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# Failing Corporate Tax Transparency and the Immediate Need to Reduce Overburdening Duplicative Tax Reporting Requirements

Ilya A. Lipin

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## FAILING CORPORATE TAX TRANSPARENCY AND THE IMMEDIATE NEED TO REDUCE OVERBURDENING DUPLICATIVE TAX REPORTING REQUIREMENTS\*

*Ilya A. Lipin\*\**

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## I. DISCLOSURE COMPLIANCE BURDEN ON CORPORATE TAXPAYERS

During the last decade, there has been a clear shift in the tax compliance mechanisms where the corporate taxpayer became responsible for divulging its financial, tax, and technical information to the Internal Revenue Service (“the Service”). This shift has been justified in order to crack down on corporate tax shelters and abusive strategies which exist due to the differences between financial and tax accounting principles and existing corporate tax loopholes.<sup>1</sup> The shift has also been warranted with the promotion of tax transparency and the Service’s goal to have more effective audits of the corporations.<sup>2</sup> Most notable disclosure compliance burdens on taxpayers introduced in the last decade were the reporting of listed and non-listed reportable transactions via Form 8886, disclosures to avoid accuracy related penalties through Forms 8275 and 8275-R, reconciliation disclosure between accounting for financial and tax purposes via Schedule M-3, and disclosure of uncertain tax positions through newly released Schedule UTP.<sup>3</sup>

The regime of compliance with disclosure requirements and implementation of reporting mechanisms are of concern to corporate taxpayers. To comply with these reporting requirements established by the Service, businesses’ tax departments need additional resources to collect information, technology, and manpower to process the collected data, and professionals to analyze and report the data on the disclosure tax forms.<sup>4</sup> Reporting of proper information located throughout multiple disclosure forms to the Service in order to protect taxpayers’ rights during audit presents a serious concern for all tax practitioners and their clients.<sup>5</sup> Comprehensive overhauls with goals to increase transparency

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1. See Shirley Dennis-Escoffier, *New Schedule M-3 Required For Reporting Book-Tax Differences*, J. OF CORP. ACCT. & FIN., Nov/Dec 2004, at 81 (noting the purpose for enactment of Schedule M-3).

2. Ron Singleton & Steve Smith, *The Increase in Transparency Requirements for Corporate Tax Positions*, THE CPA J., Mar. 2011, at 38 (stating that “The IRS has long been concerned with how to effectively audit corporations, and has recognized the importance of companies being open about questionable tax positions in making the audit process more efficient.”).

3. Erica Murray & Zachary Brandmeir, *The Road to Transparency*, TAX ADVISER, May 2010, at 314 (stating that the “most notable changes over the past decade concern reportable transactions, the introduction of Schedule M-3, and most recently the potential disclosure of uncertain tax positions to be submitted with annual tax returns.”).

4. See Anonymous, *50,000 Corporations Expected To File 2005 Schedule M-3*, 92 STANDARD FED. TAX REP. 28, June 30, 2005, at 4 (noting anticipation of a lively debate pertaining to “technology costs to support Schedule M-3 filing [requirement that] are imposed on smaller firms.”).

5. Blaise M. Sonnier, Cherie J. Hennig & Sharon S. Lassar, *Protecting Work Product in IRS*

create additional work for tax practitioners, which inevitably lead to higher costs for businesses.<sup>6</sup> For instance, the transition to Schedule M-3 in 2004 imposed new compliance costs that affected approximately 50,000 taxpayers.<sup>7</sup> When Schedule M-3 was introduced, taxpayers and tax advisers stated that compliance with the new provision would add new expenses as its tax and corporate departments would need additional resources and time to collect information, complete, and file the schedule.<sup>8</sup> The same effect is expected with full implementation of Schedule UTP. Ambiguity and complexity of the tax law associated with new legal responsibilities further increase costs and affect companies' bottom lines.<sup>9</sup>

Reporting requirements add new costs to the overall tax compliance tab. In 2002, the Tax Foundation, a nonpartisan educational organization, estimated that businesses spent approximately \$102.5 billion to comply with the federal tax code.<sup>10</sup> Between years 2001 and

*Disclosures and During the Audit After Deloitte*, TAXES, Dec. 2010, at 31 (stating that “[g]iven the extensive financial and tax disclosure requirements now required by large corporate taxpayers on Schedule M-3, and on either Form 8275, Form 8275-R, Form 8886 or the Schedule UTP, and the requirement to grant the Revenue Agent access to supporting documentation in the planning phase of an IRS audit, the protection of sensitive documents from IRS scrutiny is critical.”).

6. Murray & Brandmeir, *supra* note 3, at 316.

7. Charles Boynton & William Wilson, *A Review of Schedule M-3: The Internal Revenue Service's New Book-Tax Reconciliation Tool*, 25 PETROLEUM ACCT. & FIN. MGMT. 1 (2006), available at [http://www.irs.gov/pub/irs-utl/schedulem3reviewboyntonwilson\\_petroacctfinmgjt082306.pdf](http://www.irs.gov/pub/irs-utl/schedulem3reviewboyntonwilson_petroacctfinmgjt082306.pdf) (noting the costs associated with transition from Schedule M-1 to Schedule M-3). See Anonymous, *supra* note 4, at 1 (noting that “[m]any corporations had pleaded with the IRS, to no avail, that they needed more time to prepare databases to support the additional information required on Schedule M-3.”).

8. See John R. McGowan & David Killion, *Schedule M-3: Closing the Corporate Book-Tax Gap*, TAX ADVISER, July 2005, at 409 (stating that to comply with Schedule M-3 disclosures “[c]orporate tax departments will need additional resources to collect information, the time needed to file a corporate return will increase and practitioners will need to be compensated for the additional time required.”). See *id.* (noting that the burden of Schedule M-3 compliance “will fall on the taxpayers who have to provide the additional data for tax advisers to complete the form.”). See Patricia A. Thompson, *Comments on Schedule M-3 with the Objective of Reducing Burden and Duplication*, AICPA, Aug. 1, 2011, available at [http://www.aicpa.org/interestareas/tax/resources/taxmethodsperiods/advocacy/downloadabledocuments/aicpa\\_08.01.2011\\_sch\\_m3\\_comments.pdf](http://www.aicpa.org/interestareas/tax/resources/taxmethodsperiods/advocacy/downloadabledocuments/aicpa_08.01.2011_sch_m3_comments.pdf) (discussing current critique of Schedule M-3 and stating that “Schedule M-3 is not achieving its stated goals”).

9. See Meg Shreve, *Panelists Push for Simplification of Taxes on Individuals*, TAX NOTES TODAY, Apr. 14, 2011, at 2 (noting a comment from a tax professor from San Jose State University, Annette Nellen, who stated that “[a] tax system should follow the principle of simplicity. . . . [t]hat is, the tax law should be simple so the taxpayers can understand the rules and comply with them correctly and in a cost-efficient manner.”).

10. J. Scott Moody, *The Cost of Complying with the Federal Income Tax*, TAX FOUND., July 1, 2002, available at <http://www.taxfoundation.org/publications/show/133.html> (reporting the combined costs of individual and business tax reporting).

2006, it has been approximated that the total cost associated with compliance was higher than the amounts provided in the form of tax refunds.<sup>11</sup> In 2006, an average Fortune 500 company wrote a check for approximately \$5 million dollars on expenses associated with tax law compliance, while the largest spent over \$10 million.<sup>12</sup> Another nonpartisan tax group, National Taxpayer Union, estimated that in 2008 the cost of compliance for corporations rose to \$159.4 billion.<sup>13</sup> It is predicted that the cost of compliance will continue to rise steadily and by 2015 equal \$482.7 billion or 20.7% of the domestic revenue.<sup>14</sup>

In contrast to other countries, the time it takes the U.S. corporate taxpayer to comply with its tax requirements is significant. For instance, in comparison to corporate taxpayers in the United States, who spent on average 23 workdays on their tax returns each year, corporate taxpayers in Ireland on average spent only 9.5 days.<sup>15</sup> Countries including Finland, Spain, and Sweden simplify tax return compliance by providing taxpayers with already filled-out returns with their personalized tax data.<sup>16</sup> Other statistics report that, currently, businesses spend 2.94 billion hours to comply with the tax code.<sup>17</sup>

High compliance costs also affect the efficient operations of the government. It is estimated that in 2010 the Service's administrative costs amounted to \$12.4 billion.<sup>18</sup> These costs are likely to continue to rise with implementation of new tax reporting initiatives,<sup>19</sup> unless the

11. J. Scott Moody, *The Cost of Tax Compliance*, TAX FOUND., July 2001, at 8, available at <http://www.taxfoundation.org/files/9bd6c31673d5cc3023471165d273b6b3.pdf> (noting that the "cumulative compliance cost over the 2001-2006 period will come to almost \$930 billion while the cumulative reduction over the same period will cover little more than half the compliance costs at \$550 billion.").

12. JOEL SLEMIEROD & JON BAKIJA, *TAXING OURSELVES* 162 (4th ed. 2008).

13. See David Keating, *A Taxing Trend: The Rise in Complexity, Forms, and Paperwork Burdens* 126 (NTU Policy Paper, Apr. 15, 2009), available at [http://www.ntu.org/assets/pdf/policy-papers/pp\\_ntu\\_126\\_1.pdf](http://www.ntu.org/assets/pdf/policy-papers/pp_ntu_126_1.pdf) (referencing the percentage of paperwork burden).

14. J. Scott Moody, Wendy P. Warcholik & Scott A. Hodge, *The Rising Costs of Complying with the Federal Income Tax*, TAX FOUND., Dec. 2005, at 2.

15. Nicola M. White, *Finance Committee Looks Abroad For Tax Administration Ideas*, TAX NOTES TODAY, Apr. 12, 2011 (reporting on Senate Finance Committee hearing dedicated to examination of other country's tax administration systems with the goal of simplifying and making the United States tax system more user-friendly).

16. *Id.*

17. Arthur B. Laffer et al., *The Economic Burden Caused by Tax Code Complexity*, THE LAFFER CENTER, Apr. 2011, at 4, available at <http://www.laffercenter.com/wp-content/uploads/2011/04/2011-04-Laffer01-ComplexityofTaxCode.pdf>.

18. *Id.*

19. See George G. Jones & Mark A. Luscombe, *IRS Regulatory Burdens Create Taxpayer Opportunities*, ACCT. TODAY, Sep. 21-Oct. 4, 2009, at 18 (noting the administrative burden imposed on the Service).

Service is able to improve its processes and resources.<sup>20</sup> Creating new disclosure schedules, such as Schedule UTP, causes the Service to shift its limited resources in attempts to accomplish more.<sup>21</sup>

Compliance costs, which include disclosure requirements, also have an impact on the domestic economy. Based on a study conducted by the Laffer Center, it is estimated that compliance with the business tax code costs our economy approximately \$161.7 billion each year.<sup>22</sup> When business and individual costs are combined, it is estimated that 30% of the total tax income collected is spent on costs associated with tax compliance.<sup>23</sup> Corporate expenditures of key resources, such as time and money on tax compliance, reduce global competitiveness<sup>24</sup> and the productivity of American businesses and their workers.<sup>25</sup> It is reasonable to assume that the aforementioned costs to businesses will continue to rise if our tax code continues to increase in its complexity and additional burdens, such as new duplicative reporting requirements imposed on corporate taxpayers.

Noncompliance with the disclosure requirements is also costly. For instance, in addition to other penalties under the Code, a failure to report a listed transaction on Form 8886 will subject a corporate taxpayer to a penalty up to \$200,000, while a failure to disclose a non-listed reportable transaction on a Form will subject a corporate taxpayer to a penalty of up to \$50,000.<sup>26</sup> While a failure to complete Form 8275 or 8275-R will

20. J.D. Foster, *Looking into IRS Reform*, TAX FOUND.'S TAX FEATURES, Oct. 1997, at 7 (noting that “[t]he central problems at the IRS derive from a badly flawed management structure.”).

21. See Alison Bennett, *Congressional Tax Agenda Uncertain, Reform Awaits Presidential Leadership, Panelists Say*, BNA DAILY TAX REP., Apr. 28, 2011 (referencing comments that “new Schedule UTP, Statement of Uncertain Tax Position, likely will lead to resource shifts by the agency”).

22. Laffer, *supra* note 17, at 4 (citing that “complying with the business income tax code costs the U.S. economy \$161.7 billion.”).

23. *Id.* at 3 (stating that the U.S. taxpayers pay 30% premium on the taxes collected due to compliance costs).

24. Daniel J. Mitchell, *Corporate Taxes: America is Falling Behind*, TAX & BUDGET BUL., July 2007, available at [http://www.cato.org/pubs/tbb/tbb\\_0707\\_48.pdf](http://www.cato.org/pubs/tbb/tbb_0707_48.pdf).

25. The President’s Economic Recovery Advisory Board, *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation*, Aug. 2010, at 65, available at [http://www.whitehouse.gov/sites/default/files/microsites/PERAB\\_Tax\\_Reform\\_Report.pdf](http://www.whitehouse.gov/sites/default/files/microsites/PERAB_Tax_Reform_Report.pdf) (noting that “[b]ecause of its complexity and its incentives for tax avoidance, the U.S. corporate tax system results in high administrative and compliance costs by firms—costs estimated to exceed \$40 billion per year or more than 12 percent of the revenues collected.”).

26. 26 U.S.C. § 6707A. See Murray & Brandmeir, *supra* note 3, at 316 (noting that penalties provided by § 6707A are enforced in addition to “any other penalties the IRS has in place, including accuracy-related penalties.”). See Jeremiah Coder, *IRS Looking to Improve Penalty Process, Officials Say*, TAX NOTES TODAY, May 9, 2011 (noting the Service’s change of policy regarding tax

not increase the amount of the accuracy-related penalty, their respective filing may preclude the imposition of the penalty. Adequate compliance with all of the Service's requirements without causing undue prejudice to the client taxpayer is not always a simple task, especially when the tax code and its regulations' length equal approximately twelve Bibles.<sup>27</sup>

The benefits to corporate taxpayers from the continuing additions to disclosure requirements have not been obvious. Despite expenditures by corporate taxpayers on compliance, there is evidence that the Service has not been using all of the information it receives from additional disclosure forms.<sup>28</sup> Duplicative disclosures of the same or similar tax information that lead to additional costs are of immediate concern to the corporate taxpayer.<sup>29</sup> The estimated corporate taxpayers' compliance tax burden is summarized in Appendix 1. Part II of this article describes in detail key existing reporting requirements such as reportable transaction disclosure statement and Form 8886, disclosure statements and Forms 8275 and 8275-R, net income (loss) reconciliation disclosure form and Schedule M-3, and disclosure of uncertain tax positions through Schedule UTP. Part III of this article highlights the duplicative disclosures required by these forms and schedules and proposes means to reduce redundant duplicative reporting. The duplicative disclosures are thereafter summarized in Appendix 2. Part IV discusses possible solutions to mitigation of duplicative reporting requirements and suggests creation and implementation of a comprehensive disclosure form that should replace the existing reporting mechanism in order to achieve the desired transparency and efficiency. Lastly, Part V concludes this article.

## II. CORPORATE TAX REPORTING REQUIREMENTS

In the last decade, the policy of corporate tax reporting has shifted towards the increased disclosure of taxpayers' information and positions to the Service. The Service's shift is seen clearly in the imposed

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penalties since 2004 to "enhance voluntary compliance" and also noting a trend showing an increase of assertion of accuracy-related penalties against corporate taxpayers).

27. Rochelle L. Hodes & Lewis J. Fernandez, *Forms 8275 and 8275-R: How Much Information Is Enough?*, TAX ADVISER, July 2008, at 428. See also White, *supra* note 15 (citing the opening statement of Senator Baucus noting the length of the tax code and regulations).

28. Patricia A. Thompson, *Comments on Schedule M-3 with the Objective of Reducing Burden and Duplication*, AICPA, Apr. 25, 2011, available at [http://www.aicpa.org/InterestAreas/Tax/Resources/TaxMethodsPeriods/Advocacy/DownloadableDocuments/AICPA\\_04.25.2011\\_Sch\\_M3\\_Comments.pdf](http://www.aicpa.org/InterestAreas/Tax/Resources/TaxMethodsPeriods/Advocacy/DownloadableDocuments/AICPA_04.25.2011_Sch_M3_Comments.pdf).

29. *IRS Releases Final Schedule UTP, Incorporates Changes*, J. OF ACCT., Sept. 24, 2010, available at <http://www.journalofaccountancy.com/Web/20103378.htm>.

disclosure rules pertaining to tax shelters and positions that may not have otherwise been provided for on the tax return on Form 8886, imperatives designed to promote accurate reporting of tax transactions through Forms 8275 and 8275-R, reporting necessary to identify differences between financial and tax accounting on Schedule M-3, and detailed identification of uncertain tax positions on Schedule UTP, which are described in detail in this portion of the article.

#### A. Reportable Transaction Disclosure Statement and Form 8886

Today, taxpayers are required to disclose their tax shelter reportable transactions by attaching Form 8886 to their tax return and furnishing a copy of Form 8886 to the Office of Tax Shelter Analysis (“OTSA”).<sup>30</sup> The purpose of Form 8886 is to “disclose information for each reportable transaction” in which the taxpayer has participated.<sup>31</sup> The definition of a reportable transaction includes transactions that are listed, confidential, contain contractual protection, Section 165 losses, and other transactions of interest to the Service. A separate Form 8886 is required to be filed for each reportable transaction, unless transactions are the same or substantially similar.<sup>32</sup> The taxpayer is obligated to file a subsequent Form 8886 disclosure if the originally reported transaction becomes a listed transaction.<sup>33</sup> As demonstrated by *Millennium Marketing Group, LLC v. United States*, a failure to file Form 8886

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30. See Treas. Reg. § 1.6011-4 (requiring taxpayers defined in 26 U.S.C. § 7701(a)(1), including S-Corporations and affiliated group of corporations that joins to file a consolidated return under 26 U.S.C. § 1501 to disclose their certain reportable transactions). See Stephen G. Vogelsang, *The Final Tax Shelter Disclosure Rules: Reporting, Registration, And List Maintenance Requirements*, 78 FLA. BAR J. 30, 32 (2004) (noting reporting requirements).

31. Instructions for Form 8886, Reportable Transaction Disclosure Statement (Mar. 2010).

32. *Id.* (stating that taxpayer “may report more than one transaction on one form if the transactions are the same or substantially similar.”). See Treas. Reg. § 1.6011-4(c)(4) (stating that the term substantially similar “includes any transaction that is expected to obtain the same or similar types of tax consequences and that is either factually similar or based on the same or similar tax strategy. Receipt of an opinion regarding the tax consequences of the transaction is not relevant to the determination of whether the transaction is the same as or substantially similar to another transaction. Further, the term substantially similar must be broadly construed in favor of disclosure.”).

33. See Treas. Reg. § 1.6011-4(e)(2)(i). See Vogelsang, *supra* note 30, at 32 (stating that “[i]f a transaction becomes a listed transaction after the filing of the taxpayer’s original tax return for the year in which the taxpayer participated in the transaction, the disclosure statement must be filed as an attachment to the taxpayer’s tax return for the year in which the transaction becomes a listed transaction.”). See David Pratt, *Standards of Practice for Pension Practitioners*, 39 J. MARSHALL L. REV. 667, 669 (2006) (defining a listed transaction as “a transaction that is the same as, or substantially similar to, one that the IRS has determined to be a tax avoidance transaction and has identified by an IRS notice or other form of published guidance.”).

notifying the Service of participation in the listed transaction as prescribed by § 6011 may result in the Service assessing penalties under § 6707A of the Code,<sup>34</sup> which range in amount up to \$200,000.<sup>35</sup>

Form 8886 consists of eight sections asking the taxpayer to provide information about its entity and the transaction in question. The initial portion of Form 8886 obliges the taxpayer to identify its basic background information, relate Form 8886 to the number of the tax return and a year to which it is related, and signify if Form 8886 is being filed with an amended tax return.<sup>36</sup> Thereafter, the taxpayer is required to disclose the name of the reportable transaction, the initial year of participation in the reportable transaction, and identify the reportable transaction or the tax shelter by its registration number.<sup>37</sup> Then, the form directs the taxpayer to identify the type of the reportable transaction involved. The taxpayer has a choice of selecting a listed, confidential, contractual protection, loss, brief asset holding period, or transaction of interest as its reportable transaction. Subsequently, the taxpayer must divulge the “published guidance number for the listed transaction or transaction of interest” and disclose the “same as or substantially similar” transactions reported on Form 8886.<sup>38</sup> If the participation in the reportable transaction has occurred through the use of another entity, the taxpayer is required to identify the type of entity that was used, its name, its employer identification number (“EIN”), and the date of the Schedule K-1 received from the entity. The taxpayer is also obligated to disclose information about each paid individual or entity who “promoted, solicited, or recommended” the taxpayer to participate in the reportable transaction, or provided tax advice pertaining to the reported transaction.<sup>39</sup> The taxpayer is asked to identify the type and amount of tax benefit received from the transaction,<sup>40</sup> describe each step of the transaction that relates to the tax results, tax result protections, and the

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34. See *Millennium Mktg. Group, LLC v. United States*, No. H-06-962, 2010 U.S. Dist. LEXIS 50138 (S.D. Tex. Feb. 9, 2010).

35. See 26 U.S.C. §6707A(a)-(b).

36. See Instructions for Form 8886, Reportable Transaction Disclosure Statement (Mar. 2010).

37. *Id.*

38. *Id.*

39. See *id.* (commands the taxpayer to enter the name and address of each individual or entity to whom a fee was paid with regard to the transaction if that individual or entity promoted, solicited, or recommended your participation in the transaction, or provided tax advice related to the transaction).

40. See *id.* (allows the taxpayer to select all of the following options that apply: deductions, capital loss, ordinary loss, exclusions from gross income, non-recognition of gain, adjustment to basis, tax credits, deferral, absence of adjustment to basis, or any other benefit).

nature of the expected tax treatment for all affected years. Lastly, the taxpayer is requested to identify “all tax-exempt, foreign, and related entities and individuals involved in the transaction.”<sup>41</sup>

The Service provides for an estimated burden figure of compliance with Form 8886. The burden of compliance with Form 8886 is calculated through the overall time the disclosing party spends on the recordkeeping associated with the disclosure, learning about the law or the form, preparation, copying, assembling, and sending the form to the Service.<sup>42</sup> The compliance burden related to Form 8886 is substantial. The Service estimates that the disclosing party will spend in total 22 hours and 14 minutes to comply with requirements associated with Form 8886. Specifically, the Service approximates that the disclosing party will spend 12 hours 54 minutes on recordkeeping associated with the disclosure, 4 hours and 28 minutes on learning about the law or the form, and 4 hours and 52 minutes on preparing, copying, assembling, and sending the form to the Service.<sup>43</sup>

#### *B. Accuracy-Related Penalty Disclosure Statement Forms 8275 and 8275-R*

Forms 8275 and 8275-R are disclosure statements filed with the original tax return<sup>44</sup> that are used by taxpayers such as individuals, corporations, pass-through entities, and tax return preparers to disclose items or positions that are “not otherwise adequately disclosed on a tax return to avoid certain penalties.”<sup>45</sup> The disclosure on Form 8275 allows taxpayers to avoid accuracy related penalties due to “disregard of rules or to a substantial understatement of income tax for non-tax shelter items if the return position has reasonable basis.”<sup>46</sup> Similarly, the preparers may avoid similar penalties by disclosing “understatements due to

41. *See id.* (allowing the taxpayer to identify either as tax-exempt, foreign, or related by identifying number, provide names, identifying numbers, addresses, and brief description of the involvement. For each foreign entity, the taxpayer is required to identify its country of incorporation or existence. The taxpayer is required to explain how each related partied party is related).

42. *See id.*

43. *See id.*

44. Forms 8275 and 8275-R may also be filed with the amended tax return.

45. Instructions for Form 8275 (2011). *See* *Kadillak v. Comm’r*, 127 T.C. 184, 189 (T.C. 2006) (stating that Form 8275 “is filed to avoid an accuracy-related penalty due to disregard of rules or regulations or due to a substantial understatement of income tax for non-tax-shelter items if the return position has a reasonable basis.”).

46. *Id.* *See also* *Campbell v. Comm’r*, 134 T.C. 20, 31 (T.C. 2010) (noting that “[d]isclosure generally must be made on Form 8275 unless otherwise permitted by applicable revenue procedure.”).

unreasonable positions or disregard of rules and the economic substance penalty.”<sup>47</sup> Form 8275-R is the equivalent used by taxpayers and tax return preparers to disclose positions asserted on the tax return that are contrary to Treasury regulations.<sup>48</sup> When dealing with pass-through entities, for a disclosure to be considered adequate, a separate Form 8275 or 8275-R has to be filed for items reported for each entity.<sup>49</sup> As demonstrated by *Gran v. United States*, a failure to attach Form 8275 to the tax return may result in assessment of accuracy-related penalties.<sup>50</sup>

Accuracy-related penalties cannot be avoided despite the disclosure on Forms 8275 or 8275-R if misconduct is associated with:

negligence, disregard of rules, disregard of regulations, any substantial understatement of income tax, any substantial valuation misstatement under chapter 1, any substantial overstatement of pension liabilities, any substantial estate or gift tax valuation understatements, any claim of tax benefits from a transaction lacking economic substance within the meaning of Section 7701(o) or failing to meet the requirement of any similar rule of law, [or] any otherwise undisclosed foreign financial asset understatement.<sup>51</sup>

Both Forms 8275 and 8275-R consist of four parts: (I) general information; (II) detailed information; (III) information about pass-through entity; and (IV) explanations continued from Parts I and/or II.<sup>52</sup> Part I of both forms requires the disclosure of the rule to which the asserted tax position is contrary, identification of the contrary item or group of items by name, detailed description of the contrary items, identification of associated form or schedule, line number, and the amount. Both forms in Part II ask for a statement that includes a “description of the relevant facts affecting the tax treatment of the item.” To satisfy this requirement, the preparer must “include information that reasonably can be expected to apprise the IRS of the identity of the item,

47. *Id.*

48. Instructions for Form 8275-R (2011).

49. Instructions for Form 8275 (2011). *See also* Instructions for Form 8275-R.

50. *Gran v. United States*, No. 04-4605 SC, 2005 U.S. Dist. LEXIS 39810 (N.D. Cal. Aug. 26, 2005) (holding that the Service was justified in its decision to impose an accuracy-related penalty on the taxpayer pursuant to Section 6662(a) of the Code where “(1) the Form 8275 was not attached to the original Amended Return produced by the IRS as evidence in this case; (2) the Form 8275 was not attached to [Taxpayers’] copy of their Amended Return submitted as evidence in support of their original motion for partial summary judgment; and (3) [Taxpayers’] have not been able to produce any evidence demonstrating that the Form 8275 was actually sent or received [by the Service].”).

51. Instructions for Form 8275. *See also* Instructions for Form 8275-R.

52. *Id.*

its amount, and the nature of the controversy or potential controversy.”<sup>53</sup> Part II of Form 8275-R additionally requires a statement from the disclosing party as to why it believes the regulation is invalid. Both forms in Part II provide for a disclosure of information about the pass-through entity,<sup>54</sup> which must be completed by partners, shareholders, beneficiaries, or residual interest holders. The disclosure should include the name, address, and zip code of the pass-through entity, the pass-through entity’s identifying number, its tax year, and the Service Center where the pass-through entity files its tax return.<sup>55</sup> Lastly, both forms in Part IV request the disclosing party to offer any further explanations associated with Parts I and/or II.<sup>56</sup>

The Service provides estimation figures associated with compliance with Forms 8275 and 8275-R. With these forms, the burden is calculated by adding the overall time the disclosing party spends on recordkeeping, learning about the law or the form, and preparation and sending the form to the Service. The burden associated with compliance and filing of Form 8275 is approximately 5 hours and 41 minutes. The Service estimates that the disclosing party spends approximately 3 hours and 35 minutes on recordkeeping, 1 hour on learning about the law or the form, and 1 hour and 6 minutes on preparation and sending the form to the Service.<sup>57</sup> The burden associated with compliance and filing of Form 8275-R is estimated to total approximately 5 hours and 27 minutes. The Service determined that the disclosing party spends approximately 3 hours and 35 minutes on recordkeeping, 53 minutes on learning about the law or the form, and 59 minutes on preparation and sending the form to the Service.<sup>58</sup>

### C. *Net Income (Loss) Reconciliation Disclosure and Schedule M-3*

Financial income and taxable income serve two completely different purposes: providing “informational input to investors” and “determining current-year tax liability.”<sup>59</sup> Thus, it is not surprising that

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53. *Id.* (noting that “information concerning the nature of the controversy can include a description of the legal issues presented by the facts.”).

54. *Id.* (noting that a partnership, S Corporation, estate, trust, regulated investment company (RIC), real estate investment trust (REIT), or real estate mortgage investment conduit (REMIC) are considered to be pass-through entities).

55. *See id.*

56. *See id.*

57. *See* Instructions for Form 8275 (2011).

58. *See* Instructions for Form 8275-R (2011).

59. Daniel Shaviro, *The Optimal Relationship Between Taxable Income and Financial Accounting Income: Analysis and a Proposal*, 97 GEO. L.J. 423, 483-84 (2009) (stating that

corporate taxpayers have different motives during preparation of financial statements and tax returns. When preparing financial statements, corporations attempt to maximize their income in accordance with existing Generally Accepted Accounting Principles (“GAAP”).<sup>60</sup> Conversely, in tax law compliance, corporations seek legal minimization of income to reduce their overall bill.<sup>61</sup> The timing difference as to when income has to be recognized also often varies between financial accounting and tax rules. As a result, disparities between financial and tax income occur.

### 1. Early Attempts to Adequately Demonstrate the Differences between Financial and Tax Accounting for Income through Schedule M and M-1

For years, the Service has been attempting to provide for adequate reconciliation between financial and tax accounting. Prior to 1964, the Service used Schedule M, *Reconciliation of Taxable Income and Analysis of Earned Surplus and Undivided Profits*, which required reconciliation between beginning and ending earned surpluses.<sup>62</sup> Thereafter, in 1964, the Service implemented Schedule M-1, *Reconciliation of Income (Loss) per Books with Income per Return*, which provided for additional reconciliations to the differences between the taxpayer’s methods of accounting and financial reporting.<sup>63</sup>

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“[t]axable income and financial accounting income, while using a shared concept, serve very different purposes—determining current-year tax liability on the one hand, and providing a particular informational input to investors on the other. It is not surprising, therefore, that the two measures both ideally and actually have differences.”)

60. See Karthik Balakrishnan, Jennifer Blouin & Wayne Guay, *Does Tax Aggressiveness Reduce Financial Reporting Transparency?* (U. Penn. Working Paper Series, 2011), available at <http://ssrn.com/abstract=1792783> (stating that “[w]hile managers often desire to report high levels of income to investors, they simultaneously desire to report low levels of income to tax authorities. In the U.S., as in many other countries, tax reporting rules differ from financial reporting rules, allowing firms to report disparate levels of income to tax authorities and investors.”).

61. See Alex Raskolnikov, *Crime and Punishment in Taxation: Deceit, Deterrence, and the Self-Adjusting Penalty*, 106 COLUM. L. REV. 569, 585 (2006) (stating that “[t]he government recognized that the two accounting systems create opposite incentives: Taxpayers would prefer to have more income for financial reporting purposes, but less income for tax purposes.”). See also Rachael Hinkley, *Common Schedule M-1 Adjustments*, TAX ADVISER, Oct. 2005, at 586-88 (providing examples how accrued compensation and benefits, tax accrual, capital losses, meals and entertainment expenses, club dues, spousal travel expenses, employee-shareholder loans, prepaid expenses, and life insurance premiums may result in book-tax differences).

62. See Daniel L. Slaton, *Solving Stock Option Compensation: Why Book-Tax Conformity May Not Be The Answer*, 9 HOUS. BUS. & TAX L.J. 175, 184 (2008).

63. See Hinkley, *supra* note 61, at 586 (noting that “Schedule M-1 adjustments are based on the taxpayer’s method of accounting.”).

The current version of Schedule M-1 is used by corporations whose assets are below the threshold amount of \$10 million.<sup>64</sup> Schedule M-1 consists of ten line item questions with subparts and requires the taxpayer to identify its total income (loss) per books, federal income tax per books, the excess of capital losses over gains, and income subject to tax which was not recorded on books.<sup>65</sup> Further, Schedule M-1 requires the taxpayer to report the expenses it recorded on books but not deducted on the return, which includes depreciation, charitable contributions, travel and entertainment, and other categories.<sup>66</sup> The taxpayer is then required to disclose information about income recorded on books for the year that is not included on the tax return, itemizing the tax-exempt interest and other items.<sup>67</sup> Lastly, the taxpayer is required to disclose deductions that were not charged against book income itemizing depreciation, charitable deductions, and other items.<sup>68</sup>

In the last decade, a sizable income gap has occurred due to the differences between financial and tax accounting.<sup>69</sup> In 2004, as a

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64. See Schedule M-1, Reconciliation of Income (Loss) and Analysis of Unappropriated Retained Earnings Per Books (2010).

65. See Matthew J. Barrett, *Opportunities for Obtaining and Using Litigation Reserves and Disclosures*, 63 OHIO ST. L.J. 1017, 1077 (2002/2003) (noting that line items on Schedule M-1 explain “the differences between financial accounting net income and tax accounting net income, listing such things as income included on the return, but not recorded on the books this year; expenses, such as travel and entertainment, recorded on the books this year, but not included on the return; income, such as tax-exempt interest, recorded on the books this year, but not included on the return; and deductions, such as depreciation, included on the tax return, but not charged against book income this year.”).

66. See *id.* (noting that other travel and entertainment expenses may include any of the following items: (1) meal and entertainment expenses not deductible under Section 274(n); (2) expenses for the use of an entertainment facility; (3) the part of business gifts over \$25; (4) expenses of an individual over \$2,000 that are allocable to conventions on cruise ships; (5) employee achievement awards over \$400; (6) the cost of entertainment tickets over face value (also subject to the 50% limit under Section 274(n)); (7) the cost of skyboxes over the face value of non-luxury box seat tickets; (8) the part of luxury water travel expenses not deductible under Section 274(m); (9) expenses for travel as a form of education; and (10) other nondeductible travel and entertainment expenses).

67. See *id.* (noting that this line item applies to “any tax-exempt interest received or accrued, including any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.”).

68. See *id.*

69. See Stephen Joyce, *Senate Hearing May Discuss Legislation About Stock Option Book, Tax Differences*, BNA DAILY TAX REP., June 5, 2007, at G-3 (noting that based on Schedule M-3 reporting from December 31, 2004 to June 30, 2005, a \$43 billion gap existed between reporting for stock option expenses for book purposes and stock option deductions for tax purposes). See also George A. Plesko & Nina L. Shumofsky, *Reconciling Corporation Book and Tax Net Income, Tax Years 1995-2001*, STATISTICS OF INCOME, Winter 2004-2005, at 103, 105 (discussing data showing book-tax difference). See also Charles Boynton, Portia DeFilippes & Ellen Legel, *Preclude to*

response to the differences between financial and tax accounting that had revenue raising implications, general discontent with a 40-year old Schedule M-1,<sup>70</sup> and desire to “increase the transparency of corporate tax return filings,” the Treasury Department and the Service created disclosure form Schedule M-3.<sup>71</sup> While helpful, Schedule M-1 simply did not contain the necessary detail.<sup>72</sup> The Service found Schedule M-1 to be of limited use because it failed to adequately show significant differences between book and tax accounting “due both to the lack of uniform definitions and terminology, and the business’s ability to aggregate and net differences.”<sup>73</sup> In its news release *IR-2004-14*, the Service announced that for taxable years ending on or after December 31, 2004, corporations with total assets of \$10 million or more must file a Schedule M-3 form with its timely-filed original tax return.<sup>74</sup> A

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*Schedule M-3: Schedule M-1 Corporate Book-Tax Difference Data*, NAT. TAX ASS’N.–TAX INST. OF AMERICA, 2005, at 131 (reporting additional data showing book-tax difference).

70. Michael W. McLoughlin, William M. Backstrom, Jr. & Mark T. Hennen, *Recent Developments: Administrative Law to Taxation*, 51 LA BAR J. 436, 446 (2004) (stating that the “shortcomings of the current Schedule M-1, according to the IRS and Treasury, are that it does not provide for a uniform reporting requirement for book income and it does not provide uniform disclosure requirements for reporting differences between book and tax income.”).

71. See IR-2004-91, Treasury and IRS Issue Revised Tax Form for Corporate Tax Returns, July 7, 2004. See McGowan & Killion, *supra* note 8, at 409 (stating that “Schedule M-3 was developed in response to concern over differences between book and taxable income, declines in corporate tax revenues and dissatisfaction with Schedule M-1.”). See also Boynton, DeFilippes & Legel, *supra* note 69, at 945 (stating that “Schedule M-3’s introduction of detailed reporting requirements for permanent and timing differences is another significant improvement over Schedule M-1, as well as being an important enhancement to overall transparency.”).

72. Raskolnikov, *supra* note 61, at 591 (noting that Schedule M-1 “was helpful, but not detailed enough.”).

73. See Singleton & Smith, *supra* note 2, at 40. See also McGowan & Killion, *supra* note 8, at 409 (noting that Schedule M-1 had two major deficiencies: (1) it did not “provide a uniform reporting requirement for net income per books;” and (2) it did not “promote uniform disclosure requirements for reporting differences between financial accounting net income and taxable income.”). See also Charles Boynton, Portia DeFilippes & Ellen Legel, *A First Look at 2004 Schedule M-3 Reporting by Large Corporations*, TAX NOTES, Sept. 11, 2006, at 944 (noting dissatisfaction with Schedule M-1 and “difficulty in interpreting Schedule M-1 book-tax difference data,” and stating that “[w]hen examining Schedule M-1, the character of a particular book-tax difference usually was not determinable without further investigation . . . [which] often required contacting the taxpayer, resulting in some degree of burden to both the taxpayers and the IRS.”). See also Boynton & Wilson, *supra* note 7 (noting that “Schedule M-1 disclosures became increasingly aggregated and more difficult and time consuming to examine. In the case of large corporations, this aggregation by taxpayers and the lack of specific detail required by instructions of Schedule M-1 rendered the schedule nearly useless as an analytical tool for the purposes of determining audit risk.”).

74. See IR-2004-14. See Instructions for Schedule M-3 (Form 1120) (2005) (stating that “[a]ny domestic corporation (including a U.S. consolidated tax group consisting of a U.S. parent corporation and additional includible corporation listed on Form 851, Affiliations Schedule) required to file Form 1120, U.S. Corporation Income Tax Return, that reports on Schedule L of

domestic corporate taxpayer that is not required to file Schedule M-3 may voluntarily file it instead of Schedule M-1.<sup>75</sup>

## 2. Schedule M-3

Schedule M-3 provides for reconciliation of net income or loss for corporations with total assets that equal or exceed \$10 million,<sup>76</sup> which significantly enlarges required disclosure of book-tax differences<sup>77</sup> and provides the Service with a new tool to gather information and investigate corporate taxpayers.<sup>78</sup> Schedule M-3 expanded taxpayers' reporting requirements from ten lines previously required by Schedule M-1 to sixty-eight,<sup>79</sup> with "an emphasis on making a distinction between temporary and permanent book/tax differences."<sup>80</sup> The increased disclosure allowed by Schedule M-3 gave the Service "greater precision in identifying aggressive transactions and determining which returns need to be audited, as well as narrowing the issues examined on returns selected for audit."<sup>81</sup> Arguably, Schedule M-3 requires corporate taxpayers "to reveal [their] more aggressive transactions."<sup>82</sup> The data collected from Schedule M-3 filings allowed the Service to determine which tax returns to audit,<sup>83</sup> what issues will be examined on the selected

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Form 1120 total consolidated assets at the end of the corporations' tax year that equal or exceed \$10 million must complete and file Schedule M-3 in lieu of Schedule M-1").

75. Instructions for Schedule M-3 (Form 1120) (2005).

76. Rev. Proc. 2004-45. See IR-2004-91 (stating that "Schedule M-3 is effective for any taxable year ending on or after Dec. 31, 2004, and, in general, must be filed by a corporation required to file Form 1120, U.S. Corporation Income Tax Return, that reports on Form 1120 at the end of the corporation's taxable year total assets that equal or exceed \$10 million.").

77. Tracy A. Kaye, *Regulation of Corporate Tax Evasion: The Regulation of Corporate Tax Shelters in the United States*, 58 AM. J. COMP. L. 585, 599 (2010) (noting that "[t]he new Schedule M-3 increases the number of book-tax differences subject to required disclosure from eight to sixty-seven.").

78. Dennis J. Ventry, Jr., *Cooperative Tax Regulation*, 41 CONN. L. REV. 431, 478 (2008) (stating that "the IRS has rolled out new Schedule M-3 as part of the corporate tax return to help the IRS find relevant information (assuming all cash is accounted for properly on the return) by reconciling a corporation's financial accounting income (i.e., 'book income') with its taxable income (i.e., 'tax income')."').

79. Comparing Schedule M-1 to the current Schedule M-3, which has 68 line items in Part II and Part III.

80. George G. Jones & Mark A. Luscombe, *M-3: Evaluating One Round While Rolling Out The Next*, ACCOUNTING TODAY, Sept. 2006, at 10.

81. Kaye, *supra* note 77, at 599.

82. Scott E. Vincent, *Taxes in Your Practice, Hot List of 2004 Tax Law Changes to Plan for in 2005*, 61 J. MO. B. 50, Jan.-Feb. 2005.

83. See Crystal Tandon, *More Than 200 Returns Targeted on Basis of Schedule M-3 Data, IRS Official Says*, 2006 TNT 133-4 (July 12, 2006) (noting that based on Schedule M-3 disclosures the Service will examine more than 200 tax returns).

returns,<sup>84</sup> and reduced time spent on auditing.<sup>85</sup> Schedule M-3 was predicted to reduce time the Service spends to examine corporate tax returns and identify those book-tax differences that require further inspection.<sup>86</sup> The Commissioner of the Service's Large and Mid-Size Business Division, Deborah Nolan, stated that Schedule M-3 would "provide important tax accounting information at time of filing that previously required extensive time to develop during a tax examination."<sup>87</sup> At the time it was implemented, it was estimated that for most companies, Schedule M-3 would reveal most book-tax differences that matter during the corporate return audit<sup>88</sup> as well as any aggressive positions.<sup>89</sup>

Schedule M-3 is divided into three parts: (1) Financial Information and Net Income (Loss) Reconciliation, (2) Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return, and (3) Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/Deductions Items. Corporations that are required to file Schedule M-3 "must complete the form in its entirety," meaning all questions on Part I must be answered and all columns on Parts II and III must be finalized.<sup>90</sup> Further, any other schedule necessary to support a line item on Schedule M-3 must be attached at the time of the filing and provide all necessary information for that line item.<sup>91</sup>

Part I of the Schedule M-3 requests the corporate taxpayer to provide information about its financial statements and "reconciles

84. See Boynton, DeFilippes & Legel, *supra* note 73, at 944.

85. John Ledbetter & Lucinda Van Alst, *Schedule M-3 Update for 2007*, TAXES, Dec. 2007, at 48 (noting that "[a]ccording to the IRS, the additional information, in fact, provides about 20 percent of the on-site audit work the IRS would otherwise have to perform, reducing the on-site audit time by as much as 20 percent.").

86. See McGowan & Killion, *supra* note 8, at 408 (noting comments by Treasury's Acting Assistant Secretary for Tax Policy, Greg Jenner, who stated that "Schedule M-3 will enable the IRS to identify quickly those differences [in financial book accounting and tax accounting] that warrant additional scrutiny.").

87. *50,000 Corporations Expected To File 2005 Schedule M-3*, STANDARD FEDERAL TAX REPORTS, June 30, 2005, at 1.

88. See McGowan & Killion, *supra* note 8, at 408 (noting the comments of the Service's Senior Industry Advisor for the Large and Midsize Business Division, Robert Adams, that "it is estimated that the M-3 should reveal between 75 to 90 percent of the book-tax difference for most companies.").

89. Vincent, *supra* note 82 (noting that "[a] new Schedule M-3 requires corporations to reveal more aggressive transactions.").

90. Instructions for Schedule M-3 (Form 1120) (2005) (noting exception for Part I for consolidated tax groups, where the parent corporation needs to complete Part I only once).

91. Instructions for Schedule M-3 (Form 1120).

financial statement net income (loss) for the consolidated financial statement group to income (loss) per the income statement for the U.S. consolidated tax group.”<sup>92</sup> Due to the mandates prescribed in the Schedule M-3’s Part I, for the first time in corporate tax history, taxpayers were required to provide the identifiable measurement point of the book-tax reconciliation.<sup>93</sup>

Part II and III of Schedule M-3 have four columns that identify and distinguish the book-tax differences as well as permanent and temporary differences of each line item.<sup>94</sup> Part II permits the taxpayer to report in column (a) income (loss) per financial statement income, and in column (d) to report income (loss) as reported in the tax return. Part III uses column (a) to allow taxpayers to report expense taken per income statement and column (d) for reporting of deductions on the tax return. Both Part II and Part III dedicate their columns (b) and (c) to demonstrate the temporary and permanent differences.

One of the key benefits of Schedule M-3’s Parts II and III is the determination of temporary and permanent differences. Temporary differences occur due to the difference in timing between financial and tax reporting of income and deductions<sup>95</sup> and are separated into two types: taxable or deductible.<sup>96</sup> There are four general categories of temporary differences:

- (1) income recognized in financial statements before it is taxable;
- (2) income reported as taxable before it is recognized in financial statements;
- (3) expenses recognized in financial statements before they are deducted on the tax return; and
- (4) expenses deductible on the tax return before they are recognized on financial statements.<sup>97</sup>

One of the most common examples of a temporary difference is depreciation.<sup>98</sup> Conversely, permanent differences are adjustments that

92. *Id.* See Boynton, DeFilippes & Legel, *supra* note 73, at 944 (stating that “Part I reconciles worldwide consolidated financial statement income with income per income statement of includable corporations (members of the tax return consolidation group listed on Form 851).”).

93. *Id.* at 952 (noting the importance of Schedule M-3’s Part I).

94. *See id.* at 945 (generally describing Parts II and III of Schedule M-3).

95. See Yoram Keinan, *Book Tax Conformity for Financial Instruments*, 6 FLA. TAX REV. 676, 694 (2004) (noting that “temporary differences arise when items of income and deductions are includable in income or deductible as expenses for tax and financial reporting purposes at different times.”).

96. See Anne L. Leahey, *A Worksheet For Accounting For Deferred Taxes*, J. OF ACCT., Sept. 1995, at 87 (stating that “temporary differences are separated into two types: taxable and deductible.”).

97. Boynton, DeFilippes & Legel, *supra* note 73, at 945.

98. See Terry Shevlin, *Corporate Tax Shelters and Book-Tax Difference*, 55 TAX L. REV. 427, 429 (2002). See also Henry J. Louie, *A First Look at the Book-Tax Differences in the Foreign-*

will not reverse over time,<sup>99</sup> occur due to the differences between the financial and tax accounting rules, and directly impact the effective tax rate.<sup>100</sup> A common example of permanent differences is the reporting of stock options as employee compensation.<sup>101</sup> Because of their influence on the corporation's net income, the permanent differences have a greater risk of audit than temporary differences.<sup>102</sup>

### 3. Additional Disclosure Requirements Associated with Schedule M-3

After its initial final Schedule M-3 form, the Service added additional requirements for corporate taxpayers such as Form 8916, Form 8916-A, and Schedule B.<sup>103</sup> Starting in 2006, certain corporate taxpayers that are part of the mixed group that files Forms 1120, 1120-L, or 1120-PC became required to complete Form 8916, known as *Reconciliation of Schedule M-3 Taxable Income with Tax Return Taxable Income for Mixed Groups*.<sup>104</sup> The Service defined a mixed group to mean:

a consolidated tax group that (1) includes both a corporation that is an insurance company and a corporation that is not an insurance company, (2) includes both a life insurance company and a property and casualty insurance company, or (3) includes a life insurance

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*Source Income of U.S. Multinational Companies*, NATIONAL TAX ASSOCIATION—TAX INSTITUTE OF AMERICA PROCEEDINGS OF THE ANNUAL CONFERENCE ON TAXATION, 2005, at 138 (noting that a “commonly cited example of a temporary difference is the disparity between depreciation rules for tax and financial accounting purposes. If a company depreciates an asset under an accelerated method when determining taxable income, while depreciating that same asset under a straight-line method on its financial statements, book income will exceed taxable income in the early years of the asset's life, while the reverse would be true in the later years.”).

99. See Mitchell L. Engler, *Corporate Tax Shelters and Narrowing the Book/Tax “GAAP”*, 01 COLUM. BUS. L. REV. 539, 582-83 (2001) (stating that “permanent difference is one that will not reverse itself over time.”).

100. Boynton, DeFilippes & Legel, *supra* note 73, at 945 (noting that permanent differences may substantially affect the reported earnings per share computations and stock prices).

101. See Louie, *supra* note 98, at 139 (noting that “the commonly cited example relates to the different rules that govern the reporting of stock options as employee compensation.”).

102. Boynton, DeFilippes & Legel, *supra* note 73, at 945.

103. Although this article pertains only to corporate taxpayers, it is important to note that in 2006, Schedule M-3 reporting requirements were extended to partnerships, S-Corporations, and insurance companies that met the \$10 million threshold in assets.

104. Form 8916, *Reconciliation of Schedule M-3 Taxable Income with Tax Return Taxable Income for Mixed Groups* (2008) (providing specific instructions on how to file Form 8916).

company, a property and casualty insurance company, and a corporation that is not an insurance company.<sup>105</sup>

The purpose of Form 8916 was to “reconcile Schedule M-3 taxable income to tax return taxable income for a mixed group.”<sup>106</sup> Form 8916 requires the taxpayer to disclose the tax reconciliation amount from Schedule M-3, information pertaining to the life/non-life loss limitation amount from the supporting workpapers, any other adjustments that reconcile taxable income on the consolidated tax return from the supporting workpapers, and thereafter compute the total taxable income.<sup>107</sup> The Paperwork Reduction Act Notice states that it would take the taxpayer, in total, 6 hours and 45 minutes to comply with Form 8916, where 6 hours and 27 minutes would be spent on record keeping, 6 minutes on learning about the law or the form, and 12 minutes on preparing, copying, assembling, and sending the form to the Service.<sup>108</sup>

Also starting in 2006, corporate taxpayers are required to complete and file Form 8916-A, *Reconciliation of Cost of Goods Sold Reported on Schedule M-3*, along with their tax return.<sup>109</sup> Currently, this form is known as the *Supplemental Attachment to Schedule M-3* Form 8916-A.<sup>110</sup> The purpose of Form 8916-A is to “provide a detailed schedule of the amounts reported on the applicable Schedule M-3 for cost of goods sold, interest income and interest expense.”<sup>111</sup> Form 8916-A consists of three parts: (1) costs of goods sold; (2) interest income; and (3) interest expense. Like Schedule M-3, Form 8916-A has four columns allowing the taxpayer to disclose expenses asserted per income statement, temporary and permanent differences, and deductions taken per tax

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105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. Alison Bennett, *IRS Releases Final Drafts of Schedules M-3, Extends Reporting Deadline for Big Partners*, BNA DAILY TAX REP., Jul. 21, 2006 (stating that Form 8916-A “is meant to provide a uniform and consistent manner for taxpayers to reconcile cost of goods sold that they report in Part II of Schedule M-3 for Forms 1120, 1120S and 1065.”).

110. Form 8916-A, Supplemental Attachment to Schedule M-3 (2010) (noting that the Form 8916-A “must be filed for each separate entity required to file a Schedule M-3 for Form 1120, Form 1065, Form 1065-B, Form 1120-L, Form 1120-PC, or Form 1120S.”). See also *IRS Updates Requirements for E-Filing Mixed Returns, Related Schedules M-3*, BNA DAILY TAX REP., Feb. 1, 2010 (stating that “IRS said a Form 8916-A, Supplemental Attachment to Schedule M-3, is required to be filed for each return, including subsidiary returns, for those entities that report any amounts for the cost of goods sold, interest income, or interest expense on their returns.”).

111. Form 8916-A, Supplemental Attachment to Schedule M-3.

return.<sup>112</sup> Part I requires the taxpayer to disclose amounts attributable to cost flow assumptions, stock option expense, other equity based compensation, meals and entertainment, parachute payments, compensation with Section 162(m) limitation, pension and profit sharing, other post-retirement benefits, deferred compensation, Section 198 environmental remediation costs, amortization, depletion, depreciation, corporate owned life insurance premiums, other Section 263A costs, inventory shrinkage accruals, excess inventory and obsolescence reserves, cost or market write-downs, other items with differences, and other items without differences.<sup>113</sup> Part II asks the taxpayer to disclose the tax-exempt interest income, interest income from hybrid securities, sale/lease interest income, intercompany interest income, and any other income associated with interest.<sup>114</sup> Lastly, Part III mandates the taxpayer to provide information about interest expense from hybrid securities, lease/purchase interest expense, intercompany interest expenses paid to outside and affiliated groups, and any other interest expense.<sup>115</sup>

The burden associated with Form 8916-A supplemental attachment is substantial. According to the *Paperwork Reduction Act Notice*, it will take the corporate taxpayer in total 32 hours and 22 minutes to comply with Form 8916-A reporting requirements, where the estimated time spent on record keeping is 30 hours and 51 minutes, learning about the law or the form takes 30 minutes, preparing, copying, assembling, and sending the form to the Service is 1 hour and 1 minute.<sup>116</sup>

For tax years starting in 2009, corporate taxpayers filing Schedule M-3 are also required to complete new Schedule B, entitled *Additional Information for Schedule M-3 Filers*.<sup>117</sup> Schedule B has ten line items requiring the corporate taxpayer to answer eleven yes or no questions.<sup>118</sup> The purpose of the Schedule B is to provide “answers to additional questions” pertaining to partnership allocations, transfers of intangible

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112. *See id.* (noting that not all of the columns have to be completed. For instance, “[a] corporation is not required to complete columns (a) and (d) if the corporation is not required to complete these columns on Schedule M-3.”). *See id.* (also noting that “[c]olumns (b) and (c) must be completed for any tax year for which the corporation files Form 8916-A.”).

113. *See id.*

114. *See id.*

115. *See id.*

116. *See id.*

117. Kaye, *supra* note 77, at 599.

118. *See* Form 1120, Schedule B. Entities filing Form 1065 are required to use Schedule C. *See* Sarah Staudenraus & George Spaeth, *Ethics and Tax Procedure Corner*, J. OF PASSTHROUGH ENT., Mar/Apr 2009, at 39 (providing additional information on Schedule C).

property, cost-sharing agreements with foreign parties, changes to accounting principles, changes in method of accounting, voluntary employees' beneficiary association trusts, indirect costs, and mixed service costs.<sup>119</sup> No burden estimates have been provided for compliance with Schedule B.

As with Forms 8886, 8275, and 8275-R, the Service estimated how much of a burden would be imposed on taxpayers to comply with the new Schedule M-3. According to the Paperwork Reduction Act Notice, the compliance cost associated with the Schedule M-3 totals 85 hours and are as follows: 76 hours for recordkeeping, 4 hours to learn the schedule, and 5 hours for preparation and filing.<sup>120</sup> In comparison to Schedule M-1, which sometimes remains a part that needs to be calculated,<sup>121</sup> Schedule M-3 imposes an additional compliance burden of 81.2 hours.<sup>122</sup> When considering the possibility that a corporate taxpayer may have to file Forms 8916, Form 8916-A, and Schedule B in addition to Schedule M-3, the overall burden of compliance may amount to as much as 124 hours and 7 minutes.

#### D. *Uncertain Tax Positions and Schedule UTP*

Schedule UTP presents the broadest form of corporate tax disclosure yet.<sup>123</sup> Schedule UTP was created in part because disclosures for accounting purposes under FIN 48 did not provide the Service with the “road map” to understanding taxpayers' positions, and additional information was necessary to ensure that taxpayers complied with the tax law.<sup>124</sup> In *Announcement 2010-75*, the Service mandated filing of

119. See Staudenraus & Spaeth, *supra* note 118. Starting 2006, the Service extended the requirements of filing Schedule M-3 on partnerships, S-corporations, and insurance companies. See *IRS Explains Adequate Disclosure To Reduce Accuracy-Related Penalty*, PRACTICAL TAX STRATEGIES, Mar. 2010, at 172 (stating that “[t]axpayers that file the Schedule M-3 (Form 1065) must complete a Schedule C, Additional Information for Schedule M-3 Filers.”).

120. See Walter G. Antognini, *New Schedule M-3 Expands Reporting for Large Corporations*, THE CPA J., Aug. 2005, at 49 (citing Paperwork Reduction Act Notice calculation).

121. For instance, the California Franchise Income Return Form 100 requires calculation of Schedule M-1 regardless if the taxpayer prepares and files Schedule M-3.

122. See Moody, Warcholik & Hodge, *supra* note 14, at 8 (noting the difference between Schedule M-1, which is approximated to complete 3.8 hours, and Schedule M-3, which is approximated to complete 85 hours).

123. See Martin J. McMahon, Jr., Ira B. Shepard & Daniel L. Simmons, *Recent Developments in Federal Income Taxation: The Year 2010*, 10 FLA. TAX REV. 565, 663 (2011) (stating that The Treasury has published proposed amendments to Reg. § 1.6012-2 to require corporations to attach a Schedule UTP, Uncertain Tax Position Statement (or any successor form) to their income tax returns in accordance with forms, instructions, or other appropriate guidance provided by the IRS.”).

124. Beth Kern & Suzanne Luttmann, *Uncertain State Tax Position Financial Statement Disclosures under FIN 48 and the New Internal Revenue Service Schedule UTP*, J. OF STATE TAX.,

Schedule UTP on corporations with a specified threshold amount of assets that issue or are included in the audited financial statements and that file a domestic, foreign, life insurance, or casualty insurance tax return.<sup>125</sup> The corporate taxpayer is required to report its declared federal income positions on the U.S. federal tax return on Schedule UTP if the corporation or a related party records a reserve in its audited financial statements, or if the reserve was not recorded due to an expectation to litigate the position.<sup>126</sup> The purpose of Schedule UTP is to obtain taxpayer information about “tax positions that affect the U.S. federal tax liabilities of certain corporations that issue or are included in audited financial statements and have assets that equal or exceed”—a specified threshold amount which will decrease during the implementation period.<sup>127</sup> The threshold of assets amount in 2010 was \$100 million, which, in 2012, will be reduced to \$50 million and, in 2014, to \$10 million.<sup>128</sup>

Schedule UTP consists of three parts: (1) Uncertain Tax Positions for the Current Year, (2) Uncertain Tax Positions for Prior Years, and (3) Concise Descriptions of UTPs.<sup>129</sup> Part I of Schedule UTP requires the taxpayer to complete the following six columns: (a) list UTP by number, (b) provide for the primary section of the Code pertaining to uncertainty, (c) check mark whether the timing difference associated with the UTP is temporary or permanent, (d) identify the EIN of a pass-through entity, (e) check mark if the position disclosed is a major tax

Jan/Feb 2011, at 54 (noting that “[w]e now have over three years of disclosures under FIN 48 with the “road map” not being as clear as some taxing authorities had hoped.”).

125. See Ann. 2010-75. See Instructions for Schedule UTP (2010), noting a corporation must file Schedule UTP with its income tax return if:

1. The Corporation files Form 1120, U.S. Corporation Income Tax Return; Form 1120-F, U.S. Income Tax Return of a Foreign Corporation; Form 1120-L, U.S. Life Insurance Company Income Tax Return; or Form 1120-PC, U.S. Property and Casualty Insurance Company Income Tax Return;
2. The corporation has assets that equal or exceed \$100 million;
3. The corporation or a related party issued audited financial statements reporting all or a portion of the corporation’s operations for all or a portion of the corporation’s tax year; and
4. The corporation has one or more tax positions that must be reported on Schedule UTP.

126. Instructions for Schedule UTP (2010) (noting that a “tax position for which a reserve was recorded (or for which no reserve was recorded due an expectation to litigate) must be reported regardless of whether the audited financial statements are prepared based on U.S. generally accepted accounting principles (GAAP), International Financial Reporting Standards (IFRS), or other country-specific accounting standards, including a modified version of any of the above.”).

127. *Id.*

128. Ann. 2010-75.

129. Schedule UTP, Uncertain Tax Positions Statement (2010).

position, and (f) rank the tax position.<sup>130</sup> The Part II requirement becomes effective in 2011 and will mandate the taxpayer to provide the information for the same six columns as in Part I.<sup>131</sup> Part III of the Schedule UTP provides for ample space for a taxpayer to provide a concise description of each UTP previously identified in Part I.<sup>132</sup> As with previous forms and schedules, Schedule UTP is to be filed and attached to the corporation's income tax return.<sup>133</sup>

The Service has provided the following estimated times for completing the Schedule UTP: 2 hours 48 minutes for recordkeeping, 36 minutes for learning about the law or the schedule, and 34 minutes for preparing the schedule.<sup>134</sup> The requirements of the Schedule UTP are expected to put an additional burden on the tax department, board of directors, C-Suite, and operational business units.<sup>135</sup> As the phase-in occurs, the costly effects of compliance will trickle down to small businesses that do not have sophisticated tax departments and often do not issue financial statements. The same will occur if states adopt the federal version of Schedule UTP or enact their own requirements for UTP reporting.<sup>136</sup>

### III. WHERE DOES THE DUPLICATIVE REPORTING OCCUR

Promulgation of multiple reporting forms and schedules have created a reality where taxpayers carry a large compliance and disclosure burden as displayed in Appendix 1, while being subjected to unnecessary duplicative reporting of the same information summarized in Appendix 2.<sup>137</sup> Taxpayers' compliance burden and associated costs

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130. *Id.* See Stephen Blough, Sean Foley & Prita Subramanian, *Transfer Pricing and Schedule UTP: Questions, Answers, and Examples*, 61 TAX NOTES INT'L 371 (2011) (for extensive examples of how to complete Schedule UTP).

131. *Id.*

132. *Id.*

133. Instructions for Schedule UTP (2010).

134. See Instructions for Form 1120 (2010).

135. *Schedule UTP: The Next Step in Tax Governance and Transparency*, DELOITTE, 2010, at 5, available at [http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us\\_tax\\_UTP3\\_121310.pdf](http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_UTP3_121310.pdf) (noting the burden and cost of compliance with Schedule UTP).

136. Douglas M. Sayuk et. al., *The Proposed Federal Schedule UTP and State Conformity: Implications for Taxpayers if States Require Similar Disclosure*, ACCT. POL'Y & PRAC. REP., June 11, 2010, at 395 (noting that "various states may follow their federal counterpart and develop a Schedule UTP of their own further requiring disclosure of state specific uncertain tax positions such as nexus, apportionment, and filing methodologies.").

137. See Jorina Fontelera, *Society Comments on Proposed UTP Schedule*, NEW YORK STATE SOCIETY OF CPAS, June 17, 2010, available at <http://www.nysscpa.org/ezone/ETPArticles/61710/print/JF61710.htm>

can be significantly reduced through the study of Forms 8886, 8275, 8275-R, and Schedules M-3 and UTP, all of which contain portions that require corporate taxpayers to repeat previously disclosed information on another form and can be managed more effectively while providing the same result.

Information provided on Form 8886 will have to be disclosed by the taxpayer who files Schedule M-3. Specifically, Part II, Line 12 of Schedule M-3 requires the taxpayer to disclose all items related to the reportable transactions, including income (loss) per income statement, the amount of temporary and permanent difference, and income (loss) per tax return.<sup>138</sup> This information must be disclosed “even if there is no difference between the financial amounts and the taxable amounts.”<sup>139</sup> Form 8886 contains similar disclosure requirements as Forms 8275 and 8275-R. For instance, these forms require the taxpayer to disclose types of entities involved, a description of the transaction or assertion that will lead to the desired tax benefit, and additional explanations of relevant facts supporting the taxpayers’ position. Lastly, Schedule UTP may disclose all of the information currently contained on Form 8886.

Forms 8275 and 8275-R are virtually identical and have the same purpose of disclosure of taxpayers’ positions in order to avoid accuracy-related penalties prescribed by the Code, as all four parts of forms 8275 and 8275-R, requests for general information, detailed explanation, information about pass-through entity, and explanation mirror each other. As previously noted, duplicative disclosures are present between Forms 8275, 8275-R, and Form 8886.

Schedule M-3 also contains some of the duplicative disclosures. Specifically, column (d) of Schedule M-3’s Part II, which reveals deduction asserted per tax return, “adds to the workload because it duplicates information found in other parts of the return.”<sup>140</sup> The information found on column (a) may be found from the taxpayer’s general ledger income or expense accounts.<sup>141</sup> Additional duplicity is present in Schedule M-3’s Part II and III line items pertaining to income

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(stating that “Form 8275, Form 8275-R, Form 1120, Schedule M-3 and Form 8886—currently required for filing—already disclose many of the same items the IRS would require to be disclosed on Schedule UTP.”).

138. See Instructions for Schedule M-3 (2010) (stating that filing of a Form 8886 for any reportable transaction would require the taxpayer to report that reportable transaction on Schedule M-3, Part II, line 12).

139. *Id.*

140. See *AICPA Urges IRS to Eliminate Form 8916-A, Ease Schedule M-3 Reporting Requirements*, BNA DAILY TAX REP., Apr. 28, 2011.

141. *Id.*

and expense,<sup>142</sup> research and development, and reportable transactions which could potentially be reported on the Schedule UTP.<sup>143</sup>

In addition to duplicative reporting, there is a large amount of dependence, support, and interaction between the forms. Instructions to the forms and schedules often state that compliance with one form or schedule will satisfy the compliance with another. For instance, Forms 8886, 8275, and 8275-R support Schedule M-3.<sup>144</sup> The introduction of Schedule M-3 affected the reporting of the significant differences between financial and tax reporting<sup>145</sup> that used to be disclosed on Form 8886.<sup>146</sup> Similarly, disclosure on Schedule M-3 with an attached schedule will satisfy the requirements for reporting of a listed transaction.<sup>147</sup> However, this requirement does not necessarily relieve the taxpayer from compliance associated with Form 8886 disclosures. Interaction between Forms 8275 and 8275-R and Schedule UTP presents another example, where the Instructions for Schedule UTP state that if a taxpayer provides “a complete and accurate disclosure of a tax position” on Schedule UTP for the appropriate tax year, this disclosure will be treated as if the corporation filed Forms 8275 or 8275-R.<sup>148</sup>

142. *Id.* (noting how Parts II and III of Schedule M-3 address income items and expense items which now can be obtained through the new Schedule UTP).

143. Thompson, *supra* note 28 (suggesting elimination of certain items on Schedule M-3).

144. See Singleton & Smith, *supra* note 2, at 40 (noting that “unlike items that are combined on the M-1 or M-3, additional disclosure must be provided on Form 8275 to satisfy the adequate disclosure requirements to avoid the IRC section 6662 accuracy-related penalty.”).

145. Alistair M. Nevius, *IRS Increases Disclosure Requirements*, J. OF ACCT., May 2010, at 76 (noting that “prior to 2006, significant book-tax differences were included as a category of reportable transactions. This went away partially due to the introduction of Schedule M-3 in 2004.”).

146. See Instructions for Schedule M-3 (2010) (stating that “a corporation will be considered to have separately and adequately disclosed a reportable transaction if the corporation attaches a supporting schedule that provides the following information for each reportable transaction: (1) a description of the reportable transaction disclosed on Form 8886 for which amounts are reported on Part II, line 12; (2) the name and tax shelter registration number, if applicable, as reported on lines 1a and 1b, respectively, of Form 8886; and (3) the type of reportable transaction (that is, listed transaction, confidential transaction, transaction with contraction protection, etc.) as reported on line 2 of Form 8886.”). See Antognini, *supra* note 120, at 47-48 (for the difference in treatment pertaining to the listed transactions, where “if a transaction is a reportable transaction both because it gives rise to a significant book-tax difference and because it is covered by another category under the regulations, Schedule M-3 will not by itself prove sufficient disclosure” and the taxpayer will have to complete Form 8886).

147. See Instructions for Schedule M-3 (noting the requirements for reporting a listed transaction, which include description provided on Form 8886’s line 3 and in the event partnership is involved disclosure of the name and EIN of the involved entity reported on Form 8886’s line 5).

148. Instructions for Schedule UTP (2010) (stating that “[a] complete and accurate disclosure of a taxpayers position on the appropriate year’s Schedule UTP will be treated as if the corporation filed a Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement,

Additional methods for compliance are also provided through the Service's revenue procedures and announcements, which lead to uncertainty about which disclosures should be made where, when, and to what extent. For instance, in *Revenue Procedure 2010-15*, the Service has issued guidance when disclosure on a tax return will be deemed adequate for the purposes of Forms 8275 and 8275-R.<sup>149</sup> In *Announcement 2010-75*, the Service stated that disclosure on the Schedule UTP can be sufficient for reporting required on Forms 8275 and 8275-R. However, none of these alternate methods of reporting provide precise guidance as to what the Service wants to see from taxpayers and the outlook of the final tax deliverable. With lack of necessary guidance, taxpayers are often left with an uncomfortable choice: duplicating their disclosure in a substantially similar form, or attempting to make a general disclosure that may or may not meet the Service's standard. The duplicative reporting that is required of corporations and the relationship between forms is summarized in Appendix 2.

#### IV. REDUCTION OF DUPLICATIVE REPORTING SHOULD LEAD TO THE DESIRED CORPORATE TAX TRANSPARENCY AND EFFICIENCY

One of the solutions to reduction of compliance costs summarized in Appendix 1 for the overburdened corporate taxpayer is through improved management and use of the existing disclosure forms. This approach makes sense as it has been estimated that 90% of the overall paperwork burden comes from the Service's tax forms.<sup>150</sup> The elimination or consolidation of some of the existing forms and schedules described in this article would provide for substantial reduction in compliance burden for taxpayers. For instance, based on the estimates provided by the Service, an elimination of Form 8886 through merger with Schedule UTP or Schedule M-3 would eliminate an estimated burden of twenty-two hours associated with compliance, record keeping,

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regarding the tax position. A separate Form 8275 or Form 8275-R need not be filed to avoid accuracy related penalties with respect to that tax position.”)

149. *IRS Describes Adequate Disclosure For 2009 Returns; Provides Guidance For Schedule M-3 Filers*, STANDARD FED. TAX REP., Feb 4, 2010, at 5. See Rev. Proc. 2010-15, I.R.B. 2010-7, Feb. 16, 2010 (noting that even if the taxpayer meets the disclosure requirements provided by Rev. Proc. 2010-15, protection from accuracy related penalty under Section 6662 will not be provided if the assertion on the return does not have a reasonable basis, is attributable to a tax shelter, or is not properly substantiated by adequate records. Similarly, the disclosure will not protect tax preparers from penalty if assertion on the tax return is a tax shelter or a reportable transaction).

150. See Keating, *supra* note 13.

and filing requirements. Consolidation of Forms 8275 and 8275-R into one would shorten the taxpayers' compliance burden by at least five hours. When eliminated through consolidation with Form 8886, Schedule M-3, or Schedule UTP, the reduction in compliance burden is likely to be even higher. Reduction of Parts II and III of Schedule M-3, a requirement that only one Schedule M-3 form is filed for all taxpayers, or consolidation between Schedule M-3 and Schedule UTP would also reduce the compliance burden.

The Service has made a positive step towards reducing the burden on corporate taxpayers by reviewing whether the existing disclosure requirements function in the manner they were intended<sup>151</sup> and by announcing that it is studying ways to reduce duplicate reporting.<sup>152</sup> In its *Notice 2011-39*, the Service stated that in reviewing the comments from the public about the items that should be included on the 2011-2012 *Guidance Priority List*, it will consider whether some of its prior guidance and regulations are “outmoded, ineffective, insufficient, or excessively burdensome and that should be modified, streamlined, expanded, or repealed.”<sup>153</sup> Additional requests for comments to reduce duplicative reporting may also be found on the Service's website,<sup>154</sup> as well as an initiative to create frequently asked questions web pages in order to address taxpayer's reporting needs.<sup>155</sup> Some of the most progressive changes to reduction of duplicative disclosure reporting may come either through Schedule UTP or creation of a single new all-comprehensive reporting form for corporate taxpayers.

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151. See Alison Bennett, *IRS to Look at Corporate Governance Of Tax Risk and Transparency Issues*, ACCT. POL'Y & PRAC. REP., Oct. 2, 2009, at 916 (noting comments of the IRS Large and Mid-Size Business Division Commissioner, Steven Miller, who stated that the IRS will continue to “examine such issues as whether existing accounting rules and existing tax forms, such as Schedule M-3, provide an adequate view into the tax risk process.”).

152. See Announcement 2010-10, I. R. B. 2010-41, Oct. 12, 2010. See Heather M. Rothman, *IRS Could Issue Further Guidance by Year's End on Uncertain Tax Positions, Officials Say*, BNA DAILY TAX REP., Nov. 5, 2010 (noting comments of the IRS Special Counsel, Kathryn Zuba, “[t]he IRS is very concerned about there being an overlap of disclosure with other requirements within the law”).

153. Internal Revenue Notice 2011-39, available at <http://www.irs.gov/pub/irs-drop/n-11-39.pdf>.

154. See Schedule M-3 for Large Business & International (LB&I), available at <http://www.irs.gov/businesses/corporations/article/0,,id=119992,00.html> (listing stakeholder groups interested in helping the Service to work on reducing duplicative reporting requirements associated with the Schedule M-3).

155. See Paul, O'Connor, *TEI Requests Additional Guidance on Reporting Uncertain Tax Positions*, TAX NOTES TODAY, Apr. 27, 2011 (commanding the Service for creating FAQ page for UTP disclosures and suggesting further development of FAQ-type guidance).

A. *Increased Transparency and Reduction of Duplicative Reporting through Schedule UTP*

Practitioners believe that in some circumstances the newly introduced Schedule UTP can be used in lieu of existing disclosure forms to report information to the Service.<sup>156</sup> It has been suggested by some commentators that the Service should allow corporations to disclose their reportable transactions on Schedule UTP, instead of filing Form 8886, Form 8275, or Form 8275-R.<sup>157</sup> This position is reasonable as the Service has agreed to treat a complete and accurate disclosure of a tax position on Schedule UTP to satisfy reporting requirements mandated by Form 8275 or Form 8275-R (disclosure pertaining to positions taken contrary to Treasury regulations) regarding a tax position and its associated accuracy-related penalties.<sup>158</sup> This view is also rational due to the revenue procedures in the annually published Internal Revenue Bulletin that consider a disclosure on the tax return adequate for the purposes of substantial understatement of the accuracy-related penalty and understatements due to unreasonable positions of the preparer's penalty.<sup>159</sup>

Some tax professionals have suggested that with the introduction of Schedule UTP the Service "should eliminate Schedule M-3 because it

156. Eli J. Dicker, *Statement of Eli J. Dicker, Chief Tax Counsel*, TAX EXECUTIVES INST., INC., Oct. 18, 2010, at 7, available at <http://www.law.uchicago.edu/files/file/Schedule%20UTP%20-%20Testimony%20-%20Final%20Notes%201018%20-%20Mary%20Lou%20Fahey.pdf> (noting that Tax Executive Institute "recommends expanding the mandate of the M-3 working group to include considerations of duplication related to Forms 8275, 8275-R, and 8886, which all seek information that will be disclosed on Schedule UTP."). See also Letter to Commissioner Douglas H. Shulman, American Institute of CPAs, Dec. 2, 2010, available at <http://www.aicpa.org/InterestAreas/Tax/Resources/IRSPracticeProcedure/Advocacy/DownloadableDocuments/AICPA%2012.02.2010%20UTP%20letter.pdf> (recommending that "the IRS seek ways to alleviate the need for disclosure of the same information on Schedule UTP that is required to be disclosed on other forms and schedules.").

157. Neil D. Traubenberg, *Comments of Tax Executives Institute, Inc. on Announcements 2010-9, 2010-17, and 2010-30 relating to Uncertain Tax Positions and the Policy of Restraint submitted to The Internal Revenue Service*, May 28, 2010, at 32, available at [http://www.tei.org/Documents/Advocacy/TEI%20Comments%20on%20Ann%202010-9%20\(final\).pdf](http://www.tei.org/Documents/Advocacy/TEI%20Comments%20on%20Ann%202010-9%20(final).pdf) (stating that "Forms 8886 and 8275 already provide the IRS with significant information about specific transactions or items. To the extent an item is already disclosed in those forms . . . [Schedule UTP] will yield little or no additional information for an examiner.").

158. See Instructions For Schedule UTP: Uncertain Tax Position Statement (2010). See also Instructions For Form 8275: Disclosure Statement (2011) (noting that if the taxpayer has filed a Schedule UTP, the taxpayer "may not need to file Form 8275 to satisfy the disclosure requirements of section 6662(i)."). See also Instructions for Form 8275-R: Regulation Disclosure Statement (2011) (noting the same).

159. See Instructions for Form 8275: Disclosure Statement.

will be duplicative.”<sup>160</sup> However, other tax experts believe that eliminating Schedule M-3 in its entirety and relying exclusively on Schedule UTP “would be a serious mistake”<sup>161</sup> and suggest reduction of duplicative reporting where appropriate.<sup>162</sup> While Parts II and III of Schedule M-3 may be substantially reduced or eliminated,<sup>163</sup> Part I provides the Service with essential information about permanent and timing differences and reconciliation between worldwide accounting income and taxable income.<sup>164</sup> As of the date of this article, the Service expressed the desire to keep Schedule M-3 but revise it to eliminate any duplicative reporting in light of the new Schedule UTP.<sup>165</sup>

Although the use of Schedule UTP as an all-purpose form may help to reduce duplicative reporting, in its current state, it is unlikely to be the most effective compliance and information gathering tool. It is uncertain how the Service will be able to effectively process all of the information taxpayers currently disclose through Forms 8886, 8275,

160. Neil D. Traubenberg, *Tax Executive Institute Comments on Proposed Schedule, Draft Instructions for Disclosure of Uncertain Tax Positions*, TAX NOTES TODAY, June 1, 2010 (stating that “[i]f Schedule UTP is ultimately retained, the IRS should eliminate Schedule M3 because it will be duplicative. Taxpayers currently required to file Schedule M-3 would then revert to completing Schedule M-1 to reconcile from financial to taxable income.”). See Alison Bennett, *Broad Spectrum of Stakeholders Criticize Uncertain Tax Positions Reporting Proposal*, BNA DAILY TAX REP., June 3, 2010 (stating that “duplicative filing requirements—such as the Schedule M-3 and the Form 8886—should be eliminated.”).

161. J. Richard (Dick) Harvey, Jr., *Schedule UTP: An Insider’s Summary of the Background, Key Concepts, and Major Issues*, 10 DEPAUL BUS. & COM. L. J. 349 (2011), available at <http://ssrn.com/abstract=1782951>.

162. See Dicker, *supra* note 156. See also Neil D. Traubenberg, *Comments of Tax Executives Institute, Inc. on Announcements 2010-9, 2010-17, and 2010-30 relating to Uncertain Tax Positions and the Policy of Restraint submitted to The Internal Revenue Service*, May 28, 2010, at 32 (stating that “[t]o eliminate duplicate reporting, we recommend eliminating the disclosure of items on Schedule UTP for items subject to Schedule M-3 reporting. Alternatively, taxpayers should be permitted to incorporate such items by cross-reference to the Schedule M-3 or the requirement to file Schedule M-3 should be eliminated for taxpayers subject to Schedule UTP.”).

163. Harvey, *supra* note 161 (stating that Part II and Part III of Schedule M-3 “that combined have approximately 70 line items to categorize various income and deduction amounts” could be modified as all of these line items may not be really necessary). See Thompson, *supra* note 8, at 2-3 (providing in depth suggestion of which items may be eliminated or significantly reduced from the present Schedule M-3).

164. Harvey, *supra* note 161 (suggesting that “the two most important components of Schedule M-3 are (i) the reconciliation between worldwide financial accounting income and taxable income, and (ii) the identification of permanent and timing differences” should be retained).

165. Alison Bennett, *IRS Working on More NOL Guidance Under Uncertain Positions Initiative, Wilkins Says*, BNA DAILY TAX REP., Apr. 1, 2011 (referencing comments of IRS Chief Counsel William Wilkins who said that “although IRS has a task force in place to look at the Schedule M-3 in light of the new requirement on uncertain positions, the agency has no plans to abandon that schedule altogether. . . . [while] stressing that IRS is working to evolve the form ‘so there isn’t duplicative reporting.’”).

8275-R, and Schedule M-3. Without significantly amending Schedule UTP, certain tax professionals could choose to strategically bury the most vulnerable disclosures somewhere in the schedule. Uncertainty in the guidance could lead to the elimination of the desired level of transparency within our tax system. Lack of well-defined enforcement mechanisms provides uncertainty as to how and to what extent taxpayers will comply with disclosure requirements of Schedule UTP. Accordingly, before Schedule UTP is considered to be implemented as an all-inclusive disclosure form, the Service should consider addressing how it can effectively receive all of the desired information and the possibilities of how the new Schedule UTP reporting may be avoided by taxpayers.

*B. Obtaining Desired Level of Transparency and Reduction of Duplicative Reporting Recommendation through a New Comprehensive Form of Disclosure*

The intent of disclosure forms and schedules is the same: to provide the Service with information about the taxpayers' positions and to increase transparency. This desired effect can be achieved and implemented through creation of a comprehensive form. Tax practitioners generally believe that there are five general types of tax positions that lead to recordation of tax reserves in accordance with FIN 48 and that the Service will continue to carefully examine regardless of whether the item was disclosed: (1) items reported on Forms 8275, 8275-R, or 8886; (2) financial and tax accounting differences subject to disclosure and reconciliation on Schedule M-3; (3) transfer pricing; (4) "tiered issues" and industry specific issues; and (5) significant corporate transactions such as reorganizations, liquidations, or changes of accounting methods.<sup>166</sup>

Creation of a single schedule that covers five of these reporting situations would provide the Service with the majority of the information it seeks to ensure compliance with the U.S. tax laws and regulations. Simultaneously, the new all-inclusive schedule may potentially eliminate much of the duplicative reporting, promote uniformity, and lead to the transparency the Service is seeking from corporate taxpayers' disclosures. To avoid the problems noted in this article, drafters of the new schedule should not only concentrate on the content of information that the Service wants taxpayers to provide, but also on the most

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166. See Traubenberg, *supra* note 160.

effective way the requested information can be delivered. Thus, to help successful implementation of this new schedule, the Service could take into consideration the taxpayers' cost of compliance and legal rights from disclosing legally protected confidential information.

To ensure compliance, the Service should consider implementing proper enforcement mechanisms, which may include financial penalties, extending the statute of limitations, or removal of the policy of restraint during litigation.<sup>167</sup> The model for penalties can be adopted from already existing laws and regulations with appropriate modifications where necessary. These rules are likely to be enforced by the courts. For instance, a court in *Deutsche Bank AG v. United States* ruled that a corporate tax return that failed to attach and include associated mandatory forms could not be processed.<sup>168</sup>

A new, all-inclusive schedule that reduces compliance costs, protects privileged information, and creates desired transparency is achievable. To accomplish this objective, the Service and taxpayers need to work together, exchange ideas about implementation, be reasonable, and stay focused on the overall goal of transparency. Continuous, open communication as during the creation and formalization of Schedule UTP should allow for creation of a disclosure form that provides the Service with the information it needs to enforce tax laws and regulation, while managing corporate taxpayers' compliance costs by reducing unnecessary duplicative disclosures.

## V. CONCLUSION

Prior to promulgating any new disclosure rules, it would prove beneficial for the Service to research and compare its existing reporting requirements to determine that any new issues are not duplicative of prior forms. Undoubtedly some of the above-mentioned duplicity, compliance awkwardness, and significant burden summarized in Appendix 1 could be avoided. Reduction of duplicity present in the tax forms summarized in Appendix 2 would be consistent with the Service's objectives of "certainty, consistency, and efficiency;" facilitate identification of important tax issues for compliance; streamline audits;

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167. J. Richard Harvey, Jr., *Schedule UTP Guidance – Initial Observations*, TAX NOTES, Oct. 4, 2010, at 117 (suggesting that Service's self-imposed policy of restraint should apply only to corporations that accurately and adequately complete Schedule UTP).

168. *Deutsche Bank AG v. United States*, 95 Fed. Cl. 423 (Fed. Cl. 2010). See Thomas Cryan, John Keenan & Gretchen Woods, *Failure to Attach Forms Rendered Return Non-Processible and Not Timely Filed*, PRACTICAL TAX STRATEGIES, Feb. 2011, at 80 (describing the court's ruling in detail).

and, reduce the burden on all parties involved.<sup>169</sup> It would not be necessary for the Service to mandate new disclosures if desired information could be obtained from other existing forms or sources. While aggressively engaging in increasing revenue and enforcing compliance with tax laws, the Service also considers how their actions affect the corporate taxpayer in its attempts to comply with the existing laws and regulations.<sup>170</sup> By creating an open communication forum through Form 13285-A, the Service has taken an affirmative step towards reducing complexity of the tax code.<sup>171</sup> Time will tell whether the U.S. corporate tax regime and its duplicative reporting requirements will continue to impose heavy disclosure burdens on corporate taxpayers, or whether the Service will adopt taxpayers' practical suggestions to reduce compliance burdens and associated costs.

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169. See Singleton & Smith, *supra* note 2, at 39 (referencing the objectives of the Service).

170. Meg Shreve, *Honeywell CEO Says Tax Reform essential to Fiscal Recovery*, TAX NOTES TODAY, Apr. 12, 2011 (noting comments of David M. Cote, CEO of Honeywell International Inc., who stated that the U.S. corporate tax system “needs to be the mosquito extracting blood from the host—irritating but very survivable—and not the vampire killing the host in the process.”).

171. See Form 13285-A, Reducing Tax Burden on America's Taxpayers (Referral Form for Use by the Public), available at <http://www.irs.gov/pub/irs-pdf/fl3285a.pdf>.

**Appendix 1**

<b>Form</b>	<b>Estimated Taxpayers' Compliance Burden</b>
<b>Form 8886</b>	<ul style="list-style-type: none"> <li>• 22 hours and 14 minutes</li> </ul>
<b>Form 8275</b>	<ul style="list-style-type: none"> <li>• 5 hours and 41 minutes</li> </ul>
<b>Form 8275-R</b>	<ul style="list-style-type: none"> <li>• 5 hours and 27 minutes</li> </ul>
<b>Schedule M-3</b>	<ul style="list-style-type: none"> <li>• At least 85 hours. Estimates on compliance with Schedule B associated with Schedule M-3 have not been provided.</li> <li>• If Form 8916 is used, add additional 6 hours and 45 minutes.</li> <li>• If Form 8916-A is used, add additional 30 hours and 51 minutes.</li> </ul>
<b>Schedule UTP</b>	<ul style="list-style-type: none"> <li>• Compliance estimates have not been provided.</li> </ul>

**Appendix 2**

<b>Form</b>	<b>Unnecessary Duplicative Reporting Burden</b>
<b>Form 8886</b>	<ul style="list-style-type: none"> <li>• Can be reported on Schedule M-3, Part II, line 12, where the taxpayer is required to report all items related to the reportable transactions, including income (loss) per income statement, the amount of temporary and permanent difference, and income (loss) per tax return. The taxpayer is also required to attach details pertaining to this disclosure along with Schedule M-3.</li> <li>• Contains similar disclosure information as Forms 8275 and 8275-R.</li> <li>• Schedule UTP may disclose all of the information contained on Form 8886.</li> </ul>
<b>Form 8275</b>	<ul style="list-style-type: none"> <li>• Identical in all parts to Form 8275-R.</li> <li>• Contains similar disclosure information as Form 8886.</li> <li>• Taxpayers may disclose information contained on this form on Schedule UTP.</li> </ul>
<b>Form 8275-R</b>	<ul style="list-style-type: none"> <li>• Identical in all parts to Form 8275.</li> <li>• Contains similar disclosure information as Form 8886.</li> <li>• Taxpayers may disclose information contained on this form on Schedule UTP.</li> </ul>
<b>Schedule M-3</b>	<ul style="list-style-type: none"> <li>• Can report all of the information contained on Form 8886, 8275, and 8275-R.</li> </ul>
<b>Schedule UTP</b>	<ul style="list-style-type: none"> <li>• May include all of the information contained on Forms 8886, 8275, and 8275-R and some information contained on Schedule M-3.</li> </ul>