INTERNAL REVENUE SERVICE

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PREPARED REMARKS OF COMMISSIONER OF INTERNAL REVENUE DOUGLAS H. SHULMAN BEFORE THE 2009 NATIONAL ASSOCIATION OF CORPORATE DIRECTORS CORPORATE GOVERNANCE CONFERENCE WASHINGTON, DC OCTOBER 19, 2009

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WASHINGTON — Thank you for that warm introduction and welcome.

I realize that the IRS Commissioner has not customarily addressed the NACD's corporate governance conference…but what I want to discuss with you this afternoon is the important role that boards of directors can play in overseeing tax risk and tax strategies of corporations. After all, taxes are one of the biggest expenses of a corporation, so how they are managed is very important to most corporations.

Clearly, corporate boards of directors play an incredibly important role in the vibrancy of businesses and our economy. Boards are a source of creative ideas, strategic thinking, and, importantly, governance and oversight. Boards hold management accountable, and in that role, understanding the risk posture of the company is critically important.

So today, I want to share with you some observations of what I have seen since I've taken the helm of the organization responsible for collecting 96% of all federal receipts – around $2.5 trillion.

To begin, I understand that many of you – actually most of you – are not tax experts and you were not installed on the board because of your tax expertise. You bring other critical skills, experiences and expertise to the boardroom.

And I also understand that even with all of your sophistication, expertise and experience in business and financial affairs, it's difficult to understand the tax consequences of a complicated business transaction, such as a tax-free reorganization or a hedging transaction, let alone the corporation's overall tax profile as it relates to federal, state and international taxes. That's why you need to have strong tax departments and outside tax advisors. After all, you have finance experts to help you understand the economic value of hedging transactions, and you need tax experts to help you understand the myriad and complex tax issues facing your company.

Now, my motivation to create this dialogue with you is based in part on personal and professional experience. I moved from the business world where I interacted with boards… to FINRA, the largest independent securities regulator in the U.S. ….to the IRS, where I am focusing on major trends, such as the globalization of tax administration, and innovative ways to strengthen and improve our tax system. In all of these roles, I have seen the importance of board oversight of major areas of risk.

So, I know first hand that in the post-Sarbanes Oxley world, corporations have invested significant time and resources on compliance issues and internal controls. In the tax arena, some have instituted regular meetings between the Audit Committee and the tax director to ensure an open dialogue.

As I mentioned earlier, tax issues should remain on your radar screen – and for good reason. It's one of the biggest expenses on your income statement. In addition, a number of public companies have reported material weaknesses in internal controls related to taxes. Tax strategies can also present a financial and restatement risk, and sometimes when the cases are high profile, a significant risk to corporate reputations. In today's business climate, the general public has little tolerance for overly aggressive tax planning that can be viewed as corporations playing tax games.

So, although the complexity of the tax code may make your eyes glaze over, Board members – like you –are critically important to making sure that the tax system works well and is worthy of the confidence of the American people.

But how can you increase your oversight of tax compliance given the limited amount of time you have available and the competing business issues you face?

Well, you probably know or could figure out, that the IRS conducts risk assessments of its own when determining how to use its time and resources and whom to audit. Similarly, the board of directors can assess its corporation's tax risk profile, internal controls, and relationship with its corporate tax department, to help determine the tax matters of which it should be aware.

Now, we recognize that many businesses are trying to get it right. Positions taken in tax returns may be well-grounded and taken in good faith. Other tax positions taken may be more aggressive and use elaborately structured transactions or arrangements to push tax planning up to the edge, or beyond acceptable bounds.

Enter FIN 48, which establishes the financial statement accounting for uncertain tax positions, including recognizing and measuring their effect on financial statements.

Under FIN 48, companies must identify their material uncertain tax positions. They must quantify the company's maximum exposure and estimated likelihood of winning or losing the issue if challenged by the IRS. And they must record as a liability a specified amount of money relating to these uncertain tax positions. In other words, FIN 48 is a very significant window into tax risk, liability and management in your company.

FIN 48 paints a picture of tax risk by indicating how much money a corporation has to book in tax reserves to reflect the risk should one or more of its tax positions go south.

But let’s get behind the reserve numbers for a moment. What are they telling you – the board directors – beyond the dollars in the tax reserve?

They’re saying that the audit committee needs to know and influence what tax posture the tax planners are taking. They and you need to know whether that multi-million – or in some cases multi-billon-dollar bet – you and your company are making could be too aggressive and therefore risky.

So where does that bring us? What are the next steps?

Before I get to that, I want to be clear about what I “do” intend and “don’t” intend in this dialogue.

We don’t intend to second-guess legitimate and thoughtful business decision-making by corporate leaders. And we don’t expect that you will always agree with us on identifying and quantifying the risk of various tax positions. But we do want to engage corporate leaders about their roles and responsibilities in conducting appropriate assessment and oversight of tax risk.

I am suggesting that you, the leaders of your organizations, should have a mechanism to oversee tax risk as part of your governance process. For example you might want to:

- Set a threshold confidence level for taking a tax position…

- Discourage or eliminate opinion shopping by tax departments by having an independent tax firm, which has some direct dialogue with the board of directors, review major tax positions …

- Specifically address transfer pricing and the relative profit allocated to low-tax jurisdictions, and make sure they reflect real economic contributions made in those jurisdictions.

And diving down a little deeper, here are some questions you might ask of your tax director and your external auditors relating to FIN 48:

- What was the process for identifying uncertain tax positions and how do you know all material issues have been identified?

- How did you go about determining the maximum tax exposure relating to each uncertain tax position? What makes you comfortable that it accurately reflects your maximum exposure?

- How did you go about quantifying the likelihood of winning or losing uncertain tax positions? Do you plan to litigate the issue if the IRS challenges the position? Does the external auditor or tax advisor agree with the tax director’s assessment?

- Could the company be subject to potential penalties, such as for underpayment of tax, negligence or worse? If so, are they appropriately recorded, and perhaps more important, what does this say about how aggressive the company's position is regarding those issues?

There are already some IRS programs in place that help provide greater certainty and can give a board more comfort that there won't be second guessing down the road. For example, our compliance assurance program, or CAP where we agree on issues with the taxpayer before a corporate return is filed, envisions full disclosure by the taxpayer in exchange for real time tax certainty. And the Advance Pricing Agreement program, where we agree with a taxpayer on pricing methodology before a return is filed, provides certainty in the complex and uncertain area of transfer pricing.

Now, we're not the only government thinking about the notion that corporate taxpayers that employ sound management and governance practices on tax matters are more likely to be compliant.

One example is Australia. The Australian Tax Office publishes a *Governance Guide for Board Members and Directors* that suggests useful questions – similar to the ones I just posed – that a corporate director can ask of management.

Some of the Australian Tax Office's questions include: Is there a material difference between the losses reported for accounting purposes and the losses claimed for tax purposes? If so, can the difference be satisfactorily explained? Is the structure and financing for your business or a major transaction complicated, perhaps more complex than necessary to achieve the commercial objectives? These questions give you a flavor of what some other countries are thinking about and doing in the corporate governance area.

On a broader scale, the Organisation for Economic Co-operation and Development has charted a worldwide trend of increased boardroom attention to issues of taxation. A recent guidance document outlines good corporate governance principals in relation to tax, based on advice from governments around the world.

In summary, my main observation to share with you is this: Taxes are an important expense, and like any important expense, management responsible will try to control it. In the case of taxes, controlling it can expose the company to challenge, which can result in reputational damage and perhaps large, unexpected expenses. So you need to understand how management controls this expense and how it decides how aggressive to be. You also need to be certain that reporting is effective.

Tax expense in this sense is no different from other expenses. Manage it too loosely and you give up profit. Manage it too aggressively and there are bad consequences. You, the board, have to oversee how management manages it. That means some level of understanding, a set of policy principles and then a control system of reporting that assures you that the policy is being carried out.

My goal here today was to start a discussion about the board of directors' role in overseeing tax risk. I encourage you to have the dialogue, and offer the IRS as a resource as you continue to evolve your thinking about this topic. At the end of the day, my proposition is that the board needs to have the tools, not to do tax planning, but to oversee tax strategies and risks.

I see my time is up today. I hope it was a good start and that this beneficial dialogue will continue and mature in the weeks and months ahead. Thank you.

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