AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON ANNOUNCEMENTS 2010-9, 2010-17, AND 2010-30 WITH REGARD TO UNCERTAIN TAX POSITIONS

SUBMITTED TO THE IRS
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EXECUTIVE SUMMARY

As the national professional association of certified public accountants comprised of 360,000 members, the AICPA is uniquely positioned to comment on the IRS proposal concerning increased reporting of uncertain tax positions (UTPs). Our members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans and businesses. They provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses. It is from this broad perspective that we offer our comments on the IRS proposal regarding UTPs. These comments, divided into two sections, provide our reactions to the proposal.

In the first section, we set forth our policy concerns about the UTP proposal and our recommendation that because of those concerns, the proposal be withdrawn or possibly revised.

In recent public pronouncements, the IRS has communicated its intention to proceed with implementation of the UTP proposal. If the IRS proceeds with the disclosure regime as described in its announcements, we believe it is in the best interest of all parties that the UTP proposal be substantially revised to address the tax, financial accounting, and financial statement auditing issues addressed herein. Accordingly, in addition to our broader policy concerns with the proposal, we offer in the second section of these comments our constructive criticism through our responses to the questions posed in Announcements 2010-9 and 2010-17. In the second section, we also offer suggestions on amendments that may help mitigate some of the definitional and burden challenges inherent in the proposal.

INTRODUCTION

The AICPA understands and supports the IRS objective of increasing the certainty, consistency and efficiency of the tax compliance process. We believe, however, that the procedures as outlined in Announcements 2010-9, 2010-17, and 2010-30 could significantly impede rather than enhance the goals articulated by the IRS. Our most significant concerns with the IRS proposal are that the proposed UTP disclosure regime:

- Potentially undercuts the integrity of the financial statement process;
- Imposes increased burden and cost on taxpayers which will be substantially disproportionate to any actual benefit to the IRS;

- Creates new tension among and between taxpayers, tax advisors, and the IRS, and alters the current self-assessment system;
- Produces complexity and results in distortions that will impede the stated IRS goals;
- Disproportionately impacts small businesses; and,
- Calls for taxpayer reporting at a higher level than mandated by Congress.

Rather than mandating a new disclosure regime – with all the problems inherent in the current design – we strongly urge the IRS to focus its immediate attention and resources on dramatically improving its use and management of the significant amount of disclosed information it already possesses. Before being required to provide a substantial amount of new information, taxpayers should be confident that the IRS will be at least as diligent in analyzing and utilizing the disclosed data as taxpayers are in developing and reporting it.

BACKGROUND

Announcement 2010-9 sought comments on a proposed change in the reporting requirements for certain business taxpayers' uncertain tax positions for the purpose of improving tax compliance and administration. Announcement 2010-9 stated that the IRS was developing a schedule which would be submitted by filers of Form 1120, or by other business taxpayers, with total assets in excess of $10 million if the taxpayer has one or more uncertain tax positions of the type required to be reported on the schedule. The announcement also requested responses to eight questions centering on implementation of a new disclosure schedule.

Announcement 2010-17 raised additional questions regarding the new disclosure schedule, the scope and implementation of the proposal to report UTPs, and the proposal's application to pass-through entities and tax-exempt organizations.

On April 19, 2010, in Announcement 2010-30, the IRS released the draft Schedule UTP, Uncertain Tax Position Statement, and accompanying draft instructions. Unlike Announcements 2010-9 and 2010-17, the draft Schedule UTP and instructions indicate that, initially, only taxpayers filing Forms 1120, 1120-F, 1120-L, or 1120-PC will be required to disclose uncertain tax positions on Schedule UTP. We commend the IRS for narrowing the initial universe of required filers and we strongly encourage it not to expand the requirement to partnerships, tax-exempt organizations, and other types of business taxpayers. As described below, we believe the IRS will meaningfully reduce overall taxpayer burden if it further narrows the scope of those required to file the Schedule UTP.

Lastly, if this proposal is implemented, we recommend that it be done with a specific sunset date, such as at the expiration of a three-year period. The IRS should commit to an analysis and public disclosure of the benefits and costs associated with the requirement to complete the Schedule UTP. Unless by the end of the sunset period the IRS can demonstrate clear and verifiable improvements in compliance or efficiency, the program should be eliminated.

POLICY COMMENTS

The Proposed UTP Disclosure Regime Has the Potential to Undercut the Integrity of the Financial Statement Process

The AICPA is concerned that management judgment that determines whether or not to establish a financial statement reserve for a particular tax position may be influenced by the Service's proposal to require disclosure of tax positions for which a financial statement reserve is recorded. To avoid such an outcome, we recommend that the Service consider basing criteria for disclosure solely on the technical merits of the tax position and not on whether the company has recorded a financial statement reserve.

We understand that this proposal would not change the underlying rules for financial reporting, but believe overlaying a tax disclosure construct on the financial reporting system introduces a dynamic which could work at cross purposes with the original and fundamental purpose of the financial reporting rules. The importance of reliable, transparent financial reporting should not be compromised as part of this IRS tax disclosure initiative. Basing disclosure solely on the technical merits of the position avoids this potential and allows the Service to focus its resources without affecting company decisions over which tax positions are reserved for financial statement purposes.

Basing disclosure on technical merits is also more compatible with the Service's stated commitment to its policy of restraint as it would clearly separate the Schedule UTP disclosure requirements from the more nuanced decisions made for financial reporting purposes and documented in the tax accrual workpapers. We believe requiring disclosure of positions based on the merits rather than on financial reporting will result in companies identifying the types of uncertain positions which the IRS says it needs to have in order to better achieve certainty, consistency and efficiency.

We believe that such an approach, when taken together with the Service's other initiatives, including the Schedule M-3, Form 8886 for Reportable Transactions, Form 5471, and the vast array of other e-filed information reports, will enable the Service to efficiently focus on companies' riskiest tax positions without all of the burden that will otherwise be associated with the proposal outlined in Announcement 2010-9.

The Proposed UTP Disclosure Regime Will Impose Increased Burdens and Costs on Taxpayers Which Will Be Substantially Disproportionate to Any Actual Benefit to the IRS

While the UTP proposal is based on the premise that taxpayers will merely transfer data from the financial statement to the new Schedule UTP, the actual process will be more complicated and burdensome. For some tax positions, the amount of the maximum tax adjustment is not readily available. The measurement process for accounting purposes often focuses on the expected tax benefit that is more likely than not to be sustained. If one outcome is more likely than not to be reached upon settlement, identifying all possible outcomes may not be relevant. While the draft instructions address some of the burdens and uncertainties in calculating the maximum tax adjustment, it still requires a new set of calculations beyond the calculations performed for financial statement purposes.

We also question why the Service has requested disclosure of tax positions where there is an administrative practice of accepting the tax position. Disclosure of these tax positions does not seem to be relevant for the Service's expressed objectives of determining where to focus its limited resources. If the Service is concerned that its agents have misunderstood IRS positions and incorrectly or inconsistently decided not to challenge certain positions, there are several more efficient ways of addressing this issue than to attempt to identify these issues as line-item taxpayer disclosures. Before imposing this disclosure requirement on all taxpayers, the IRS could enlist its agents along with industry and professional groups to help identify areas in which taxpayers believe the IRS has established an administrative practice to accept or decline to challenge certain positions. Given that the financial statement analysis often does not sharply focus on these types of administrative practices, the burden could be substantially mitigated if the IRS took this approach in lieu of the currently proposed requirement.

If the Service retains the concept of maximum tax adjustment and all the additional work that comes with the concept, we recommend that it at least allow taxpayers to report the results of the calculation in ranges. To require a specific amount for each item, as the draft schedule currently does, implies a misleading degree of precision. Furthermore, once the "maximum" number is determined, it will bear no accurate relationship to the actual risk of the position. On its face, many such calculations will often serve to mislead the IRS on the actual riskiness of the position, thereby almost certainly requiring extra work on the part of the taxpayer to ensure that the IRS does not misinterpret and misuse the data.

As detailed in our response to Question 5 posed in Announcement 2010-9, we recommend the following revisions, should the Service implement the UTP disclosure regime:

- Announcement 2010-9 states that the schedule will require the reporting of uncertain tax positions beyond those for which a reserve is required under FIN 48 or other accounting standards, for example, disclosures related to litigation of a position. The scope should be narrowed to exclude positions for which the taxpayer clearly has the intention of litigating.

- Notwithstanding Announcement 2010-9, the scope of the disclosure regime should not include any position for which the IRS has a general administrative practice of not examining a position (e.g., expensing of low-cost assets). To require reporting of these positions is contrary to the Service's position that such transactions or tax reporting is either immaterial in relation to the return or is not effective to pursue.

- Disclosure should not be required for those items that have an immaterial effect on the federal tax liability or are related to timing differences.

The Proposed UTP Disclosure Regime Will Adversely Impact the Roles of Taxpayers, Tax Advisors, and the IRS in the Self-Assessment System

Announcement 2010-9 has the potential to inject a new dynamic into the judgment exercised within the financial reporting process for tax uncertainties, particularly with respect to the

measurement of tax positions for which a company has reached the recognition standard under FIN 48 and therefore has concluded that its tax position has at least a more likely than not likelihood of confidence.

By relying upon financial reporting determinations to drive tax reporting requirements, certain potential consistency and fairness concerns arise, beginning most fundamentally with the differing potential treatment of U.S. generally accepted accounting principles (GAAP) filers as compared to International Financial Reporting Standards (IFRS) or other comprehensive basis of accounting (OCBOA) filers and extending to financial reporting judgments and considerations which vary even among companies within particular industries and of comparable scale.

Additionally, by requiring taxpayers and tax return preparers to essentially lay out potential audit issues on the disclosure form, concerns about abrogation of privilege become a significant issue. While we expect that privilege is actually invoked in a relatively small number of circumstances, it will still generate considerable contentiousness among and between clients, their auditors and their tax advisors and return preparers. Moreover, the differences in the precision with which uncertain tax positions are required to be reported under different accounting systems (e.g., U.S. GAAP, IFRS, "other country-GAAP") potentially creates artificial differences in the risk profile disclosed to the IRS. This will inevitably create frustration and a sense of unfairness for those who think their financial statement process disadvantages them relative to their peers and competitors. This tension has the potential to undermine the public's perception of fairness and consistency - two of the key drivers behind the IRS proposal.

The Proposed UTP Disclosure Regime Will Have a Disproportionate Impact on Small Businesses

Many small, privately held entities do not employ in-house personnel who have expertise in performing FIN 48 analyses and calculations. This situation will likely result in inadequate disclosures of required information on IRS-mandated disclosure forms unless these entities spend additional amounts to have an external advisor prepare the disclosures for them. Small taxpayers are especially concerned about the increased cost of both audits and tax return preparation. They are also very concerned that their "foot-faults" or inadvertent omissions will expose them to additional IRS liabilities and scrutiny that will increase the time and cost that they must devote to the new disclosure regime.

In this regard, the AICPA believes the $10 million asset threshold should be significantly elevated. We urge the adoption of a rule that would only apply the UTP reporting requirement to large taxpayers. We, therefore, recommend that a conjunctive test under which only taxpayers that had total assets of in excess of $50 million AND annual gross receipts in excess of $100 million be subject to this requirement. The Service used a similar conjunctive threshold when it established a method for distinguishing between large and small taxpayers for the simplified deduction method for the Section 199 deduction established by Treas. Reg. § 1.199-4(e).

Tax-Exempt Entities. We note with approval the exclusion of tax-exempt entities from the requirement to file a Schedule UTP for the 2010 tax year. We urge the permanent exclusion of tax-exempt entities from the filing requirement. As a broad principle, we think that these entities

should not be subject to any uncertain tax position disclosure regime as such entities are generally not subject to federal income taxation. In this context, we believe the associated compliance burdens on these entities would outweigh the relative benefits of such potential disclosure.

We also recognize that tax-exempt organizations could have an uncertain tax position to the extent the entity has unrelated business taxable income. Nevertheless, it is unclear how a tax-exempt entity should handle the situation when the organization is taking the position that an item is not unrelated business income and Form 990-T (Exempt Organization Business Income Tax Return) is not required to be filed. Under these circumstances, disclosure is currently being made on Form 990, Schedule D, Supplemental Financial Statements. Also, certain items for exempt organizations are based on reasonable estimates, such as overhead and Form 990-T expense allocations. We believe the IRS should include a standard of reasonableness, under which disclosure would not be required for items that represent reasonable estimates derived by the tax-exempt entity.

Pass-Through Entities. We also note with approval the exclusion of pass-though entities from the requirement to file a Schedule UTP for the 2010 tax year and urge the permanent exclusion of these entities from the filing requirement. These entities generally are not subject to federal income tax, and we believe the associated compliance burdens outweigh the relative benefits of potential disclosure. For example, because partnerships and most S corporations do not pay U.S. income tax, and in many instances the preparers of these returns will not know each owner's U.S. income tax rate, the pass-through entity would generally not be in the position to report an uncertain tax position's potential income tax effect. We recognize that pass-through entities (particularly partnerships) could have corporate partners or other partners/owners who may be required to conduct a FIN 48 analysis, and would support the requirement that such entities report to their affected partners the information required for those partners to fulfill their UTP reporting responsibilities on their returns.

If, notwithstanding our recommendation above, partnerships are included in the uncertain tax position disclosure regime, then it is critical that the IRS implement procedures enabling partnerships to timely report any uncertain tax positions to the partners, thereby ensuring that the partners are potentially able to report such positions timely on their tax returns.

The Proposed UTP Disclosure Regime Calls for Taxpayer Reporting at a Higher Level Than Mandated by Congress

We think it is unwise for the IRS, without a change in law or regulation, to set the disclosure bar for a filing position for tax purposes at a higher level than enacted by Congress. Requirements for the disclosure of tax return positions already exist.

The Internal Revenue Code (IRC) generally requires disclosure of tax return positions in those circumstances when the taxpayer does not have "substantial authority" for the position. Specifically, section 6662 imposes a 20 percent penalty on any portion of a taxpayer's underpayment of tax attributable to any substantial understatement of tax due to negligence,

substantial underpayments of income tax, and valuation misstatements; or substantial overstatement of pension liability. In the context of section 6662, generally if the taxpayer does not have "substantial authority" for a position, to avoid the accuracy-related penalty, the position would have to be adequately disclosed on the return, such as on Form 8275 or 8275-R. On the other hand, the "more likely than not" (MLTN) standard (discussed immediately below) reflects a greater than 50 percent likelihood of prevailing on the merits of a tax position recorded on a tax return. Section 6694 sets forth similar requirements for tax return preparers.

Announcement 2010-9 would require taxpayers to disclose uncertain tax positions on a new schedule regarding positions that are considered reportable under FIN 48 for financial accounting purposes or other generally accepted accounting principles (including IFRS and country-specific generally accepted accounting standards). Under FIN 48, the taxpayer is required to assess whether an income tax return position would more likely than not (MLTN) withstand challenge by the IRS; if the tax position does not (in the judgment of the business) have a MLTN potential of withstanding such an IRS challenge, the company is required to disclose the position as an uncertain tax position on its financial statements. Thus, assuming we are not referring to a reportable transaction, the IRS' proposed uncertain tax positions disclosure regime would impose a higher reporting standard than is required under the Internal Revenue Code (which requires a reporting standard of substantial authority for items not associated with tax shelters).

While the announcement states that the proposal only requires the disclosure of uncertain tax positions on the tax return, it also strongly emphasizes the Service's right to compel the production of the taxpayer's risk assessments or tax reserve amounts (through the release of the tax accrual work papers) by issuance of a summons as authorized by the case of *United States v. Arthur Young*, 465 U.S. 805 (1984).

In describing the impact of the *Arthur Young* case at a 2007 tax conference, former Commissioner Larry Gibbs stated:[1]

> My recollection of what happened after *Arthur Young* was that many companies began to explore the possibility of using lawyers to deal with tax reserves. And I think that the concern that arose over that caused the SEC to contact the IRS. And I think it was something that [Commissioner] Roscoe Egger understood very well, and it is what led to the current policy of restraint on tax accrual work papers.
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> If we get to the point where the legal profession and the accounting profession start squabbling with one another again, then it's going to be most interesting…And the tensions that puts on having more disclosure, more transparency with respect to things, for example, in the tax reserve…and I think it's in everybody's best interest to kind of back off, take a deep breath, and look at where we are, before we start getting into things that I think can lead all of us to a much more difficult planet.

[1] 2007 Tax Analysts Conference, Key Issues in Tax Policy: Effective Tax Administration and Transparency: What Lessons Can Be Learned From Changes Made in the IRS Large and Midsize Business Division and What Improvements Can Be Made?, Tax Analysts, Washington, DC, April 13, 2007, page 22.

Announcement 2010-9 has the potential to alter the relationship between external auditors and accountants and their clients by further imposing concerns about privilege to matters that should receive robust consideration in the context of financial statement disclosure, thereby having the potential of reducing transparency to investors and the financial markets. This impacts the delicate balance, struck by the deliberations over FIN 48, between the concern for accurate and transparent financial reporting and prejudicing the business affairs of a corporation.

The IRS Should Optimize Its Use of Current Taxpayer Information Reporting Before Implementing the UTP Disclosure Regime

While the AICPA has provided detailed responses to the questions raised by Announcements 2010-9 and 2010-17 (as found below), our comments in this section provide suggestions relating to alternative methods of disclosure to the procedures detailed in the announcement. In this context, we recognize that the stated rationale of Announcement 2010-9 is (1) to help the IRS focus its examination resources on returns with specific uncertain tax issues and issues of sufficient magnitude to warrant inquiry, and (2) to enable the Service's examination teams to identify issues more quickly and efficiently.

We believe alternative disclosure regimes can provide the IRS much of the insight it seeks at a fraction of the cost associated with the proposal defined in Announcement 2010-9. First, IRC section 6662 currently requires disclosure for return positions not at the "substantial authority" level. Many tax professionals believe the Service has done little to evaluate the disclosures which it currently receives. At a minimum, it is premature to superimpose a significantly more comprehensive and cumbersome new system before the IRS has demonstrated any commitment to the systematic use of disclosures it already possesses - including those that come with the IRC section 6011 requirements and the Schedule M-3.

Because of the forgoing concerns, we recommend that the UTP proposal be postponed. However, if postponement is not granted, we encourage the IRS to at least pilot this new regime and reserve judgment about its expansion until it has the opportunity to thoroughly evaluate both the intended and unintended consequences of the new process on the larger taxpayer community.

QUESTIONS RAISED IN ANNOUNCEMENT 2010-9

Announcement 2010-9 requested comments on eight questions. Notwithstanding our policy concerns expressed above, we now turn our attention to those questions.

Question 1: How the maximum tax adjustment should be reflected on the schedule so that it provides the Service with an objective and quantifiable measure of each reported tax position (e.g., specific dollar amount or by appropriate dollar ranges)?

The Announcement indicates that the new schedule is intended to "aid the Service in focusing its examination resources on returns that contain specific uncertain tax positions that are of particular interest or of sufficient magnitude to warrant Service inquiry." Hence, disclosure of the maximum amount of potential federal tax liability for each uncertain tax position is to enable

the Service to gauge the "magnitude" of the tax position in order to determine where to focus its attention.

Neither the amount of the reserve nor the maximum potential federal tax adjustment is critical for determining the magnitude of the position. Under the proposal, taxpayers would list for each uncertain tax position (except for transfer pricing and valuation positions) the entire amount of U.S. federal income tax that would be due if the position were disallowed in its entirety on audit. The amount is further defined as the maximum tax adjustment for the position reflecting all changes to items of income, gain, loss, deduction, or credit if the position is not sustained. As the purpose for the amount is to obtain information about the magnitude of the issue, identifying the range of the federal income tax benefit of the tax position should be sufficient for the Service to identify and prioritize where to focus its attention. The form could specify predetermined dollar ranges. These ranges could be as few or as many as the Service determines it needs to allocate resources. To illustrate, taxpayers could be asked to identify if the tax position is: (1) $1 million or below, (2) greater than $1 million and less than or equal to $10 million, (3) greater than $10 million and less than or equal to $100 million, and (4) greater than $100 million.

If one of the purposes of disclosure is to assess the magnitude of the position, taxpayers could identify for each uncertain tax position the applicable range that the tax benefit of the position falls within. We recommend that the amount be "bucketed" based on a relatively simple determination of the estimated tax benefit of the position. For many positions, this will be a straightforward computation. For some tax positions where there are multiple possible outcomes, there could be very low probability extremes that the taxpayer may not have even considered in assessing its financial statement risk.

In order to mitigate the burden of the disclosure statement on taxpayers, the Service should allow taxpayers to use a reasonable estimate of the benefit of the tax position in determining the applicable range and not require taxpayers to perform additional studies or calculations to identify the worst case (i.e., maximum amount) solely for purposes of the disclosure statement.

The Service should clarify whether taxpayers are required to disclose uncertain tax positions in connection with returns filed with other tax jurisdictions that could have an effect on U.S. federal tax liability (e.g., a non-U.S. withholding tax exposure may result in a future U.S. foreign tax credit benefit). We recommend that the Service only require disclosure of uncertain tax positions on federal income tax returns. Disclosure of tax positions related to other jurisdictions would not facilitate the stated objective of determining where the Service should focus its efforts.

Question 2: What alternative methods of disclosure of the amount at issue would allow the Service to identify the relative importance of the uncertain tax positions?

There are a number of alternative methods that the Service could consider for determining the relative importance of the uncertain tax positions. In addition to the concerns about maximum tax adjustment discussed under Question 1, another issue is that the maximum tax adjustment does not consider the level of risk associated with the tax position. Hence, the maximum tax adjustment could lead the IRS to focus on tax positions where there is the potential for a large

adjustment and yet a very low probability that the large adjustment will occur. This would not improve examination efficiency.

A number of alternative methods of disclosure should be considered. First, consideration should be given to requiring only a description of the issues, listed in order of magnitude, without amounts. The IRS could extend the concept adopted for transfer pricing and valuations and require taxpayers to list their uncertain tax positions in order of magnitude which would provide the Service with an indication of the relative materiality of the issues. A list of issues without amounts provides a basis for risk assessment based on the nature of the issue and will promote issue-driven audits.

Another alternative method would be to collect information about uncertain tax positions on Schedule M-3. In lieu of the proposed Schedule UTP, taxpayers could identify information reported on the Schedule M-3 that corresponds to an uncertain tax position and the form could be expanded to collect the other requested information. Taxpayers are already providing information that should be factored into the audit selection criteria (i.e., reportable transactions, substantial understatements and book-tax difference detail). Consideration should be given to aligning this information and making one integrated request.

For taxpayers that are under continual audit, their returns are examined regardless of the information provided on the schedule. Hence, consideration should be given to exempting these taxpayers from providing the information with their returns as the data is not used for return selection. Rather, for taxpayers under continuous audit, collecting the description of issues at the opening conference for the year under examination could meet the Service's objective.

Taxpayers that are part of the Compliance Assurance Program (CAP) have, by virtue of their acceptance into the program, agreed to a level of transparency with respect to potential tax return positions. Inasmuch as the program itself requires contemporaneous disclosure of all significant tax positions and a post-CAP affirmation that all material positions have been addressed, we urge the Service to exempt CAP taxpayers from the requirement to prepare the schedule.

<u>Question 3:</u> Whether the calculation of the maximum tax adjustment should relate solely to the tax period for which the return is filed or to all tax periods to which the position relates, and whether net operating losses or excess credits should be taken into account in determining the maximum tax adjustment?

It is important to balance the IRS' need for information with the burden being placed on most taxpayers when providing that information. The stated purpose of the proposed schedule is to permit the IRS to determine the most effective and efficient deployment of audit resources. In order to accomplish this objective, the following alternative disclosure regimes should be considered:

1. Report the adjustment based on the highest applicable tax rate applied to the total of all adjustments included in taxable income for the year. Temporary differences should not be subject to reporting to permit focusing on permanent items representing potential leakage in the tax system.

2. Permit taxpayers to report the actual amount of financial statement reserves in lieu of making other disclosures and completing the form. This approach may be preferable for taxpayers with limited reserves, subject to reporting only one specific issue, or having limited resources to complete the schedule.

Question 4: How the related entity rules should be applied?

Announcement 2010-9 states:

> In addition to those positions for which a tax reserve must be established under FIN 48 or other accounting standards, uncertain tax positions will include any position related to the determination of any United States federal income tax liability for which a taxpayer or a related entity has not recorded a tax reserve because (i) the taxpayer expects to litigate the position, or (ii) the taxpayer has determined that the Service has a general administrative practice not to examine the position. For this purpose, a related entity is any entity that is related to the taxpayer under sections 267(b), 318(a), or 707(b).

The draft UTP instructions clarify that a corporation related to another corporation because of the application of section 267(b)(3), should not be required to report the other corporation's uncertain tax position, unless the corporations are part of an affiliated group of corporations as defined within section 1504 and are included in a single consolidated tax return. In that case, a single Schedule UTP should be filed as clarified in Announcement 2010-30.

Announcement 2010-17 subsequently requested comments on "how uncertain tax positions should be reported in various related entity contexts, such as how members of a consolidated group for financial statement or tax return purposes or entities that are disregarded for federal tax purposes should report uncertain tax positions?"

As mentioned above, in the case of a consolidated return, the parent corporation should report all uncertain tax positions of the group, including positions related to intercompany transactions. If an uncertain tax position relates to activity of a subsidiary before entering the consolidated tax return, the parent should include this position in the consolidated group report if the position could affect the federal tax liability of the consolidated group. If a subsidiary ceases to be a member of the consolidated group, an uncertain tax position of the subsidiary should be reported by the parent even after the subsidiary ceases to be a member of the group if the position could affect the federal tax liability of the group.

Pass-through Entities. Where a corporation owns a direct interest in a partnership meeting the requirements of section 707(b), the corporation will already have identified and reported the UTP on its financial statements whether or not it is included in a consolidated financial statement. Schedule UTP contemplates the inclusion of these UTPs (See Column D of Parts I and II of Schedule UTP). If a partnership is indirectly related to a corporation as defined by section 707(b), any UTP of the partnership should only be reported on Schedule UTP if it is included in a financial statement that includes both the corporation and partnership. If a partnership's UTP is included on a financial statement that includes the corporation, the corporate partner should

include the proportionate share (direct or indirect) of the partnership's threshold amounts based upon the corporate partner's interest in the partnership to determine if the reporting threshold is met. The corporate partner will then determine if the position requires disclosure. The corporation's determination of whether disclosure is necessary would take into account any offsetting amounts at the corporate level that would offset the amount reported.

With respect to disregarded entities, and generally consistent with the treatment of these entities for federal tax purposes, the entities should be included with the corporate owner and any uncertain position of the entity should be reported by the corporation.

Rather than expanding upon the number of entities reporting to the government, a partnership related to a corporation as defined within section 707(b) should report to the affected partner the gross amount of the uncertain position attributable to that partner's interest in the uncertain position along with a description consistent with that called for in the announcement. The partnership should likewise report to the corporate partner its proportionate share of the partnership's threshold amounts based upon the corporate partner's interest in the partnership. The corporate partner will then determine if the position requires disclosure. The corporation's determination of whether disclosure is necessary would take into account any offsetting amounts at the corporate level that would offset the amount reported.

Question 5: Whether the scope of the Announcement should be modified regarding the uncertain tax positions for which information is required to be reported (e.g., positions for which no tax reserve has been established because the taxpayer determined the Service has a general administrative practice not to examine the position)?

The announcement should be modified such that it is clearly understood that the schedule only requires the disclosure of uncertain tax positions directly related to U.S. federal tax liabilities. In the scope paragraph of the announcement, the Service uses the phrase "...relating to uncertain tax positions involving United States federal income tax." (Emphasis added.) However, in other comments the announcement states that a taxpayer will have to "provide information about their uncertain tax positions that affect their United States federal income tax liability." (Emphasis added.) Uncertain tax positions can relate to international and state income tax matters. These transactions or positions could "affect" a taxpayer's federal income tax liability. The announcement should clearly state that it applies only to those positions that directly involve federal income tax.

The announcement states that the schedule will require the reporting of uncertain tax positions beyond those for which a reserve is required under FIN 48 or other accounting standards. An example is provided related to litigation of a position. The scope should be modified to exclude positions for which the taxpayer clearly has the intention of litigating. Disclosures in this category would potentially reveal the taxpayer's risk and litigation analysis which is inconsistent with the Service's stated policy of restraint.

Question 5 triggers another modification that we believe is warranted. The scope of the disclosure regime should not include any position for which the IRS has a general administrative practice of not examining a position (e.g., expensing of low-cost assets). To require reporting of

these positions would appear to be contrary to the Service's position that such transactions or tax reporting is either immaterial in relation to the return or is not effective to pursue. As suggested in our comments above, there are significantly less costly and burdensome ways to discern this insight, to the extent the IRS wants to gain a better understanding of the administrative practices to which it and its agents have contributed.

Question 6: **Whether transition rules should be used or criteria modified to either include or exclude certain businesses *(sic)* taxpayers (e.g., the proposed threshold of $10 million total assets)?**

The currently proposed threshold ($10 million in total assets) is too low. Furthermore, the announcement's ultimate scope (i.e., the potential that business returns, other than Form 1120, might be covered by the announcement at a later date – such as pass-through returns) creates the likelihood that a significant and unwarranted burden will fall upon entities that represent low tax avoidance risk.

The IRS already has at its disposal several years of collected disclosures (e.g., reportable transactions; Schedules M-3 and related schedules; and Forms 8275). Taxpayers have put significant time and effort into providing these disclosures. Based upon this considerable information, the IRS ought to be able to craft a more precise disclosure requirement that would compel taxpayers to disclose the types of transactions the IRS feels represent true tax avoidance risk. We recommend the IRS consider this alternative to the overly broad proposed requirement described within the announcement.

The current threshold amount needs to be increased, as was discussed above, to at least $50 million in assets. An alternative and preferable disclosure trigger would be to combine asset size with annual revenues. As described in more detail above, we recommend a conjunctive test under which only taxpayers that had total assets in excess of $50 million AND annual gross receipts in excess of $100 million be subject to the UTP reporting requirement.

Form 1120-F Filers and Schedule UTP

If Form 1120 filers are to be required to file Schedule UTP, we agree that, for fairness, Form 1120-F filers also should be subject to the requirement. There currently is uncertainty, however, regarding how the proposed $10 million asset threshold would apply to Form 1120-F filers. The draft instructions provide that Form 1120-F filers should meet the $10 million asset threshold if "the higher of the beginning or end of year total assets amounts reported on Schedule L of Form 1120-F . . . is at least $10 million." There are two ambiguities regarding the application of this threshold to Form 1120-F filers.

The first ambiguity relates to whether the asset threshold applies based on a foreign filer's U.S. or worldwide assets. For ease of reporting, Form 1120-F filers are given the option of reporting the balance sheet on Schedule L in terms of either worldwide assets or U.S. assets. The AICPA recommends that, regardless of whether a foreign filer chooses to complete Schedule L based on its U.S. or worldwide assets, foreign filers with U.S. assets of less than $10 million should not be required to file Schedule UTP. Foreign filers with small U.S. businesses will face the same

challenges completing the schedule as other small businesses, and the fact that a foreign filer has substantial non-U.S. assets is not relevant to the materiality of its U.S. tax exposures. Moreover, it would be onerous to require foreign filers to prepare a separate balance sheet for its U.S. business in order to have the lower threshold apply. At the most, application of a U.S. asset threshold for filing the Schedule UTP might warrant requiring foreign filers that report a worldwide balance sheet on Schedule L to also report their gross U.S. assets as of the beginning and end of the taxable year.

The second ambiguity relates to how to deal with foreign companies that file 1120-F "protective returns." For example, a foreign corporation may believe that its U.S. activities more likely than not do not rise to the level of a trade or business or a permanent establishment under a relevant U.S. tax treaty, but nonetheless records a reserve on its foreign books for a small potential tax risk for U.S. corporate income tax. In order to protect its right to claim expenses, the foreign corporation should protectively file a Form 1120-F that reports no gross receipts subject to U.S. tax.

A taxpayer that completes Schedule L based on its U.S. assets is required to include all assets used in the United States and all other assets used in connection with a U.S. trade or business. For Form 1120-F filers, and in particular, for protective filers, whether any of the taxpayer's assets are in this latter category may itself turn on an uncertain tax position. In order to avoid this interaction and to keep the $10 million threshold consistent and objective, the AICPA recommends that, for purposes of applying the threshold to Form 1120-F filers, U.S. assets should be defined only with reference to assets located in the United States.

In addition, in order to avoid significant burdens on Form 1120-F protective filers, the AICPA recommends that protective filers that meet the asset threshold, however determined, and therefore are required to complete the schedule, should only be required to report any uncertain tax positions that go to the threshold question of whether they have a U.S. permanent establishment or trade or business, since, in general, the Service would have to examine this position before any other possible U.S. uncertain tax positions would become relevant.

<u>Question 7:</u> How the new schedule should address taxpayers that initially did not record a reserve for an issue, but in later years do record a reserve?

This question relates specifically to an item for which a reserve is later provided, which could arise either because a reserve was not required in a prior year (due to a change in facts, etc.) or because a taxpayer should have recorded a reserve in an earlier year but the reserve was somehow omitted. Subsequent changes resulting from the evaluation of new information should be treated differently than a new evaluation or new interpretation of information available at the time of preparing the previous schedule. Notwithstanding our recommendations of more comprehensive changes in the proposal, we think the draft instructions deal adequately with this issue.

<u>Question 8:</u> Whether the list of information proposed to be included should be modified, including whether certain information should be requested in some circumstances upon examination rather than with tax return?

The concept of maximum tax exposure is addressed elsewhere in these comments and represents numerous inherent deficiencies. We urge the Service to allow taxpayers to report their total maximum tax adjustment either as an aggregate absolute number or as an aggregate number that falls within a range. If the government wants any additional information associated with the "maximum adjustment," we recommend it have the taxpayer identify the types of positions included within the maximum adjustment, but only require specific per-position measurement data upon audit.

As currently proposed, the Schedule UTP would require "[t]he rationale for the position and a concise general statement of the reasons for determining that the position is an uncertain tax position." We do not believe either of these statements should be required as part of the initial submission. Both require subjective evaluation and expression that would be extraordinarily difficult to capture in a way that the government could expect to receive with the Schedule UTP. We acknowledge the IRS attempts to clarify this issue through the three examples contained in the draft instructions. While these examples infer some additional calibration for what the IRS would consider adequately "concise," much ambiguity remains about what precisely would be required in order to make an adequate disclosure. Absent consistency in the data and its meaning, the IRS will be unable to effectively sort by this information. Therefore, we believe the IRS should only request the "rationale for the positions" and "the reasons for determining…the [uncertain] position…," upon its selection of the taxpayer for examination.

QUESTIONS RAISED IN ANNOUNCEMENT 2010-17

Announcement 2010-17 requested comments on three questions, as detailed below.

Question 1: Do the disclosures required by the new schedule duplicate those required by other forms, thus making forms, such as the Form 8275 and 8275-R, unnecessary or redundant in some circumstances?

There are a number of forms or schedules that the Service requires taxpayers to utilize for varying reasons for disclosure purposes. These include Schedule M-3 for corporate, partnership, and S corporation taxpayers, Form 8886 for reportable transactions, the Form 8275 disclosure statement, and the Form 8275-R regulation disclosure statement. We are concerned that the IRS is not currently utilizing these disclosure statements sufficiently; effective use of these forms and schedules would alleviate the need for triggering the disclosure of (in many cases) the same information which would likely be disclosed under a proposed uncertain tax position disclosure statement.

If the IRS made better use of the array of disclosure forms and schedules currently required by the Service (without reliance on a new uncertain tax position disclosure regime), it could significantly mitigate needless and burdensome influences on decisions made for financial reporting purposes and reduce unnecessary friction between companies and their auditors.

One alternative is to collect information about uncertain tax positions on Schedule M-3. In this context, the taxpayer could identify information reported on Schedule M-3 that corresponds to an uncertain tax position, and the Schedule M-3 could be expanded to collect other requested information. Our suggestion about an expanded Schedule M-3 is conceptually similar to the premise posed by this Question 1 of Announcement 2010-17. Our response to Question 3 under Announcement 2010-9 suggests that taxpayers are already providing information that should be factored into the audit selection criteria (i.e., reportable transactions, substantial understatement and book tax differences detail); and thus, consideration should be given to aligning this information into one integrated request, again dovetailing with the premise of Question 1 of Announcement 2010-17.

Question 2: What type of uncertain tax positions should be reported by pass-through entities and tax-exempt entities?

For the reasons detailed above, we recommend that as a broad principle, pass-through entities and tax-exempt entities should not be subject to any uncertain tax position disclosure regime as such entities are generally not subject to federal income taxation. In this context, we believe the associated compliance burdens on these entities would outweigh the relative benefits of such potential disclosure.

Question 3: How uncertain tax positions should be reported in various related entity contexts, such as how members of a consolidated group for financial statement or tax return purposes or entities that are disregarded for federal tax purposes should report uncertain tax positions?

This question is covered by our response to question 4 of Announcement 2010-9, as provided above.

SUMMARY

We appreciate the opportunity to comment on the proposed new disclosure regime. As reflected in our comments above, we believe the proposal is misguided in several respects. We clearly support the overarching goals of certainty, consistency and efficiency, but believe this proposed disclosure process has the very distinct potential of injecting a quotient of burden, complexity and uncertainty which will outweigh the projected benefits. Taxpayers already confront a daunting challenge in the complexity of the tax code and the regulations that define their reporting and return preparation responsibilities. These proposed new disclosure requirements will fall heavily on a universe of taxpayers already challenged to timely meet the far-reaching demands of both the financial statement and tax return processes. Any additional burden ought to come only after the most careful analysis of benefits and burdens. To that end, we respectfully encourage the IRS to withdraw the UTP proposal in order to focus its attention and resources on the disclosed information it already possesses. At the very least, the Service should recast its proposal to affect fewer taxpayers while fundamentally re-thinking the most burdensome and onerous aspects of the current proposal, including the concept of maximum tax adjustment and the requirement to disclose positions the proposal identifies as uncertainties

related to the intention to litigate or an IRS administrative practice. Finally, a sunset period, such as three years, would allow the IRS sufficient time to analyze the benefits and costs associated with the program and to disclose this information to the public.