



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

May 19, 2006

The Honorable Charles E. Grassley
Chairman, Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Senator Grassley:

I am pleased to respond to your letter of March 8, 2006, on the most significant compliance issues within the responsibility of the Large and Mid-Size Business Division (LMSB). LMSB's taxpayer base consists of the largest businesses in the United States, including corporations, sub-chapter S corporations, and partnerships with assets greater than \$10 million, including over 6,100 publicly traded companies. LMSB taxpayers file approximately 176,000 income tax returns annually, and while the population base remains relatively stable, we continue to see an increase in complex business structures and pass-through return filings. LMSB taxpayers, particularly public companies, are driven to show high after-tax profitability to shareholders in a very competitive and complex economic environment. They have the resources and willingness to aggressively defend and contest tax law positions.

As you requested, we have outlined below the top LMSB tax compliance concerns and matters that raise questions about whether the actions of taxpayers are keeping with the intent and spirit of the Internal Revenue Code (the Code). In addition, we have outlined certain tax policy issues that we believe are worthy of discussions among the IRS, the Treasury Department, and the Finance Committee.

Introduction

Our response is divided into three parts. First, we discuss the current environment of large and mid-size businesses, our challenges, and the focus of our compliance efforts. Second, we list current specific compliance issues and how we are addressing these issues. These compliance issues include complex international transactions, significant domestic issues, compliance issues resulting from or impacted by provisions in the American Jobs Creation Act (AJCA), and tax shelters. Finally, we identify focus areas for discussion of reform.

I. General Environmental Challenges Affecting Compliance

We face new and more challenging tax administration problems resulting from globalization, complexity of the Code, complexity of business transactions, and the growing book-tax gap.

Globalization: Tax administration is complicated by the rapid pace at which businesses are continuing to expand globally. A growing percentage of large and mid-size business tax filings are from multinational businesses that have a myriad of subsidiaries and partnerships operating within an enterprise structure where the ultimate parent is as likely to be foreign as domestic. A growing number of U.S. businesses acquire raw materials, inventory, financing, products and services from foreign businesses. These events are natural outcomes of an increasingly global economy and businesses have the right to optimize their global structures. Nonetheless, the complexities of globalization and cross-border activity continue to challenge the Code and U.S. tax administration. With multiple domestic and global tiered entities, it is often difficult to determine the full scope and resulting tax impact of a single transaction or series of transactions. Complexities of globalization and cross-border activity create opportunities for aggressive tax planning demonstrated in several of the international/global current compliance issues mentioned in this letter.

Complexity of the Internal Revenue Code: The Code continues to expand, becoming more complex and challenging to administer. Large businesses utilize every available resource to explore opportunities to reduce their tax liability by challenging the most intricate and complicated Code provisions. Every new tax law, even those that are simple on their face, creates additional complexity while providing taxpayers with further tax planning opportunities adding to our challenges to administer the Federal Tax System. These changes make it more difficult for us to treat similarly situated taxpayers in a consistent manner. Three of the current specific compliance issues mentioned in this letter arise from new Code provisions enacted by the AJCA.

Complexity of Transactions: Large businesses engage in sophisticated transactions that result in complex relationships with multiple filing requirements. Tax administration continues to be challenged by the increasing number of high value, sometimes cross-border, mergers, acquisitions and other multifaceted international and domestic tiered transactions. The increasing volume and complexity of these transactions make it difficult for us to identify them and to effectively address them in a timely manner.

Growing Book-Tax Differences: Companies strive to reflect the highest possible after-tax profits in their financial statements while at the same time being incentivized to report the lowest possible taxable income and tax liability. The difference between income reported by public companies to their shareholders

and income reported on their tax returns to the IRS has grown dramatically in recent years, from \$79.0 billion in 1995 to \$203.8 billion in 2002.¹ The climb slowed in the period 2000-2002 when the economy cooled down and the equity markets declined. When post-2002 data becomes available, given that the economy returned to a period of expansion and the equity markets have recovered, we believe we will see the increase in book-tax differences pick up where it left off in 2000.

Research indicates that book-tax differences sometimes indicate significant compliance risk, as is the case in many of the issues discussed in Section II below. When the details of business transactions and book-tax differences are not visible, the accurate determination of shareholder value, the efficiency of capital markets and the correct determination of tax can be jeopardized. An extreme example was highlighted by the Congressional investigation of Enron. The company told its shareholders during the period 1995-2000 that it earned a robust \$13 billion, whereas for the same 5-year period, the company's Federal Income Tax Returns reported only \$76 million in taxable income.

The IRS Addresses These Challenges

We have taken a proactive approach to dealing with the challenges of effective tax administration in the environment described above. Overall, our strategy depends on making compliance checks as much as possible on a real-time or near-real-time basis, being as current in our examinations as possible, and having as much transparency to book-tax differences and other indicators of risk as possible. To that end, we have initiated several programs that foster transparency, currency, pre-filing compliance opportunities, and improved efficiencies in issue and risk identification.

We are looking at various methods to better address issues involving cross-border/multi-national enterprise activities as well as the domestic items that are a subject of this letter. In general, we have found Issue Management Teams (IMTs) to be successful when we employ them to provide executive oversight and focus upon areas of high risk. We have used IMTs to combat tax shelters, and have expanded their use to include other areas of high compliance risk. We have also used special teams of experienced personnel to assist with the examination of specific issues in the tax shelter arena, and plan to use similar teams to address other compliance issues. Additionally, we are working to enhance the use of internal web site information to better inform examiners of high risk areas and the steps they must take to ensure consistent application of the law.

Improving Transparency: To improve transparency of corporate taxpayers, we introduced a new Schedule M-3. The Schedule M-3 provides more detail on book-tax differences, enabling us to identify and focus more quickly and precisely

¹ See attached chart of Book-Tax Difference Trend.

on those tax returns and issues that present the highest potential compliance risk.

Improving Currency and Transparency: We introduced the Compliance Assurance Program (CAP), to improve both currency and transparency. The CAP is a real-time approach to compliance review that allows us, working in conjunction with the taxpayer, to determine tax return accuracy prior to filing. We believe the CAP is more efficient than a post-filing examination—we are currently piloting the model and will refine as necessary—as it provides corporations certainty about their tax liability for a given year within months, rather than years, of filing a tax return. This win-win program greatly reduces taxpayers' compliance burden and their need for contingent book tax reserves, while increasing currency and allowing for more efficient use of our resources.

Pre-Filing Compliance: We created the Pre-Filing Agreement (PFA) program to provide taxpayers an opportunity to request that revenue agents examine and resolve potential issues before tax returns are filed. We continue to explore ways to improve and create additional pre-filing compliance opportunities and are designing another pre-filing initiative to expand our ability to work with LMSB taxpayers on a pre-filing basis to address their federal tax liability compliance.

Improving Issue and Risk Identification: LMSB identifies emerging high risk issues as early as possible, issuing guidance to taxpayers and examiners on the proper treatment of these issues, and efficiently and vigorously examining those returns where taxpayers engage in that behavior. One additional method we are employing to improve issue identification and the selection for examination of high risk returns is electronic filing (*E-Filing*). Many corporations are now required to file their tax returns electronically and this mandate will expand in future tax years. *E-filing* will provide more consistent treatment and data analysis for efficient, near real time identification of high risk issues and taxpayers. *E-filing* and Schedule M-3 together also allow us to more efficiently identify and exclude lower risk taxpayers from consideration for examination.

The approaches described above better position us to more timely address the rapid change of business in the domestic and global arenas. The earlier we learn of emerging trends, the better positioned we will be to adjust resources to appropriately address compliance risks.

II. Current Specific Compliance Issues and Actions Taken

The most significant compliance problems facing LMSB are issues that include one, several, or all of the following factors: significant impact on one or more industries; a large number of taxpayers; significant dollar risk; substantial compliance risk; and/or high visibility. In addition to these general problem areas, LMSB also continues to combat tax shelters and other abusive tax avoidance schemes.

To address these tax compliance challenges, to dissuade promoters and others from initiating new ones, and to achieve our key goal of tax compliance through service and enforcement, we are working to make our examination resources more efficient, using tools to increase taxpayer disclosure and transparency, leveraging technology, and reengineering our processes to identify and resolve emerging issues and potentially abusive transactions.

The volume of return examinations has increased with a focus on returns where we have identified significant compliance issues. IMTs have been, or are in the process of being, established for all issues with significant compliance problems. We continue to work with Counsel to ensure written guidance is provided to examiners for addressing each of these significant compliance issues. Examiners are expected to consider penalties on all returns with examination adjustments and on promoters of tax avoidance schemes. Below is a summary of our most significant compliance problems and the actions we are taking to address these areas of non-compliance.

International/Global Transactions

Transfer of Intangibles Offshore/Cost Sharing: Tax issues associated with the transfer of intangibles outside the United States have been a high risk compliance concern for us and have seen a significant increase in recent years. Taxpayers, especially in the high technology and pharmaceutical industries, are shifting profits offshore through a variety of arrangements that result in the transfer of valuable intangibles to related foreign entities for inadequate consideration. Cost sharing arrangements are often the method of choice for this activity. The buy-in amount in cost sharing arrangements is particularly troublesome. It is often understated, resulting in the improper shifting of income offshore.

As part of our response to these issues, we proposed a comprehensive set of cost sharing regulations in August 2005, that seek to ensure such arrangements do not facilitate a disguised transfer of intangible assets outside the United States in a manner inconsistent with the arm's length standard. We intend to finalize these regulations this year.

We have also established a cost sharing IMT to improve Service-wide coordination in the identification, development, and resolution of cost sharing issues. The team issued a cost sharing audit checklist in 2005 that provides guidance to field examiners for developing potential cost sharing audit issues and ensuring consistency. The team has completed its efforts to identify and review cases with a cost sharing issue to determine the impact and compliance risk. The team is developing a coordinated issue paper that will provide the basis and support for examining issues and to assist with potential Appeals Settlement

Guidelines. In 2005, the LMSB Commissioner issued guidance to field examiners for requesting transfer pricing documentation.

Abusive Foreign Tax Credit Transactions

Taxpayers are manipulating the Code to create and claim foreign tax credits (FTCs) where the associated foreign-source income is not taxed in the United States. One type of transaction involves the inappropriate separation of the FTCs from related foreign-source income. These transactions typically involve the acquisition of assets that generate an income stream or built-in gain that is subject to foreign taxes but not U.S. taxes; or, the use of partnerships, foreign consolidated regimes, or "check the box" reverse hybrid entities to obtain FTCs before the related foreign income is subject to U.S. tax. In addition, cross-border financing transactions are being structured to generate abusive FTC results. In the case of U.S. lender transactions, a U.S. person makes a loan to a foreign person in a transaction structured to shift a portion of the borrower's foreign tax liability to the U.S. lender. In the case of U.S. borrower transactions, a U.S. person borrows from a foreign person in a manner that allows the U.S. person to pay creditable foreign taxes in lieu of deductible interest. In both types of cases, the FTCs are used to shelter unrelated foreign source income. These structured financing transactions often result in the duplication of tax benefits through the use of certain structures designed to exploit inconsistencies between U.S. and foreign laws. We are aware of 11 structured financing transactions with an estimated \$3.5 billion at issue in these cases.

To address cross-border financing transactions that are designed to generate FTCs, LMSB has formed an IMT. The team will work to: identify and address all open cases with an abusive FTC issue; identify and explore all viable legal arguments to combat the abuses including the application of judicial doctrines, such as economic substance, and/or step transaction arguments; provide guidance to the field; and pursue possible legislative and/or regulatory modifications. Due to the global aspects of this issue, we must consider tools available under international treaties and exchange of information agreements. In addition, the IRS and Treasury have several major regulatory projects underway that will address numerous issues involving the inappropriate separation of FTCs from related foreign-source income.

Abusive Hybrid Instrument Transactions: Taxpayers can use hybrid instruments, hybrid entities, and similar structures to capitalize on differences between foreign and domestic tax laws because these structures are often treated differently for U.S. and foreign tax purposes. This kind of arbitrage can be the natural outgrowth of global economies and disparate tax systems. Concern exists, however, that in some cases,

hybrid instruments or entities might be used to avoid U.S. tax rules. For example, inappropriate FTCs can be generated. The use of these hybrid instrument transactions by U.S. multinational domestic corporations and foreign controlled domestic subsidiaries is a common practice. Indications are the use of these types of transactions is on the rise.

In response, we recently formed an IMT to develop a Service-wide position on hybrid instruments. Due to the global aspects of this issue, we will consider international treaties and simultaneous examination processes. In addition, the IRS and Treasury have a number of guidance projects under way that would address some of the issues raised by hybrid instruments, hybrid entities, and similar structures.

Transfer Pricing: Taxpayers are continuing to shift significant profits offshore. Taxpayers often manipulate the price of related transactions so that the income of an economic group is ostensibly earned in low tax jurisdictions, or in no jurisdiction, rather than in the U.S., thus lowering the enterprise's worldwide tax burden. We apply the arms length principle to determine the appropriate allocation of income between related parties based upon the application of acceptable transfer pricing methodologies (section 482 of the Code).

In response to the significant compliance risks of transfer pricing issues, the LMSB Commissioner issued a Transfer Pricing Compliance Memorandum in January 2003 that provided instruction and guidance to all field examination personnel regarding potential transfer pricing issues. Additionally, the LMSB Commissioner issued a Transfer Pricing Documentation Memorandum that requires all field examination personnel to request and review taxpayer transfer pricing studies. As a subset of the transfer pricing issue category, a section 936 Termination Strategy issue has been identified for additional compliance coordination. Associated with the sunset of section 936, taxpayers have created structured transactions to transfer U.S. intangibles that were used in Puerto Rico to other low tax jurisdictions. An IMT has been established to identify, coordinate, and propose resolution alternatives for this issue. Field examiners and technical advisors will provide technical support to teams with the development of this tax issue.

Significant Domestic Issues

R & E Credit Claims: Taxpayers are filing refund claims, often marketed to them on a contingency fee basis, to claim additional research credit. These claims are frequently based on unsupported amounts, nonqualified expenditures, or estimates for which the taxpayers do not have contemporaneous documentation. The Ogden Service Center has received 673 corporate tax year claims for more than \$1.3 billion in additional credits since we released Notice 2002-44 (July 8, 2002). This notice provides a new filing address and guidance for the research credit or refund. The increase in

the number of research credit refund claims, often filed late in the examination cycle, has placed an enormous resource burden on many examination teams. In addition to the administrative burden created by the filing of these research credit claims, other significant issues need to be resolved, such as identifying the business entity within a consolidated group that is claiming the credit, prototype issues, re-computation (or computation for the first time) of base period historical information for the years 1984 through 1988, and start-up company issues. Most of these issues are exacerbated by a lack of contemporaneous records to support the amounts claimed.

To address improper research credit claims, we have a number of administrative actions in process. These include conducting training and providing expert guidance to examiners to assist with examining the issue, the issuance of a Research Credit Audit Technique Guide (ATG), and the issuance of four Coordinated Issue Papers providing guidance on the research credit.

The difficulties we have encountered in administering this credit are exacerbated by the temporary nature of the credit. In addition, the credit's structure raises a number of technical issues – defining what constitutes "qualified research," determining the proper treatment of section 174 depreciation expenses, defining "supplies" and "gross receipts" (as well as determining the treatment of foreign gross receipts), and defining the effects of the section 280C(c) reduced credit election, to name a few. Although the Treasury Department and the IRS are working to address many of these issues through the administrative guidance process, substantial noncompliance will likely continue in this area.

Universal Service Fund (USF): Federal and state governments impose taxes on telecommunication service consumers to fund subsidies to the telecommunication carriers for universal service programs. The issue is whether amounts received by telecommunications carriers from federal and state universal service programs constitute non-shareholder contributions to capital under section 118, or are taxable income under section 61. The funds are paid to reduce rates and are charged to customers so that certain customers in high cost areas or rural areas are not charged more than customers in urban areas where costs are lower. The tax impact per year is about \$2.5 billion for the federal USF payments alone. A complete dollar estimate for the state USF payments is not available now, but it is substantial. Approximately 1,500 carriers are receiving USF subsidies, and, combined with the expansion of the USF program, the number is likely to increase in the future along with the total amount of subsidies.

Some telecom taxpayers are receiving significant USF subsidies and not reporting them as income. The position of these carriers, that the USF subsidy is a non-shareholder capital contribution that is not taxable income

under section 118, creates a competitive disadvantage for compliant taxpayers. Taxpayers are relying on the language in the Federal Telecommunication Act of 1996 that the funds are to be used for "the provision, maintenance, and upgrading of facilities and services for which the support is intended." The use of section 118 by businesses to exclude other governmental subsidies is spreading—benefits, such as local incentives for a business to relocate to or stay in its jurisdiction and for utility companies to continue to provide basic services, are being claimed as nontaxable under section 118, while related expenses are being fully deducted.

We believe these positions often are without merit, and we have challenged them on audit. We have issued a Coordinated Issue Paper directing examiners to take specific audit positions which was followed by an Appeals Settlement Guideline allowing for minimal litigation hazards. We believe the courts will sustain our position under the current statute. Nevertheless, we are working on guidance to address the USF issue.

Mixed Service Costs: Some electric and gas utility companies have changed their method of accounting to allow them to consider certain large self-constructed assets "routine and repetitive" under the simplified service cost method (SSCM), which allows a much faster (on occasion it has been immediate) write off. The impact of this issue is substantial.

Our position is that the classification as "routine and repetitive" is often flawed. We recently published a regulation that eliminates this issue as of August 2005. An IMT is currently examining 62 claims that pre-date the regulation changes. The IMT is partnering with other IRS functions and external stakeholders to develop a resolution strategy that will resolve open cases under Rev. Rule. 2005-53. No additional legislation or legal guidance is currently required. The new regulations remove the ambiguity for what qualifies as "self constructed assets" that led to the 62 taxpayer claims.

Issues Resulting From or Impacted by the American Jobs Creation Act

Section 199 Issues: This AJCA provision provides a deduction for certain manufacturing activities conducted in the United States. The section 199 deduction increases from 3% of qualified income during the first 2 years, to 6% for the next 3, and finally reaches 9% in 2010. Many difficult issues arise as a result of this complex section, some of which we are addressing in regulations that we will soon finalize. We are concerned, however, that mass-marketed, contingency fee-based refund claims will become a problem under section 199.

We have formed an IMT has been formed to address the many potential issues which may arise and are paying special attention to the potential

challenges posed by different business types and industries in which taxpayers operate. We issued extensive guidance under section 199 : Notice 2005-14 in January 2005 and proposed regulations in October 2005. The IMT has regular communications with external stakeholder organizations and the Multi-State Tax Commission. It will use Information gathered on calendar year 2005 filings to determine audit selection and compliance risks and to create a Coordinated Issue Paper.

Foreign Earnings Repatriation (Sec. 965): This AJCA provision provides a limited window for companies to repatriate foreign earnings to the United States provided they satisfy certain requirements and conditions. Audit issues are likely to include compliance with board approved reinvestment plans, and the compliance of repatriated funds with regulatory requirements. Significant tax dollars are at stake. As of late 2005, 91 of the Standard and Poor's 500 had repatriated or planned to repatriate funds under this provision.

To address this issue, we have established a process to capture tax return information from 2005 tax returns filed by taxpayers claiming the benefits of this provision. The IMT formed for this issue has developed initial administrative guidance for field examiners to use for compliance checks of taxpayers claiming the benefit to ensure compliance. In 2005, we issued three pieces of published guidance regarding section 965d: Notice 2005-10; Notice 2005-38; and Notice 2005-64.

Executive Compensation (Sec. 409A): Section 409A was enacted as part of the AJCA. It provides that the executive or other service provider must include all deferred amounts under a nonqualified deferred compensation (NQDC) plan for all taxable years to the extent they are not subject to a substantial risk of forfeiture and not previously included in income, unless certain requirements are met. If the service provider does not meet these requirements, it will be taxed on the deferred amounts, and will owe an additional 20% tax and an additional tax based upon interest on the deferred tax. This issue crosses all industries. The "Estimated Budget Effects of the Conference Agreement for H.R. 4520" estimates the revenue impact for all taxpayers is approximately \$1 billion for tax years 2005-2014. This issue is reflected on Schedule M-3.

While section 409A is effective for taxable years beginning on or after January 1, 2005, we have issued guidance that extends certain transition relief until December 31, 2006. Other transition relief provides that information reporting for 2005 will not be required until further guidance is issued. We have formed an IMT and most, if not all, of its activity is focused upon issuing final guidance for both the transition and post-transition periods. Guidance issued to date includes: Notice 2005-1 – December 20, 2004 (revised January 6, 2005); Proposed Regulations – September 30, 2004.

Tax Shelters and Other Abusive Tax Avoidance Transactions

One of the most significant compliance challenges facing us is the early identification of abusive transactions. In an effort to address this challenge, the Office of Tax Shelter Analysis (OTSA) continues its effort to identify and combat abusive tax shelters through analysis of Forms 8886 – Reportable Transaction Disclosure Statement filed by investors, and Forms 8264 – Application for Registration of a Tax Shelter filed by material advisors. We assigned for examination listed transactions identified on Form 8886s. We evaluate non-listed transactions identified on Form 8886s for emerging issues and other enforcement action as appropriate.

To effectively use the strengthened material advisor rules enacted in the AJCA, we are focusing more heavily on the Form 8264s in order to identify promoted transactions as early as possible. Analysis of transactions at the time of implementation better enables us to develop a position and take preemptive measures to address any abuse.

To address abusive transactions more quickly, we have implemented a new emerging issue process. The new process, while still under refinement, will expedite the assembly of an IMT to more effectively develop our position with the goal of getting ahead of abusive transactions before returns are filed claiming inappropriate benefits.

LMSB continues to allocate resources to abusive transactions as a top priority. LMSB initiatives such as settlement agreements or Appeals Settlement Guidelines have helped us address these transactions, resulting in billions of dollars in collected taxes, interest, and penalties. In addition to recapturing lost revenues, targeting abusive transactions produces favorable returns on investment relative to other populations of returns, and should reduce future non-compliance by deterring repetition. We do not believe this effort is over, and continue to look for ways to better leverage the enhanced reporting rules and penalties under AJCA to help us in identifying new transactions.

III. Tax Policy Issues and IRS Focus Areas for Discussion of Reform

To effectively address the compliance challenges of globalization, the complexity of the Code and modern business transactions, and the growing book-tax gap, we need support and perhaps new legislation that will improve our ability to effectively administer the Code. Several tax policy issues and focus areas are briefly described below.

Book-Tax Differences

We think the Senate Finance Committee should examine the increase in book-tax differences in greater depth in order to fully understand its impact on compliance. Such a review might reveal opportunities to eliminate some of the book-tax non-conformity.

We believe that some reduction in the number of book-tax differences could help to improve compliance. As is readily seen from the attached chart depicting the growth in book-tax differences, book-tax differences will require the use of a growing percentage our resources to enforce tax compliance. Efforts to address book-tax differences could eliminate many potential compliance issues that stem from the tension to increase reportable financial statement profits while decreasing taxable income and tax liabilities. There are many book-tax differences specifically established by the Code that are temporary differences by nature. A meaningful reduction in the number and size of temporary book-tax differences might reduce compliance risk overall and, to a large degree, the amount of resources we spend in policing those differences. Resources relieved could focus more effectively on compliance enforcement areas related to permanent loss of revenue.

Other Tax Policy Issues and IRS Focus Areas for Discussion of Reform

Tax Administration Support Needed for R&E Credit Claims: The R&E credit should be made permanent. Recordkeeping and substantiation requirements need to be more comprehensive to improve our ability to effectively administer the Code for R & E credit refund claims. These claims continue to have a substantial adverse effect on compliance and produce substantial administrative burdens. The temporary nature of the credit, its repeated renewals, and its incremental nature each contribute to these difficulties. In addition, the credit's structure raises a number of technical issues, such as, defining what is "qualified research" and the "costs" that qualify for the credit. While these problems may be alleviated to a degree by additional regulatory guidance or legislation to clarify or resolve some interpretative issues, we believe that absent substantial simplification in the structure of the credit itself and a targeted penalty provision aimed at frivolous or negligent assertions of qualified research expenditure credit claims, substantial non-compliance will continue in this area. Issues involving one aspect or another of the R&E credit constitute a high portion of chief counsel's significant case litigation inventory.

The IRS and Treasury are currently working on a number of guidance projects to improve application and administration of the R&E credit. These projects include: internal use software; gross receipts for purposes of the research credit computation; computation and allocation of the research credit for controlled groups; and section 174 depreciable property for purposes of the research credit.

Penalties are Needed for Improper Refund Claims: The accuracy related penalties in the Code apply only in the case of an underpayment of tax and provide no disincentive to taxpayers who file frivolous or negligent claims for refund. We believe this encourages promoters, including accounting firms, to market improper refund of claims schemes. The Finance Committee could consider how the accuracy-related penalty could be expanded to cover abusive refund claims.

Improved Summons Enforcement Process: Improved summons enforcement processes are needed to increase the effectiveness of summonses and reduce resources and time needed for enforcement. The current process requires us to issue a summons and, if it is not complied with, to seek to enforce it in the Federal District Court using the Court's contempt power. This is time consuming and expensive to the Government and puts a burden on the District Courts. The Finance Committee could consider addressing this problem through revisions to the rules imposing sanctions against taxpayers who make improper objections to, or fail to properly respond to a summons, or through enactment of a streamlined process in which to seek enforcement of a summons.

I would be happy to discuss the above concepts and policy issues with the Senate Finance Committee or members of its staff, at your convenience. Please call Floyd Williams at (202) 622-3720, if you would like to discuss these issues.

Thank you for the opportunity to highlight what we believe to be our greatest compliance challenges. We look forward to working with the Committee on problems in the Large and Mid-Size Business community and exploring ways to better equip us to deal with these problems. I am also writing to Senator Baucus.

If you have any questions, please contact me or call Deborah Nolan, LMSB Commissioner, at (202) 283-8710.

Sincerely,



Mark W. Everson

Book-Tax Income Difference Measures

- Two Measures of Book Income
 - Worldwide Pre-Tax Income from Compustat (Net of State and Other Income Tax Expenses)
 - Pre-Tax Income from Form 1120, Schedule M-1 (Lines 1 + 2)
- Relative to Net Taxable Income (Form 1120, Line 28)

Worldwide Income Differences (\$ Billions)

Category	1995	1996	1997	1998	1999	2000	2001	2002
Worldwide Income								
Total	79.0	94.2	98.1	134.4	194.0	214.1	121.3	203.8
LMSB Industry								
Financial Services	12.0	13.3	22.4	41.4	52.3	44.6	28.4	46.9
Natural Resources	7.8	16.6	16.7	8.1	20.6	32.0	41.8	24.9
Comm, Tech. & Media	13.3	18.7	16.2	21.7	64.8	76.7	5.0	42.7
Retail, Food, Pharm & Health	17.8	26.9	25.3	31.3	28.7	41.2	37.5	58.2
Heavy Manufact. & Transp.	27.8	17.9	16.5	30.6	26.1	17.7	6.1	27.7
Global Character								
Domestic	5.0	8.0	9.8	7.4	9.8	14.1	15.6	13.8
Multinational	74.0	86.2	88.3	127.1	184.3	200.0	105.7	189.9
Profitability								
Net Inc > 0	66.5	75.7	71.1	103.7	149.7	155.8	141.5	159.1
Net Inc ≤ 0	12.5	18.6	27.0	30.8	44.3	58.4	-20.1	44.7

Worldwide Book & Tax Income (All Firms)

