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Prepared Remarks of IRS Commissioner Doug Shulman to the American Bar Association, Toronto, Canada

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WASHINGTON — It is my great honor and privilege to be in Toronto addressing the ABA.

It is a very busy time at the IRS. And while I could speak to you today about many important issues, ranging from:

- Our international efforts, including the recent announcement of the realignment and renaming of our Large and Mid-Size Business Division to Large Business and International;
- To our return preparer initiative;
- To our efforts to implement recent legislation;

I would like instead to focus today on transparency which is part of our larger strategy to get to and resolve taxpayer issues more quickly.

I have been clear since my first day on the job that I thought transparency and increased information flow were the key to the future of sound, fair and efficient tax administration.

If we receive information with tax returns and from third parties, we can identify potential non-compliance more efficiently and target our resources more effectively. I also believe the concept of more transparency is consistent with our nation's historic framework of a voluntary compliance system. Our tax system is set up in such a way that taxpayers fill out their own returns. This self-assessment system reflects the fact that it is the taxpayer, and not the IRS, who possesses all of the information relevant to tax liability. We then use information reported by the taxpayer to make judgments about issues to pursue, and returns to audit.

Inherent in this system is the basic assumption that a taxpayer will be forthcoming in dealing with the IRS with respect to the items it has reported on its tax return, including the underlying positions related to those items. But this is much more than an assumption – it is the foundation on which our tax system is built.

Guided by the fundamental principle that transparency is essential to achieving an effective and efficient self-assessment tax system, the IRS took a major step towards transparency with Announcement 2010-9. It described our proposal to require business taxpayers to report basic information regarding their uncertain tax positions when they filed their tax returns.

I believe that it helps achieve what most taxpayers and the IRS strive for and basically want:

- We want certainty regarding a taxpayer's tax obligations sooner rather than later;
- We want consistent treatment across taxpayers; and
- We want an efficient use of government and taxpayer resources by focusing on issues and taxpayers that pose the greatest risk of tax noncompliance.

As I said last January when the announcement was released, and as I still believe today, our proposal represented a reasonable approach. But I also believed that it was important to allow taxpayers an opportunity to provide input on the proposal.

So while it is unusual for the IRS to provide drafts of forms and instructions in advance of their implementation, in April we released a draft of the Schedule UTP and its instructions and asked for public comments regarding the overall proposal and the specifics of those drafts. I thought this step was essential to facilitate meaningful comment on the details of the proposal.

We have worked very hard to engage in a constructive dialogue to address legitimate concerns regarding the design and implementation of the proposal.

This morning, I am pleased to announce that we have completed our review of the comments and later today will be releasing the final Schedule UTP and its instructions effective for 2010 tax years. At the same time, we will be releasing a directive to the field, and important modifications to the policy of restraint that will provide guidance to IRS examiners and other personnel regarding how we will implement UTP reporting.

But before I discuss the final Schedule UTP and how it differs from the original proposal, I want to once again discuss our goals in developing the requirement to report uncertain tax positions. These goals are simple:

- Create certainty sooner for taxpayers;
- Cut down the time it takes to find issues and complete an audit, which benefits both the IRS and taxpayers;
- Ensure that both the IRS and taxpayer spend more time discussing the law as it applies to their facts, and less time looking for information;
- Help us prioritize taxpayers for examination;
- Help us identify issues where there is uncertainty and where we need to develop further guidance;
- Help us prioritize selection of issues during an audit; and
- Obtain key information regarding uncertain tax positions without getting into the heads of the taxpayers or their advisors, as it relates to quantifying risk.

I believe the final Schedule UTP that is being released today fulfills these goals in a very balanced and sensible fashion. The final product addresses important concerns expressed by affected taxpayers and the practitioner and business community and moves us towards our shared objectives of efficiency, earlier certainty, and consistency of tax administration regarding corporate taxpayers.

Let me take a few minutes to discuss the major comment areas and describe how we made important changes to address those that we determined would improve the proposal while preserving its core objectives.

To start I would like to focus on a set of comments that could be best characterized as concerns regarding the technical aspects of and burden associated with filing the schedule.

The first of these relates to questions raised about who should have to file the new schedule beginning with the 2010 tax year. We initially proposed that it should be all companies with over $10 million in assets who issue audited financial statements. We heard concerns that this was too much too soon for smaller companies.

In response, we have instituted a five-year phase in for filing the schedule. The largest corporations – those with $100 million or more in assets will file beginning with 2010 tax years …those with $50 million in assets beginning two years later … and those with $10 million in assets beginning two years after that. This will give corporations with total assets under $100 million additional time to comply with the new reporting requirement.

Next, I would like to discuss the proposed requirement that Schedule UTP filers include a calculation of the Maximum Tax Adjustment, or MTA, with respect to each tax position included on the schedule. We felt we needed to size issues in order to prioritize audit selection and issue focus. However, we asked taxpayers if there was another way to ascertain a sense of materiality or order of magnitude.

We received many comments on this proposed requirement that on the whole expressed two basic concerns: (1) that the requirement was burdensome because an MTA was not currently being calculated; and (2) that the MTA would in many cases be significantly greater than any potential adjustment with respect to an issue – giving the IRS a distorted view related to the risk of particular issues.

After hearing these concerns and reviewing alternative approaches, we decided to eliminate the MTA requirement as a means to quantify the reported positions. Instead of assigning a specific maximum tax adjustment to a position, the final Schedule UTP requires a filer to rank its UTPs from highest to lowest based on the size of the position. Taxpayers will use U.S. federal income tax reserve amounts to rank the positions on the schedule, but will not be asked to provide reserve amounts anywhere on the schedule.

The last area I want to touch on in this comment category is the requirement to identify positions that a taxpayer did not reserve for either because of a taxpayer's expectation to litigate the issue or because of an administrative practice of the IRS. Related to this were comments seeking clarification regarding the reporting of tax positions that were immaterial or unambiguous.

With respect to the disclosures required for positions that are not subject to a reserve due to an administrative practice of the IRS – after reviewing the comments, we determined that the concerns about the administrability of this requirement outweighed the value of the information that may be included. Therefore, we have eliminated the requirement to report so-called "administrative practice" positions.

Regarding the "expect to litigate" category, we ultimately determined that the information provided by this requirement was necessary to meet our goals. However, we clarified the instructions to respond to concerns that this category could have been read more broadly than it was intended and could require disclosure of highly certain or immaterial positions.

Taken together, these changes – the phased-in implementation of the Schedule for corporations with assets under $100 million; the elimination of the requirement to calculate and include a maximum tax adjustment for each position; the clarification of the expect to litigate requirement; and the elimination of administrative practice positions – address important burden and reporting concerns raised by affected taxpayers and their representatives, while still allowing us to achieve the proposal's goals.

The next major category of comments concerned how the proposal impacted privilege and the IRS' long standing policy of restraint.

We received comments about the potential sensitivity of the requirement for Schedule UTP filers to provide a concise description for all uncertain tax positions included on the Schedule UTP. These comments raised concerns that the disclosure of tax positions on Schedule UTP could enable adversaries to raise questions of waivers of privilege with respect to confidential communications related to the disclosed tax positions.

We believe these concerns principally arose from the fact that the draft instructions required Schedule UTP filers to provide the rationale for a position reported on the Schedule along with a description of the nature of the uncertainty related to that position. The final instructions eliminate these requirements and make it clear that a taxpayer need only disclose information sufficient to identify the issue and the relevant facts. In addition, the instructions now specifically state that the concise description should not include information related to the corporation's assessment of the hazards of a tax position or an analysis of the support for or against the tax position.

I believe that this significant change, made in response to comments we received, will continue to provide us with the information we need while at the same time addressing the concerns raised about privilege.

We are also releasing today an announcement that clarifies and strengthens the policy of restraint. There are three key changes described in today's announcement that I want to bring to your attention:

- We provide that disclosing issues on the Schedule UTP does not otherwise affect the protections afforded under the policy of restraint.

- We provide that drafts of issue descriptions and information regarding quantification or ranking of issues are protected under the policy.

- We adopt a policy that we will not seek documents that would otherwise be privileged, even though the taxpayer has disclosed the document to a financial auditor as part of an audit of the taxpayer's financial statements.

These changes are designed to reassure taxpayers that we are not seeking their legal analysis or risk assessments. We are instead seeking issue identification that will help accomplish our shared goals of efficiency, certainty, and consistency that I described earlier. I remain committed to the important taxpayer protections afforded by the longstanding IRS policy of restraint and under existing privilege laws.

The final major area of comments I would like to address this morning relates to concerns raised, not about the proposal itself, but instead about how the IRS will use the information it receives on Schedule UTP. Many of the comments voiced anxiety about how IRS agents would use the information reported on the schedule during examinations.

To address these concerns, and make clear our expectations for how the information should be used, we are releasing a directive to the field later today that will provide initial guidance to the IRS personnel who will be on the front lines administering the new UTP reporting requirements.

The directive makes clear that we expect examiners to engage with taxpayers early in the process to eliminate uncertainty as quickly as possible, whenever possible. This is key to our overall philosophy and shared goal of creating certainty sooner and being more efficient and effective. Also, over the next year, our examiners will receive special training on the handling of Uncertain Tax Positions.

In addition, a centralized process or triage team will be established to review UTPs and to determine their proper treatment. We know that Uncertain Tax Positions are uncertain for a number of reasons. There may be ambiguity in tax law and a lack of published guidance. Our triage team will identify trends of areas of uncertainty, and this will become an important source of inputs to our guidance pipeline. I see working with our colleagues at the Treasury Department and publishing guidance to clarify uncertain areas based on what we learn from Schedule UTP filings as a measure of success.

The directive to the field also reinforces longstanding principles of fairness and impartiality that are essential to balanced and principled tax administration.

Now I recognize that issuing such a directive cannot and will not ensure perfection, but we are committed to the positions and principles contained in the directive. However, should you see a problem, I urge you to make us aware of it. That will provide us the best chance to work out any bumps along the road to implementation as quickly as possible.

Some also expressed concerns that the reported UTP information would be automatically disclosed to foreign governments under treaties or information exchange agreements. Let me assure you that there will be no automatic release of UTP information to other governments. Our treaties and information exchange agreements do not require disclosure of information in cases in which there is no reciprocity, so it would be very, very rare to exchange such information unless the requesting government has similar information it can make available to the IRS. Further, even if reciprocity did exist, we would consider other

factors in determining whether to disclose the information, including the relevance of the information to the foreign government, which in many cases would not be present.

Before I close this morning, I would like to talk for a little bit about some of the other important initiatives we provide aimed at earlier and speedier issue resolution and greater efficiency and certainty. They are a major part of the overall re-tooling of our relationship with large corporate taxpayers.

A perfect example is the CAP program. In exchange for more openness and transparency on the corporate taxpayer's part, we help resolve issues early and ensure accurate returns are filed. Taxpayers who are transparent with us get certainty with respect to their obligations at the time their return is filed, rather than waiting for the regular examination.

I am a staunch advocate of CAP and believe that it is time to make the pilot permanent. We soon will be issuing guidance that will make CAP permanent and available to a greater number of taxpayers.

The permanent CAP will also include elements missing from the pilot, such as a Pre-CAP process that provides taxpayers a defined path to get into CAP and a CAP maintenance program for taxpayers already in CAP for a number of years where we will address and resolve issues with taxpayers as they arise.

Our toolkit also includes Industry Issue Resolution Projects. These involve the cooperative efforts of industry representatives, our operating divisions, our Chief Counsel, and the Treasury Department to reach administrable, common sense solutions for uncertain tax areas.

Industry Issue Resolution is really another form of guidance and helps reduce uncertainty on business tax issues within particular industries, such as our forthcoming guidance for the telecommunications and electric utility industries to resolve capitalization versus repair issues for network assets.

We have also made a major change to the Fast Track Settlement Program which should encourage more use of this issue resolution tool.

Our LB&I and Appeals functions have recently removed internal barriers that may have discouraged the use of the program. For example, it used to be that an examiner's case was left open in our tracking system during the time it went to Fast Track Appeals. This increased the examiner's cycle time and created a potential disincentive for the use of Fast Track. We have fixed this and an examiner will get credit for closing a case at the time it goes to Fast Track. I have also ensured that our Appeals function has the resources to handle more fast track cases, and now every taxpayer will have the opportunity to use the process.

Now, rather than spending time on a full audit…ending with a dispute and thus opening up an appeal… the process will be collapsed, speeding up issue resolution. The program's historical success rate in resolution is 80 percent, so it is a win/win for the IRS and taxpayers in the category of certainty sooner.

The last issue I want to discuss is the Schedule M3. The M3 has been a very useful tool in specific areas for specific taxpayers. It has helped us square up US and Global accounting and better understand permanent versus temporary issues.

However, I have always believed in continuous improvement. But it is especially important that when we look for new information…like the Schedule UTP…that we examine the other information that we already require.

To this end, we are forming an M3 working group with industry involvement to look at ways to reduce burden and duplication.

I believe that the combination of steps we are announcing today demonstrates our commitment and our preparedness to implement reporting of uncertain tax positions, while taking into account the legitimate concerns of taxpayers and their representatives.

The Schedule UTP we are releasing today is a principled and balanced approach that will improve tax administration concerning our largest and most complex taxpayers. It will also provide significant benefits to taxpayers, including getting them earlier certainty as to their uncertain tax positions, while preserving important taxpayer protections and respecting the important relationships the taxpayer has with its tax advisors and independent auditors.

This enhanced transparency, coupled with our extensive set of initiatives aimed at improving issue resolution, is a positive step forward for our nation's tax system.

By working together we can achieve an improved relationship between the IRS and corporate taxpayers, and mutual benefits in the areas of earlier certainty, efficiency, and consistency as to corporate tax administration.

I appreciate your attention this morning and I look forward to continuing the dialogue on important issues that affect us all.

Thank you.

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