SPECIFIC AREAS OF MAJOR CONCERN

HIGH PRIORITY

1. **Tax Shelters**

   The Tax Section is gratified that the Treasury and Internal Revenue Service are focusing intently and publicly on the tax shelter problem, and we are pleased that the LMSB Division is playing such a pivotal role in this effort. We think there is much that can be done from an administrative standpoint to address the problem. We are closely examining the administrative announcements and regulations released on February 28, 2000, and we will give you any suggestions or comments we have regarding those actions.

   We are hopeful that in implementing the new requirements for taxpayer disclosure you will require, or at least encourage, a higher level of corporate and personal accountability for the transactions. We think that if a senior corporate officer knows he or she will be personally accountable for the facts and assumptions on which a large, tax-aggressive transaction is based, there will be greater advance scrutiny of such transactions at a higher level within the corporation.

2. **Indopco**

   We believe that development and communication of principles for resolution of Indopco issues in a manner that minimizes unnecessary conflict and reduces future audit burdens for both taxpayers and the Internal Revenue Service should be one of the highest Service priorities. In particular, where past industry practice has been to deduct a class of expenditures that the Service concludes should now be capitalized, the Service should develop transition mechanisms. Even more fundamentally, the decision to challenge established industry practices of expensing should be openly discussed to receive input from taxpayers.

MEDIUM PRIORITY

1. **Research and Experimentation Credit**

   The Section would urge that LMSB review the state of the law and audit practices with respect to the research and experimentation credit (IRC section 41). There is considerable uncertainty about certain tests that must be met in order to qualify for the credit. This uncertainty, in turn, has resulted in numerous conflicts between companies and the Service on audit. Two issues exemplify this uncertainty: (i) the definition of internal use software, and (ii) the introduction of the so-called “discovery test.” Resolution of these two issues, whether through additional guidance or by streamlined audit procedures (or a combination of both), would significantly reduce the number and level of taxpayer audit disputes.
2. Changes in Method of Accounting

Closely related to the capitalization questions raised by the Service's developing view of Indopco are questions related to the rules prohibiting accrual basis taxpayers from changing elements of their accounting procedures without the prior consent of the Commissioner. Rapid changes in accounting procedures in large and mid-sized businesses are now occurring because of new products, new technologies, improved financial control systems, improved performance measurement systems, assimilation of foreign-based businesses (and accounting systems), and other business evolutions. These business driven changes present the Service and LMSB taxpayers with significant challenges under the existing regulatory system. Even though these taxpayers almost always use the accrual accounting method, changes in historical procedures are frequently necessary to reflect new business contexts. From a GAAP accounting standpoint, these differences and these changes within taxpayers' accrual accounting systems are typically immaterial.

The Service has an obvious interest in uniformity of treatment of similarly situated taxpayers and also consistency of accounting treatment where necessary to ensure sensible and efficient tax administration. However, as currently administered, the change of method rules do not yield uniformity or sensible and efficient tax administration for large numbers of accrual method taxpayers. (It is also arguable whether they are optimal for a clear reflection of income.) In our view, far too many Service and taxpayer resources are devoted to this area. The Service badly needs to develop new accounting method procedures that will allow LMSB taxpayers to react quickly to changes in their businesses and accrual accounting systems. As business processes change, accounting procedures must change. Accordingly, unless income is disappearing or deductions are multiplying, accounting procedure changes for good business reasons need to be accommodated. We believe the Service's old procedures and attitudes have been outrun by the new business reality.

* These comments have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.