transactions as required by Treas. Reg. § 1.6011-4. Announcement 2002-63, 2002-2 C.B. 72. See also Memorandum from Commissioner, Large and Mid-Size Business Division and Commissioner, Small Business/Self-Employed Division, *Obtaining Tax Accrual Workpapers Related to Abusive Tax Avoidance Transactions* dated June 17, 2002, which discusses both the new policy with respect to listed transactions and describes the requirements for requesting audit workpapers and tax accrual workpapers in all other cases.

Discussion

Some questions have been raised regarding the definition of tax accrual workpapers. Tax accrual workpapers are those audit workpapers, whether prepared by the taxpayer or by an independent accountant, relating to the tax reserve for current, deferred and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to footnotes disclosing those tax liabilities on audited financial statements. They reflect an estimate of a company's tax liabilities and may also be referred to as the tax pool analysis, tax liability contingency analysis, tax cushion analysis, or tax contingency reserve analysis.

The name given the workpapers by the taxpayer or its accountant is not determinative as to whether the papers are tax accrual workpapers. Rather, if the papers are described by the definition given above, the papers are tax accrual workpapers. The Service's policy of restraint in not requesting tax accrual workpapers is limited to papers falling within this definition.

The definition does not include documents created prior to or outside of the consideration of whether reserves should be created, even though these documents may have been subsequently used in the preparation of the tax accrual workpapers or are attached to workpapers. These preexisting documents likely fall within the scope of the general IDRs issued at the beginning of an examination and should be produced by the taxpayer or the accountant even though no request for the tax accrual workpapers has been made.

Workpapers and tax return preparation documents that reconcile net income per books or financial statements to taxable income also do not fall within the definition of tax accrual workpapers since these documents are part of the tax return preparation process, and the information is required to be reported on income tax returns, usually on schedules designed to report those reconciliations. Reconciling workpapers are also within the scope of the general IDRs issued during an examination.

Additionally, the existence of, and the amount of, reserve accounts are not within the scope of the definition of tax accrual workpapers.

Finally, this Notice is limited to clarifying the definition of tax accrual workpapers. The Notice neither addresses the definition of the more general category of audit workpapers nor reflects any change in the policy regarding tax accrual workpapers or when audit workpapers will be requested by the Service.

Because of the sensitive nature of requests for tax accrual workpapers, field attorneys are to work with the operating divisions in preparing any requests for tax accrual workpapers and will review proposed summonses for tax accrual workpapers. Field attorneys should coordinate with the office of the Associate Chief Counsel (Procedure & Administration) with respect to questions regarding the definition of tax accrual workpapers and prior to the issuance of any administrative summons or discovery request for tax accrual workpapers. Counsel will review questions regarding tax accrual workpapers and proposed summonses as a high priority matter and complete the review as soon as possible so as not to delay the examination process.

Any questions about the provisions of this Notice should be directed to the Office of the Associate Chief Counsel (Procedure & Administration): with regard to summonses, Branch 3, Collection, Bankruptcy & Summonses, at 202-622-3630; with regard to discovery matters, Branch 3, Administrative Provisions & Judicial Practice, at 202-622-7940; and with regard to general questions about the Notice, George Bowden or

