

Prepared Statement of I.R.S. Commissioner Schulman Delivered at the New York State Bar Association Tax Section, on January 26, 2010, Announcing Disclosure Requirement for Uncertain Tax Positions of Large Corporations (\$10 Million in Assets)

WASHINGTON - It's a great honor to address the New York State Bar Association Taxation Section. I look forward to beginning a dialogue with you that will start - but I trust - not end today. Today, I want to discuss complexity...and more to the point, how we are trying to work smarter to manage complexity. Complex systems abound...from the structure of nature itself... to global economies and international trade...to legal systems...to our own complicated daily lives that seem to defy simplification.

Complexity has become a whole field of study and even a cottage industry for authors and consultants trying to make sense of complex business models and operations. Multinational companies need to manage complexity, whether it's their own structures, products, processes, information ...and yes, taxes which are steeped in complexity.

And as we do our best to understand and manage complexity, some joke that we have gone from complexity to perplexity.

Tax law complexity affects everyone today...from individual taxpayers filing a 1040 form... to wealthy individuals ... to business and corporate taxpayers ...to the IRS itself.

More than just collecting the revenue to run the federal government, the IRS has also been tasked with administering a number of large social programs through the Tax Code and implementing significant sections of major pieces of legislation, such as the Economic Stimulus bill and the American Recovery and Reinvestment Act.

Mind you, tax law complexity is nothing new. And the Tax Code is already four times longer than War and Peace and grows each year.

Now, if you were thinking I was leading up to a speech on tax law simplification, I am sorry to disappoint you. That's a speech for another day and another time.

Frankly, we need to deal with today's messy reality that tax law complexity has put on all of our plates. And we must be realistic. In today's global and diverse economy, business and tax laws are going to remain complex.

However, that does not mean we have to surrender to complexity or be reduced to tilting at windmills...quite the contrary. At the IRS, we're trying to evolve our programs to deal with an ever more complex world. In short, we are trying to work smarter.

By working smarter, we can tease out more certainty and consistency in the application of the tax laws. This greater certainty can benefit both corporations and the IRS. By working smarter, we can be more efficient and make better use of precious resources. Let me give you some examples of how we're trying to match deed to word.

In the individual taxpayer arena, we have a number of initiatives that we believe will produce positive results. For example, late last year, we launched the Global High Wealth Industry Group to centralize and focus IRS compliance expertise involving high wealth individuals and their related entities.

This is a game-changing strategy for the IRS. Initially, we will be focusing on individuals with tens of millions of dollars of assets or income. Going forward, we will take a unified look at the entire complex web of business entities controlled by a high wealth individual, which will enable us to better assess the risk such arrangements pose to tax compliance.

We want to better understand the entire complex economic picture of the enterprise controlled by the wealthy individual and to assess the tax compliance of that overall enterprise. We cannot do this by continuing to approach each tax return in the enterprise as a single and separate entity. We must understand and analyze the entire picture.

Our efforts to put a dent in offshore tax evasion also illustrate our working smarter strategy. As you know, we have a lot of activity in this area: from some groundbreaking cases, to our voluntary disclosure program, to legislation being considered by Congress, to increased international cooperation with other governments. We're looking for and finding points of leverage - what some call "nodes" of activity - where multiple people not paying taxes can be detected. Financial institutions are one such potential node of activity. Promoters of evasion schemes are another.

Our international enforcement and detection efforts are expanding and becoming better informed. For example, mining for information from the more than 14,700 disclosures that came in during our recent voluntary disclosure program is a way to identify financial institutions, advisors, and others who

promoted or otherwise facilitated US persons hiding assets and income offshore and attempted to shirk their tax responsibilities at home.

Let me also observe that the ramifications from our offshore compliance efforts and our voluntary disclosure program go far beyond the billions of dollars in revenues we will be collecting from these taxpayers. It will change the conversations that practitioners and tax return preparers will be having with many of their clients this coming tax filing season.

Moreover, the real watershed will come over the next 10, 20 and 30 years. Those who came in under the voluntary disclosure program will be in our tax system going forward, and the risk calculus of people thinking about hiding assets overseas to avoid paying taxes has changed dramatically. That protects the US Treasury and our tax base from erosion in the long-term.

Working smarter in the international tax arena also requires heightened cooperation and interaction with other countries' tax authorities. Clearly, the success we seek in the international arena cannot be achieved by the US alone.

We've already seen positive steps towards greater cooperation among nations, such as in April, when the G-20 heads of state agreed in a show of unity to act against tax jurisdictions that impede legitimate tax enforcement.

In addition, we are going to try some new approaches in the international arena. One such approach is the work we are doing to develop a protocol to conduct joint audits with some of our treaty partners. In theory, a joint audit conducted with another country's tax authority and IRS will reduce burden on a corporate taxpayer, who won't need to go through a similar exercise twice, as well as allow for competent authority resolution earlier in the process. Perhaps, we could even have competent authority as part of the audit team itself. It will also ensure that the corporation gives the same information to both tax authorities, reducing opportunities for arbitrage.

We are also trying to work smarter in the area of transfer pricing. We have been exploring the transfer pricing area for some time and determined we needed to change the way we do business in this area. From a taxpayer's perspective, it seemed that all too often we were taking too long to resolve transfer pricing issues... that it was difficult for the taxpayer or representative to know who at the Service was responsible for resolving the issue... and that we were not always consistent in our resolution of these issues.

From our perspective - while we have a phenomenal cadre of experts in this area - we needed more people with industry specific and transfer pricing expertise to match up with corporate taxpayers and to

fully develop the issues, discuss them with taxpayers and their representatives, and ultimately resolve the issues for the large number of taxpayers with transfer pricing issues.

In order to address these issues, and ensure organizational consistency and focus, we are establishing a Transfer Pricing Practice within our Large and Mid-Size Business operating division so we can strategically and systematically administer transfer pricing issues. The idea here is to create a group of experts in the transfer pricing area that we can use to coordinate our handling of the most important issues to taxpayers and to us, identify emerging issues and trends, and provide consistency in outcomes in our transfer pricing cases.

I believe that at the end of the day, taxpayers and tax authorities pretty much want the same thing out of the tax system. They want certainty regarding a taxpayer's tax obligations sooner rather than later. They want consistent treatment across taxpayers. They want an efficient use of government and taxpayer resources by focusing on the issues and taxpayers that pose the greatest risk. And that's all about working smarter.

Working smarter also includes maximizing the use of our resources, while leveraging other players in the tax system to help us ensure compliance with the law. We recently unveiled a major initiative to oversee tax preparers who are an integral part of the tax system. With the complexity of the tax code, more and more Americans now turn to a preparer to help them file their taxes. We estimated that there are somewhere between 900,000 and 1.2 million paid tax return preparers. And making them an integral link to our service and compliance strategies will help us do our job.

We announced that we plan to require registration, minimum competency testing, and continuing education of paid tax return preparers. In addition, once we set up and administer a testing process, we will create a public database of preparers, so that taxpayers can find out if they are dealing with a qualified preparer. We are also shifting enforcement resources to focus on preparers. Beginning this filing season we are expanding our "knock and talk" and other programs to visit thousands of preparers to discuss their operations and ways to reduce preparer error rates.

The goals of the strategy are to improve service to taxpayers, increase compliance, and enhance the integrity of the overall tax system. I think this creates leverage for us, and is a smart use of our resources.

Another important player in the tax system is the Corporate Board of Directors. I have recently been reaching out to corporate board members to discuss the importance of appropriate oversight of tax compliance and I will continue to do outreach in this community. My proposition is simple: Tax

expenses are like other major expenses. Manage them too loosely and you give up profit. Manage them too aggressively and there are bad consequences.

The board must oversee how management manages them. And that means some level of understanding, a set of policy principles and then a control system of review and reporting that assures the board that their policy is being carried out. Many corporate boards do have a regular dialogue regarding tax risk with their CFOs, tax directors and external tax advisors. My goal is to promote good corporate governance on tax issues and engage the corporate community in a dialogue about the appropriate role of the board of directors in tax risk oversight. This will continue to be a theme of ours.

Finally, I want to talk about Transparency....

We have been taking a hard look at transparency regarding business tax issues. Accounting for income taxes and tax risk has changed over the past several years. Accounting for uncertain tax positions is much more articulated now than in the past. And auditing firms are conducting much more extensive reviews of materials used to make decisions on tax reserves reflected in a taxpayer's financial statement.

Several months ago, I announced that the IRS was studying these changes and was exploring ways to improve transparency regarding material tax issues so that we can achieve the three objectives of certainty, consistency, and efficiency for us and taxpayers.

The IRS is taking a major step towards transparency that I want to announce today related to changes we are proposing to reporting requirements regarding business taxpayers' uncertain tax positions.

The Announcement we are issuing today does two things. First, it describes proposed reporting requirement at the "time-of-filing." Second, it highlights specific areas where we are requesting public comment and thus serves to further our continuing dialogue with practitioners, business taxpayers, and others regarding how to improve tax administration and compliance regarding many of our nation's business taxpayers.

Before I get into the meat of the proposal, let me set some context.

Today, we spend up to 25 percent of our time in a large corporate audit searching for issues rather than having a straightforward discussion with the taxpayer about the issues. It would add efficiency to the process if we had access to more complete information earlier in the process regarding the nature and materiality of a taxpayer's uncertain tax positions. The goals of our proposal are simple: to cut down the

time it takes to find issues and complete an audit... ensure that both the IRS and taxpayer spend time discussing the law as it applies to their facts, rather than looking for information...and to help us prioritize selection of issues and taxpayers for examination.

Let me explain the Announcement and what it means to business taxpayers. Reporting uncertain tax positions would be required at the time a return is filed by certain business taxpayers: those who have both a financial statement prepared under FIN 48 or other similar accounting standards reflecting uncertain tax positions and assets over \$10 million. Under the Announcement, these taxpayers would be required to annually disclose uncertain tax positions in the form of a concise description of those positions and the maximum amount of US income tax exposure if the taxpayer's position is not sustained. By concise, we mean a few sentences that inform us of the nature of the issue, and not pages of factual description or legal analysis.

Let me say a few things about this proposal. We have taken what I believe is a reasonable approach. We could have asked for more...a lot more... but chose not to. We believe we have crafted a proposal that gives us the information we need to do our job without trying to get in the heads of taxpayers as to the strengths or weaknesses of their positions.

We will be looking only for a brief description of the issue and the maximum amount of US income tax exposure. The proposal does not require the taxpayer to disclose the taxpayer's risk assessment or tax reserve amounts. We are asking for a list of issues that the taxpayer has already prepared for financial reporting purposes, in order to improve the efficiency and effectiveness of tax examinations. We are also looking for the maximum exposure, so we can allocate our exam resources appropriately. We need to have a sense of materiality and whether we should spend exam resources on an issue.

We do not believe we will be adding substantial new work or burden on taxpayers. These taxpayers are already required to establish tax reserves for uncertain tax positions in determining their financial statement income under US or foreign accounting standards, such as FIN 48. So the work is already being done. We are asking for more transparency.

Just to be clear again, this proposal would not require that taxpayers disclose how strong or weak they regard their tax positions or report to us the amounts they reserved on the books regarding those positions.

And as part of this proposal, the IRS would otherwise retain its longstanding policy of restraint as it applies to tax accrual workpapers.

I think this is a sound proposal that will significantly advance the ball in the transparency area. We understand this proposal will generate a good deal of discussion and debate, and we welcome that. We look forward to public comments and the upcoming dialogue regarding this important announcement. Our mission with respect to our large business audit program, indeed our entire audit program, is to collect the proper amount of tax and to use our compliance tools to foster on-going compliance by all taxpayers, including our largest taxpayers. Our responsibility is the same as the responsibility of our taxpayers - apply the law as it currently exists, not how we would like it to be, and do so with neither a thumb on the scale in favor of the government, nor in favor of the taxpayer.

Our ultimate goal with respect to our large case audit program is to bring taxpayers into compliance and keep them there with strategies that are less time and resource intensive than our traditional audit process. Our work on corporate governance is part of this strategy as is the transparency proposal I outlined today. In fact, we have moved down this path with the Compliance Assurance Program or "CAP." This program allows taxpayers that are transparent with us with respect to their tax issues to get certainty with respect to their tax obligations at the time their return is filed. Indeed, with regard to several of our CAP taxpayers that have been in the program for a number of years, we will be moving them to what we refer to as a monitoring program, where we address and resolve issues with a taxpayer as they arise. We are looking to expand and make permanent the CAP program in the near future.

While we understand that there will always be a need for our traditional audit process, we will continue to try to work smarter. We will use new techniques, and count on enhanced transparency, to help us maximize the use of our resources and spend our time on the issues and taxpayers who pose the greatest compliance risk. In the future, the IRS will depend more and more on information and new alternatives to the traditional audit process to ensure compliance with the tax laws.

In conclusion, I want to thank you again for inviting me today to share some ideas and plans with you that I believe can benefit both the corporate community and the IRS, and maintain the integrity of our tax system. Of course, the challenges I described today were not created in a day-and-a-night and cannot be solved in a day-and-a-night. I am a big believer that institutions like the IRS need to constantly evolve to keep up with an ever changing business environment. As the world has become more complex, we will continue to try to work smarter. And as we try new techniques and evolve our programs, we will look forward to hearing your feedback and having an ongoing dialogue.