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I.R.S. Plan to Uncover Companies' Tax Strategies

By DAVID KOCIENIEWSKI

It is the tax world's version of blind man's bluff.

Every year, thousands of the nation's largest corporations are required to report to the I.R.S. whether they have reduced their tax bills by using questionable accounting strategies.

They have to supply an estimate of how much they might owe if those strategies failed to withstand an audit.

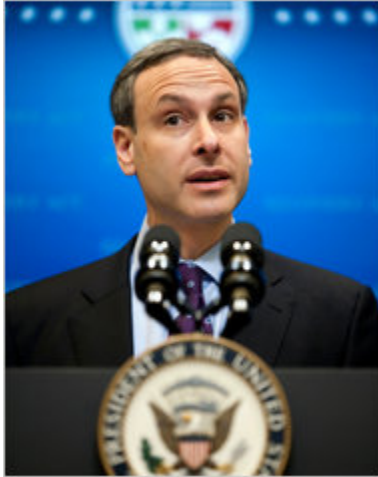
They even have to set aside enough money to pay the government if their claims are found to be improper.

But the corporations are not obliged to reveal precisely what those uncertain tax positions are — and if the I.R.S. does not manage to ferret them out and challenge them before the three-year statute of limitations expires, the companies can keep the money.

Now, the [Internal Revenue Service](#) is calling an end to the game. Beginning next year, the agency plans to mandate that corporations also provide a brief description of their uncertain tax positions and their rationale, offering essentially a road map for its auditors.

The stakes are enormous. According to one law firm's analysis of the most recent filings with the [Securities and Exchange Commission](#), the companies in the Fortune 500 this year reported more than \$200 billion in uncertain tax positions — exceeding the \$138 billion paid in corporate taxes last year. At least 40 companies exceeded \$1 billion in such reserves: [Microsoft's](#) was \$5.4 billion; [Bank of America](#) reported \$5.2 billion; the [American International Group](#) listed \$4.8 billion; and [Goldman Sachs](#), \$1.9 billion.

Douglas H. Shulman, the I.R.S. commissioner, who wrote and is promoting the plan, which has rattled the accounting world, said it was intended to make tax collection more efficient and to urge businesses to comply more closely with the law. While some companies may pay more taxes, Mr. Shulman acknowledged, the new procedures would also help businesses by encouraging Congress and the I.R.S. to clarify ambiguous portions of the nation's convoluted tax code more quickly.



Joshua Roberts/Bloomberg News

Douglas Shulman, the I.R.S. commissioner, would require corporations to provide a description of any uncertain positions.

“We are moving away from what I would describe as a contentious relationship, where we spend too much of our time identifying issues, to one where we know the issues from the outset and spend our time engaging on appropriate issues,” Mr. Shulman said.

Though transparency may be considered a virtue by the person collecting taxes, it is viewed as a menace to the people whose job is to minimize them. Mr. Shulman’s initiative, which even his critics concede he has the authority to enact, has set off an anguished response from corporations and accountants. They predict that it will make a cumbersome system even more costly and confrontational.

David A. Lifson, former president of the New York State Society of Certified Public Accountants, cautions that the plan will allow tax authorities to bully taxpayers by bludgeoning them with the very advice they received from their own accountants and tax lawyers.

“We barely ever see a revenue agent who doesn’t find an issue and try to extract some kind of payment for its nuisance value,” said Mr. Lifson, a partner at the accounting firm Crowe Horwath. “Now they want you to give the enemy all the guns and walk into a tax audit ducking. And they can pester you into paying more taxes rather than taking the trouble to figure out what amount is fair.”

Others warn that the I.R.S. may gain transparency at the expense of investors and the financial markets. Because the additional disclosure may touch on legally privileged information, some tax lawyers fear that corporate executives may withhold information from their auditors and accountants, who assess a company’s finances and actual value.

Many tax practitioners also expect the advent of yet another game of cat and mouse, as corporations devise new ways to limit what information is subject to disclosure.

While corporations have long complained about the increasingly complicated way the United States taxes businesses, Mr. Shulman’s proposal would be a fundamental shift in a system where voluntary compliance and regulatory complexity have raised creative interpretation of the tax code to a high art.

The current corporate rate of 35 percent is higher than that in many other developed countries. But Congress has larded the code with so many deductions and loopholes — including a dollar-for-dollar credit for taxes paid to foreign

Tax Uncertainty

A study of S.E.C. filings by a law firm shows that the 500 biggest U.S. corporations have set aside over \$200 billion to cover their potential liabilities for uncertain tax positions, which is more than the total of \$138 billion the I.R.S. collected in corporate taxes in 2009. Here are some of the companies with the largest tax reserves:

LARGEST RESERVES FOR UNCERTAIN TAXES In billions		LARGEST RESERVES COMPARED WITH REVENUE In billions		RATIO TO RESERVE REVENUE
General Electric	\$8.7	Starwood Hotels and Resorts	\$1.0	21.2%
Pfizer	7.7	Agilent Technologies	0.9	20.8
AT&T	7.5	Energy Future Holdings	1.6	17.2
JPMorgan Chase	6.6	Amerigroup	0.9	17.0
General Motors	5.4	Merck	4.3	15.8
Microsoft	5.4	Pfizer	7.7	15.3
Bank of America	5.3	Morgan Stanley	4.1	12.9
Wells Fargo	4.9	Boston Scientific	1.0	12.7
A.I.G.	4.8	Yahoo	0.8	12.4
I.B.M.	4.8	Avis Budget Group	0.6	11.8

Source: Ferraro Law Firm

governments and generous deductions for depreciation and debt financing — that the effective rate paid by most companies is below 22 percent, lower than in most developed countries.

That combination of high marginal rates and a plethora of arcane write-offs and shelters has created a structure that encourages, and rewards, companies that use aggressive tax strategies. Companies routinely hire outside lawyers to review their tax claims and judge the likelihood of withstanding a challenge.

In 2006, the I.R.S. began requiring companies to report any tax savings from an accounting strategy that had not been judged “more than likely” to withstand an audit.

According to S.E.C. filings, at least 11 corporations reported last year that their potential tax liabilities totaled 10 percent or more of their revenue. [Starwood Hotels and Resorts](#) posted a \$999 million tax reserve, 21 percent of its revenue of \$4.7 billion; [Agilent Technologies](#) reserved \$930 million, 21 percent of its revenue of \$4.48 billion.

After he was sworn in as commissioner in 2008, Mr. Shulman found that auditors sometimes spent 25 percent of their time searching — often in vain — for what those positions might be. He decided that more disclosure would eliminate “a tremendous waste of time for the auditors and the taxpayer.”

As now written, Mr. Shulman’s plan would force corporations to file a new form, Schedule UTP, providing a concise description of any uncertain positions and their rationale for claiming them. Mr. Shulman has said repeatedly that the I.R.S. will use the information to determine which tax rules are causing confusion, rather than to single out specific businesses for an audit.

I.R.S. officials say they do not know the total amount of uncertain tax positions reported by United States corporations. Even if they did, it would be difficult to project how much the government might recover because Mr. Shulman acknowledged that some of the uncertain positions would be found legitimate.

A database compiled by the Ferraro Law Firm and called the [Ferraro 500](#) ranked the Fortune 500 corporations by the size of their reserves for uncertain tax positions and found that the top five were: [General Electric](#), which set aside

\$8.7 billion to cover potential taxes, interest and penalties; Pfizer, \$7.7 billion; AT&T, \$7.5 billion; JPMorgan Chase, \$6.6 billion; and General Motors, \$5.4 billion.

Although the corporations' reserves include amounts that could be owed to states or foreign governments, the overwhelming majority of the potential liability is believed to be for United States federal taxes.

Mark Luscombe, a federal analyst at CCH, a company that offers tax advice, said he expected that many filers would take a more conservative approach because of the rules.

"Just knowing that more detailed information about those transactions will be readily accessible to the I.R.S. will make people more careful," he said. "They'll probably prepare every submission as carefully as if it was a legal defense."

Others suspect that businesses might devise ways to avoid having their tax positions deemed uncertain or to ask that any legal advice be given verbally, so it would be easier to omit from a return.

Mr. Shulman said that he hoped the guidelines would encourage companies to be forthcoming in seeking I.R.S. rulings before filing their returns or enrolling in the Compliance Assurance Program, which assigns auditors to work with major corporations to resolve tax questions in real time.

"A lot of corporations are playing it by the book," Mr. Shulman said. "The people who will most change their behavior are the people who play the audit lottery game and try to hide things from us."