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May 28, 2010

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Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Announcements 2010-9, 2010-17 and 2010-30

Dear Commissioner Shulman:

Enclosed are comments on announcements 2010-9, 2010-17 and 2010-30. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stuart M. Lewis
Chair, Section of Taxation

Enclosure

cc: Michael Mundaca, Assistant Secretary (Tax Policy), Department of the Treasury
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ABA SECTION OF TAXATION

COMMENTS ON ANNOUNCEMENTS 2010-9, 2010-17 AND 2010-30: DISCLOSURE OF UNCERTAIN TAX POSITIONS

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Thomas J. Callahan, Council Director for the Administrative Practice Committee, Gregory J. Gawlik, Kathryn Keneally, Council Director for the Standards of Tax Practice Committee, and Fred F. Murray, Chair of the Administrative Practice Committee. Substantive contributions were made by Joan C. Arnold, Jason S. Bazar, William H. Caudill, Todd G. Golub, Mark Harris, Michael Hirschfeld, Bahar Schippel, Steven R. Schneider, Giovanna Sparagna and John P. Warner. The Comments were reviewed by Emily A. Parker of the Section’s Committee on Government Submissions.

Although many of the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member (or firm or organization to which each member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 28, 2010

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EXECUTIVE SUMMARY

These comments (“Comments”) address the proposals in Announcement 2010-9,¹ Announcement 2010-17,² and Announcement 2010-30³ (collectively, the “Announcements”). The Announcements propose a new information gathering mechanism that would require certain business taxpayers to disclose uncertain tax positions (“UTP” or “UTPs”) on a newly developed draft schedule (“Schedule UTP”) in accordance with draft instructions (“Instructions”) applicable to the Schedule UTP. The Internal Revenue Service (the “Service”) issued the drafts of Schedule UTP and the related Instructions as part of Announcement 2010-30 on April 19, 2010. These Comments are provided in response to the Service’s requests for comments set forth in the Announcements.

Tax Policy Considerations

1. We support the Service’s efforts to improve tax administration through programs designed to increase transparency. Moreover, we support the principle that taxpayers should not be permitted to “hide” issues to gain an advantage in the audit process. However, notwithstanding our commitment to transparency, we recommend that the disclosure proposals as set forth in the Announcements be withdrawn in the interests of sound tax administration. Of primary importance, as discussed in the conclusion to the May 28, 2010, letter submitted on behalf of the American Bar Association (the “ABA”), the disclosure proposals “are inimical to the fundamental protections afforded by the attorney-client privilege, the [section 7525⁴] tax practitioner’s privilege, and the attorney work product doctrine.”⁵

Alternatively, in the event that the Service implements the disclosure proposals, we recommend that the Service modify the proposals to (i) require disclosure of only the list of issues on Schedule UTP, (ii) eliminate the maximum tax adjustment disclosure and (iii) eliminate the requirements that the taxpayer state the rationale for the tax position and the reasons why the tax position was determined to be a UTP. We believe that disclosure of the list of issues, although still raising concerns with respect to preservation of the privileges and protections, would be sufficient to satisfy the Service’s concerns regarding issue identification and allocation of scarce audit resources.

2. We are concerned that the disclosure proposals effectively displace the policy of restraint. Specifically, taxpayers may be required to disclose their tax accrual

¹ 2010-7 I.R.B. 408.

² 2010-13 I.R.B. 515.

³ 2010-19 I.R.B. 668.

⁴ References to a “section” are to a section of the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

⁵ American Bar Association Letter “IRS Proposals Requiring Disclosure of Uncertain Tax Positions” (May 28, 2010) available at http://www.abanet.org/poladv/letters/attyclient/2010may28_scheduleutp_1.pdf. The ABA letter is limited to the protections afforded to advice and work product of attorneys.

workpapers to defend against a claim that penalties should apply because of inadequate disclosure on Schedule UTP. In the event that the Service implements the disclosure proposals, we recommend that the Service confirm that taxpayers may continue to withhold information and materials that fall within a claim for protection under the attorney-client privilege, the section 7525 tax practitioner privilege, or the attorney work product doctrine.

3. In the event that the Service implements the disclosure proposals, we recommend that the Service conduct training sessions, and develop protocols (including promulgation of effective guidance to the field) to (i) ensure that revenue agents are able to conduct a discerning review of the disclosures, and thereby properly develop issues, and (ii) minimize any risk that revenue agents will simply set up on audit the largest dollar issues disclosed on Schedule UTP. We also recommend careful coordination with other existing examination initiatives and programs, such as the Compliance Assurance Program, Issue Tiering strategy, and Industry Issue program. Further, we recommend that additional training and resources be committed to the Appeals function to assure the independence of Appeals, strict compliance with the ex parte rules, and that Appeals has experienced and trained personnel to handle the anticipated increase in Appeals issues resulting from audit adjustments based primarily on the UTP disclosures.

4. In the event that the Service implements the disclosure proposals, we recommend that the Service continue to identify forms and schedules that duplicate the information required to be reported on Schedule UTP, and that the Service eliminate duplicative disclosure requirements. Alternatively, the Service might consider a hybrid approach whereby taxpayers list on the Schedule UTP (perhaps in a new Section IV) other forms, schedules, or statements filed by the taxpayer containing comparable disclosures.

Substantive Aspects of the UTP Disclosure Initiative

5. In the event that the Service implements the disclosure proposals, we recommend that the Service consider deleting the proposed disclosure concerning administrative practice. Under United States generally accepted accounting principles (“GAAP”), a tax position based on administrative practice may be sufficiently “certain” (or immaterial) to be excluded from the tax reserve analysis. Thus, absent an administrative practice exclusion, taxpayers may be required to do additional analysis that would not otherwise be required under GAAP.

Alternatively, we recommend that the Service promulgate guidance concerning the scope and application of the proposed disclosure regarding administrative practice. We are concerned that the disclosure proposal may be overbroad and that taxpayers may not understand the types of administrative practices that need to be identified and reported.

6. In the event that the Service implements the disclosure proposals, we recommend that the Service clarify what constitutes “an opinion” for purposes of the definition of an “audited financial statement.” Specifically, taxpayers may have

independent third party auditors express a negative assurance (*i.e.*, a “review”) that financial statements are in accordance with GAAP, rather than have a traditional “certified” audit opinion issued.

7. In the event that the Service implements the disclosure proposals, we recommend that the Service clarify that a UTP for purposes of this reporting requirement is intended to be a UTP with respect to the Code and not with respect to a non-U.S. tax jurisdiction.

8. In the event that the Service implements the disclosure proposals, we recommend that the Service consider revising the disclosure program to limit the disclosure requirement to publicly reporting corporations (*i.e.*, corporations that report to the Securities and Exchange Commission (“SEC”) with respect to their stock or debt). These corporations likely have sophisticated financial systems and prepare their financial statements in accordance with GAAP. Consequently, these corporations would be in the best position to efficiently prepare Schedule UTP based upon tax reserve analysis that already has been performed for GAAP.

If the Service elects a broader application of Schedule UTP, we recommend that both pass-through entities and tax-exempt organizations ultimately be excluded from the disclosure requirements. Alternatively, we recommend that, prior to the date of implementation, the Service issue additional guidance addressing the specific circumstances under which pass-through entities and tax-exempt organizations would have to report UTPs. For example, would a partnership or an S corporation be required to report only when there is a question as to the entity’s own potential tax liability, such as in the case of a defective election? Similarly, would a tax-exempt organization be subject to reporting only when there is a potential for unrelated business taxable income, or when the organization may deem its tax-exempt status to be in jeopardy?

9. We recommend that taxpayers currently included in the Compliance Assurance Program be exempted from filing Schedule UTP, as those taxpayers already are subject to similar reporting requirements.

10. In the event that the Service implements the disclosure proposals, we recommend that the Service consider eliminating the maximum tax adjustment disclosure. We are concerned that disclosure of any tax amount on Schedule UTP would reflect, at least to some degree, the taxpayer’s thought process regarding the merits of a particular issue. Moreover, we also are concerned that revenue agents (despite training to the contrary) might still set up an issue based on the magnitude of the maximum tax adjustment amount reflected on Schedule UTP, rather than based on a thoughtful evaluation of the issue.

If the Service decides to require disclosure of a maximum tax adjustment amount, we support the Service’s decision to require calculation of the maximum tax adjustment only on an annual basis and to exclude interest and penalties from the computation. We also applaud the simplified approach for calculating the maximum tax adjustment for transfer pricing and valuation issues. Moreover, we recommend that the Service issue

additional guidance addressing how pass-through entities should determine and quantify the maximum tax adjustment amount for any tax position. For example, should a federal income tax benefit to one of the ultimate owners of the pass-through entity be netted against the federal income tax detriment to one or more of the other ultimate owners? Also, to what extent should the pass-through entity take into account the specific tax attributes of each of its ultimate owners in determining the maximum tax adjustment amount for any tax position?

11. In the event that the Service implements the disclosure proposals, we recommend that the Service reduce the level of detail requested with respect to the “concise description” of a taxpayer’s UTP. In that regard, although still raising concerns, we believe that the Service’s need for issue identification would be adequately met if a concise description of an issue (similar to “notice pleading”) was included on Schedule UTP, although requiring this description would still raise concerns as discussed below.

12. In the event that the Service implements the disclosure proposals, we recommend that the Service delete the requirement that taxpayers provide “the rationale for the position and a concise general statement of the reasons for determining the position is an uncertain tax position.” By asking a taxpayer to provide both the rationale for its legal position and the reasons that it believes that the tax position is uncertain, we believe the Service is essentially asking the taxpayer for a glimpse into the substantive risk assessment underlying the position, which the Service has stated it does not intend to do. We believe that taxpayers should have the right to maintain confidentiality and privilege with respect to the legal rationale for the positions reported on their returns.

13. In the event that the Service implements the disclosure proposals, we recommend that any further consideration of specific penalties attributable to preparation and filing of Schedule UTP be made in the context of comprehensive penalty reform.⁶

⁶ See ABA Section of Taxation Statement of Policy Favoring Reform of Federal Civil Tax Penalties (Apr. 21, 2009), available at <http://www.abanet.org/tax/pubpolicy/2009/090421statemntciviltaxpenalties.pdf>.

DISCUSSION

I. Background

On January 26, 2010, the Service issued Announcement 2010-9⁷ detailing its intention to begin requiring certain business taxpayers to attach a schedule (*i.e.*, Schedule UTP) to identified business tax returns (*e.g.*, Forms 1120), which schedule would disclose information concerning a taxpayer's UTPs. Announcement 2010-9 indicates that the schedule would require annual disclosure of UTPs that affect the taxpayer's United States federal income tax liability. Announcement 2010-9 states that the Service has authority to request this information under existing U.S. Supreme Court precedent,⁸ but that the Service would not require a taxpayer to disclose its risk assessment or actual reserve amounts. Announcement 2010-9 emphasizes that the Service would continue to exercise its policy of restraint⁹ in requesting taxpayers' tax accrual workpapers in examinations, but that the policy would be revisited and revised as necessary to ensure that the Service is able to obtain complete and accurate information regarding taxpayers' UTPs on a timely basis. Announcement 2010-9 notes that many taxpayers already are required under Financial Accounting Standards Board ("FASB") Interpretation No. 48 ("FIN 48")¹⁰ to disclose UTPs for which they have established reserves.

Announcement 2010-9 calls for business taxpayers with total assets in excess of \$10 million to disclose information relating to UTPs they report for FIN 48 purposes.¹¹ The disclosure is to include a concise description of each UTP for which the taxpayer (or related party)¹² has recorded a reserve in its financial statements,¹³ and the rationale for having taken the position, as well as a general statement detailing the reasons why it was

⁷ 2010-7 I.R.B. 408.

⁸ *Id.* (citing *United States v. Arthur Young*, 465 U.S. 805, 815 (1984)).

⁹ I.R.M. 4.10.20.3.2 (07-12-2004); *see also* Announcement 2002-63, 2002-2 C.B. 72.

¹⁰ *Interpretation No. 48 – Accounting for Uncertainty in Income Taxes, An Interpretation of FASB Statement No. 109*, Financial Accounting Standards Board, Norwalk, CT, No. 281-B, June, 2006. In June, 2009, FASB issued FAS 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162*, effective for financial statements issued for interim and annual periods ending after September 15, 2009. Statements of accounting standards that precede the Codification are superseded. FASB Statement No. 109 may be found in the Codification at ASC 740. FIN 48 may be found in the Codification generally at ACS 740-10-25-5 through 25-8, 25-10 through 25-17, ASC 740-10-30-7, 20, ASC 740-10-35-3, 6, ASC 740-10-40-2, 3, 5, ASC 740-10-40-4, 5, ASC 740-10-45-4, 11, 12, 25, ASC 740-10-50-15, 19, ASC 740-10-55-3, 4, 5, 83, 85, 86, 88 and ASC 740-10-60-14.

¹¹ The Announcement notes that taxpayers who are not subject to FIN 48 may nevertheless "be subject to other requirements regarding accounting for uncertain tax positions. For example, taxpayers may be subject to other generally accepted accounting standards, including International Financial Reporting Standards (IFRS) and country-specific generally accepted accounting standards."

¹² A related party is any entity that is related to the taxpayer under section 267(b), 318(a) or 707(b).

¹³ Taxpayers also would be required to disclose any position for which a reserve has not been created because the taxpayer either (i) expects to litigate the position, or (ii) has determined that no reserve is necessary on account of a general administrative position by the Service not to examine a particular position.

determined that the position is a UTP. In addition, the description must contain the following elements:

- The Code sections potentially implicated;
- A description of the taxable year or years to which the position relates;
- A statement that the position involves an item of income, gain, loss, deduction or credit against tax;
- A statement that the position involves a permanent inclusion or exclusion of any item, the timing of that item, or both;
- A statement whether the position involves a determination of the value of any property or right; and
- A statement whether the position involves a computation of basis.

The schedule also would require that the taxpayer specify, for each UTP, the entire amount of United States federal income tax that would become due if the position were disallowed in its entirety on audit. The amount would represent the maximum tax adjustment, taking into account all changes to items of income, gain, loss, deduction and/or credit if the position is not sustained. Finally, this maximum tax adjustment amount would be determined without regard to the taxpayer's calculation of its likelihood of prevailing on the merits.

Announcement 2010-9 also states that the Service is reviewing the potential applicability of penalties with respect to taxpayers that fail to make adequate disclosure. In that regard, the Service is considering asking Congress to enact a specific penalty that would be imposed on taxpayers who fail to file the Schedule UTP, or who fail to make adequate disclosure.

In Announcement 2010-17,¹⁴ the Service clarified that taxpayers would be required to file the Schedule UTP with respect to tax returns relating to calendar year 2010 and for fiscal years that begin in 2010. In other words, the Service clarified that the Schedule UTP would not be required for 2009 tax returns filed in 2010.

On April 19, 2010, the Service issued Announcement 2010-30,¹⁵ along with drafts of Schedule UTP and related Instructions. In Announcement 2010-30 (and related Instructions), the Service clarified the following points:

- For 2010 tax years, only corporations with assets of \$10 million or more who file an identified Form 1120 series would be required to file Schedule UTP. These required filers include (i) corporations required to

¹⁴ 2010-13, I.R.B. 515.

¹⁵ 2010-19 I.R.B. 668.

file Form 1120, U.S. Corporation Income Tax Return; (ii) insurance companies required to file either Form 1120L, U.S. Life Insurance Company Income Tax Return, or Form 1120 PC, U.S. Property and Casualty Insurance Company Income Tax Return; and (iii) foreign corporations required to file Form 1120F, U.S. Income Tax Return of a Foreign Corporation. No other Form 1120 series filers would be required to file Schedule UTP for the 2010 tax year.

- Under a transitional rule, a corporation would not be required to report a UTP taken in (i) a tax year ending before December 15, 2009, or (ii) a tax year beginning on or after December 15, 2009, and ending before January 1, 2010, regardless of whether or when a reserve was recorded with respect to the UTP.
- For 2010 tax years, pass-through entities and tax-exempt organizations would not be required to file Schedule UTP.
- The Service will continue to review the extent to which taxpayers would be subject to duplicate filing requirements if a Schedule UTP is required to be filed. For 2010 tax years, corporations that file Schedule UTP would not be required to file Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement.

II. **Tax Policy Considerations**

A. **Introduction**

We appreciate the opportunity to provide comments on this proposed significant development in tax administration. We support the Service's efforts to improve tax administration through programs designed to increase transparency and to foster a spirit of cooperation between and among taxpayers, tax practitioners, and the Service. However, notwithstanding our commitment to promoting a fair and efficient federal tax system for all parties, we are concerned that the proposals in the Announcements may not be in the best interest of sound tax policy. Accordingly, we begin with a discussion of several concerns regarding the potential effect of the disclosure proposals on tax administration, and then we discuss specific matters related to the Announcements, Schedule UTP and the Instructions.

B. **Effect on Privilege/Work Product Doctrine**

Section 6601 provides, in part, that “[e]very person liable for any tax imposed by this title . . . shall . . . render such statements . . . as the Secretary may from time to time prescribe.”¹⁶ However, the Service's ability to compel taxpayers to disclose information

¹⁶ Similar rules apply for partnerships and tax-exempt organizations. Reg. § 1.6031(a)-1(a)(2) (“The partnership return must contain the information required by the prescribed form and the accompanying instructions”); Reg. § 1.6033-2(a)(1) (Except as otherwise provided, “every organization exempt from

“is subject to the traditional privileges and limitations.”¹⁷ These privileges and limitations include the attorney client privilege, the section 7525 tax practitioner privilege and the work product doctrine.¹⁸ Thus, taxpayers may withhold information from the Service when the attorney client privilege, the section 7525 tax practitioner privilege or the work product doctrine applies.¹⁹

As discussed in the conclusion to the May 28, 2010, letter submitted on behalf of the ABA, the disclosure proposals “are inimical to the fundamental protections afforded by the attorney-client privilege, the . . . section 7525 tax practitioner’s privilege, and the attorney work product doctrine.”²⁰

In addition, there have been and likely will continue to be disputes over the Service’s ability to compel taxpayers to disclose detailed information concerning UTPs, specifically in the context of tax accrual workpapers.²¹ We believe that taxpayers have the legal right, pursuant to both common law and the Code, to protect information by asserting the attorney-client privilege, the section 7525 tax practitioner privilege, and the work product doctrine. We also believe the judicial process should be respected and permitted to run its course. Accordingly, we recommend that the disclosure proposals set forth in the Announcements be withdrawn in the interests of sound tax administration.

Alternatively, in the event that the Service implements the disclosure proposals, we recommend that the Service modify the proposals to (i) require disclosure of only the list of issues on Schedule UTP, (ii) eliminate the maximum tax adjustment amount disclosure requirement and (iii) eliminate the requirement that the taxpayer state the rationale for the tax position and the reasons why the tax position was determined to be a UTP. We believe that disclosure of the list of issues, although still raising concerns with respect to preservation of the privileges and protections, would be sufficient to satisfy the Service’s concerns regarding issue identification and allocation of scarce audit resources.

taxation under section 501(a) shall file an information return specifically setting forth . . . such other information as may be prescribed in the instructions issued with respect to the return”). To the extent that taxpayers are not forthcoming with information, the Service may use its summons authority under section 7602 to enforce compliance.

¹⁷ *United States v. Arthur Young*, 465 U.S. 805, 816 (1984).

¹⁸ *United States v. Adlman*, 134 F.3d 1194, 1196 (2d Cir. 1998) (“IRS summons are ‘subject to the traditional privileges and limitations,’ including the work product doctrine codified at Rule 26(b)(3).” (citations omitted)).

¹⁹ *Id.*

²⁰ American Bar Association Letter “IRS Proposals Requiring Disclosure of Uncertain Tax Positions” (May 28, 2010) available at http://www.abanet.org/poladv/letters/attyclient/2010may28_scheduleutp_1.pdf.

²¹ See, e.g., *United States v. Textron, Inc.*, 577 F.3d 21 (1st Cir. 2009), *cert. denied*, U.S. Lexis 4373 (2010); *Regions Financial Corp. v. United States*, 101 A.F.T.R.2d (RIA) 2008-2179 (N.D. Ala. 2008) (tax accrual workpapers were protected by the work product privilege because the documents were created in anticipation of litigation); *United States v. Rockwell*, 897 F.2d 1255 (3d Cir. 1990) (free reserve file can be subject to protection provided proper steps are taken to establish protection); *United States v. El Paso Co.*, 682 F.2d 530, 544 (5th Cir. 1982) (finding that tax accrual workpapers were prepared “to back up a figure on a financial balance sheet” rather than in anticipation of litigation. Thus, the tax accrual workpapers were not subject to the work product privilege).

C. Effect on Policy of Restraint

The policy of restraint was originally implemented, in part, because of concerns that taxpayers “were no longer preparing tax accrual information or were refusing to grant access [to] independent auditors since the IRS could then gain access to this information.”²² As might be expected, “[t]his matter also was of concern to the Securities and Exchange Commission since their desire was for full financial disclosure.”²³ In connection with implementation of the policy of restraint, Commissioner Egger stated the following:

[The policy of restraint] will eliminate routine requests for tax accrual workpapers by examiners when they first walk in the door. We found that such occurrences had happened. Under the revised procedure such routine requests should stop. I should remind you, however, that if a case is referred to our Criminal Investigation Division then these revised procedures do not apply.

After the examiner takes these actions and then still determines a need to request access to the tax accrual workpapers, the request must be: [a]pproved by the Chief of the Examination Division; and [l]imited to those portions of the tax accrual workpapers that are material and relevant and related to the specific issue or issues identified.

This is an important and substantial change. This is a radical change from our prior practice since the new procedures will require a high level of management approval before an examiner requests access to tax accrual workpapers. This level of approval should ensure that the procedures are applied uniformly across the country and in limited fashion.

Let me repeat for emphasis that the revised procedures are not intended to close the door to our examiners in requesting tax accrual workpapers. *Instead, they are meant to ensure that requests for such workpapers do not become a standard examination procedure* and that our requests for them are limited to those cases when unusual circumstances make it necessary to have access to the workpapers to complete an examination.²⁴

Under the policy of restraint, a high level Service official (Chief of the Examination Division) had to approve requests for tax accrual workpapers, and Commissioner Egger confirmed that “requests for tax accrual workpapers [would] not become a standard examination procedure. . . .”²⁵

It appears that disclosure proposals effectively displace the policy of restraint because the Service is asking for information that constitutes a significant component of the tax reserve analysis. In addition, we believe that the concerns raised by Commissioner Egger in 1981 are still valid today. Thus, we recommend that the Service

²² Remarks of Commissioner Roscoe L. Egger, IR-81-49, 1981 WL 176339 (May 5, 1981).

²³ *Id.*

²⁴ *Id.* (emphasis added).

²⁵ *Id.*

continue to follow Commissioner Egger’s position that the types of disclosures contemplated on Schedule UTP “not become a standard examination procedure.”

Moreover, setting up reserves for contingent tax liabilities requires that an assessment be made as to the extent and strength of legal authority for a particular return position. Thus, the “policy of restraint” has long reflected the principle that when examining agents seek information concerning such reserves, they should proceed carefully so as not to invade privileged communications or the mental impressions of counsel.

By contrast, the information that is proposed to be included on Schedule UTP would, for example, cover not only those items that are subject to tax reserves, but also those positions as to which the taxpayer in fact anticipates litigation. Moreover, the disclosure proposals also would require disclosure of “the rationale for the position and a concise general statement of the reasons for determining that the position is an uncertain tax position.” Rather than carefully delineating information that is and properly should be protected by the attorney-client privilege, section 7525 tax practitioner privilege, or work product immunity, the disclosure proposals appear to seek disclosure of information that would often necessarily be intertwined with privileged attorney-client communications or attorney analysis of the kind protected by the work product doctrine.

We also are concerned that if the Service asserts penalties for inadequate disclosure, taxpayers may be required to disclose their tax accrual workpapers to defend their initial disclosure. This would contravene the Service’s stated intent not to seek tax accrual reserve information.

In the event that the Service implements the disclosure proposals, we recommend that the Service confirm that taxpayers may continue to withhold information and materials that fall within a claim for protection under the attorney-client privilege, the section 7525 tax practitioner privilege or the work product doctrine.

D. Effect on Tax Administration

1. Additional Burden on the Service

Demands for published guidance from the Service may increase with the implementation of the suggested process, potentially compromising anticipated increases in tax compliance or administrative efficiency. Taxpayers may elect to seek more clarity from the Office of Chief Counsel concerning the application of necessarily broad rules to specific facts when determining whether or not to book a tax reserve. Any significant increase in demand for specific guidance from the Service could burden the ruling, Pre-Filing Agreement and Advance Pricing Agreement processes and require the diversion of resources to those processes. Stakeholders may request more detailed Regulations than before, particularly Regulations containing safe harbors, thereby potentially increasing the resources necessary to complete Regulation projects.

The proposed disclosure of UTPs might encourage some taxpayers to take aggressive financial reporting positions to avoid disclosure of a UTP as proposed under

the Announcements. A desire to avoid disclosure of a UTP may cause taxpayers to seek tax advisors who will provide the level of certainty needed to avoid disclosure.

Taxpayers may increase pressure on tax advisors to reach particular levels of certainty regarding tax positions to avoid UTP disclosures, which might result in a general decline in the quality of tax advice in the market. For example, this pressure might be applied if the tax advisor has concluded that the taxpayer's position is correct under the law and the facts, but there is uncertainty. The tax advisor might be pressured to give a "strong should" opinion on the issue which might permit the taxpayer to avoid discussing the issue with the taxpayer's financial auditor. Conversely, some taxpayers may over report UTPs in the hope of camouflaging sensitive positions.

Because the Service would be requiring disclosure of highly sensitive information, taxpayers would need to have confidence in the Service's ability to responsibly use the information and, if not, voluntary compliance might suffer because taxpayers might avoid disclosing information on Schedule UTP for fear that revenue agents would set up those issues on audit, and reflect the maximum tax adjustment as a starting point for negotiations. Consequently, in the event that the Service implements the disclosure proposals, we recommend that the Service conduct training sessions, and develop protocols (including promulgation of effective guidance to the field) to (i) ensure that revenue agents are able to conduct a discerning review of the disclosures, and thereby properly develop issues, and (ii) minimize any risk that revenue agents will simply set up on audit the largest dollar issues disclosed on Schedule UTP. We also recommend careful coordination with other existing examination initiatives and programs, such as the Compliance Assurance Program, Issue Tiering strategy, and Industry Issue program. Further, we recommend that additional training and resources be committed to the Appeals function to assure the independence of Appeals, strict compliance with the ex parte rules, and that Appeals has experienced and trained personnel to handle the anticipated increase in Appeals issues resulting from audit adjustments based primarily on the UTP disclosures.

2. **Additional Burden on Taxpayers**

We believe that the expected results of a new compliance initiative should be sufficient to justify the additional burden placed on taxpayers. Currently, taxpayers are subject to significant federal,²⁶ state and local tax reporting and disclosure obligations.

²⁶ In addition to numerous questions and additional schedules included in the many forms that report a tax liability (e.g., Schedule M-3, in the series of corporation and partnership tax returns, Forms 1120 and 1065), Notice 2008-13, 2008-1 C.B. 282, and Notice 2008-46, 2008-1 C.B. 868 list the following information returns and reports that are not tax returns reporting a liability: Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding; Form 1065, U.S. Return of Partnership Income (including Schedules K-1); Form 1120S, U.S. Income Tax Return for an S Corporation (including Schedules K-1); Form 5500, Annual Return/Report of Employee Benefit Plan; Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues; Form 8038-G, Information Return for Government Purpose Tax-Exempt Bond Issues; Form 8038-GC, Consolidated Information Return for Small Tax-Exempt Government Bond Issues; Form 1099 series of returns; Form W-2 series of returns; Form W-8BEN, Beneficial Owner's Certificate of Foreign Status for U.S. Tax Withholding; Form SS-8, Determination of Worker Status; Form 990, Return of Organization Exempt from Income Tax; Form 990-EZ, Short Form

Consequently, we would recommend that the Service reconsider additional disclosure requirements that would burden taxpayers with additional compliance costs without a meaningful concomitant increase in useful information to the Service. To this end, we applaud the Service's decision, as outlined in the Instructions, to treat taxpayers as having filed a Form 8275 or Form 8275-R with respect to tax positions that are properly reported on Schedule UTP.

In the event that the Service implements the disclosure proposals, we recommend that the Service consider taking a similar approach, when possible, with respect to the myriad of other reporting requirements faced by taxpayers, either exempting taxpayers from filing a duplicative form or schedule if disclosure of the position is appropriately made on Schedule UTP, or exempting taxpayers from disclosing on Schedule UTP if the position is otherwise reported to the Service in some other manner. Alternatively, the Service might consider a hybrid approach whereby taxpayers list on the Schedule UTP (perhaps in a new Section IV) other forms, schedules, or statements filed by the taxpayer containing comparable disclosures.

Return of Organization Exempt From Income Tax; Form 990-N, Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required To File Form 990 or 990-EZ; Form 1040-ES, Estimated Tax for Individuals; Form 1120-W, Estimated Tax for Corporations; Form 2350, Application for Extension of Time to File U.S. Income Tax Return; Form 2350 (SP), Application for Extension of Time to File U.S. Income tax Return (Spanish Version); Form 4137, Social Security and Medicare Tax on Unreported Tip Income; Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes; Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return; Form 4868 (SP), Application for Automatic Extension of Time to File U.S. Individual Income Tax Return (Spanish Version); Form 5558, Application for Extension of Time to File Certain Employee Plan Returns; Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns; Form 8109, Federal Tax Deposit Coupon; Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips; Form 8809, Application for Extension of Time to File Information Returns; Form 8868, Application for Extension of Time To File an Exempt Organization Return; Form 8892, Application for Automatic Extension of Time to File Form 709 and/or Payment of Gift/Generation-Skipping Transfer Tax; Form 8919, Uncollected Social Security and Medicare Tax on Wages; Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts; Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner (Under section 6048(b)); Form 5471, Information Return of U.S. Persons With Respect To Certain Foreign Corporations; Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code); Form 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax; Form 8858, Information Return of U.S. Persons With Respect To Foreign Disregarded Entities; Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships; Form 8288-A, Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests; and Form 8288-B, Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests. Other required information reports include the Form 90-22.1, Report of Foreign Bank and Financial Accounts.

III. **Substantive Aspects of the UTP Disclosure Initiative**

A. **Identification and Disclosure**

1. **Tax Position**

The Instructions state that a “tax position is based on the unit of account in the audited financial statements in which the reserve is recorded.” Schedule UTP requires the reporting of a tax position in either of the following two cases:

- A corporation’s federal income tax position must be reported on Schedule UTP when the corporation or related party has recorded a reserve in an audited financial statement.
- A corporation’s federal income tax position must be reported when the corporation or related party has *not* recorded a reserve because either (i) the tax position is expected to be sustained in litigation, or (ii) administrative practice of the Service supports the decision not to create a reserve for a particular tax position.

We applaud the Service for clarifying that the definitions of a “unit of account” and a “tax position” are to be tied directly into the principles (*e.g.*, “GAAP”) used by the corporation for its audited financial statements.

In the event that the Service implements the disclosure proposals, we recommend that the Service consider deleting the proposed disclosure concerning administrative practice. Under GAAP, a tax position based on administrative practice may be sufficiently “certain” (or immaterial) to be excluded from the tax reserve analysis. Thus, absent an administrative practice exclusion, taxpayers may be required to do additional analysis that would not otherwise be required under GAAP.

Alternatively, we recommend that the Service promulgate guidance concerning the scope and application of the proposed disclosure regarding administrative practice. We are concerned that the disclosure proposal may be overbroad, and that taxpayers may not understand the types of administrative practices that need to be identified and reported.

2. **Audited Financial Statement**

The Instructions state that an “audited financial statement means a financial statement that an independent third party expresses an opinion on under GAAP, IFRS, or other country-specific accounting standards . . . that requires a taxpayer to record a reserve for federal income tax purposes.”

In the event that the Service implements the disclosure proposals, we recommend that the Service clarify what constitutes “an opinion” for purposes of this definition. Specifically, taxpayers may have independent third party auditors express a negative

assurance (*i.e.*, a “review”) that financial statements are in accordance with GAAP, rather than have a traditional “certified” audit opinion issued.

3. **Clarification of UTP**

The Instructions state that Schedule UTP requires the reporting of a corporation’s federal income tax positions for which the corporation or a related party has recorded a reserve in an audited financial statement. A tax position taken in a tax return is described in the Instructions as a tax position that would result in an adjustment to a line item on that tax return if the position is not sustained.

The language contained in the Instructions would be difficult to apply with respect to non-U.S. UTPs. Specifically, for purposes of determining a FIN 48 reserve, a taxpayer may have a UTP with respect to a non-U.S. tax issue (an “FUTP” or “foreign UTP”). That FUTP may have a potential U.S. tax effect because when the FUTP is resolved the taxpayer’s U.S. foreign tax credit may increase or decrease. As such, the FUTP may affect a line item on the U.S. federal income tax return. We suggest, however, that reporting the FUTP will not advance the purpose of the proposed disclosure, and we recommend that reporting FUTPs not be required.

The stated purpose and intent of Announcement 2010-9 is to assist the Service in identifying quickly and efficiently significant issues (including UTPs) that might be the subject of an audit by the Service. That purpose is not advanced by listing FUTPs, as those positions are foreign in nature and would not be part of an audit by the Service.

Accordingly, in the event that the Service implements the disclosure proposals, we recommend that the Service clarify that a UTP for purposes of this reporting requirement is intended to be a UTP with respect to the Code and not with respect to a non-U.S. tax jurisdiction.

B. **Identification of Business Taxpayer**

In the event that the Service implements the disclosure proposals, we recommend that the Service consider revising the disclosure program to consider limiting the disclosure requirement to publicly reporting corporations (*i.e.*, corporations that report to the SEC with respect to their stock or debt).²⁷ These corporations likely have sophisticated financial systems and prepare their financial statements in accordance with GAAP. Consequently, these corporations would be in the best position to efficiently prepare Schedule UTP based upon tax reserve analysis that already has been performed for GAAP.

If the Service elects a broader application of Schedule UTP, we suggest the following:

²⁷ Corporations that file or are required to file reports with the SEC pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended.

As noted previously, Announcement 2010-30 clarifies that, for 2010 tax years, pass-through entities and tax-exempt organizations would not be required to file Schedule UTP. We agree with this decision. However, we recommend that both pass-through entities and tax-exempt organizations ultimately be excluded from the disclosure requirements. We believe that disclosure at the pass-through entity level would be redundant because Schedule UTP would require a corporate partner to make a disclosure and to provide a corresponding Employer Identification Number for the partnership. In addition, as a practical matter, a pass-through entity does not identify or quantify for financial accounting purposes UTPs taken in the pass-through entity return because the liability for such taxes falls on the ultimate owners of the pass-through entity.

Each Form 990, Return of Organization Exempt from Income Tax, filed by a tax-exempt organization is required to be disclosed to the public. We are concerned that donors or other stakeholders may be misled by the disclosures on Schedule UTP, and that donors may curtail donations on the belief that a tax-exempt entity may not be in compliance with the tax laws.

In the event that the Service requires pass-through entities and tax-exempt organizations to file Schedule UTP, we recommend that, prior to the date of implementation, the Service issue additional guidance addressing the specific circumstances under which pass-through entities and tax-exempt organizations would have to report UTPs. For example, would a partnership or an S corporation be required to report only when there is a question as to the entity's own potential tax liability, such as in the case of a defective election? Similarly, would a tax-exempt organization be subject to reporting only when there is a potential for unrelated business taxable income, or when the organization may deem its tax-exempt status to be in jeopardy?

We also recommend that taxpayers currently included in the Compliance Assurance Program be exempted from filing Schedule UTP, as those taxpayers already are subject to similar reporting requirements.

C. Elimination of Maximum Tax Adjustment

In the event that the Service implements the disclosure proposals, we recommend that the Service consider eliminating the maximum tax adjustment disclosure. We are concerned that disclosure of any tax amount on Schedule UTP would reflect, at least to some degree, the taxpayer's thought process regarding the merits of a particular issue. Moreover, we also are concerned that revenue agents (despite training to the contrary) might still set up an issue based on the magnitude of the maximum tax adjustment amount reflected on Schedule UTP, rather than based on a thoughtful evaluation of the issue.

On January 26, 2010, Commissioner Shulman said "[t]he goals of our proposal are simple: to cut down the time it takes to find issues and complete an audit."²⁸ We

²⁸ IR-News Rel. 2010-13, 2010 I.R.B. LEXIS 52.

believe that disclosing only the issue list on Schedule UTP and not disclosing any dollar amount associated with any particular issue would meet this goal. If only the issue list was disclosed, we believe auditors would reduce auditing time, and taxpayers would feel more comfortable that information contained on Schedule UTP would not be used for unintended purposes. We also believe, however, that even this limited disclosure is problematic because privilege protections may be lost when a taxpayer uses information to help prepare a tax return.²⁹

If the Service decides to require disclosure of a maximum tax adjustment amount, we support the Service's decision to require calculation of the maximum tax adjustment amount only on an annual basis and to exclude interest and penalties from the computation. We also applaud the simplified approach for calculating the maximum tax adjustment for transfer pricing and valuation issues. Moreover, we recommend that the Service issue additional guidance addressing how pass-through entities should determine and quantify the maximum tax adjustment amount for any tax position. For example, should a federal income tax benefit to one of the ultimate owners of the pass-through entity be netted against the federal income tax detriment to one or more of the other ultimate owners? Also, to what extent should the pass-through entity take into account the specific tax attributes of each of its ultimate owners in determining the maximum tax adjustment amount for any tax position?

D. Content of "Concise Description"

As discussed in the conclusion to the May 28, 2010, letter submitted on behalf of the ABA, the disclosure proposals "are inimical to the fundamental protections afforded by the attorney-client privilege, the . . . section 7525 tax practitioner's privilege, and the attorney work product doctrine."³⁰ We are concerned that if the proposals were implemented, the Service would expect taxpayers to disclose too much detailed information about the nature of each UTP listed on Schedule UTP. Specifically, although the Instructions ask for a "concise description" of the tax position, the Instructions also ask for "the rationale for the position and the reasons for determining the position is uncertain," which appears to be essentially a requirement to disclose the taxpayer's legal position and analysis. The "Examples of concise descriptions" set forth in the Instructions are very extensive and we believe that the Examples, as written, present a notable risk of subject matter waiver of privileged legal advice. For example, Example 15 in the Instructions states "The corporation has taken the position that the pledge of Fsub stock did not result in an investment in U.S. property under section 956. The issue is whether there was an investment in U.S. property causing a deemed distribution of

²⁹ *United States v. Frederick*, 182 F.3d 496, 500 (7th Cir. 1999) ("The information that a person furnishes the preparer of his tax return is furnished for the purpose of enabling the preparation of the return, not the preparation of a brief or an opinion letter. Such information therefore is not privileged.") *United States v. Davis*, 636 F.2d 1028, 1040 (5th Cir. 1981) ("papers generated by an attorney who prepares a tax return are not within the work product privilege simply because there is always a possibility that the IRS might challenge a given return.")

³⁰ American Bar Association Letter "IRS Proposals Requiring Disclosure of Uncertain Tax Positions" (May 28, 2010) available at http://www.abanet.org/poladv/letters/attyclient/2010may28_scheduleutp_1.pdf.

Fsub earnings to the corporation as a result of the treatment of an item of Fsub's income that defers its recognition." We believe that the Service's goal of adequate disclosure may be met by reducing the level of detail in the Examples. In that regard, it seems that the Service's needs for issue identification would be met if a concise description of each issue (similar to "notice pleading") was included on Schedule UTP. Even this more limited disclosure still raises concerns, however, because privilege protections may be lost when a taxpayer uses information to help prepare a tax return.³¹

Moreover, in the event that the Service implements the disclosure proposals, we recommend that the Service eliminate the requirement that taxpayers provide "the rationale for the position and a concise general statement of the reasons for determining the position is an uncertain tax position."³² By requiring a taxpayer to provide both the rationale for the taxpayer's legal position and the reasons that the taxpayer believes that the tax position is uncertain, the Service is essentially asking the taxpayer for a glimpse into the substantive risk assessment underlying the position – something the Service has stated that it does not intend to do. We believe that taxpayers should have the right to maintain confidentiality and privilege with respect to the legal rationale for the positions reported on their returns. To the extent that the Service may question the taxpayer about its legal position or the "rationale" for a tax position, we believe such requests should be made in the context of an examination as they are now. During an examination, a taxpayer is in a better position to assess the risks associated with disclosure and to either provide the requested information or to assert applicable privileges as appropriate.

E. **Penalties**

Taxpayers already are subject to a host of penalties that are designed to enforce compliance. We recommend that any further consideration of specific penalties attributable to preparation and filing of Schedule UTP be made in the context of comprehensive penalty reform.³³ We also are concerned that a taxpayer might be required to disclose its tax accrual workpapers to defend against any such penalties, which we believe to be contrary to the intent of the Service.

F. **Effect on Financial Reporting**

The Announcement might affect the relationship between a taxpayer and its independent auditor. Specifically, we are concerned that implementation of the Announcements might:

- Compromise the objectives of the auditing process by making it less likely that taxpayers and their auditors would accrue for potential tax liabilities;

³¹ See *United States v. Frederick* and *United States v. Davis*, *supra*, at fn. 29.

³² Announcement 2010-9 at p.4.

³³ See *Statement of Policy Favoring Reform of Federal Civil Tax Penalties* of the American Bar Association Section of Taxation (Apr. 21, 2009), available at <http://www.abanet.org/tax/pubpolicy/2009/090421statemntciviltaxpenalties.pdf>.

- Jeopardize the independence of auditors by requiring auditors to assume a more significant role in tax compliance in addition to their existing responsibilities to the shareholders;
- Increase the reporting requirements imposed by auditors concerned that the Service might question a decision or impose penalties on a client for underreporting a UTP, which questioning and penalties are particular concerns for issues involving areas of the law for which guidance is lacking on common but complex issues (such as branch foreign exchange treatment under section 987), issues that do not lend themselves to a single answer (such as valuation or transfer pricing issues), and factual issues for which auditors may be less willing to rely on reasonable representations from a taxpayer in assessing UTPs; and
- Require accounting firms to become arbiters of the requirements for disclosure of UTPs, which may result in inconsistent treatment of similarly situated taxpayers when different accounting firms have different views regarding the uncertainty of a given tax position.