May 3, 2012

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

Re: Comments on the Use of Schedule UTP

Dear Commissioner Shulman:

Enclosed are comments on the use of schedule UTP by the Internal Revenue Service Large Business and International Division. 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,

William M. Paul
Chair, Section of Taxation

Enclosure

cc: Emily S. McMahon, Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service
Heather C. Maloy, Commissioner, Large Business and International Division, Internal Revenue Service
ABA SECTION OF TAXATION
COMMENTS ON THE USE OF SCHEDULE UTP BY THE
INTERNAL REVENUE SERVICE LARGE
BUSINESS & INTERNATIONAL DIVISION

The following 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, these Comments should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Kevin Johnson and Don Rath, of the Committee on Administrative Practice of the Section of Taxation. Substantive contributions were made by members of the Task Force on the Schedule UTP of the Committee on Administrative Practice. The Comments were reviewed by Sheri A. Dillon, Committee Chair for the Committee on Administrative Practice. The Comments were further reviewed by Tom Callahan of the Section’s Committee on Government Submissions and by Scott D. Michel, Council Director for the Committee on Administrative Practice.

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

Contact: Sheri A. Dillon
202-373-6757
Sheri.Dillon@bingham.com

Date: May 3, 2012
EXECUTIVE SUMMARY

We commend the Internal Revenue Service (the “Service” or “IRS”) for the extensive guidance that it has issued regarding the completion of Schedule UTP\(^1\) and its plans for use of Schedule UTP, especially with regard to Commissioner Maloy’s and Deputy Commissioner Miller’s deliberate, centralized phase-in for using the Schedules UTP in examinations of the 2010 tax year. We further commend the Service for its consideration of the tax community’s input regarding the disclosures required to be made, the revisions to Schedule UTP and the instructions thereto, and its clarification regarding Schedule UTP and the Service’s policy of restraint.

We recognize that the Service’s objectives of reducing the time it takes to identify issues, ensuring that the Service and taxpayers spend more time discussing the law as it applies to their facts, identifying areas of uncertainty regarding guidance, and helping prioritize selection of issues and taxpayers for examination, are important to its mission of fair and balanced tax administration.\(^2\) To assist the Service in integrating Schedule UTP in tax examinations to achieve these important tax administration objectives, we respectfully submit these recommendations regarding the Service’s use of Schedule UTP.

1. We recommend that the Service provide a process by which taxpayers can request expedited review of issues identified on Schedule UTP, as well as clarify how existing guidance may be used to request expedited review of a UTP issue.

2. We recommend that, consistent with its stated objectives with regard to Schedule UTP disclosures, the Service clarify its “policy of restraint” and no longer require the taxpayer to affirmatively assert privilege to defend against production of tax accrual information, tax opinions, or legal analyses with respect to properly disclosed uncertain tax positions (“UTP” or “UTPs”)

Alternatively, we recommend that the Service clarify its audit procedures in light of its current policy of restraint and make clear in its requests for information that it is not requesting a taxpayer’s “otherwise privileged information” with respect to UTPs listed on Schedule UTP and that privilege has not been waived as a result of disclosure of such otherwise privileged information to a taxpayer’s financial auditors.

---


3. We recommend that the Service implement a policy that requires approval of a Territory Manager or more senior Service executive prior to allowing an Exam Team to open issues disclosed on a 2010 Schedule UTP for a prior tax year. We also recommend that the Service provide guidance to its employees regarding the types of unusual circumstances that might warrant auditing of a pre-2010 UTP.

4. We recommend that the Service’s centralized review process for Schedule UTP be a transparent process achieved by formation of a liaison committee comprised of members from the tax community (e.g., taxpayers, tax practitioners, taxpayer representatives, etc.) and through the issuance of periodic reports.

DISCUSSION

On January 26, 2010, the Service issued Announcement 2010-9\(^3\) in which it proposed that certain business taxpayers be required to disclose their UTPs annually on a prescribed form (Schedule UTP) constituting part of their tax returns. On April 19, 2010, the Service released for comment a draft Schedule UTP and instructions for completion.\(^4\) The Service received a large number of comments on the overall proposal, including whether and how the Service should implement the requirement to file a Schedule UTP, as well as on the draft schedule and instructions. After review and consideration of the comments it received, on September 24, 2010, the Service released the final Schedule UTP and instructions to be filed by corporate taxpayers beginning with their 2010 returns.\(^5\) On that same date, Deputy Commissioner for Services and Enforcement Steven Miller released a directive setting forth the planned treatment of UTPs by Large Business & International (“LB&I”) examiners and other personnel, i.e., the policy on use of Schedule UTP (the “Policy & Use Directive”).\(^6\) Also on September 24, the Service issued Announcement 2010-76\(^7\), addressing the application of the policy of restraint to documents prepared in connection with the Schedule UTP and related privilege considerations.

On May 11, 2011, LB&I Commissioner Heather Maloy, as part of LB&I’s preparations for integrating Schedule UTP into the Service’s examination process, issued a memorandum on the centralized management of LB&I returns with Schedules UTP (the

---

\(^3\) 2010-1 C.B. 408.

\(^4\) See Announcement 2010-30, 2010-1 C.B. 668.


\(^7\) Announcement 2010-76, 2010-2 C.B. 432.
“Centralized Management Memo”) to LB&I employees. In this memorandum, Commissioner Maloy explained that 2010 Schedules UTP filed in 2011 would not be released to the Service’s Examination function (“Exam”). Instead, the Schedules UTP would be gathered and studied by a centralized unit. The memorandum further instructed Exam that it should not request or accept copies of Schedules UTP outside of the centralized process. Subsequently, on August 31, 2011, Commissioner Maloy issued guidance covering the use of Schedule UTP as part of the Compliance Assurance Process (“CAP”) Program, and explained that it applied only to returns filed for the 2010 tax year by taxpayers that were in CAP in 2010. And on November 1, 2011, Commissioner Maloy released a memorandum (the “UTP Procedures Memo”), with its stated purpose being to provide further Schedule UTP guidance and procedures applicable to all LB&I field examinations other than CAP examinations.

The implementation of the Schedule UTP constitutes perhaps the most significant increase in tax reporting in recent memory and will greatly affect the Service’s audits for years to come. We view the guidance promulgated on September 24, 2010, the Frequently Asked Questions (“FAQs”), and the internal memoranda regarding the policy and use of Schedule UTP as an interdependent package. Considered together, this package begins to provide a picture of how the Service will utilize Schedule UTP in tax examinations. We commend the Service for its issuance of timely and wide-ranging guidance. Nevertheless, there remain some details to be worked out. While others have commented on uncertainties about the information required by the Schedule UTP itself, our comments are directed at the Service’s use of the Schedule UTP in tax audits.

We recognize that the Schedule UTP is designed to expedite return selection and issue identification, and to allow the Service and taxpayers to spend more time discussing


the law as it applies to their facts, rather than searching for information.\textsuperscript{12} We have also considered that Schedule UTP is intended to be a tool for identifying areas of uncertainty regarding guidance, and to help prioritize selection of issues and taxpayers for examination.\textsuperscript{13} To assist the Service in its process of further developing its use of Schedule UTP, and to encourage cooperation between Exam and taxpayers in the Service’s audits of tax years in which Schedules UTP have been filed, we respectfully make and discuss the following recommendations:

A. Recommendation: We recommend that the Service provide a process by which taxpayers can request expedited review of issues identified on Schedule UTP, as well as clarify how existing guidance may be used to request expedited review of a UTP issue.

Deputy Commissioner Miller recognized in his Policy & Use Directive, and Commissioner Maloy similarly recognized in her UTP Procedures Memo, that not every issue that is listed on the Schedule UTP and for which a taxpayer has established a reserve is worthy of an examination or an audit adjustment. We commend the Service for continuing to emphasize that the disclosure of an UTP, in and of itself, does not justify an examination or adjustment. For those disclosures that do merit examination, however, we anticipate that there will be many instances in which the taxpayer's UTP is susceptible to a quick resolution.

Taxpayers and the Service should seek to avoid protracted audits of UTPs that do not warrant a heightened level of review. For example, a heightened level of review does not seem to be appropriate where a reserve exists because the tax position is uncertain due to a lack of authority or an ambiguity in the law, rather than due to the position being viewed as improper or aggressive. In such a case, the taxpayer may have taken a reasonable position with which Exam might agree, but Exam may nevertheless feel constrained in its ability to resolve the matter due to the lack of clear authority. To avoid expending unnecessary Service and taxpayer resources on such issues, we recommend that the Service implement procedures that will allow taxpayers to request expedited review of Schedule UTP issues that do not warrant heightened review.

As part of the proposed expedited process, we believe it would be helpful to permit taxpayers to inform the Service of areas of technical expertise that may be needed to understand the nature of the issue. In that way, the taxpayer would be providing notice to the Service of additional necessary resources, such as Service personnel with training

\textsuperscript{12} Deputy Commissioner Miller stated in the Policy & Use Directive that the Schedule UTP is designed to expedite return selection and issue identification, and moving forward through the audit, examiners are expected to engage with taxpayers early in the process to eliminate uncertainty as quickly as possible. Consistent with these objectives, we believe all parties involved in the examination process should seek to avoid a result where the disclosures on Schedule UTP increase the length and complexity of audits, and thus correlatively increase tax administrative costs to the Service and tax compliance costs for taxpayers.

in specific areas (e.g., economists, financial products specialists, international agents, valuation engineers, etc.) who may be needed to help resolve the issue.

We also suggest that the Service develop a specific procedure by which a taxpayer could identify and request expedited review of the Schedule UTP positions it believes susceptible to expedited resolution. In large-case LB&I audits, the taxpayer and Exam could address these issues as part of the pre-audit planning meeting that takes place at the beginning of each audit cycle. Although Exam might retain the final decision as to whether any issue identified by the taxpayer would qualify for expedited review, we envision that if the Service were to implement the expedited review process, the taxpayer would be given the opportunity to present its case for the Schedule UTP issues that it determines should be eligible for expedited review.14 We further suggest that a procedure for management review be included in the process in the event that Exam does not agree to allow issues to proceed to expedited review.

Notably, the Service has already developed expedited procedures in other contexts that might be adapted to the expedited review of certain Schedule UTP issues. For example, the Service has a Pre-Filing Agreement program that allows taxpayers to have issues reviewed, and when appropriate, resolved through a Pre-Filing Agreement prior to the taxpayer filing a return.15 We recommend that the Service adopt a similar post-filing expedited procedure for resolving UTPs for which the taxpayer's position is susceptible to expedited resolution. Expedited review of such issues would conserve Service resources by obtaining certainty earlier in the examination process. In addition, taxpayer resources would also be used more efficiently because early agreement on the status of UTPs may permit taxpayers to avoid the need to record financial statement reserves for these same UTPs in future years.

B. Recommendation: We recommend that, consistent with its stated objectives with regard to Schedule UTP disclosures, the Service clarify its “policy of restraint” and no longer require the taxpayer to affirmatively assert privilege to defend against production of tax accrual information, tax opinions, or legal analyses with respect to properly disclosed UTPs. Alternatively, we recommend that the Service clarify its audit procedures in light of its current policy of restraint and make clear in its requests for information that it is not requesting a taxpayer's “otherwise privileged information” with respect to UTPs listed on Schedule UTP and that privilege has not been waived as a result of disclosure of such otherwise privileged information to a taxpayer’s financial auditors.

In response to privilege concerns raised when the UTP regime was first announced,16 in Announcement 2010-76 the Service modified its policy of restraint (the

14 Such a process could work very much like the presentation and disclosure of issues in CAP audits.


“Modified Policy of Restraint”). The Modified Policy of Restraint expanded the Service’s policy of restraint by confirming that the Service will “forgo seeking particular documents that relate to uncertain tax positions and the workpapers that document the completion of Schedule UTP.” Specifically, the Modified Policy of Restraint provides that the Service will no longer assert that a taxpayer has waived privilege by disclosing to its independent auditors “otherwise privileged” documents, such as legal opinions or other documents that would assist the auditor with understanding the transactions and the legal basis for the transactions, or the determination of the adequacy of the tax reserves. In addition, the Service generally will not request the supporting schedules for Schedule UTP and will allow redactions to relevant tax reconciliation workpapers.

Consistent with the Modified Policy of Restraint, Commissioner Maloy confirmed in her November 1, 2011, UTP Procedures Memo that Exam cannot request tax accrual workpapers or otherwise privileged information disclosed to a taxpayer’s independent auditors. However, her memo appears to expand the policy of restraint, stating that:

For issues that are disclosed on the Schedule UTP, the team may ask the taxpayer for information about the relevant facts affecting the tax treatment of the position and information about the identity of the tax issue. The team cannot ask the taxpayer to explain their rationale for determining that the issue was uncertain, or for information about the hazards of the position or an analysis of support for or against the tax position.

UTP Procedures Memo (emphasis added).

We commend the Service for expanding its policy of restraint to include “otherwise privileged documents” that have been disclosed to taxpayers’ financial auditors and documents used to prepare Schedule UTP. Nevertheless, we note that the current policy still allows the Service to pursue privileged taxpayer information (e.g., tax accruals, tax opinions, and taxpayer’s legal analyses) by requiring taxpayers to affirmatively assert that such materials are “otherwise privileged.” Moreover, although the policy also provides that the Service will not counter with a waiver argument in the event disclosure of such otherwise privileged documents was made to a taxpayer’s independent auditors, the policy does not preclude Exam from otherwise arguing that privilege was waived.

---


18 Id.

19 See UTP Procedures Memo (“The team cannot ask the taxpayer why a Schedule UTP issue is uncertain, nor can the team ask the taxpayer for copies of workpapers used to prepare Schedule UTP, any Tax Accrual Workpapers, or for any documents privileged under the modified policy of restraint.”)

20 Notably, the Modified Policy of Restraint does not on its face apply to Department of Justice lawyers representing the Service in tax litigation cases.
Consistent with Commissioner Maloy’s UTP Procedures Memo, we recommend that the Service refrain from requesting the information in the first instance, thus no longer requiring taxpayers to affirmatively assert privilege with respect to legal analyses and judgments made in connection with disclosures of UTPs.

There would be substantial benefits for both the Service and taxpayers to no longer requiring taxpayers to assert privilege to protect their confidential advice and work product. Most importantly, both the Service and taxpayers would avoid devoting expensive and time-consuming resources to assert and substantiate privilege claims where the Service has already, as a policy matter, conceded that it will not request the information or assert that privilege does not apply.

Second, such a policy would forestall privilege disputes. Taxpayers and the Service will inevitably continue to disagree as to whether information or documents are “otherwise privileged” under the attorney-client privilege, the section 752521 tax practitioner privilege, or the work product doctrine. Because the scope of the privileges remains uncertain, it may similarly be unclear as to what in fact constitutes “otherwise privileged materials.”22 To the extent that the Service and a taxpayer do not share a view as to whether a taxpayer’s communications are “otherwise privileged,” lengthy privilege disputes between the Service and taxpayers will likely continue. Given that the information contained in a taxpayer’s legal analyses, hazards evaluations, or similar judgments do not bear on a taxpayer’s substantive tax liability, we believe that the Service’s resources would be better spent gathering the evidentiary facts and performing its own legal analyses of the issues, rather than seeking a taxpayer’s potentially privileged materials.23

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

22 For example, taxpayers and the Service continue to disagree over the applicability of the work product doctrine to documents prepared in relation to a taxpayer’s tax analysis, and the courts have yet to reach consensus. Compare *El Paso Co. v. United States*, 682 F.2d 530 (5th Cir. 1982), applying the “primary purpose” test for work product, with *United States v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010), applying the “because of test,” and with, *United States v. Textron Inc.*, 577 F.3d 21 (1st Cir. 2009), which appears to create new test for work product requiring that the document be prepared “for use” in litigation.

23 Furthermore, it remains unclear as to what materials in fact constitute “tax accrual workpapers.” Tax accrual workpapers are generally defined as workpapers and related documents prepared to support the taxpayer’s accrual of liabilities for federal income taxes for financial reporting purposes. See, Announcement 2002-63, 2002-2 C.B. 72; I.R.M. 4.10.20.2, Audit Workpapers, Tax Accrual Workpapers, and Tax Reconciliation Workpapers Defined (July 14, 2004). To the extent that the Service does not view related tax opinions or legal memoranda as part of “tax accrual workpapers,” the Service may assert that such documents are not protected by the Modified Policy of Restraint, and a privilege dispute could ensue. However, this dispute could be avoided if Exam were no longer to seek such documents. Should Exam no longer seek privileged materials or require the taxpayer to affirmatively assert privilege as a defense to production, the definition of what constitutes tax accrual workpapers becomes much less important.
We believe that the UTP Procedures Memo is consistent with our recommendation that the Service refrain from requesting the taxpayer’s legal analysis and judgments with respect to issues disclosed on Schedule UTP. Accordingly, we recommend that the Service amend the Modified Policy of Restraint to reflect that the Service will not request a taxpayer’s legal analysis or support with respect to properly disclosed UTPs. In the alternative, if the Service determines not to amend its Modified Policy of Restraint, we recommend that the Service publicly inform taxpayers that Exam is not requesting “otherwise privileged documents” and that such documents include those disclosed to outside auditors. We suggest that this be accomplished by the Service providing standard language for a mandatory Information Document Request (“IDR”), which Exam must use when requesting information relating to properly disclosed UTPs.

C. Recommendation: We recommend that the Service implement a policy that requires approval of a Territory Manager or more senior Service executive prior to allowing an Exam Team to open issues disclosed on a 2010 Schedule UTP for a prior tax year. We also recommend that the Service provide guidance to its employees regarding the types of unusual circumstances that might warrant auditing of a pre-2010 UTP.

The Service’s UTP Procedures Memo suggests that, with the approval of the Team Manager, an Exam Team may open an issue disclosed on a 2010 Schedule UTP for a prior year whether or not the prior year is currently under examination. We respectfully suggest that the Service limit the opening of issues disclosed on Schedule UTP in prior-year audits to rare and unusual circumstances. In addition, the Service should consider requiring a higher level of approval, at or above the Territory Manager level, before an Exam Team would be permitted to audit an issue disclosed on a 2010 Schedule UTP for a prior tax year. We also suggest that the Service issue guidance to instruct Exam management and agents on the factors to consider in opening a 2010 Schedule UTP issue for a prior year.

In its introductory announcements for the Schedule UTP reporting regime, the Service signaled that the Schedule UTP was to be implemented on a prospective basis starting with the 2010 tax year. The Service was clear that taxpayers were not required to disclose UTPs that occurred in tax years prior to 2010. Announcement 2010-75 states: “The instructions [for Schedule UTP] clarify that tax positions taken in years before 2010 need not be reported in 2010 or a later year even if a reserve is recorded in audited financial statements in 2010 or later.” Based on the Service’s announced position, many in the corporate tax community concluded that the Schedule UTP was to be implemented on a prospective basis, not only as a reporting regime, but as an IRS audit tool. The Service’s routine use of 2010 Schedule UTP to identify and audit issues in prior tax years appears to be contrary to both the Service’s original intent and the corporate tax communities’ expectations.

In the UTP Procedures Memo, Commissioner Maloy recognizes that a Schedule UTP disclosure “is not sufficient to automatically raise the issue in a prior year,” and that
“it is unusual to open an issue in a prior year.” Nevertheless, the memorandum permits agents to open 2010 Schedule UTP upon receiving the Team Manager’s approval.

We suggest that this process creates the possibility of disparate treatment of corporate taxpayers. Without guidance and input from Senior Management, some Team Managers may routinely grant approval for their Exam Teams to open UTP issues for prior years, while others may rarely grant such approval. Consequently, there may be dissimilar treatment for similarly situated corporate taxpayers.

In addition, utilization of 2010 Schedule UTP in prior year audits could impede the Service’s commitment to audit currency. The Service, with its currency initiatives, has elicited the cooperation of corporate taxpayers in developing audit plans and setting aggressive schedules for taxpayers to provide information in order to complete LB&I audits in an efficient and timely manner. The routine use of 2010 Schedule UTP’s to identify and open issues in ongoing audits of corporate taxpayers’ prior tax years could well delay such audits and undermine the Service’s currency objectives.

In order to enhance audit currency, and facilitate the fair and consistent treatment of corporate taxpayers, we respectfully request that the Service issue guidance setting forth (i) the types of unusual circumstances that would warrant the opening of a Schedule UTP issue for a prior tax year and (ii) a requirement that approval of a Territory Manager or higher level Service executive be required before an Exam Team would be permitted to open an UTP issue for a prior tax year.

D. Recommendation: We recommend that the Service’s centralized review process for Schedule UTP be a transparent process achieved by formation of a liaison committee comprised of members from the tax community (e.g., taxpayers, tax practitioners, taxpayer representatives, etc.) and through the issuance of periodic reports.

The Service has created a centralized unit to study the Schedule UTP and to identify common issues for which Service guidance might be required and ensure the fair and consistent treatment of taxpayers. We appreciate the Service’s creation of this centralized unit and believe that it will yield substantial benefits in the use of Schedule UTP as an audit tool.

We recommend that the Service’s Centralized UTP Unit and its study of implementation issues be a transparent process in which the tax community, including taxpayers, the ABA Tax Section, and other organizations representing the interests of taxpayers be given the opportunity to review findings of the Centralized UTP Unit and comment on its proposed guidance and recommendations. To that end, the Service might consider forming a liaison committee, and the committee could provide a forum for representatives of taxpayers to participate in the process as issues develop with regard to the form, content, and use of Schedule UTP. By creating a transparent process and a regular dialogue with taxpayers and tax professional groups, the Service will foster greater cooperation and buy-in from the tax community.