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The Honorable Donald L. Korb
Chief Counsel
Internal Revenue Service
Room 3026
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Washington, D.C., 20224

Re: *Proposed Changes to the Process for Obtaining the Commissioner's Consent to Change a Method of Accounting — CC:PA:LPD:RU (Notice 2007-88)*

Dear Mr. Korb:

On November 13, 2007, the Internal Revenue Service released Notice 2007-88 (2007-46 I.R.B. 993), inviting comment on a proposal to revise the process by which taxpayers obtain the consent of the Commissioner of Internal Revenue to change a method of accounting for federal income tax purposes. On behalf of Tax Executives Institute, I am pleased to submit the following comments.

Background on Tax Executives Institute

Tax Executives Institute is the preeminent international association of business tax executives with 7,000 members representing 3,000 of the leading corporations in the United States, Canada, Europe, and Asia. TEI represents a cross-section of the business community, and is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and the government alike. As a professional association, TEI is firmly committed to maintaining a tax system that works — one that is administrable and with which taxpayers can comply.

Members of TEI are responsible for managing the tax affairs of their companies and must contend daily with the provisions of the tax law relating to the operation of business enterprises. We believe that the diversity and professional training of our members enable us to bring a balanced and practical perspective to the issues raised in Notice 2007-88.

Current Process for Accounting Method Changes

Section 446(e) of the Internal Revenue Code requires taxpayers to obtain the consent of the Commissioner before changing a method of accounting. The consent requirement promotes consistent accounting practices and eases the burden on the Commissioner to detect accounting method changes. To request consent, a taxpayer files a Form 3115, *Application for Change in Accounting Method*, that describes the current and new method of accounting, identifies the items or transactions that will be treated differently under the new method of accounting, and computes an adjustment for the amount by which the change from the old to the new method of accounting will produce a change in the total taxable income of the taxpayer (hereinafter “the section 481(a) adjustment”). The section 481(a) compensating adjustment is necessary to prevent the omission or duplication of items of income or deduction from the determination of a taxpayer’s taxable income that might result from the use of inconsistent accounting methods in different tax periods.

Under current procedures and depending on the nature of the accounting method to be changed, the Commissioner will grant consent on either an “automatic” or “nonautomatic” basis. The automatic consent procedures apply to changes in methods of accounting specifically prescribed in guidance issued by the Commissioner, principally in Rev. Proc. 2002-9.¹ To request a method change eligible for automatic consent, a taxpayer attaches the Form 3115, including the calculation of the section 481(a) adjustment, to its timely filed income tax return for the “year of change” and sends a copy to the IRS national office. As long as the taxpayer complies with the rules set forth in Rev. Proc. 2002-9, it is deemed to have received the Commissioner’s consent, subject to examination. On examination, the IRS may review and confirm that (1) the taxpayer is eligible for the automatic consent procedure, (2) the method is a permitted method, (3) the method is implemented correctly and applied to the proper items or transactions, and (4) the taxpayer computed the section 481(a) adjustment amount correctly.

The nonautomatic consent method is governed by Rev. Proc. 97-27.² Together with a user fee, the taxpayer submits Form 3115 to the IRS national office during the year in which the proposed change is requested to be effective. The national office reviews the application and considers, among other issues, whether the requested method is permitted, clearly reflects income, and whether the section 481(a) adjustment is properly computed. The nonautomatic consent process frequently requires a taxpayer to submit supplemental information and documentation explaining the application of the method to the taxpayer’s items or transactions and may involve one or more meetings or teleconferences with IRS representatives. As with the automatic consent process, upon approval of a change, the application of the change in method to specific items or transactions is subject to confirmation on examination. The permissibility of the method, though, is generally not subject to challenge.

¹ 2002-1 C.B. 327, modified and clarified by Announcement 2002-17 (2002-1 C.B. 561), modified and amplified by Rev. Proc. 2002-19 (2002-1 C.B. 696), and amplified, clarified, and modified by Rev. Proc. 2002-54 (2002-2 C.B. 54).

² 1997-1 C.B. 680, as modified and amplified by Rev. Proc. 2002-19 (2002-1 C.B. 696), as amplified and clarified by Rev. Proc. 2002-54 (2002-1 C.B. 432).

Notice 2007-88

In Notice 2007-88, the IRS describes a proposal to streamline the process for securing the Commissioner's consent for changes to a taxpayer's accounting methods while preserving the ability of the IRS to effectively monitor those changes. The current process would be replaced by a three-tier system.

In the "standard" consent process, a taxpayer that timely files a properly completed Form 3115 would be granted consent for its requested change, subject to confirmation on examination that (1) the accounting method is a permitted method and is properly implemented and applied to the taxpayer's items and (2) the amount of the section 481(a) adjustment is properly computed. The IRS anticipates that the vast majority of accounting method change requests would be made through the standard consent process because, in addition to incorporating the automatic consent procedure of Rev. Proc. 2002-9 (or its successor guidance), taxpayers would submit all other requests except those requiring "specific" consent or for which a letter ruling is sought.

The second, or "specific consent," process would be reserved for accounting method changes (1) specifically identified in published guidance as requiring specific consent of the IRS or (2) for which taxpayers seek terms or conditions different from, or a waiver of scope limitations that apply to, applications for change under the standard consent procedure. The specific consent procedures process would be similar to those employed for obtaining consent under the current nonautomatic method, except that the time for filing the application would be accelerated to the last day of the ninth month of the requested "year of change" (hereinafter the "ninth-month rule").³ If consent is given, the method would be accorded "audit" and, in most cases, "ruling" protection;⁴ hence, the year of change and the permissibility of the method would not be susceptible to challenge on examination, although the specific application to the taxpayer's transactions and items and the computation of the section 481(a) adjustment would likely be subject to confirmation.

The third process, "letter ruling consent," would be equivalent to a letter ruling request. Under this procedure, the request for consent would include a complete statement of facts, copies of documents pertinent to the transactions or items, statements of supporting or contrary authorities, examples of the application of the new method, and a completed Form 3115. The request would be required to be filed by the last day of the ninth month of the requested taxable year of change and the user fee would be the currently much higher user fee for letter rulings rather than the user fee currently imposed for nonautomatic consent. If the change is approved and the taxpayer complies with the terms and conditions of the ruling, including the year of change, the field's role would be confined to confirming the application of the method to the items described and the method will not be subject to challenge on examination.

³ Where an application is filed after the ninth month of the requested year of change, no late filing relief would be accorded under Treas. Reg. § 301.9100, but the application would be considered timely filed for the subsequent year.

⁴ The IRS might decline to provide ruling protection in some cases.

General Comments

TEI commends the IRS for issuing Notice 2007-88, proposing an approach to streamline the process for obtaining the consent of the Commissioner for changes in accounting methods, and inviting comments on other approaches. The approach holds promise for simplifying and expediting the process for implementing and administering accounting method changes while preserving the Commissioner's power to scrutinize accounting methods generally. The benefits of the proposal may include reducing taxpayer burden, minimizing government resources devoted to accounting method changes, and increasing certainty for both taxpayers and the government alike that taxpayers' methods of accounting clearly reflect income. As a result, taxpayers will likely be afforded greater certainty of their tax liabilities in a more timely fashion and both government and taxpayer resources can be conserved. Also, by minimizing uncertainty over the propriety of taxpayers' accounting methods, taxpayers may be able to reduce their tax accruals for uncertain tax positions under FIN 48. Some aspects of the proposed approach, however, give pause whether taxpayers will be afforded more or *less* certainty in requesting changes in accounting methods. Hence, while the proposed approach should be considered, TEI offers the following specific comments and recommendations for improvement:

I. Standard Consent Process

Under the proposal, the standard consent process would likely become the default method for securing most accounting method changes. All accounting methods currently qualifying for the automatic consent process would be submitted under the standard consent process. In addition, all other accounting methods would be eligible for the standard consent process unless the IRS issues guidance specifically identifying the particular method — or its application — as ineligible for standard consent and, thus, requiring submission under the “specific” or “letter ruling” consent processes.

A. *Audit Protection*

The Notice states that a taxpayer that is not under examination submitting a request under the standard consent process will obtain “audit protection” for its accounting method change. As defined in the Notice, “audit protection” assures the taxpayer that it will not be required to change its method of accounting for the item or transaction prior to the taxpayer's requested year of change. Under current practice, audit protection is accorded only where the change in method is granted (or deemed automatically granted). The IRS is considering providing audit protection under the standard consent process even where consent to adopt the specific method requested by the taxpayer is not granted.⁵

TEI recommends that the IRS provide taxpayers with audit protection even where it does not grant consent to or approve the specific application of the method adopted by the taxpayer. According taxpayers audit protection will provide an incentive for taxpayers to identify improper

⁵ 2007-46 I.R.B. 993, 996.

methods of accounting and voluntarily change them. Indeed, filing a Form 3115 highlights the accounting for an item as a potential issue for examination and thus invites special scrutiny. If the method requested by the taxpayer is not approved, the IRS's remedy should be to make the adjustments necessary to correct the method's application to specific items. A flaw in the taxpayer's application of a method should not, as revenue agents frequently assert, cause a complete disallowance of the proposed method or give rise to the imposition of a new method that the taxpayer would not apply.⁶ In other words, a taxpayer should not be subject to potentially harsher results where it identifies an improper method of accounting and voluntarily corrects it. According audit protection in all cases, even where the method is not approved, would be a significant improvement over the current process.

B. *Ruling Protection*

Requests to change to the methods of accounting specified in Rev. Proc. 2002-9 (or successor guidance) for "automatic changes" in method would be required to be submitted under the standard consent procedure.

Prior to the issuance of the Notice, ruling protection was implicit in approved accounting method changes, but the definition and scope of that protection was nebulous. Accordingly, taxpayers were occasionally surprised by challenges on examination to the specific application of the method adopted. Under the Notice, ruling protection is seemingly equivalent to the "effect of consent" described in section 8 of Rev. Proc. 2002-9 (as well as section 10 of Rev. Proc. 97-27 for nonautomatic method changes). Thus, a taxpayer receiving consent under the approach described in the Notice for a method qualifying for automatic consent would not be required to change its method of accounting except for one of the situations described in section 8.01 of Rev. Proc. 2002-9 applies (*i.e.*, a change in statute; a decision of the United States Supreme Court; the issuance of temporary or final regulations; the issuance of a revenue ruling, notice, or other statement in the Internal Revenue Bulletin; the issuance of a written notice that the change was not in compliance with all applicable provisions of Rev. Proc. 2002-9 or *in accord with the current views of the IRS*; or a change in material facts on which approval was premised (emphasis supplied)). Moreover, except in rare or unusual circumstances, a taxpayer subsequently required to change methods for one of the aforementioned reasons would be permitted to make the change prospectively, provided (1) the taxpayer complied with all the provisions of the procedure, (2) there was no material misstatement or omission of facts from the application, (3) there was no change in the material facts represented in the application, (4) there was no change in law, and (5) the taxpayer to whom consent is granted acted in good faith in relying on the consent.

1. General. One problem with the current accounting method change process is that it is insufficiently transparent. Taxpayers do not necessarily know that a method they seek to apply is impermissible because it is not "in accord with the current views of the IRS." Clearly, a taxpayer that changes to a method that is not permitted under the Code, a decision of the U.S. Supreme Court, temporary or final regulations, or other published guidance should not be

⁶ Eliminating or substantially modifying section 9.02 of Rev. Proc. 2002-9 may be necessary to implement this recommendation.

accorded ruling protection upon changing to an impermissible method. On the other hand, a taxpayer that discovers that it is using an erroneous method (or, more often, applying a method erroneously), voluntarily changes to a method of accounting that is *not* clearly improper, applies the method consistently, and computes the proper amount of section 481(a) adjustment should be afforded some measure of ruling protection. In other words, there is a range of behavior between good faith corrections and bad faith attempts to manipulate accounting methods — and ruling protection should be provided for good faith corrections of changes in method.

2. Definitions. If the terms “audit protection” and “ruling protection” are used in the guidance implementing the approach described in the Notice, the scope and meaning of each term and its application and effect should be clearly defined for each consent process. In other words, the rules and conditions for consent to a change in method should be clear from the four corners of the document rather than by reference to other guidance. More important, “ruling” and “audit” protection should be accorded to changes that qualify for “automatic” consent under Rev. Proc. 2002-9 (or its successor guidance).

3. Effect of Examination or the Statute of Limitations. One of taxpayers’ frustrations with the current process is that requests for changes in method are frequently subject to scrutiny by the National Office. The consent letter issued by the National Office, however, neither defines the scope of the scrutiny nor accords protection for the detailed application of the approved method to specific items. Hence, taxpayers must frequently defend their “approved” method changes from challenges by IRS examiners. Moreover, even after examination in one year, the IRS might — though it rarely does — challenge the taxpayer’s application of its method in a subsequent year.

We believe taxpayers deserve finality in respect of their accounting methods. If ruling protection is not to be accorded to taxpayers as a result of filing an application for a change in method under the standard consent process, then, at a minimum, ruling protection should be accorded either upon examination of the change in method or upon the running of the statute of limitations for the year of change. Hence, the revenue procedure implementing the proposed approach should provide that, upon an examination of the taxpayer’s return for the year of change, the method and its application to specific items are deemed approved and, absent a change in facts and circumstances, may not be changed except as provided in section 8.01 of Rev. Proc. 2002-9. If the year of change is not examined, the running of the statute of limitations for the year of change should, absent a change in facts and circumstances, also preclude changes except as provided in section 8.01 of Rev. Proc. 2002-9.

C. *Taxpayers under Examination*

Except during certain “window” periods, taxpayers under examination are generally precluded from submitting requests for changes in their accounting methods. Under section 6.01 of Rev. Proc. 97-27, a taxpayer under examination for a period of 12-consecutive months may file a request within the first 90 days of the taxable year to which the change would apply unless the method of accounting has been placed in suspense by an examining agent or otherwise identified as under examination. A taxpayer may also generally file a request for a

change in accounting method during the 120-day period after the conclusion of an examination regardless of whether a subsequent examination has commenced. Similarly, taxpayers under examination are precluded in many cases from using the automatic consent procedures of Rev. Proc. 2002-9.⁷ As a result, the window periods are frequently the only avenue for Coordinated Industry Case (CIC) taxpayers to request changes in method.

1. TEI recommends that, in updating the *automatic* consent procedures (which will be incorporated in the standard consent procedures), the IRS consider making the standard consent process available to all taxpayers, including those under examination. If the examination team has not identified in an audit plan, Information Document Request, or Notice of Proposed adjustment that the method of accounting is potentially under examination, all taxpayers should be permitted to change to methods of accounting that are identified in Rev. Proc. 2002-9 (or its successor guidance). If the method is acceptable and qualifies for automatic approval, it should be acceptable under nearly all circumstances. The only exception should be where the examination team has already expended resources identifying an issue. Finally, the IRS should clarify that “automatic” consents are accorded “ruling” and “audit” protection.

2. Assuming the current windows are retained, then for accounting method changes that are not currently governed by the automatic consent guidance (or do not become subject to the automatic consent process in successor guidance to Rev. Proc. 2002-9), TEI recommends that the 90-day window during which taxpayers under examination file requests for changes in method be moved back to begin 30 days *before* the beginning of the taxable year for which the change is requested and end 60 days after the beginning of the taxable year of change. Under TEI’s proposal, the “year of change” would remain the taxable year that begins *during* the 90-day window. By moving the window back 30 days, *and* adopting TEI’s recommendation to accord audit protection for all voluntary method changes, taxpayers would be able to file their accounting method change requests prior to year end and potentially minimize the accrual of income taxes for an uncertain tax position in their financial statements under FIN 48. Under the current method change rules, the taxpayer cannot file Form 3115 until the beginning of the year of change. Thus, the taxpayer cannot assert “as of” its year-end balance sheet date that the IRS would not be able to adjust an erroneous tax accounting method and propose an adjustment for the years preceding the year of change. Hence, a financial statement accrual would likely be required even for a noncontroversial automatic method change where the method would not be challenged.

3. Finally, we encourage the IRS to expand the number and scope of methods for which “automatic” consent is available, thereby expanding the number of accounting method requests that should qualify for both “audit” *and* “ruling” protection. The National Office is in a better position than taxpayers to assess whether the current volume of requests for accounting method changes includes too many “plain vanilla” requests that should be automatic and provide guidance about which methods are acceptable.

⁷ The general rule in sections 4.02 and 6.03 of Rev. Proc. 2002-9 preclude taxpayers under examination from filing requests for automatic consent, subject to specifically enumerated exceptions in the procedure’s Appendix.

D. *Documentation to be Submitted for Standard Consent.*

The Notice states that (1) requests for changes in method that are not “substantially complete” will be denied consent and (2) that taxpayers will be unable to perfect their requests as they would currently be permitted under section 10.02 of Rev. Proc. 2002-9. No ruling or audit protection would be accorded where consent is denied. The IRS intends to issue guidelines and examples of what constitutes a substantially complete Form 3115. The Notice also states that “minor omissions or errors on Form 3115 would not result in the denial of consent.”

Although we understand the National Office’s need for complete information to evaluate whether additional scrutiny of a proposed method of accounting is warranted, the extreme consequences for an “incomplete” Form 3115 is troubling. It is difficult if not impossible for taxpayers to predict what level of factual detail or legal analysis and support the IRS might require to justify the application of the taxpayer’s proposed method of accounting. We recommend that the IRS reconsider this requirement. The vastly different results for an “incomplete” Form 3115 and “minor errors and omissions” may turn on small differences in judgment.

E. *Scope and Effect of National Office Review.*

The Notice states that, in addition to screening the standard consent applications for completeness, the IRS will review whether the new method is permissible. If the method is permissible, no further action will be taken and the taxpayer will not be advised of the review. Where the propriety of the method is uncertain, the National Office will contact the taxpayer for additional information. If the National Office determines that the method is impermissible, the taxpayer would be offered a conference of right. If following the conference, the determination is adverse to the taxpayer, the request will be denied.

Since the National Office will be scrutinizing the requests for changes in method for both completeness and the propriety of the method, the screening process should end with the taxpayer’s having a rebuttable presumption that the method of accounting is correct. Thus, during the examination phase, any changes to the application of the taxpayer’s method to specific items should be minimal in scope and effect. In the absence of substantial evidence that the method is incorrectly applied, examining agents should *not* be permitted to reexamine the same issues reviewed by the National Office and invalidate the taxpayer’s application of its method. Without a rebuttable presumption about the correctness of the method, any National Office resources conserved during the application process may be more than consumed reviewing technical advice requests arising from examinations.

F. *Alternative — or Ninth-Month — Filing Rule for Other or “Nonautomatic” Changes Filed under the Standard Consent Process*

The Notice states that, for methods of accounting that are not eligible for the current automatic consent procedure, the IRS is considering requiring taxpayers to file Form 3115

by the ninth month of the requested taxable year of change rather than as an attachment to the tax return for the year of change. The ninth-month rule would afford the IRS time to consider the requested change in advance of the taxpayer filing its return.

Although accelerating the due date of requests for “nonautomatic” changes in method will afford the IRS national office additional time to consider method change requests, the Notice seemingly contemplates according little or no corresponding benefit or incentive to taxpayers (apart from possibly expanding the scope of “audit” protection). If the IRS accorded audit protection to the year of change in all cases, taxpayers would have some benefit, but we believe that benefit should be extended to all voluntary requests and should not be dependent on filing by the ninth month of the year of change. Alternatively, if the IRS accorded “ruling” protection for items approved under the proposed ninth-month rule, the process would be tantamount to either a fast-track advance consent process (under the current rules for nonautomatic changes) or a simplified and accelerated “letter ruling” request process. Indeed, it is unclear why requests for method changes filed under the “specific” consent process, which also must be filed by the ninth month of the requested year of change, would “usually” receive ruling protection, whereas requests submitted by the ninth month under the “standard” consent process would not. Depending on the complexity of the method change presented, we believe the IRS should commit to approving the requested method change within a prescribed time period, declining to issue a ruling (without adverse consequences to the taxpayer), or requesting the taxpayer to refile its request under the letter ruling consent process.

II. Specific Consent Process

A. Taxpayers under Examination

Although the Notice is unclear, taxpayers under examination, including those subject to continuous examination in the CIC program, may be precluded from using the specific consent process unless they are within one of the window periods specified in Rev. Proc. 97-27 or Rev. Proc. 2002-9. Given the additional scrutiny that method changes submitted for approval under the specific consent process would likely receive, taxpayers under examination should not be precluded from using the specific consent process. Unless a particular item or application of a method has been identified by the examining agents in an audit plan, information document request, or a notice of proposed adjustment, a taxpayer should be permitted to apply for a change under the specific consent procedure.

B. Ninth-Month Rule

Requests for changes in method under the specific consent process would be required to be filed by the ninth month of the requested year of change. An otherwise qualified request filed after the last day of the ninth month of the taxable year and before the beginning of the succeeding taxable year would be considered a timely request for the succeeding taxable year. If the request for consent is granted, audit protection would apply and ruling protection would “usually” apply. In its discretion, however, the IRS may decline to provide ruling protection.

1. Late or early filed requests? A request filed after the last day of the ninth month of the taxable year and “before the beginning of the succeeding taxable year” would be considered timely filed in respect of the succeeding taxable year. Presumably, the taxpayer also has until the ninth month of the succeeding taxable year to file a request for specific consent for the succeeding taxable year. We recommend that the IRS clarify that requests for specific consent can be filed at any time in advance of the requested year of change, but *no later than* the last day of the ninth month.

2. Ruling protection. Unlike requests filed under the standard consent process, a request for specific consent filed by the last day of the ninth month of the requested year of change will “usually” be accorded ruling protection. In its discretion, however, the IRS may decline to grant ruling protection. Should ruling protection be withheld, however, the IRS might produce a “heads IRS wins; tails taxpayer loses” effect: The IRS will issue guidance identifying the method changes for which taxpayers must seek specific consent, but when the taxpayer complies with the requirements and avails itself of the specific consent process, it may nevertheless be denied ruling protection. If this rule is retained, the discretion to deny ruling protection should be employed sparingly and — without disclosing taxpayer specific information — the IRS should, at a minimum, commit to issuing public guidance describing the reasons it might deny ruling protection.

3. Window periods. If, contrary to TEI’s recommendation, taxpayers under examination are not permitted to employ the standard or specific consent processes, it is unclear how the 90- and 120-day windows will be coordinated effectively with a requirement to file the request by the last day of the ninth month of the year of change.

III. Pilot Program for the Proposed Approach

Before implementing changes to the current process for accounting method changes, the Notice states that the IRS will establish a pilot program to evaluate the operational effects and results under the proposed approach. Separate guidance establishing the pilot program will be announced following the evaluation of comments submitted in response to Notice 2007-88.

TEI concurs with the proposal to establish a pilot program because it will provide the IRS, taxpayers, and practitioners alike an opportunity to evaluate the efficacy of the process. Participating taxpayers and practitioners should be invited to submit feedback and recommendations based on their experience under the pilot program. Together with the IRS’s evaluation, the feedback will permit adjustments to be made to the proposed approach. To give full effect to the range of taxpayer experiences, the pilot program should last long enough to encompass taxpayers’ experiences on examination of method changes implemented under the various consent processes. Depending on the currency of IRS examinations, that may require the pilot program to extend for at least two and possibly as long as five years.

Conclusion

Tax Executive Institute appreciates this opportunity to present its recommendations on

Notice 2007-88. These comments were prepared under the aegis of TEI's Federal Tax Committee, whose chair is Carita R. Twinem. If you have any questions, please do not hesitate to contact Ms. Twinem at 414.256.5141 (or twinem.carita@basco.com) or Jeffery P. Rasmussen of the Institute's legal staff at 202.638.5601 (or jrasmussen@tei.org).

Respectfully submitted,

Tax Executives Institute

A handwritten signature in black ink, appearing to read "R J McDonough", written in a cursive style.

Robert J. McDonough
President

cc: Andrew J. Keyso
Brenda D. Wilson