

**INTERNAL REVENUE SERVICE
ADVISORY COUNCIL**

**LARGE BUSINESS AND INTERNATIONAL
SUBGROUP REPORT**

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INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC Large Business & International Subgroup (hereafter “Subgroup”) is comprised of seven tax professionals with diverse backgrounds including experience in large corporate tax departments, large public accounting and law firms, and academia. These diverse experiences make the Subgroup uniquely qualified to provide LB&I valuable insight on a broad range of issues. We have been honored to serve on the IRS Advisory Council and appreciate the opportunity to submit this report.

The Subgroup has had the opportunity to discuss several topics throughout the year with LB&I management. This report is a summary of those discussions and the Subgroup’s recommendations with respect to each topic. We would like to thank LB&I Commissioner Heather Malloy and the professionals on her staff for their time spent discussing these topics with the Subgroup and for their valuable input and feedback.

The Subgroup is reporting on the following six issues:

1. Remote Work

With respect to remote work, LB&I asked the Subgroup for its views on how the IRS’ use of remote work concepts can be expanded and improved to more efficiently deploy the Service’s limited resources. Significant cost and time savings can be gained through expanding the use of remote work in LB&I audits. The Subgroup believes LB&I could benefit greatly from working with large accounting firms to understand how those firms employ remote work concepts in performing audits of their largest multinational clients.

2. Commercial Awareness

LB&I asked for the Subgroup’s assistance in identifying ways LB&I may gain greater commercial awareness, an issue has been addressed in prior years’ reports. This year’s

report is largely a refinement of our previous discussions and contains several specific recommendations regarding education and training the Subgroup believes would increase commercial awareness within LB&I. These include employee initiated education, and both formal and informal training programs developed with the assistance of taxpayer groups.

3. **Schedule UTP**

The Schedule UTP discussions have been an extension of the Subgroup's work last year, including a follow up on last year's recommendations, a discussion of the guidance that has been issued this year through frequently asked questions ("FAQs"), and the Subgroup's suggestions for additional guidance in the form of new FAQs or clarifications of those already published. In particular, the Subgroup recommends that any future guidance be vetted in draft form with taxpayer groups to ensure such guidance aligns with the accounting rules and practices followed by taxpayers.

4. **Distance Learning**

Regarding distance learning, the Subgroup was asked to provide advice as to how distance learning methods employed by the Service may be improved. The report offers insights based on the advancements members have seen in the marketplace in the use and deployment of distance learning methodologies, and contains several specific recommended actions for LB&I to follow in the adoption and maintenance the latest distance learning methodologies and technologies.

5. **Fast Track Settlement**

With respect to the Fast Track Settlement process ("FTS"), LB&I requested our insights regarding expanding usage in order to facilitate earlier resolution of issues and to

assist in managing the workload of IRS Appeals. The Service has had some success this year by focusing on increased communication with taxpayers regarding the benefits of FTS. However, the Subgroup believes that the FTS process should be redesigned and improved to gain greater acceptance within both the Service and the taxpayer community. Recommendations include adoption of a more regimented, step by step, framework for conducting mediation sessions and expanded authority for case managers within the context of FTS.

6. **Use of Academic Research**

Our report notes that the academic community produces a substantial amount of research on topics that are of little use outside of academia. This mandated research represents a potential free resource for the IRS. The Subgroup suggests that the IRS consider taking advantage of this research activity by providing suggestions to academia for research on topics of interest to the IRS.

ISSUE ONE: REMOTE WORK

Executive Summary

Expanding the use of “remote work” for IRS examinations and projects offers many benefits to both the IRS and taxpayers. The IRS has for many years used remote work concepts for deploying its international and engineering specialists on large examinations as an adjunct to a larger onsite examination. In 2006, the IRS expanded the use of remote/offsite examinations as an alternative to the full scope examination for a limited number of pre-identified significant issues. Targeted use of remote work concepts helps to better deploy IRS resources, especially for special projects requiring the use of limited resources.

The large public accounting firms have pioneered the use of remote work with clients in the performance of their audit function and the preparation of tax returns. There has been general acceptance of remote work provided the client/taxpayer is confident that data is transmitted, maintained and accessed in a secure manner.

Background

The Subgroup was asked to provide advice on what we are seeing in the marketplace as best practices regarding the use of remote work and our thoughts on what types of issues and areas would lend themselves to a remote examination. We were also asked to express our views regarding possible taxpayer concerns with respect to the use of remote examinations.

Our comments are focused on working remotely rather than telework arrangements with IRS employees. Although many of the processes and technology requirements are similar, we would define teleworking as working “offsite” at almost any location, such as working from an IRS employee’s home office. On the other hand,

remote work would generally involve an IRS team located in multiple locations or at a location different from the taxpayer, (e.g., all examination team members assigned to a specific taxpayer could be working from different locations in either IRS offices or other places). However, it may still be advisable to have certain key members of the examination team periodically or permanently at the taxpayer's business site during the examination process.

Technology is available to enable the IRS to bring the right resources to the right place and at the right time. The large accounting firms have pioneered the processes, data security, technology and controls necessary to implement remote work as part of their audit examination of large, and in many cases multinational, clients. Accounting personnel from around the country (or from other countries) form audit teams that are connected through technology to provide these services. Similar to the IRS, the accounting firms handle extremely confidential financial and tax information and have developed the technology, processes and controls to ensure that their clients' information is secure. Accounting firm audit clients are now accustomed to having a remote workforce with electronic access to the most confidential financial information. In addition, the accounting firms may also prepare a client's tax returns in a number of remote locations using different individuals with the optimal skills and availability. In that the IRS would face similar and analogous issues, much could be learned from the experiences and best practices of the large accounting firms.

Advantages – Remote Work

In addition to the significant cost and time savings, there are a number of advantages to remote work. These include:

- Potentially more flexible work arrangements will be available and less travel will be required for IRS employees.
- Remote work expands the potential recruiting pool by facilitating employment in locations and situations where professionals normally would not be available to work for the IRS, for example at locations that do not have an IRS office.
- Employee relocation and travel expenses, as well as “bricks and mortar” office expenses, will be significantly reduced.
- More efficiency will translate into shorter cycle time in handling examinations and projects due to:
 - Better spreading out of the workload and quicker redeployment of resources,
 - Less travel time and costs, and
 - Increased ability to bring people with the right skills, expertise and availability to any examination or project independent of geographic boundaries.
- Remote work offers more diverse work experience to IRS personnel, e.g., a Boston employee can be included as part of the examination of a Texas energy company.

Accounting Firm Experience-Remote Work

A significant percentage of the professional, client-serving staff of the large accounting firms, including many partners, have dispensed with permanent physical offices in favor of “virtual” offices. This translates into large cost savings and a greater

focus on serving clients. Many work from a client's office, at a firm provided "visitor's office" when traveling or in their home city, or from home. Many of the accounting firm facilities use a "hoteling" concept where partners and employees sign in and reserve a designated visiting office, a conference room or other facilities. Appropriate office supplies, equipment such as printers and fax machines, and administrative assistance are provided.

We believe that the following considerations are important to implementing a successful remote work environment:

- Technology is the key that enables remote work. Today's remote worker must be supported by the technology that will enable him or her to work with multiple teams, geographies and taxpayers without being physically present.
- All necessary information must be organized, retrievable and available on-line.
- When working within a remote team, team members' responsiveness and availability are paramount.
- A simple assignment system for visitor offices needs to be established. These visitor offices must be provided with appropriate supplies and technology (printer hook up, network access, etc.).
- A standard technology platform across the organization is required, and it must include significant security features limiting access to laptop computers and limiting the unauthorized copying of sensitive materials.

- Standardized processes and collaborative, project management software are needed to facilitate remote work examinations and projects. The project software should include secure data storage, a discussion board, work flow and scheduling software, team calendar and team member profiles, instant messaging for team members, check in/check out document management software that provides version control, and the ability to easily transfer large data packages. The software may also include a secure interface allowing taxpayers access to certain information.
- Supervisory personnel should have their own assigned “800 number” with the ability to convene conference calls, and the team or selected team members should be provided mobile internet access.
- It is important to have a voice mail system that automatically sends an email to the IRS employee notifying him of a message in his voice mailbox. The voice system might also have a secure capacity to reroute calls to an IRS employee’s private telephone number or to another number designated by the IRS employee.
- An “experts to call” and a skills network should be established for a rapid response to tax technical and procedural questions.
- Tax technical and industry knowledge should be available on line in a repository of information for employees similarly connected, (e.g., by industry focus, division, branch, etc.).

Recommendations

1. The IRS should consider significantly expanding the use of “remote work” for LB&I examinations and projects in order to obtain significant efficiency and cost savings benefits, as well as reduced disruption to taxpayers. The IRS may want to pilot this process with a number of taxpayers presently participating in the CAP program.
2. The commitment and effort necessary for the development and design of the processes, controls and technology cannot be overestimated; however the rewards of a successful deployment are enormous. The IRS as a first step should obtain as much information as possible from the large accounting firms, who have been operating in this manner for years, in order to obtain information on best practices and lessons learned.
3. In deploying the remote work paradigm, the IRS should work with taxpayers who have concerns. We believe that having an IRS point of contact within the remote team is important in gaining taxpayer acceptance. That person or persons may be “on site” at the taxpayer’s location for all or portions of the examination. The use of remote IRS team members has been in use for years for specialists such as engineers and international tax personnel, and we believe that the transition to expand remote work will generally be well received by taxpayers.

ISSUE TWO: COMMERCIAL AWARENESS

Executive Summary

LB&I asked for the Subgroup's assistance in identifying ways to gain greater "commercial awareness."

The Subgroup has addressed this issue in the past, and recommended that the best path to acquiring greater commercial awareness was through education and training. The benefits of enhanced commercial awareness through education and training, for both LB&I and taxpayers, were discussed in prior Subgroup reports and are summarized below.

The Subgroup has identified various concrete steps that LB&I should take in order to establish the education and training programs necessary to increase commercial awareness.

Background and Analysis

The Subgroup has previously stated that the cornerstone of gaining commercial awareness is to create educational programs whereby professional associations, industry groups, and taxpayers (the "taxpayer community") would become active in the training and development of LB&I. Commercial awareness would assist LB&I in becoming more "connected" to the taxpayer community, in order to gain a better understanding of matters from both a commercial and a tax perspective. An education or training program provided by outside stakeholders is the best way to acquire such "commercial awareness."

There are mutual benefits of such educational programs for both LB&I and the taxpayer community. These educational programs would result in increased transparency

through frequent and candid communication between LB&I and outside stakeholders, and provide LB&I with an expedited way to better understand the industries and business dynamics of LB&I taxpayers. For the taxpayer community, an understanding of LB&I's concerns (both substantive and administrative) could help to inform business decisions.

The Subgroup reiterates that a two-sided commitment to transparency and communication is critical. The taxpayer community would expect LB&I to approach the educational program with a commitment to reciprocity and engage in open dialogue on any issues of concern. The taxpayer community expects, at a minimum, an objective reaction to the topics being discussed and a "business-like" discussion regarding matters.

In addition, impartiality and proportionality by LB&I are necessary for the successful implementation of an educational program. The Subgroup envisions that certain issues discussed in an educational program will likely involve some degree of tax uncertainty. Accordingly, in order for an educational program to be worthwhile and successful, LB&I must act impartially, rather than as an advocate.

The end result of this process should be "win-win." Both LB&I and taxpayers have limited resources. Greater commercial awareness gained by LB&I through these educational programs should permit more efficient audits and more certainty for both LB&I and the taxpayer community.

The potential topics for educational programs are limitless, and could be tailored to LB&I's current and specific interests. For example, the taxpayer community may provide education to LB&I regarding business practices, the business environment, the economy, or capital markets in general. On the other hand, educational programs could be more targeted and specific, and focus on particular transactions.

The Subgroup recognizes that certain topics may not be conducive to a broad, industry-wide discussion. Nuances and differences in fact patterns among transactions could make it difficult to reach a consensus regarding a presentation. In those situations, it may be useful to have both an industry meeting for a high-level review of the topic, and also separate “one-off” meetings with individual members of the industry.

It is noteworthy that LB&I currently has a formal type of educational program for commercial awareness in place in the Financial Services sector. All participants involved in this program have commented that it is a very useful and constructive endeavor. Engaging in this program of educational sessions on topics of mutual interest has resulted in easing administrative burdens on both sides, a more efficient use of audit resources, and promoting more certainty. The Subgroup applauds LB&I and the senior executives in the Financial Services industry for implementing this program. LB&I should continue to engage in this program in Financial Services, and it should use this program as a model to expand with similar programs across its other industry groups.

Although formal educational programs are useful and should be continued and expanded, LB&I should also take steps to implement more informal means of education in order to gain commercial awareness. Informal approaches would allow LB&I to become more “nimble”, which would permit LB&I to gain knowledge more quickly and potentially use that knowledge in a current audit cycle. For example, an informal approach can be as simple as an LB&I Industry Director reaching out to various members of the taxpayer community to share industry knowledge. This knowledge can then be shared with agents in the field. If there are concerns about contacting members of the taxpayer community individually, LB&I should consider establishing informal working

groups with rotating memberships within the various industries, so that all interested taxpayers and professional organizations could be represented. The benefits presented here are obvious. While a formal educational program is of course useful, it can be limited in its application. It is often planned well in advance and focuses on a specific topic. Informally, rather than being constrained by a planned schedule, LB&I could reach out anytime, as needed, to gain information on “real-time” topics as they arise.

Another informal approach to gaining commercial awareness can be gleaned from certain practices of the Organisation for Economic Co-operation and Development (OECD). In the past, the OECD has reached out to industry groups for drafting assistance in connection with various projects. This has resulted in the “secondment” of members of corporate tax departments and professional services firms to the OECD for purposes of contributing to those projects. LB&I should consider making similar requests with respect to their future initiatives.

In addition, LB&I should encourage its employees to develop commercial awareness on their own. This can be done in several ways with the benefit of assistance from outside stakeholders. For example, revenue agents could request internal policies (e.g., transfer pricing policies) of taxpayers they are assigned to audit in order to better understand industry practices. In the same vein, revenue agents could coordinate meetings through the tax department with other functions of the taxpayer they are auditing (e.g., accounting policy, treasury, business unit), in order to gain general information or awareness, as opposed to a meeting regarding a specific audit issue or transaction. Also, in particular for financial products agents, LB&I could reach out to various exchanges, like the New York Stock Exchange or Chicago Mercantile Exchange,

in order to have discussions regarding how the markets function or how trades are executed. Finally, professional organizations like the American Institute of Certified Public Accountants have published excellent materials that describe industry practices for a range of business segments.

In short, there are numerous ways in which LB&I may partner with the taxpayer community to gain commercial awareness. Furthermore, these taxpayer groups are in a unique position in which to impart commercial awareness. It is difficult to envision a better avenue for gaining commercial awareness about an industry than from the members of that particular industry itself.

Recommendations

1. As an initial matter, LB&I should make “commercial awareness” about a particular industry part of the job description for employees working within that respective industry.
2. LB&I should encourage employees to join and become active within industry groups and professional associations, which often offer discounted memberships for government employees.
3. LB&I should encourage employees to gain commercial awareness by reviewing the internal policies of the taxpayers they are auditing, as well as by reading published materials that describe the particular industry.
4. LB&I senior executives should identify the particular members of the taxpayer community from which they would like to gain greater commercial awareness. LB&I should then attempt to establish educational programs in union with those groups, using the established program in the Financial Services sector as a model.

5. In addition to the formal educational programs identified in recommendation four, LB&I should attempt to pursue and establish contacts for informal programs, including the possibility of secondments from corporate tax departments and professional services firms to work on projects and initiatives.
6. LB&I should develop means to share acquired commercial awareness throughout the organization. For example, it should leverage from the experience of agents that have worked Compliance Assurance Process cases and their “real-time” experiences. In addition, for purposes of disseminating information, LB&I should consider developing an internal blog that summarizes industry information and statistics, so that taxpayers that are outside industry norms could be identified.

ISSUE THREE: SCHEDULE UTP

Executive Summary

The requirement to disclose uncertain tax positions on Schedule UTP attached to Form 1120 is new for 2010 tax return filings. The Subgroup is concerned that some of the IRS guidance issued in the instructions to the schedule and in FAQs is not consistent with the manner in which unrecognized tax benefits are accounted for under U.S. GAAP or IFRS. With hindsight, we believe that this could have been avoided by having a more robust external review process of the Schedule UTP and FAQs prior to their initial issuance. Given the complexity of the accounting rules governing uncertain tax positions, this review would necessarily involve input from outside groups including accounting firms as well as this Subgroup, whose members have significant experience with uncertain tax positions. The Subgroup recommends that the IRS issue further guidance in the areas noted below.

Background

In 2010 the IRS announced that for tax years beginning after December 31, 2009, tax positions for which certain corporations with assets in excess of \$100 million have recorded a liability for unrecognized tax benefits under U.S. GAAP, IFRS or other country-specific accounting standards in their financial statements (or would otherwise have recorded such a liability but for an intent to litigate) must be disclosed on Schedule UTP. The IRS released on March 23, 2011 some additional guidance in the form of seven frequently asked questions (“FAQs”) and on July 19, 2011 released an additional eight FAQs; all fifteen are now posted on the IRS website. The Subgroup continues to believe that the requirement to disclose UTPs is bad tax policy and has the potential to

create a more adversarial climate in tax audits. In addition, the disclosure requirement is premised on the act of recording a reserve in a taxpayer's financial statements. However, there is no definition of the phrase "recording a reserve" in the tax or accounting literature since FIN 48 established the use of a benefit recognition approach for accounting for income tax positions rather than a reserve approach. Therefore, it is critical that clear guidance be issued so that taxpayers have clear instructions they may rely on in completing the Schedule UTP and so that the schedule will be appropriately interpreted by IRS auditors.

Recommendations

1. The Subgroup has detailed suggestions in Exhibit A, items one to five regarding clarifications needed in some of the examples in the instructions to Schedule UTP and in the FAQs, in order to make all these consistent with income tax accounting rules or to provide further explanations.
2. **The Subgroup made other comments in the 2010 IRSAC report which were not addressed in the FAQs, but we continue to believe these comments are relevant. For your convenience we include these comments in Exhibit A, verbatim as items six to nine, except for item six where we have added further explanation.**
3. The Subgroup recommended in the 2010 report to eliminate the requirement to disclose a position for which no liability for an uncertain tax position was recorded because the taxpayer intends to litigate. We continue to recommend this, but if this is not adopted we believe that further guidance is necessary to clarify what constitutes a position with the intent to litigate. We note that the

decision on whether to book such a liability is not based on willingness to litigate.

It is based on an assessment of the correctness of the position. If the position is correct, the taxpayer does not establish a liability, regardless of the position of the IRS. Given that the willingness to litigate is not a critical part of the analysis undertaken in establishing liabilities for uncertain tax positions, it is necessary that specific guidance be issued.

EXHIBIT A: RECOMMENDATIONS ON UTP REPORTING

As noted in the main body of our comments, there is no concept of recording a “reserve” for uncertain tax positions in U.S. GAAP or IFRS. In our recommendations below we use the term “reserve” to avoid confusion as we reference its use in the Schedule UTP and FAQs.

1. Use of Part I versus Part II. UTP FAQ two addresses the situation when a corporation records a reserve in its audited financial statements for 2010 and then later eliminates the reserve in subsequent interim financial statements issued prior to the filing of the 2010 tax return. The answer provides that the reserve would need to be disclosed if the interim financial statements are unaudited and would not if those interim statements were audited. The Subgroup recommends that the IRS be specific as to what constitutes an audit for this purpose. For example, many companies file Forms 10Q with the SEC. Such forms which are issued on a quarterly basis (other than year end) are generally not audited but may be reviewed by an outside attest firm. Does the IRS intend to treat such reviewed statements as audited for purposes of this FAQ?

2. Definition of reserve.

- a. The instructions to the schedule provide: “A corporation or a related party records a reserve for a U.S. federal income tax position when a reserve for U.S. federal income tax, interest or penalties with respect to that position is recorded in audited financial statements of the corporation or a related party.” FAQ six acknowledges that the term reserve is not a defined accounting term and provides that a reserve is recorded when an uncertain tax position is stated anywhere in financial statements and may be indicated by several types of journal entries which include: i. an increase in a current or non-current liability for income taxes or a reduction in a current or non-current receivable for income taxes or ii. a reduction in a deferred tax asset or an increase in a deferred tax liability. This description is that used in the Summary page of FIN 48 and refers to how the reserve should be presented on the financial statements. It does not discuss the journal entries that must be made to record the reserve. The subgroup notes that the distinction between how the reserve is recorded in a journal entry(s) and how it is presented on the audited financial statements, could cause confusion especially for those taxpayers not using U.S. GAAP and suggest instead the following language: A reserve for an uncertain tax position is recorded when there is a difference between the tax benefit of a tax position taken in a tax return and amount of benefit recognized in the financial statements. Tax reserves may be recorded on the books through a variety of journal entries including the following:

- DR Income tax expense and CR Income tax reserve
- DR Equity and CR Income tax reserve (in case of prior period adjustment)
- DR Goodwill and CR Income tax reserve (in case of purchase price accounting)

The presentation and classification of that reserve on the audited financial statements vary depending on the accounting standards being used and the facts.

Such reserves may be classified on the audited balance sheet as either current or non-current income tax liabilities (or a reduction of a current or noncurrent tax receivable). In some cases the reserves are presented gross but in other cases they may be netted against a deferred tax asset such as a net operating loss carryforward to which they relate.

- b. We also recommend that the guidance address questions relating to acquisitions and dispositions, such as when a corporation acquires a target:
 - i. Is the reserve that is included in the books of a target company considered a “reserve” that the acquirer must disclose in the year of acquisition since it is part of the purchase price accounting done by acquirer?
 - ii. Is the additional reserve that acquirer records for pre-acquisition uncertain tax positions not previously recorded by target a “reserve” even though it is booked through goodwill and not profit and loss?

3. Interest and penalties.

- a. FAQ four provides that interest and penalties should not be included in the quantification of the related UTP in determining the ranking and determination of the major status of UTPs disclosed, if the amount of interest or penalties relating to a tax position is not separately identified in the books and records associated with that position. However, the accounting rules allow taxpayers several alternative ways in which to account for interest and penalties relating to tax contingencies, including classifying the interest and penalties as part of the tax reserve or classifying it as a non-tax reserve. See No. FIN 48 (ASC 740-10). The Subgroup recommends that the IRS provide a follow-up to FAQ four to cover the case when interest and penalties are not recorded as part of the tax reserve but are separately identified with respect to a particular tax position.
- b. The instructions to the Schedule UTP provide that subsequent increases or decreases to a reserve that was previously disclosed do not require disclosures in subsequent years. FAQ 11 further provides that post-2009 accruals of interest that are part of a reserve for a tax position taken on a pre-2010 return should not be reported on Schedule UTP, consistent with the transition rule in the instructions for Schedule UTP. The Subgroup recommends that additional guidance be issued to clarify that such treatment also applies to accruals of interest on reserves recorded for post-

2009 tax return positions as well to clarify the treatment of penalties recorded with respect to both pre and post-2009 tax positions.

4. Position taken on a return. The instructions to the Schedule UTP provide that a tax position taken on a U.S. federal income tax return must be disclosed when a reserve has been recorded (or was not recorded because of expectation to litigate) with respect to that position. FAQ 12 provides that a corporation must disclose any such position that would result in an adjustment to any line item on any schedule or form attached to the Form 1120 but includes no specific examples. The Subgroup notes that this would result in disclosure of positions that would have no current federal income tax impact. For example, a reserve is established on the financial statements of a controlled foreign corporation (“CFC”) related to a position taken on the CFC’s tax return in a foreign country. That position would result in a change in earnings and profits and foreign tax of that CFC reported on Form 5471 but would result in no change in U.S. federal income tax liability unless there is a remittance (or deemed remittance under subpart F) from that CFC. Large multinational corporations may have hundreds of CFCs many of which may have recorded reserves for uncertain tax positions on their local country financial statements. If all such reserves are reported on the Schedule UTP there will be myriad of items reported with no current U.S. federal income tax impact. In fact, the realization of such uncertain tax positions when the CFC makes a remittance will result in a decrease in U.S. federal income tax whereas the purpose of the Schedule UTP is to disclose items which would result in additional tax. As another example, a corporation establishes a reserve for a

5. Use of net operating loss or credit carryforwards. FAQ ten clarifies example nine in the instructions regarding the need to disclose a position that results in a net operating loss (“NOL”) or credit carryforward for which a reserve is recorded in the year in which the NOL or credit arose. The FAQ concludes that the position should only be disclosed in the year in which it arose and not in the carryforward year in which the NOL or credit is used on the tax return. While we agree with the overall conclusion, the example in the FAQ is not consistent with income tax accounting rules. The FAQ posits the case where a corporation claims an item of deduction, loss or credit on its 2010 return which results in an NOL or credit that cannot be used in 2010 and is carried forward. Per the FAQ the corporation records a reserve for such item twice, first in 2010 and again in 2012 when the item is used on the corporation’s tax return. But under the accounting rules, absent other intervening circumstances no reserve would be recorded in 2012 for the position taken on the 2010 return since the reserve was previously recorded in 2010. The example implies that by mere passage of time the reserve initially

recorded in 2010 would be adjusted. However, the reserve recorded in 2010 would be adjusted in subsequent years, including the year in which it is used, only if something occurred causing such adjustment such as issuance of new guidance relating to the position for which the reserve was established. Because the IRS's guidance regarding tax attribute carryforwards is solely governed by the examples in the FAQs and schedule instructions, the Subgroup is concerned that the facts in FAQ ten will not be applicable to any taxpayers. Accordingly, the Subgroup recommends that the example in FAQ ten be revised to comport with actual income tax accounting precepts for NOL and credit carryforwards as follows:

Question: A corporation claims an item of deduction, loss, or credit on its 2010 tax return and that tax return contains an NOL or a credit. The NOL or credit cannot be used in 2010 and is carried forward. The corporation records a reserve with respect to the tax position that is reflected on an audited financial statement in 2010. The NOL carryforward or credit carryforward is used to reduce the tax liability reported on the 2012 tax return. In 2012 new guidance is issued with respect to the tax position and as a result of that guidance the corporation adjusts the reserve with respect to that tax position that is reflected on an audited financial statement in 2012. How should that item be reported on Schedule UTP?

Answer: A corporation must report a tax position taken on its 2010 tax return on Schedule UTP if a reserve is recorded in an audited financial statement with respect to the tax position. As stated in example 9 of the Schedule UTP Instructions, claiming an item of deduction, loss, or credit is a tax position. Since

the corporation recorded a reserve for that tax position in 2010, the corporation should report that tax position on Schedule UTP filed with its 2010 tax return.

This reporting in 2010 is the only reporting required. We recognize that example 9 of the 2010 Schedule UTP instructions caused confusion with respect to this issue. Even though the future use of the NOL or credit carryforward is a tax position for which the corporation recorded a reserve, the IRS will not require reporting with respect to the future use of NOLs or credit carryforwards since the reserve was already recorded and disclosed in the 2010 Schedule UTP. The corporation therefore should not report the use of the NOL or credit carryforward on the Schedule UTP filed with its 2012 tax return.

As noted above, the Subgroup made other comments in the 2010 IRSAC report which have not been addressed, but we continue to believe these comments are relevant. Items six to nine below are taken verbatim from the 2010 report, except for item six where we have added further explanation.

6. Temporary items. The Schedule UTP includes codes so that tax positions are marked as either temporary or permanent. The final instructions provide that: “A corporation or a related party records a reserve for a U.S. federal tax position when a reserve for income tax, interest or penalties with respect to that position is recorded . . .” When a tax reserve for an uncertain temporary difference is recorded under U.S. GAAP or IFRS a corresponding deferred tax asset in exactly the same amount is also recorded. A net financial statement impact arises only

where there is a material temporary difference on which a reserve for interest expense would be required. The Subgroup recommends that the instructions provide that the only item to be disclosed on the Schedule UTP with respect to temporary items is the interest. In Example six of the instructions, an expenditure was made in 2010 and a reserve was recorded in 2010 due to uncertainty of whether it should be deducted in 2010 or amortized over five years. If the reserve was recorded due to potential interest only, however, the most likely scenario would be that the reserve would not be recorded until 2011, since the due date of a calendar 2010 tax return is in March 2011 and interest would not accrue until that date. Accordingly, we recommend that Example six be revised to provide:

Example 6: Temporary items. A corporation incurs an expenditure in 2010 and claims the entire amount as a deduction on its 2010 return. During the course of reviewing its tax positions for purposes of establishing reserves for U.S. federal income taxes for its 2010 audited financial statements, the corporation determines it is uncertain whether the expenditure should instead be amortized over 5 year and records a reserve and an offsetting deferred tax asset for the position with respect to the position taken in 2010. In its 2011 financial statements, the corporation records interest with respect to the reserve it recorded in 2010 (since interest would not accrue with respect to that position until March 15, 2011). In each of the years 2012 through 2014 the corporation increases the interest amount. The tax position taken in the 2010 tax year should not be reported on Part I of the Schedule UTP filed with the 2010 tax return since there is no net reserve recorded in the financial statements for that year. The interest recorded in

- the reserve in the 2011 financial statements must be reported on Part II of the Schedule UTP filed with the 2011 tax return. No disclosures are required with respect to the additional interest recorded in each of years 2012 through 2014.
7. Year in which position should be reported. The draft general instructions on page one stated that a tax position is required to be reported on a Schedule UTP for a year if, at least 60 days before filing the tax return, a reserve has been recorded with respect to that position. Page two of the draft instructions further stated that if the decision to set up the reserve was made within 60 days of filing a tax return, then the position must be reported on Part I of the Schedule UTP for the current year or on Part II of the Schedule UTP for the next tax year. We initially recommended that the option to disclose a tax position on Part I of the current tax return, where determination was made within 60 days of filing the return, be referenced on page one of the general instructions. However, Announcement 2010-75 provides that the instructions clarify that a tax position is reported on Schedule UTP once (1) a reserve for a tax position is recorded and (2) a tax position is taken on a return regardless of the order in which those two events occur. On page one of the instructions, under reporting current year and prior year tax positions, the instructions provide: “Do not report a tax position on Schedule UTP before the tax year in which the tax position is taken on a tax return by the corporation.”

The examples in the instructions appear to confuse the reporting issue. In Example six, regarding a temporary item, a taxpayer establishes a reserve in 2010 due to uncertainty as to whether an expenditure should be deducted in 2010 or

amortized over five years. The taxpayer did not provide reserves in any of the years 2011 to 2014 with respect to the issue. The instructions conclude that the taxpayer has taken a position in its tax return in each of the years 2010 through 2014, but should disclose the position on Schedule UTP for 2010 only, since it did not record a reserve for this position in 2011 to 2014.

In Example seven, regarding a permanent item, a taxpayer establishes a reserve in 2010 for an amortized deduction to be claimed over five years due to uncertainty of whether any deduction or amortization may be allowable. The instructions conclude that the corporation has taken a position in its return in each of the years 2010 through 2014 and that the tax position must be disclosed on a Schedule UTP for each of the years 2010 through 2014. It further notes that the result would be the same if, instead of recording the reserve in 2010 for all of the tax positions taken in each of the five years, the corporation records a reserve in each year that specifically relates to the tax position taken on the return for that year.

The only distinction between Examples six and seven is that Example six deals with a temporary item, whereas Example seven deals with a permanent item. If the intention is that the timing of taking the tax position on the return triggers the disclosure, not the timing of the reserve, that should be specifically stated.

8. Unable to obtain information. The Schedule UTP provides a box to check in Part I and Part II if the taxpayer was unable to obtain information from related parties sufficient to determine if a tax position is an uncertain tax position. We

recommend that the instructions provide further explanation of when this box should be checked. The instructions could state: “For example, it is intended to be used when a taxpayer’s controlling shareholder prepares the income tax reserves but does not inform the taxpayer.”

9. Unit of account. Page one of the general instructions of the draft Schedule UTP stated: “A tax position is based on the unit of account in the audited financial statements in which the reserve is recorded. A tax position taken in a tax return means a tax position that would result in an adjustment to a line item on that tax return if the position were not sustained. A line item on a tax return may be affected by multiple units of account, in which case each unit of account must be reported separately on Schedule UTP.” The final sentence was changed in the final instructions to read: “If multiple tax positions affect a single line item on a tax return, report each tax position separately on Schedule UTP.” We recommend that “item” be replaced by “item(s)” each place it appears so that it is clear that a unit of account may impact more than one line item on a return.

ISSUE FOUR: DISTANCE LEARNING

Executive Summary

The Subgroup was asked to provide advice and observations on what we are seeing in the marketplace regarding the use and deployment of distance learning. The use of distance learning has been expanding as new technologies and teaching methodologies have enabled students who are not physically present in a traditional educational setting (such as a classroom) to participate in a learning experience that in some cases has significant advantages over the lecture-style classroom format. Many educators have come to the conclusion that courses properly developed and taught on line can be easier for the students to understand and retain.

The Internal Revenue Manual defines distance learning as:

Distance Learning - Covers a wide set of applications and processes such as web based learning, computer-based learning, virtual classrooms, and digital collaboration. It includes the delivery of content via Internet, Intranet/Extranet (LAN/WAN), audio-based and video-based, satellite broadcast, interactive TV, and CD-ROM (Internal Revenue Manual 6.410.1.1.1D (03-12-2009)).

Background

The learning and education function of the IRS is governed by the Leadership Development Executive Council (LDEC) whose purpose is to provide strategic oversight for critical training issues, leadership development and succession planning (Internal Revenue Manual 6.410.1.1.5 (04-24-2009)). The implementation and administration of the learning and education function is the responsibility of the IRS Human Capital Office,

Leadership, Education, and Delivery Services (LEADS). The mission of the LEADS organization is to provide overall governance and guidance to the education community, set education policy and standards, and maintain and administer policy and guidelines for IRS learning and education (Internal Revenue Manual 6.410.1.1.6 (03-12-2009)).

The IRS employs the Enterprise Learning Management System (ELMS) as the official system for recording and tracking training data. ELMS is a web-based application that managers, employees, and the learning and education community access from their computers to manage training and employee development. Employees can also access and launch web-based training directly from ELMS.

One of the learning and education goals of the IRS is to promote distance learning. The applicable section of the Internal Revenue Manual provides *“Since classroom training has a limited capacity to address individual employee training needs, the Service must continue to promote the development and delivery of courses through non-traditional training methods such as e-learning as an alternative to classroom training, which will contribute to the IRS goal of becoming a learning organization. The IRS has an e-learning strategy that will utilize technology to promote the acquisition and sharing of knowledge and expertise efficiently and effectively –thereby supporting critical business outcomes and the subsequent creation of a learning organization.”*

The IRS has identified the benefits for a transition to e-learning as:

- Fewer hours dedicated to instructor preparation and delivery
- More consistency in training
- Just-in-time, just enough training
- Potential for prescriptive, customized training

- Competency development accelerated
- Travel time reduced
- Expanded opportunities for training to a wider audience at no additional cost
- Fewer training funds used for training-related travel, which frees up funds for development of more learning solutions and opportunities

The Subgroup believes that additional advantages of online or computer-based learning include:

- Students may have the option to select learning materials that meet their level of knowledge and interest.
- Students can study anywhere they have access to a computer and Internet connection.
- Self-paced learning modules allow students to work at their own pace.
- Virtual classroom software can be used to bring small groups together for real-time discussions.
- Bulletin boards, chat rooms, and discussion threads can also be used to promote group interaction.
- E-learning can accommodate different learning styles and facilitate learning through a variety of activities.
- Class work can be scheduled around work and family.
- Students can test out of or skim over materials already mastered, and thus concentrate efforts in mastering areas containing new information and/or skills.

- Students can stop during a course to check reference materials, take a break, etc., and resume where they left off.
- Students can playback lectures, etc., that they need to review or better understand.
- E-learning can also develop knowledge of the Internet and computer skills.
- Distance learning can leverage the time of the best teachers and make them available to a large audience.

Recommendations

1. The IRS should continue its process of expanding the development and use of distance learning, and consider the redeployment of existing courses in a distance learning format.
2. Often course materials of a technical nature become obsolete as developments in the tax law occur. The IRS should assign someone who specializes in the technical area which is the subject matter of the training course to be responsible for ensuring the content is up to date. This practice is used successfully within the public accounting profession.
3. Members of the LEADS organization responsible for course design and teaching should become members of tax education organizations (such as the American Taxation Association (ATA) and the Association of American Law Schools, Section of Taxation) where they can participate in the various conferences dealing with the latest distance learning technologies and teaching methodologies. In this

manner, the IRS members would be exposed to the best distance learning practices that are occurring in our universities and law schools.

4. The leadership of the ATA has indicated that they would welcome the opportunity to meet with members of LEADS. The IRS should follow through on this offer to obtain the ATA's input on distance learning trends, best practices and pitfalls.

ISSUE FIVE: FAST TRACK SETTLEMENT

Executive Summary

The Fast Track Settlement Procedure (“FTS” or “the process”) was established in 2003 with a goal of expediting the resolution of cases and offering taxpayers another alternative dispute resolution procedure. The process is essentially a mediation, with an Appeals Office Official (“AOO”) serving as a neutral participant using dispute resolution techniques to facilitate settlement between the examination team and the taxpayer.

The IRS is concerned about the relatively low level of FTS usage. The number of issues referred to and resolved in FTS has consistently been a small fraction of the total number of unagreed issues arising in audits. Meanwhile, the workload in the IRS Appeals Office is very high, and some cases take several years to resolve in the Appeals Office.

The IRS is trying to address this problem through increased communication regarding FTS throughout the organization. While this internal focus is helpful, the Subgroup does not believe communication alone will bring FTS usage to desired levels. Rather, we believe that the IRS should determine the reasons the process is not being used in more cases, modify the process to address those underlying reasons, and then market the improved FTS process to both the IRS and the taxpayer and tax advisor communities.

Background and Analysis

Revenue Procedure 2003-40 provides taxpayers with the detailed information regarding the FTS process, including case eligibility, the application process, and the settlement process. Internal guidance is provided in the Internal Revenue Manual in section 4.51.4. The advertised advantages of the FTS process are the potential for a resolution within 120 days, no need for a formal Appeals protest, and the retention of all

traditional appeals rights in the event resolution is not achieved.

The recent internal focus on increased communication about the FTS process has been positive in that there has been some increased usage of the process, but usage is not near the levels desired. The Subgroup believes there are many reasons why the process has not become a preferred alternative dispute resolution technique, as discussed below.

First, despite the increased communication regarding the FTS process, there is still a general lack of understanding of the process within segments of the IRS field, as well as within the taxpayer and tax advisor communities. Also, many taxpayers are concerned that the process will not successfully resolve their issues, and that as part of the process they will be giving an advantage to the IRS by outlining their possible litigating position.

Second, the IRS exam team and taxpayers often enter into the process attempting to obtain a 100 percent win or concession, but the process is not intended to produce that result. The FTS sessions often involve several members of the examination team, the case manager, perhaps a territory manager, IRS counsel and a technical advisor. Taxpayers often bring several members of their internal staff as well as outside advisors. Sessions can bog down with too many vocal participants, and become a debate about the relevant facts as opposed to a presentation of each side's technical position. Also, taxpayers may not always have their ultimate decision maker attend the session, and case managers are hesitant to consider hazards of litigation in considering the possible resolutions suggested by the AOO. As a result the process fails to achieve resolution in about 15 percent of cases, and can leave affected taxpayers and tax advisors with the view that the process was a waste of time. This negative view then spreads across the taxpayer and tax advisor

communities.

Recommendations

The Subgroup believes that it is critical to first address problems inherent in the present FTS process and then market the revised process both within the IRS and to the taxpayer and tax advisor communities.

While the Subgroup has highlighted two salient issues with the current FTS process, we expect the wider taxpayer and tax advisor communities to have additional concerns about the current FTS process. Therefore, as an initial step, the Subgroup recommends the IRS solicit input from the public before beginning to revise the process. Input from the ABA, AICPA and TEI would likely point out other issues that should be addressed when revising the process.

Meanwhile, the Subgroup has the following recommendations with respect to the process, including the requirements for acceptance of issues into the FTS process, the framework of the FTS sessions, and for the marketing of a revised process.

1. First the unwillingness to compromise or to make a decision is potentially fatal to the FTS process. Thus the Subgroup recommends that, as a condition for acceptance of an issue into the process, the case manager and the taxpayer's decision maker (e.g., V-P of Tax) should be required to jointly sign a statement to the effect that both parties are willing to compromise (i.e., to settle the issue at something between the return position and the proposed adjustment). This would "set the tone" for the FTS session, clearly identify the decision makers on both sides, and put the onus on the decision makers to control the expectations of their representatives in the FTS session.

2. The Subgroup recommends that the parties develop a mutually agreed statement of fact as a precondition to entering into FTS. Issues involving two different viewpoints of the salient facts are not likely to be resolved through mediation.
3. The Subgroup also believes changes should be made to the manner in which the FTS sessions are conducted, as follows.
 - We recommend that the FTS session begin with the AOO stating his or her understanding of the issue and the relevant facts. After an appropriate discussion time, the field and the taxpayer would be required to acknowledge their agreement with the AOO's summary before proceeding further.
 - The AOO would then summarize his or her understanding of both parties' technical arguments and obtain sign-off from both sides. The FTS session would then proceed with each party stating the merits of its technical position.
 - After both sides have had adequate time to express their positions, the AOO would excuse all IRS and taxpayer representatives except for the two decision makers before mediation commences.
4. Solely for purposes of the Fast Track process we recommend that the Case Manager be required to consider hazards of litigation and furthermore be granted settlement authority for Fast Track issues.
5. The Subgroup recommends that the revised FTS process include a post-process critique. The AOO would document the taxpayer's and the field's feedback relative to the process. The purpose would be to clearly identify the elements of

the process that are working and those that are not working. This feedback should be monitored by a national office “champion” of the FTS program charged with the responsibility to periodically update the process through the IRM and published guidance.

6. Finally, with respect to marketing, the Subgroup recommends the IRS develop a set of marketing initiatives aimed at educating taxpayers and tax advisors regarding the improved FTS process through speeches and presentations made by senior IRS officials to industry groups, the ABA, AICPA and TEI. Facts relating to the FTS process could also be published periodically in the tax press, including the number of cases accepted into FTS, the success rate, and the types of issues being resolved in FTS. The IRS may also consider preparing marketing materials including promotional materials accessible on the IRS website and articles for publication in the tax press outlining improvements in the process and its potential benefits to taxpayers. Such initiatives would improve the awareness and understanding of the improved process and its benefits, thereby increasing taxpayer participation in the FTS process.

ISSUE SIX: USE OF ACADEMIC RESEARCH

Executive Summary

The IRS should consider providing the tax academic community with suggested topics for academic research that would be of interest to the Service. While the IRS would benefit from unbiased, cost-free research for its use, professors would have the satisfaction of spending their research efforts on topics that matter.

Background

The three primary responsibilities of the academic faculty of higher educational institutions are to teach, to do advanced research and publish in their areas of specialty, and to serve the public through, for example, providing information and advice to governments. Professors of accounting, economics and taxation perform quantitative research involving the gathering and analysis of data, empirical studies, and legal tax research. Generally, their research and publications are unbiased, independent and objective, as they are subject to extensive peer review and comment. One of the most difficult challenges for professors is in the selection of research topics that provide relevant information to parties outside the academic community. Members of the tax academic community belong to a number of organizations—for example, the American Taxation Association (ATA) represents professors who teach undergraduate and graduate tax courses and members of the Association of American Law Schools, Section of Taxation (AALS) teach tax at the law school level.

The mission of the Research, Analysis, and Statistics Division of the Internal Revenue Service is to provide strategic research, analysis, studies, and support to internal and external stakeholders. The Division fulfills its mission through the operation of five groups: the National Research Program Office, the Office of Research, the Office of

Program Evaluation and Risk Analysis, the Office of Servicewide Policy, Directives and Electronic Research, and the Statistics of Income Division. Some of their publications include IRS prepared research papers published on the IRS website (<http://www.irs.gov/taxstats/article/0,,id=242261,00.html>), the *Statistics of Income (SOI) Bulletin*, The IRS Data Book, and IRS Research Bulletins which contains papers presented at the annual IRS Research Conference.

Recommendations

1. The IRS should establish a process whereby the IRS suggests to the tax academic community research topics that would be of interest and helpful to the Service. For example, in the announcement calling for papers to be presented at the annual IRS Research Conference, the IRS could suggest topics of interest involving tax administration, policy and proposals for legislation.
2. IRS officials often speak at meetings of organizations such as the ATA and the AALS. During those presentations, the speakers could suggest areas of interest for potential research.
3. The Research, Analysis, and Statistics Division should work with organizations such as the ATA and AALS to determine ways to disseminate to the tax academic community potential research topics.