

May 21, 2010

The Honorable Douglas Shulman

Internal Revenue Service

CC:PA:LPD:PR (Announcement 2010-9)

Room 5203

P.O. Box 7604, Ben Franklin Station

Washington, DC 20044

**RE: Announcements 2010-9, 2010-17, and 2010-30**

**Related to Reporting Uncertain Tax Positions**

Dear Commissioner Shulman:

The purpose of this letter is to support Announcements 2010-9 and 2010-17, requiring the reporting of uncertain tax positions by some taxpayers, and Announcement 2010-30, proposing a Schedule UTP for the reporting of those positions. The disclosure of uncertain tax positions is essential to bring needed transparency, fairness, and greater efficiency to the process for examining tax returns, and a uniform approach through a separate schedule would benefit both taxpayers and the Internal Revenue Service (IRS). This letter is intended not only to support those announcements, but also to urge that the proposed approach be strengthened to cover more taxpayers and streamlined to reduce the reporting burden on taxpayers.

Over the last decade, the U.S. Senate Permanent Subcommittee on Investigations, which I chair, has conducted multiple investigations into offshore tax abuse, illegal tax shelters, and other abusive tax avoidance schemes. For example, in 2006, the Subcommittee released a report and held hearings on six case studies showing how U.S. financial professionals, including bankers, lawyers, accountants, investment advisors, and others were using offshore tax havens to help U.S. taxpayers dodge payment of U.S. taxes. In 2003 and 2005, the Subcommittee released reports and held hearings showing how leading accounting firms, such as KPMG, were designing, marketing, and implementing complex and abusive tax shelters to help U.S. taxpayers dodge their tax obligations. In 2008 and 2009, the Subcommittee held hearings and released a report showing how some non-U.S. banks were assisting U.S. clients to establish offshore corporations, trusts, and accounts to hide assets abroad. Over the years, the Subcommittee has also sponsored studies by the Government Accountability Office which found that two-thirds of U.S. corporations paid no tax over a seven-year period, despite total gross receipts of \$2.1 trillion, and that most large U.S. publicly traded corporations and federal contractors have sponsored multiple subsidiaries in offshore tax havens. The Subcommittee has estimated that offshore tax abuses alone result in unpaid taxes each year totaling about \$100 billion.

The Subcommittee's investigations provide concrete evidence of the need for transparency in reporting aggressive, complex, and potentially abusive tax positions. Action in recent years by the Financial Accounting Standards Board (FASB) to require financial statements to identify

separate reserves established to cover uncertain tax positions, shows that addressing such positions in a straightforward way can increase the efficiency and consistency of tax examinations, while curtailing unfair tax avoidance. The decision by the IRS to build upon the FASB approach and establish a new schedule to provide additional information about uncertain tax positions is a thoughtful and sensible development that will promote the goals of efficiency, consistency, and certainty in tax enforcement. The IRS's proposal would benefit from some additional improvements, however, as the IRS and taxpayers embark on this important new effort.

**Persons Required to File UTP Schedules.** The proposed UTP Schedule and instructions state that only a limited group of corporate taxpayers will be required to file the new schedule. Specifically, Announcement 2010-30 states that the requirement to file UTP Schedules will apply to: (1) corporations who are required to file Form 1120, insurance companies who are required to file Form 1120 L or Form 1120 PC, and foreign corporations who are required to file Form 1120 F, who have (2) uncertain tax positions, and (3) assets equal to or exceeding \$10 million, if (4) they or a related party issued audited financial statements for all or a portion of the tax year at issue. The proposed schedule and instructions provide that other corporate taxpayers, such as real estate investment trusts and regulated investment companies, as well as pass-through entities, and tax-exempt organizations will not be subject to the reporting requirement. Instead, the IRS will determine whether they should be required to file UTP Schedules after comments have been submitted.

Again, the IRS is to be commended on its decision to establish the new UTP Schedule. However, its overly narrow approach to who should file the new schedule should be broadened to require the filing of UTP Schedules by all corporations, pass-through entities, and tax-exempt organizations, which have uncertain tax positions, assets of \$10 million or more, and audited financial statements. This broader approach would impose a more level playing field among various types of businesses, and ensure that entities of a similar size are treated in a similar way. It would also simplify the filing requirement. Moreover, the proposal to exempt certain types of entities, such as partnerships and real estate investment trusts, from the filing requirement would create unwarranted tax incentives favoring those entities over corporations, for no apparent reason. By requiring UTP Schedules to be filed by all entities that are of a certain asset size and that use audited financial statements, this broader approach would help ensure comparable tax treatment and that no greater burden is placed on large pass-through entities and tax-exempt organizations than on the limited group of corporate taxpayers now identified in the Announcement. The IRS's goals of increased transparency, efficiency, and consistency would be advanced by a reporting requirement that applies to this broader class of taxpayers.

**Information in UTP Schedules.** The proposed schedule and instructions seek certain information related to three categories of uncertain tax positions: (1) positions for which a reserve is reflected in the taxpayer's financial statements; (2) positions for which no reserve is reflected because the taxpayer expects to litigate and win the position; and (3) positions for which no reserve is reflected because the IRS has a general administrative practice of not examining the position. Although some published comments have questioned the need to require information relating to uncertain tax positions for which no reserve is reflected, all three categories identify, on their face, vital areas of inquiry for the IRS in carrying out its examination function. Businesses that fail to set aside reserves on their financial statements should not be rewarded for doing so, and the IRS should not create a tax incentive that would encourage businesses to avoid setting up reserves to cover their uncertain tax positions. The bottom line is that businesses with uncertain tax positions should have to disclose them to the IRS, whether or

not they establish a reserve for them. For those reasons, the final schedule and instructions should retain the requirement that information be reported for all three categories of uncertain tax positions.

A second issue involves the Maximum Tax Adjustment (MTA), set forth in Column F of Parts I and II of the proposed schedule. The MTA requires the taxpayer to provide an estimate of the dollar amount of maximum potential U.S. federal income tax liability, determined on an annual basis without interest or penalties, for each of its uncertain tax positions. However, determination of the MTA for uncertain tax positions involving transfer pricing or valuation issues is not required. Instead, the taxpayer is required to rank those positions by size based on either the amount taken in reserve or the estimated adjustment to tax that would result if the position were not sustained.

The MTA is designed to give the IRS information about the approximate size of a particular uncertain tax position to enable the IRS to evaluate the materiality or significance of the position when designing its examination plans for taxpayers. The MTA is an important and sensible requirement, but because the MTA may be difficult to calculate and, as currently drafted, would require specific dollar amounts for some positions and size rankings for others, it is also complex. It might better serve the IRS's purposes, while also simplifying the UTP Schedule, to require taxpayers to report the size of each uncertain tax position by selecting from a set of pre-determined ranges provided by the IRS. This streamlined approach would allow taxpayers to segregate their positions into baskets designed by the IRS in a way that would facilitate the Service's examination needs without unduly burdening taxpayers. As noted in the comment letter submitted by the New York State Bar Association Tax Section on March 29, 2010, those ranges or baskets could be set by dollar amount, by percentage of revenue or expenses, or by percentage of the total reserve. Using such a range system for reporting the size of each uncertain tax position would facilitate a more uniform and efficient approach that would support the IRS's examination needs, while reducing the burden on taxpayers.

**Penalties for Failure to File UTP Schedules.** In Announcement 2010-9, the IRS indicated that it is evaluating additional options for penalties to be imposed when a taxpayer fails to file the UTP Schedule or fails to make adequate disclosure in the Schedule. Because uncertain tax positions may yield significant tax benefits, some taxpayers may have an economic incentive not to complete the UTP Schedule fully and on time, so penalties for noncompliance may be key to ensure prompt filings. At the same time, such penalties must be able to be imposed in an efficient manner without litigation.

Currently, Section 6651 of the Internal Revenue Code contains a graduated penalty that applies to taxpayers who fail to file a return. One obvious solution is for the IRS to make it clear that it intends to apply that existing penalty to any failure to file the UTP Schedule. The Section 6651 penalty is well understood, the IRS has extensive experience applying it, and only minimal changes would be needed to apply it to UTP Schedules. The IRS also set a precedent in taking this approach when it applied Section 6651 penalties to a life insurance company that failed to file a required annual statement with its income tax return. See GCM 38057 (Aug. 22, 1979). Taking this approach would subject taxpayers to a 5% penalty for every month that the UTP Schedule is past due, with a maximum penalty of 25%. That type of graduated penalty, which increases over time and is proportional to the unpaid tax, is appropriate for the new Schedule.

The IRS has indicated that it is also considering seeking legislation to design a specific penalty for the failure to file or failure to adequately disclose information in a UTP Schedule. Separate penalty provisions have been enacted, for example, for the failure to file Form 8886, Reportable

Transaction Disclosure Statement, under Sections 6707 and 6707A. While the IRS could pursue a similar penalty with respect to UTP Schedules, such a penalty may take years to enact into law, and may not provide better incentives than Section 6651.

Thank you for this opportunity to comment on the proposed reporting process for uncertain tax positions.

Sincerely,

/s/

Carl Levin

Chairman

Permanent Subcommittee on Investigations