

**Prepared Remarks of William J. Wilkins,  
IRS Chief Counsel  
Federal Bar Association Tax Section  
March 5, 2010**

It's a pleasure to address this group. I think most of us count ourselves as fortunate to have found our way into practicing tax law in Washington, particularly if we have had a chance to work in government. Of course, everyone becomes frustrated with tax law processes and tax law complexity. Even so, the opportunity to consider tax issues from the standpoint of the national interest, working with talented and public spirited tax practitioners to solve challenging problems, makes the experience a real privilege.

In our recruiting spiel, we like to say that the Office of Chief Counsel is the largest tax firm in the United States – we have about 1600 lawyers and about 2500 total employees. However, the more interesting point is that today's IRS has close to 100,000 employees, so we are

serving a very large organization with relatively few people.

In broad terms, what we do involves three big tasks: creating regulatory infrastructure for administration of general tax statutes; handling resolution of tax conflicts; and providing legal advice to the Commissioner and other IRS executives. How we do these things is important, because doing them the right way means that tax administration is carried out consistently with the rule of law. We lawyers are always in danger of getting all high and mighty about the rule of law. However, the value of the rule of law is all too obvious in a world where, as we see in the news every day, many people cannot rely on their public institutions to protect their physical safety and property rights. So, it is important to the system that taxpayers see that tax administration is not based on the whim of an all-powerful tax collector, but is in fact grounded in duly enacted statutes that can be invoked by taxpayers in fair and neutral administrative and judicial processes.

But back to the work of the office -- the most important breakdown in responsibilities is between national office subject matter experts and litigators in the field. The responsibilities of the two Deputies, Clarissa Potter and Chris Sterner, generally are divided along this line.

The National Office lawyers, who work under Clarissa, the Deputy for Technical matters, are all located in the Washington headquarters building. These lawyers are mostly devoted to the guidance process and to specialized subject matter advice to the field. They are essential to our mission of providing for uniform, correct, and impartial application of the tax laws. The Associate offices also serve as critical resources as we contribute to the development of new legislation that affects tax administration.

Chris is the Deputy for Operations, and he oversees our lawyers who are assigned to the IRS operating divisions. The Division Counsel are dispersed in offices throughout the country. They are the direct link

between our office and the examination function; and they handle our extensive Tax Court docket. In complex examinations, they will assist in advising examiners on key legal issues, including on how to develop facts that are relevant to the legal analysis. In less complex cases, they may only begin to touch the case when it is docketed in the Tax Court.

Part of the role of Division Counsel is to determine whether the positions advanced in examination or litigation reflect an official Service position; and if not, to work with the appropriate Associate Chief Counsel office so as to assure uniform, correct, and impartial administration of the tax laws. This kind of consultation is most common when there has been a recent statutory or regulatory change, or when there has been a significant new court decision. Practitioners know that there are several kinds of written legal advice that can result from such consultations. This advice is not the official position of the IRS unless it is published in the Federal Register or the Internal Revenue Bulletin –

such as in the case of regulations, Revenue Rulings, Revenue Procedures, and Notices. Private letter rulings, technical advice memoranda, generic legal advice, and the relatively informal advice that has started to be published recently is not an official position. To us, however, it is important to our mission of applying consistent interpretations pending official positions.

We also have offices devoted to the IRS' general legal functions, such as labor relations, ethics, and contracting; and to managing our budgets and our physical operations. These are non-tax positions, but the Associate Chief Counsels in these functions are among my most valued advisors.

In addition to our management responsibilities, the senior officials within the Office serve as legal and policy advisors to the Commissioner and other top executives of the IRS. The core team here includes me, the two Deputies I mentioned before, the Division Counsel leadership from

the four operating divisions, and a handful of experienced assistants who work for me and the two Deputies in the front office. The Commissioner's initiatives, such as return preparer regulation, disclosure of uncertain tax positions, and international tax compliance, involve significant input from these Counsel leaders and from Counsel subject matter experts. We are constantly responding to calls for legal assistance in a variety of matters involving tax administration, interaction with other parts of the government, and responses to various kinds of urgent situations. We are dedicated to providing top quality support in these areas, keeping our eye on the big picture, being creative, and being alert to risks and opportunities.

One of the things I have personally worked on is the initiative on uncertain tax positions reflected in Announcement 2010-9. Much of the work had preceded my arrival, but in the fall it became more structured, with presentation of issues and options to IRS leadership, drafting of the

Announcement, and eventually discussions with other government stakeholders including Treasury and Justice.

I have heard some people speak as if this initiative is an outgrowth of the Textron case and other litigation over application of the work product doctrine to various kinds of tax documents. I personally think that's a bit off the mark. I think the more important development was the fact that the accounting rules surrounding uncertain tax positions evolved in a way that made it necessary to deal with these issues. Under GAAP today, corporations must generate these kinds of tax issue lists, and their independent auditors must review those lists in the process of certifying the financials.

Some have asked, why would the IRS exam team be interested in knowing those issues – but come on, that question almost answers itself. The more realistic question is, why would the IRS choose to spend time finding these issues, or risk not finding them, when the issues are there

for the asking and not protected by any privilege? I don't doubt that people can and will come up with reasons why the IRS should not ask for this kind of information, but the fact that it exists makes it almost impossible not to wrestle with this issue. The point is, of course the information is helpful in an examination – so granted that it's helpful, what is the best thing to do for sound tax administration and fair treatment of taxpayers?

The other important piece of context is that today's IRS, under Commissioner Shulman, is interested in using information to make tax administration better, and in engaging private sector stakeholders to make tax administration better. That is why we ask for legislation calling for financial institutions to help us identify offshore accounts of U.S. taxpayers; why we are proposing to monitor and regulate tax return preparers; and why we are dedicated to effective implementation of recent legislation in areas like basis reporting and credit card reporting.

In the corporate sector, the Commissioner is commending some corporate boards and audit committees for adopting procedures to help the board understand a company's tax risk profile. While we believe this is good for the company itself, it may also lead to improved tax administration. For example, imagine a company where the tax officer and the finance officer are really, really focused on short term earnings or cash flow. If that company's tax risk assessment is elevated to a board committee with more of an eye on overall enterprise risk and long term sustainability, some tax administration benefits may come about through leveraging the participation of the board.

As I said earlier, it was clear early on that we faced a broad question of tax administration against the background of the existence of obviously useful information. Part of the process was cataloging the different kinds of information being created in the financial accounting process, and making decisions about whether, on balance, obtaining a

particular kind of information would have a beneficial effect on tax administration. Another part of the process was deciding whether we were talking only about using information in audits, or whether we were also talking about using information for audit selection. In particular, we would need to obtain disclosure at the time of the return if this tool were to be used for audit selection. Another part of the process was determining whether and how to assign a dollar size to each issue, again trying to strike an overall balance in favor of the best tax administration outcome.

The two broad categories of potentially available information were issues and dollar sizes. The sub-categories of issues were basically the three categories that are referenced in the Announcement, which are: (1) issues for which a reserve exists, whether it's a 100% reserve or some lesser amount; (2) issues for which the taxpayer is relying on an IRS administrative practice not to examine an issue, rather than a strict legal

interpretation, to avoid reserving; and (3) issues that a taxpayer expects to win by litigating, that it would have created a reserve for if it expected to settle short of litigation. This last category can be a bit confusing, but it comes from the fact that, if you are determined to litigate and not settle, only two outcomes – zero cents and 100 cents on the dollar – are possible in most cases. If the 100 cent outcome is the more likely one, and you are determined not to settle, the accounting guidance appears to say you should claim the full tax benefit based on the 100 percent being the most likely outcome – again, there being only two possible outcomes. If settlement is a possibility, then you would create a reserve if the most likely outcome is having to concede something to the IRS to gain a settlement.

A final category of issue-related information arising from financial accounting work consisted not so much of information as it did of documents – backup memos and tax opinions being prominent examples.

It was obvious that these kinds of documents would not be part of a schedule filed with a tax return, so the form of disclosure helped resolve this issue. Under the policy of restraint, if a document like this is responsive to an IDR, the taxpayer can hold it back by successfully asserting a claim that the document is part of its tax accrual workpapers, absent application of the special rules about listed transactions. The considerations here were similar to the considerations about obtaining the taxpayer's risk percentages. The thinking was that issue identification and sizing would provide most of what was needed, without having to engage in debates over the fairness or legality of looking at the taxpayer's written analysis.

The categories of dollar size information that was potentially available included the size of each issue without regard to risk assessments; the reserved amount by issue; the reserved amount in the aggregate for federal income tax; the risk percentage used to determine

the reserve amount for each issue; and all of the above either aggregated over all years or broken down by years. It was in these dollar amount areas that balancing was most critical, and in which definitional choices were the most challenging.

Part of the challenge was the fact that knowing the company's risk-adjusted number for each issue held the potential to be extremely helpful for purposes of prioritizing issues within an audit, for identifying returns for audit, and for identifying emerging issues of potential concern. It was understood that a \$100 million issue with high settlement value to the company was less interesting than a \$100 million issue where the taxpayer believed that the IRS was more likely than not to win if the issue were litigated. It was understood that, if there were no adjustment for risk, both issues would appear to be the same size on the schedule.

On the other hand, getting a risk percentage or a reserve number – from which a risk percentage could pretty easily be estimated – was

certain to be controversial. We knew there would be bitter complaints about the fairness of taking advantage of the taxpayer's work and expense in assessing its tax risks; about the potential of creating expectations around audit results tied to the reserve number; and even about legal issues of the kind that are currently being litigated in tax accrual workpapers cases.

So we were – and we are – faced with a choice between getting no numbers; getting maximum numbers with no risk adjustment; and getting some kind of risk adjusted number. My personal view is that this is a return selection issue, rather than an issue of prioritizing issues within audits – because numbers can and will be shared in the audit process itself – including risk assessments if the taxpayer feels like sharing those. With no number at all, we only have the issue description to help us prioritize returns for audits. With familiar issues, maybe that's enough, but for issues that the IRS is not familiar with, it may not be. With a

maximum number, we have something to go on for return selection, with the recognition that the maximum number is not reflective of the precise value of the issue. With a risk adjusted number, there may be incremental improvement in audit selection, with the question being whether that improvement is large enough to outweigh the controversy, and to outweigh the merits of arguments against requiring taxpayers to share their risk assessments.

The final point on numbers is that order of magnitude is more important than precision. As previously mentioned, in my view the usefulness of numbers is primarily for selection of returns for audit. The interest level in an issue will be roughly the same whether the sizing is accurate, or is off by ten percent. That is why we asked for comment on alternative approaches for sizing of issues, including use of ranges. We did not ask specifically about including an upper range that is unbounded – larger than X – but that is a question in my mind. We have heard in

particular that issues involving valuation are hard to size other than perhaps by order of magnitude; and that sizing by a tax base number – income or deduction – might be better than sizing by a tax number. We are very interested in suggestions in these areas.

I think the list of issues on which we requested specific comment reflect the kinds of other issues that we wrestled with and will need to resolve as this goes forward. Many of them relate to this issue of assigning sizes to issues, including whether to separate or aggregate taxable years. One is what to do about issues that first become identified for reserve purposes after a relevant year's return has already been filed.

To provide some additional background on some early questions:

- We do expect to release a draft schedule and instructions in time to obtain commentary on those.

- We do not plan to require this information for any returns earlier than calendar 2010 returns.
- A company that does not have certified financials will not need to file this schedule.
- This is about federal income tax positions, so there is nothing here on excise or payroll taxes. An entity that does not pay federal income tax would not file one of these schedules, unless it had a risk exposure that could make them subject to income taxes, such as a classification risk.
- A taxable corporation that invests in a passthrough entity may or may not have to schedule something relating to the passthrough investment – this would turn on what they did in connection with their accounting reserve for uncertain tax positions.

- We have heard comments about potential overlap with other disclosures, in particular the 8275 forms, and we would invite discussion of whether implementation of this new schedule would permit phasing out other disclosure regimes.

Let me conclude by addressing a point that should be obvious.

Just because an issue is scheduled and sized does not mean that particular audit results are expected from the examiner. It is true that this will be a new tool and that examiners will need to learn and understand what it means and what it does not mean. The educational role on this will be shared – LMSB and Counsel will do their part, but I do not doubt that taxpayers and their very able representatives will participate vigorously and effectively in that education process. We in Counsel understand that our mission is to provide fair and impartial interpretation of our revenue laws. Part of

this is our belief that issues should be decided on the merits, and not on how well they can be hidden. But another part is that outcomes should be based on applying the law as written to the actual facts, and not on any dollar target, and not on anyone's view of how the law should have been written.

Thank you for the opportunity to speak to you today. I promised I would take questions as time permits, so please approach the mike if you have a question.