

# Chapter 7

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## Large Case Examinations

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*Worried about an IRS audit? Avoid what's called a red flag. That's something the IRS always looks for. For example, say you have some money left in your bank account after paying taxes. That's a red flag.*

Jay Leno

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## § 7:1 Large Business and International Division

In 2012, the Commissioner of the Large Business and International (LB&I) division of the Internal Revenue Service (IRS or “Service”), realigned LB&I division’s structure in an effort to make the division more agile, efficient and consistent in its ongoing operations. The change was effective on October 1, 2012.<sup>1</sup> The 2012 realignment consists of six groups of industries and one examination support function. Although LB&I retained its current six-industry organizational structure it realigned industries so they follow more contiguous geographic boundaries.

- Communications, Technology and Media (consisting of taxpayers related to computer production, media (including communication and software), sports franchises, and recreational firms. There are approximately 15,300 taxpayers comprised of 1,100 large businesses and 14,200 mid-size businesses.).
- Financial Services (taxpayers related to commercial and foreign banking, securities, insurance companies, investment bankers, mutual funds, law and accounting firms, and other financial intermediaries. There are more than 43,000 taxpayers in this category.).
- Heavy Manufacturing and Pharmaceuticals Transportation (manufacturing processes, aerospace, and the development and manufacture of pharmaceutical and biotechnology products).

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1. On October 1, 2010, the former Large and Mid-Size Business (LMSB) division reorganized and changed its name to the Large Business and International (LB&I) Division. The organizational shift was intended to place greater emphasis on international compliance for U.S. businesses. The LB&I organization was expected to enhance the then current International program by adding additional resources. Most of the additional examiners, economists and technical staff were current employees who specialize in international issues within other parts of the old LMSB.

The IRS established the 2010 realignment in an effort to strengthen international tax compliance for individuals and corporations in several ways, including identifying emerging international compliance issues more quickly; removing geographic barriers, allowing for the dedication of IRS experts to the most pressing international issues; increasing international specialization among IRS staff by creating economies of scale and improving IRS international coordination; ensuring the right compliance resources are allocated to the right cases; consolidating oversight of international information reporting and implementing new programs, such as the Foreign Account Tax Compliance Act (FATCA); coordinating the Competent Authority more closely with field staff that originate cases, especially those dealing with transfer pricing; and centralizing and enhancing the IRS’s focus on transfer pricing.

- Natural Resources and Construction (consisting of over 17,000 large and mid-size businesses that are engaged in the oil and gas, mining, utilities, forestry, chemical, waste management, and construction industries).
- Retailers, Food, Transportation and Healthcare (consists of approximately 300 large and 18,000 mid-size taxpayers with assets greater than \$10 million dealing in food and beverages, retailing, hotels, transportation, agricultural commodities, farms and healthcare).
- Global High Wealth (high wealth individuals and the networks of enterprises and entities they control. The Group was created to try and better assess the perceived risks such arrangements pose to tax compliance and the integrity of the tax system.).

The Field Specialists organization was also realigned within the LB&I industries. Computer Audit Specialists joined the RFTH Industry, engineers joined the NRC (Natural Resources and Construction) Industry, and Financial Products Specialists became part of the Financial Services Industry. Employment Tax Specialists became part of the SB/SE Specialty Programs group. These changes were intended to apply LB&I's resources to examine cases more strategically, better manage its casework and ensure more consistent execution and resolution of its examinations, and provided synergies between agents and specialists, in an effort to strengthen the industry groups and help them to more efficiently identify the important tax issues.

After the realignment, there are twenty-two territory managers reporting to different DFOs. Twenty-five team managers are reporting to different territory managers than they previously did. However, most field teams remained intact and employees continued to report to their current team managers. The Global High Wealth Industry was unaffected by the 2012 realignment.

The LB&I division also formed a new Shared Support group with its own director. These functions include Business Systems Planning, Management & Finance, and Planning, Analysis, Inventory and Research. This change allows the Deputy Commissioner (Operations) to focus exclusively on domestic strategy and operations and was renamed Deputy Commissioner (Domestic).

The Assistant Deputy Commissioner (International) oversees many aspects of tax treaty administration, including the new Treaty Assistance and Interpretation Team (TAIT), the Exchange of Information Program, Joint International Tax Shelter Information Centre

(JITSIC), and LB&I's support of the Treasury Department in Treaty and TIEA negotiations. The ADCI also oversees and coordinates LB&I's foreign posts, cross-BOD strategic initiatives, and participation in multinational organizations such as the Organization for Economic Cooperation & Development (OECD) and Centro Interamericano de Administraciones Tributarias (CIAT). In addition, International handles transfer pricing, cross-border coordination of international issues, individual compliance and business compliance.

In January of 2012, the IRS created its advance pricing and mutual agreement (APMA) program under LB&I's jurisdiction with the goal of bringing efficiencies as well as quality enhancements to the Advance Pricing Agreement (APA) program and the double tax functions. The APA and the U.S. Competent Authority office were previously under the jurisdiction of the IRS Office of Chief Counsel and were transferred to an office under the transfer pricing director in the IRS Large Business and International Division's international operation. Both the old LMSB and the 2010 LB&I organizational structure contrasts to the former geographic alignment, which used to be the cornerstone of the Service's organization.<sup>2</sup> After the service's restructuring in 1998, LMSB cases were assigned and managed by the new line of business structure. Ironically, the 2012 realignment is moving back to a more geographic organizational structure.

## § 7:2 What Is a Large Case Audit?

A large case audit is an examination of the taxpayer's return to verify the income, deductions, credits and other benefits to ensure the correct tax liability for those taxpayers with assets over \$10 million. Large case examinations fall into two categories, Industry Cases (IC) or Coordinated Industry Cases (CIC).<sup>3</sup> The Service uses a point system in order to determine whether the taxpayer's examination falls into the IC or CIC category.<sup>4</sup> The *Internal Revenue Manual* (IRM)<sup>5</sup> sets forth the criteria the Service uses to identify which taxpayers will be part of the CIC Program. The formula awards points for each of the following factors:

- the gross assets of the entity and all effectively controlled domestic and foreign entities;

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2. For a brief discussion of the former IRS organization, see chapter 3, Organization of the IRS.

3. Previously referred to as Coordinated Examination Program (CEP).

4. IRM 4.46.2-2 Responsibility (03-01-2006).

5. The IRM provides policies and regulations for all IRS employees and is available on-line at [www.irs.gov/irm](http://www.irs.gov/irm).

- the gross receipts of the entity and all effectively controlled domestic and foreign entities;
- the number of operating entities;
- the number of separate industries involved;
- the number of team members and specialists required; and
- the estimated support work required of other Revenue Agents.

In addition, the IRS has the option of classifying a taxpayer as CIC even if it does not meet the point criteria of the IRM, if the IRS deems the return to be of sufficient complexity to warrant inclusion and believes that it would benefit from the application of a team examination approach.<sup>6</sup>

The key differences between an IC examination and a CIC examination involves the amount of resources applied and the time the Service spends on the examination. Another key distinction is that once a taxpayer is selected into the CIC program, that taxpayer is generally under examination year after year, cycle after cycle. Although there are situations when a taxpayer is dropped from the CIC program, once labeled a CIC taxpayer, consider the company part of the IRS examination family. Under the new LB&I structure and other key initiatives, however, taxpayers may see more limited scope audits and fewer CIC examinations and some increased focus on passthroughs.

### **§ 7:2.1 Industry Case**

An IC is considered any case that has not been identified as a CIC and is subject to LB&I procedures and oversight. Most of the audit procedures set out in the LB&I examination IRM sections pertain to both IC and CIC taxpayers. However, Revenue Agents are to exercise judgment as to the extent those procedures apply and the extent to which an audit plan is designed. The degree of detail included in an audit plan for each examination will depend upon the size of the case, its complexity, and several other factors. Unlike a CIC examination, an IC audit may have only one agent assigned or a team consisting of other specialists, depending upon the issues present in an examination. It is not uncommon that a taxpayer will be assigned one or more Revenue Agents, his or her manager plus an international agent and a Computer Audit Specialists (CAS) as part of the examination team.

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6. IRM 4.46.2.5 Point Criteria Factors (03-01-2006), Exhibit 4.46.2-2, Criteria for the Identification of Coordinated Industry Case Program ([www.irs.gov/irm/part4/irm\\_04-046-002.html#d0e458](http://www.irs.gov/irm/part4/irm_04-046-002.html#d0e458)).

It is the lead IC agent's decision whether to involve other specialists as the examination progresses.

### **§ 7:2.2 Coordinated Industry Case**

The CIC program replaced the Coordinated Examination Program (CEP), which the IRS initiated in the late 1960s as a response to the growth and increased complexity of large corporate organizations. CIC was established with the objective of bringing all segments of a business together for one concurrent examination with centralized responsibility. CIC examinations are for large corporate taxpayers, with specific criteria for size and complexity of audit. The CIC examination will include the primary taxpayer and all of its effectively controlled entities, plus those entities that are unrelated but associated with the taxpayer in activities having significant tax consequences. The name of the primary taxpayer is generally designated as the name of the CIC examination where multiple entities are involved.<sup>7</sup> CIC is considered to be one of the Service's most valuable programs, due to the fact that it consists of approximately 20% of exams resources, but results in about two-thirds of the proposed dollar adjustments.<sup>8</sup>

In a CIC examination, the team consists of Revenue Agents and specialists (such as engineer Revenue Agents, economists, international examiners, computer audit specialists, excise tax Revenue Agents, and employment tax Revenue Agents) who are assigned to examine the taxpayer returns, along with a Team Coordinator<sup>9</sup> and a case manager who oversees the examination.<sup>10</sup> The Team Manager is the overall supervisor responsible for organizing the examination and managing the IRS agents and specialists. The Team Manager consults with the Technical Advisors in planning the audit, anticipates the need for future technical advice, and generally is responsible for the eventual outcome of the examination. Whereas the Team Coordinator is a Revenue Agent assigned to coordinate the responsibilities of

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7. IRM 4.46.2.1 Overview (03-01-2006).

8. In March of 2012, the Service announced it will review its CIC examination process with an eye toward modernizing its risk assessment capabilities, improving its case development and resolutions, and by its reliance on the Schedule UTPs and CAP it might be able to extend the reach of its personnel to the many other compliance priorities which warrant attention and away from CIC.

9. A Team Coordinator is a revenue agent assigned to a LB&I case, where one or more team members or specialists contribute to the examination of the case.

10. A Case Manager is also referred to as a Team Manager; agents use the terms interchangeably.



the audit team and ensure good communications within the team and with the taxpayer. The Team Coordinator is involved with the day-to-day task of keeping the examination team moving forward. Additional Revenue Agents may be assigned to the team and their duties are limited to various assigned tasks. Technical Advisors are responsible for analyzing and coordinating significant industry issues. The Technical Advisor will inform the team of current industry issues, assist in identifying issues and work with the team in developing a legal position. The Technical Advisor is involved as a consultant and does not have line authority over the Team Manager or the Team Coordinator; their objective is to ensure uniform and consistent treatment of issues among taxpayers. One of the first team members to arrive at an examination is the Computer Audit Specialists (CAS). The CAS is the IRS's computer specialist in the area of automatic data processing and record keeping. The CAS is responsible for testing the accuracy and adequacy of the taxpayer's systems and gathering data and synthesizing it for the other team members. Other members of the team consist of engineers (who may review research credits, depreciation, valuation, numerical or economic analysis), economists (who may assist in Transfer Pricing or valuation issues), financial products specialists (knowledgeable in various kinds of financial products), international examiners (responsible for the identification and coordination of international tax issues), and employment and excise tax specialists. Each member of the team reports to their functional manager and works as a team member under the Team Coordinator. Above the Team Manager are the Territory Manager, the Director of Field Operations, and then the Industry Director.

If the issues are not agreed to during the examination, then the Team Manager is responsible for reviewing the taxpayer's protest to Appeals, reviewing the Service's rebuttal to the protest and, if necessary, recommending changes to the Revenue Agent's Report (RAR) before transferring the case to Appeals.

### **§ 7:3 LB&I Examination**

Managing the IRS examination process can be intimidating for any business and taxpayers need to not only prepare for the examination but should have an understanding of the process. For purposes of this chapter, both IC and CIC examinations are referred to as LB&I. If there are any specific differences, it will be noted in the text; however, some of the key administrative differences are as follows:

	IC	CIC
Annual WorkPlan	No	Yes
Initial Risk Analysis	Signed by TM <sup>11</sup>	Signed by TTY MGR <sup>12</sup>
Mid-cycle Risk Analysis	Signed by TM	Signed by TTY MGR
Formal Planning Meeting	No	Yes
Formal Opening Meeting	No	Yes
Team Manager Planning File	No	Yes
Workpaper Retention	No	Yes
Pointing Required	No	Yes
Exam Plan	Streamlined	Yes
Revenue Procedure 94-69	No	Yes
Post-Exam Critique	No	Yes
Cycle Time Goals	Nine months	Eighteen months

LB&I uses several risk analysis systems and tools to determine which returns should be examined. The Service uses electronic screening systems which rely on the use of taxpayers' historical return data and information collected from e-filed returns, including Form 8886 for Reportable Transactions, Forms 8275 and 8275-R used to acquire accuracy-related penalty protection and the Schedule UTP. In addition, there are check-the-box questions on returns, such as Form 1120, Schedule B, question 10, which asks whether a position was taken relative to Sec. 118, contributions to capital by a non-shareholder (which is a tiered issue). There are also issues identified through National Research Projects which might be evident from information on returns and that impact the decision whether or not to examine

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11. Team Manager.

12. Territory Manager.

a return. The Service is also increasing its examination focus to include partnership audits.<sup>13</sup>

The Service also uses publicly available information including SEC filings that contain financial statements, financial statement tax disclosures and other footnote disclosures, as well as other available SEC information about restatements and sanctions. The IRS also looks at public press reports, online searches, company websites, announcements of M&A activity and lawsuits, and settlements reported in the press.

Once selected for examination, there are a number of key steps taken place behind the scenes. First, consideration is given to factors that could prevent a Revenue Agent from initiating an examination. These factors include a short statute of limitations, conflicts of interest, and repetitive audits by the same examiner.<sup>14</sup> The next step in the process is the planning phase. The IRS views this planning process as its single most important activity in properly conducting an examination. The Service believes that intelligent, innovative planning and the development of a well-defined Examination Plan will effectively serve the Team Manager in directing and controlling the examination and will be of benefit to the taxpayer.

### **§ 7:3.1 IRS Currency Initiative**

In 2004, the Service embarked on its currency initiative—a balancing act of conducting shorter audit cycles with quicker results without jeopardizing compliance.<sup>15</sup> The Service determined that providing certainty and resolving controversies on a more contemporaneous basis would assist it in timely identifying potential corporate scandals or tax abuse. Since 2004, the Service has faced an additional challenge in that a large amount of experienced agents and managers were eligible for retirement, and with a lack of resources the Service has had

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13. Historically, the Service examined partnership returns at a much lower rate than it audited corporation returns. In fiscal 2011, the IRS audited 13,770 partnership returns doubling the previous ten years' audits but it only represents 0.4% of the total partnership returns filed the previous year (the comparable rate for corporations (excepting subchapter S entities) was 1.5% and appropriately 30%) and were closed without any change to the partnership return.
  14. IRS Policy Statement P-4-6 prohibits examiners and their managers from examining or surveying a tax return if a relationship impairs impartiality. A conflict of interest exists if an examiner's personal relationships or private interests (usually of a financial or economic nature) conflict, or raise a reasonable question of conflict, with the examiner's public duties and responsibilities.
  15. IRM 4.46.3.1.1 Currency in LB&I (07-26-2011).

the difficult task of streamlining its audits in order for the currency initiative to be effective. Former IRS Commissioner Mark Everson stated that one of the Service's goals would be to double the number of corporate audits and bring corporate taxpayers' audits current. Currency was defined as bringing its audit inventory to returns filed within three years or less in the open examination cycle. Larger cases were to be completed in two years, with the field audit report to be ready in eighteen months. Over the last couple of years, there has been a strong push on closing cases more quickly and evaluating older years on the basis of potential adjustments, resulting in a better use of IRS assets. The currency has been working in getting the cycle times shorter and closer in time to the filing of the returns.

There are many reasons and benefits that examining returns in a timely fashion is good for both the IRS and the taxpayer: (1) taxpayer records are more easily accessible and available on current years; (2) taxpayer personnel are more familiar with transactions selected for examination and are more likely to be available; (3) resolution tools could eliminate issues from future examinations; (4) the utilization of pre-filing agreements for future returns is more feasible; and (5) the Service sees a direct link between currency and improved employee and taxpayer satisfaction.

The Currency Initiative has created many opportunities to resolve cases more quickly at the examination level and has led to a push for using various Alternative Dispute Resolution (ADR) techniques to close cases. In 2006, the Service announced that it reduced audit cycle time from thirty-seven months to twenty-nine months over a two-year period for the very large coordinated industry taxpayers, and for mid-size taxpayers audit cycle time has dropped from sixteen months to thirteen months over the same period. Currency has allowed the IRS to examine taxpayer records which are more easily accessible and available for current years. Taxpayer personnel are more familiar with current transactions selected for examination and are more likely to have documentation readily available and have historical knowledge. In addition, the Service has focused on resolution tools in an effort to eliminate issues from future examinations, thereby reducing the burden on both the Service and the taxpayer. Over the last couple of years, there has been a general consensus that the Currency Initiative has been favorable to both the Service and LB&I taxpayers. However, this has put a strain on taxpayer resources as the Agents are pushing for quicker IDR responses and creating some inflexibility in granting additional time to respond to Notices of Proposed Adjustments or thirty-day letters.

Over the years the Service has applied different methodologies to achieve its currency goal. Some or all of the options below have been employed by a Revenue Agent or Team Manager to improve currency:

**Limited-scope audits**—Issues are identified and prioritized using materiality thresholds through the risk analysis process. Limited scope audits focus on the highest priority issues and limit the scope of an examination by focusing on the materiality threshold. The key to this type of audit is the definition of “materiality.” It appears the IRS has a much lower threshold for materiality than would be expected by large companies or typically applied by their financial statement auditors. Taxpayers should discuss materiality with the team early in the process.

**Skip-cycle examinations**—The option of skipping a year or more of examining a return in order to get current may be considered. The Team Manager might consider requesting that the taxpayer file an amended return in order to incorporate all carryover adjustments from a prior cycle rather than conduct an examination.

**Multi-year examinations**—Sometimes currency can be accomplished by combining more than two years in a cycle or by adding a year to the current cycle. The Team Manager should consider multi-year examinations and use them if cases can be completed more expediently by employing this option.

### **§ 7:3.2 IRS Planning Process**

Typically, the first step in the IRS’s planning process is to perform and document a preliminary risk analysis to determine if the case is worthy of examination.<sup>16</sup> This preliminary analysis, completed by the Team Manager prior to assignment to examiners for audit, applies to both CIC and IC cases. The Service’s focus is to examine more current tax years if the initial planning analysis so indicates. Collectability of taxes should be considered by the Revenue Agent during the preliminary risk analysis as well. One thing that practitioners should keep in mind is early taxpayer involvement in the audit planning process, and maintaining an effective working relationship throughout the examination provides opportunities that should not be discounted.

If a taxpayer is designated as a CIC case, the IRS begins by assembling a team which is lead by a Team Manager, whose key responsibilities are to organize, control and direct the examination. The Team Manager then assembles the audit team including a Team Coordinator, relevant specialists such as international examiners, computer audit specialists, engineer Revenue Agents, financial products agents, economists, local counsel attorney, and other agents and non-specialist agents as required. The Team Manager then identifies the areas to be included in the Examination Plan.

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16. IRM 4.46.3.1.1 Currency in LB&I (07-26-2011).

For CIC taxpayers, the IRS typically maintains a planning file which each examination team updates and provides to the next examination team. The planning file contains significant taxpayer information as well as information concerning issues raised in previous audit cycles. The planning file usually contains the following types of information:

- Taxpayer history, including a history of any reorganizations or acquisitions;
- Taxpayer organizational structure, including any recent changes in its organizational structure;
- Taxpayer examination history record;
- Taxpayer Annual reports;
- Taxpayer Audit and other reports, and accompanying workpapers, of other federal, state and local agencies that conducted examinations of the taxpayer;
- Taxpayer Securities and Exchange Commission filings;
- Identification of the taxpayer's principal officials and representatives;
- The location of the taxpayer's records and facilities;
- A description of the taxpayer's records;
- An identification of transactions potentially affecting subsequent year returns;
- A year-by-year summary of examination adjustments;
- A year-by-year summary of audit techniques used;
- Unusual examination problems;
- Chart of accounts and the taxpayer's accounting manuals;
- Copies of National Office rulings affecting the taxpayer;
- Copies of contracts and agreements having a significant bearing on subsequent years; and
- The most recent prior cycle Examination Plan.<sup>17</sup>

In this day and age of the Internet and publically available information, most agents search the Internet to obtain information on the taxpayer in the early stages of planning.

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17. *Id.*

In June of 2010, the Service announced its “Quality Examination Process” (QEP), replacing the 2003 LMSB Division and Tax Executive Institute (TEI) Joint Audit Planning Process.<sup>18</sup> The QEP: “Achieving Quality Examinations through Effective Planning, Execution and Resolution” Program was designed as a systematic approach for engaging and involving taxpayers in the tax examination process, from the earliest planning stages through resolution of all issues and completion of the case.<sup>19</sup> The program incorporated the LB&I restructure and outlined the examination process from start to finish, and it explained LB&I and taxpayer responsibilities to ensure an efficient and effective examination. LB&I revenue agents are required to review the publication with taxpayers at the start of new examinations.<sup>20</sup> The new QEP brochure is more marketable but time will tell if the program and new title will change agents’ behaviors going forward from the old joint audit plan.

### **[A] Examination Process**

Prior to the start of any examination, the taxpayer should conduct its own internal review to determine if there are any significant exposure items, areas in which additional documentation and/or support should be gathered or developed including transactional documentation.

#### **[A][1] Preliminary Meetings and Discussions**

Taxpayer involvement in the planning process can provide for a more efficient and effective examination. Typically, for the larger taxpayers there are one or more informal meetings during the initial planning phase and for smaller or mid-size companies this meeting typically takes place during the opening conference. With the emphasis on the “Achieving Quality Tax Examinations through Effective Planning, Execution and Resolution”<sup>21</sup> the preliminary meetings have morphed into more formalized Rules of Engagement where the parties discuss the roles, expectations, and responsibilities for both the exam team and taxpayer.

The Rules of Engagement typically cover:

- Identification of individuals authorized to serve as point of contact for the exam team.

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18. Available at [www.irs.gov/pub/irs-utl/f4764.pdf](http://www.irs.gov/pub/irs-utl/f4764.pdf).

19. [www.irs.gov/Businesses/Quality-Examination-Process](http://www.irs.gov/Businesses/Quality-Examination-Process).

20. Note: IRM Section 4.46—LMSB Guide for Quality Examinations—was updated on July 22, 2011 to reflect the QEP changes. Existing references to the Joint Audit Planning Process are being removed and replaced with information about the Quality Examination Process.

21. IRS Publication, 4837, Achieving Quality Tax Examinations through Effective Planning, Execution and Resolution.

- Discussion of Team's findings from the preliminary risk analysis.
- Establishing a timeline with specific milestones in an effort to provide accountability.
- Processes for monitoring and adjusting the plan for ongoing developments, and how changes in the plan by either party will be communicated.
- Methods for tracking taxpayer and IRS resource needs and constraints and advising each other when planned vacations, training, periods of high workload and/or other significant factors may result in delays or increased burden.
- Exam team site requests for taxpayer-provided arrangements (for example, office space, Internet access, building security, emergency drills, information/data security, secure email, etc.).
- Prior examination results (CIC) or (IC), to determine if areas of review can be limited or eliminated.
- Preaudit and initial risk analyses.
- Taxpayer's plans for, or anticipation of, filing of claims or affirmative issues.
- Potential domestic or international industry issues, coordinated issues, and/or Issue Practice Groups (IPGs) and International Practice Networks (IPNs).
- New audit initiatives and general administrative procedures; IDR management process; Form 5701 process; and issue resolution strategies and options.
- Rollover adjustments that resulted from a prior examination.
- Providing secure email to taxpayer.
- Applicability of limited scope audit procedures to this examination (LIFE, remote audits, etc.).
- Materiality threshold agreements, developed when the exam team is determining exam scope.

The joint planning process should provide the taxpayer an opportunity to discuss time commitments and set in motion a cooperative working relationship with mutual goals (that is, to complete the examination in an efficient and timely manner). This is the time that the Taxpayer should point out its busy seasons and any possible resource constraints during the next twelve-to eighteen-month period or any other administrative issues.



One key to a successful examination includes proper communication between the taxpayer and the team. The IRM specifies that the examination should be approached in the “spirit of mutual cooperation” and that the taxpayer and the IRS will benefit if each work toward a “candid and professional relationship.” For smaller or mid-size companies, this meeting typically takes place during the opening conference.

### **[A][2] IRS Planning Meeting(s)**

Prior to the Opening Conference the Team Manager should arrange an internal meeting or series of meetings with the entire examination team. This should include specialists, specialist managers, the Team Coordinator, team members, and the Team Manager. Others may be invited if their presence will add value to the meeting. This could include Area Counsel, Technical Advisors, and higher levels of management. The IRS recognizes the need for taxpayer involvement at the planning stage. The Team Manager is encouraged to seek mutual understandings between the taxpayer and the IRS regarding each other’s priorities, resources and time frames. In addition, the Team Manager should discuss the use and role of specialists, the role of Area Counsel attorneys, efforts to keep the examination process current, potential problems associated with examining proprietary information, trade secrets, and other sensitive information, and potential penalties. The Team Manager is encouraged to reach an understanding with the taxpayer regarding the conduct of certain aspects of the examination. This includes developing procedures for resolving questions on the content of IDRs and time periods for responding to IDRs, coordinating the examination of off-site facilities and records, and establishing the need for examiners to advise the taxpayer of potential new issues. Finally, the IRM directs the Team Manager to include in the planning process discussions with the taxpayer of appropriate methods to resolve issues at the lowest possible level through the use of requests for technical advice, identification of issues appropriate for Team Manager settlement authority, and ADRs (such as fast track settlement and early referral to appeals).<sup>22</sup> During an opening conference it tends to be obvious which Team Managers have actually had meetings with the team members and which ones have not. There are even times when agents meet each other for the first

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22. IRM 4.46.3.2.2 Formal Planning Meeting with Examination Team (12-29-2009).

time at the opening conference and have not discussed the taxpayer's facts, issues and circumstances. The opening conference may also be the agent's first introduction to the taxpayer, its business, and maybe even the industry.

### **[A][3] Opening Conference**

The opening conference is the first formal meeting with the taxpayer. Typically, administrative matters are discussed, timing commitments made during preliminary meetings are firmed up and an overall discussion of the administrative process takes place. The opening conference is conducted by the Team Manager and Team Coordinator. It is not unusual for the other team members, specialists and their managers, and Area Counsel to also attend or ask questions.<sup>23</sup>

A typical opening conference will cover the administrative matters such as introduction to LB&I, discussion of possible ADRs, time frame and expectations for issuance of IDRs, Notice of Proposed Adjustments (NOPA), response time, years under examination, whether the team contemplates extending the examinations to other years or other returns (employment or excise), estimated completion date for issuance of IDRs, NOPAs, and the issuance of a thirty-day letter in an unagreed case. The team will also discuss their expectation of office space and other matters such as security concerns and use of email or faxes.

However, one of the most important aspect of the opening conference, and one that should not be overlooked, is that it gives the taxpayer an opportunity to educate the team as to the company's business, company's accounting records and policies, unusual busy times or resource issues, and an overview of key issues expected to be reviewed during the examination. For example, if the taxpayer has transfer pricing policies with a U.S. tax impact the company may consider providing a presentation educating the team on the relevant facts, law and companies analysis. This can be done at the opening conference or scheduled for a later date with just the relevant agents instead of taking place with the entire examination team at the table. But the opening conference gives the taxpayer an opportunity to address their administrative and technical issues if they so desire.

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23. IRM 4.46.3.2.3.2 Conference Participants (07-26-2011).

**PRACTICE POINTER**

One thing to keep in mind is a large percentage of agents and managers are career employees and are not familiar with the business issues impacting a tax department and they may lack the understanding regarding the challenges of being able to gather and provide the requested information in a timely fashion and the time conflicts and demands unrelated to the IRS examination. Team Coordinators and Team Managers really want to understand the business and the structure and it can be very beneficial to taxpayers if they can eliminate basic misconceptions or misunderstandings right from the beginning. If the company lacks adequate resources or support at the time of the examination it is extremely important for the agents to understand the resource constraints and not to assume the company is intentionally failing to cooperate. Typically in large cases, the agent focuses on materiality as well as issues of focus within the IRS. Walking the team through the Company's transfer pricing policies, organizational structure, acquisitions, research studies, or complex transactions may eliminate unnecessary requests and provide the Company the opportunity to present the information in the most favorable light before the agent is predisposed to reaching an unfavorable conclusion. The Company may consider walking the agents through its analysis, or even consider having a company employee provide a technical discussion such as what the company does in the research arena that qualifies for a R&D credit, or offer up a company employee to discuss a particular transaction, or an economist to discuss why the selected set of comparable companies was appropriate in determining the arm's-length value.

**[A][4] IRS Preliminary Examination Work<sup>24</sup> and Risk Analysis**

The risk analysis process gives the examiners a basis for forming their examination procedures.<sup>25</sup> The initial risk review usually involves reviewing related returns, the planning file, commercial services, and public records as well as consultations with specialists. With today's technology a taxpayer should assume the agent has done an Internet search on the company and may have reviewed any SEC filings or news releases. The teams' initial review will form the basis

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24. IRM 4.46.3.2.2.1 Planning Considerations (12-29-2009).

25. IRM 4.46.3.2.2 Formal Planning Meeting with Examination Team (12-29-2009).

for the examination plan and should be supplemented by information gained at the opening conference and subsequent IDR responses. That is why it is important for taxpayers to consider being proactive early in the examination in an effort to try and control the administrative process and educate the team as to factual, legal, or administrative issues up front.

The Service's Risk Analysis is an integral part of its planning process for both CIC and IC examinations.<sup>26</sup> The analysis involves managers, examiners, as well as the taxpayer at the early stage of the examination in an effort to determine the appropriate scope and duration of the examination. The risk analysis should be used for LB&I tax returns for both CIC and IC. The detail and depth of the process will vary according to the complexity of the tax return. If done correctly it will aid in the audit planning process, could reduce cycle time, and hopefully would result in a more efficient examination thereby creating currency for both the IRS and the taxpayer. The analysis is an ongoing process throughout the entire examination (the risk assessment must be conducted with the initial planning of the examination, when 50% of the case time has been reached, or when a significant event occurs). Risk assessment should address issues such as:

- (1) Does the return need to be examined;
- (2) What is the level of compliance;
- (3) How much time will the examination take;
- (4) What are the expected results of the examination;
- (5) What is the adjustment potential;
- (6) What is the potential impact on future years;
- (6) What are the industry issues, practices, and trends;
- (7) Are there any relevant coordinated issues;
- (7) What is the financial condition of the company—collectability; and
- (8) What are the Service's available resources?

The risk analysis is a subjective process and should be based on the agent's experience and judgment, as well as an objective analysis. Virtually all the factors discussed above are difficult to estimate and subject to change, therefore the risk analysis process should be periodically revisited and updated. Risk analysis considered during

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26. IRM 4.46.3.2.2.2 Risk Analysis and Risk Management (12-29-2009).

the planning process should be documented by the Team Manager and maintained in both the manager's binder and the case file and discussed with the taxpayer.

It is mandatory that revenue agents and any specialists involved in the examination conduct an initial and a mid-point (50% of the total case time has been reached) risk assessment. The Examiner's Risk Analysis Worksheet requires that each issue detail the issue description; materiality factors and potential adjustment; estimated time needed; any additional resources required and the determination of whether or not to initiate the issue. The revenue agent will then submit the risk analysis to the Team Manager with a recommendation to continue, expand, or reduce the scope of the examination. The initial risk assessment must be submitted to the team manager with a copy of the plan. The Team Manager must approve the risk assessment and the examination plan. Both the initial and 50% risk analysis documents will be shared with the taxpayer once the revisions have been approved by the Team Manager. Practitioner should ask about the analysis and discuss with the team.

#### **[A][5] The Examination Plan**

The Team Manager and the Team Coordinator will prepare the Examination Plan (work plan) after the planning meetings are completed and the preliminary examination work is accomplished. The Examination Plan is divided into three parts. Part one of the Examination Plan consists of the agreements with the taxpayer regarding administrative and procedural matters in connection with the audit. This section includes agreements concerning the location of the audit, the scheduling of IRS examination team members involved, the space and equipment to be provided by the taxpayer, the records to be provided by the taxpayer, the analyses to be prepared by the taxpayer, and the lines of communication between the taxpayer and the examination team. Part two of the Examination Plan includes a description of the taxpayer, including its organizational structure, business activities, major product lines, and accounting and internal control systems. This section also includes administrative matters such as instructions for the routing of requests for information to and from the taxpayer and procedures for raising issues during the audit. More importantly, however, this section will identify any audit areas subject to intensive examination, special audit techniques to be used, documentation desired for specific issues, and the priority of issues to be examined. Part three of the Examination Plan, the Examination Procedures Section, sets forth the assignments of the various team members (with any special instructions), the planned commencement and completion date for each assignment, the sequence of the examination, the depth of the examination for each issue, and the audit

priorities. In addition, in this part of the plan the team members are supposed to identify the specific auditing procedures and techniques they intend to use.<sup>27</sup>

Although the work plan is key to framing the relevant issues and time frame of the examination, it is not unusual to receive the work plan many months after the opening conference. Taxpayers should push to see the completed work plan as it will provide insight into the key issues to be examined and the anticipated time frame on each issue and the estimated completion date of the examination. But with any plan it may be revised, updated, or changed.

### **§ 7:4 Taxpayer Preparation for Large Case Examinations**

Although it is important to have an understanding of the administrative process, taxpayers are at a clear advantage as they possess the facts, historical information, and access to key company employees. Taxpayers and representatives involved in an audit or dispute with the IRS should exercise considerable judgment, discretion and caution. Unknown or potentially sensitive issues might arise during the course of any audit. However, with proper preparation surprises should be limited and controlled.

Throughout the audit the representative must balance the duties owed to the client with the representative's ethical and legal obligations.<sup>28</sup> Effective representation requires that the representative understand the entire administrative process and the inherent limitations and challenges involved at each level of the process. Prior to the start of any IRS examination, the taxpayer and its representatives should review and complete a preaudit examination of their own in order to develop a comprehensive audit management strategy.

The completion of an internal preaudit review will serve as the foundation for a comprehensive, effective and proactive audit management strategy and will help the tax professional function as a more effective advocate. The taxpayer and its representatives should undertake a risk analysis similar to that performed by the Revenue Agent. The taxpayer and its representative have a distinct advantage, as they have immediate access to relevant information and, more importantly, access to employees with knowledge of the company, prior transactions, and financial data including financial statement reserves.

As part of the preaudit risk analysis the taxpayer and its representative should review the returns at issue with particular attention paid

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27. IRM 4.46.3.4 The Examination Plan (03-01-2006); *see also* IRM 4.46.3.2.2.4 Conducting the Planning Meeting (09-04-2013).

28. *See* chapter 2, Circular 230 and Ethics of Tax Practice.

to the M-3 adjustments, as well as any disclosures made with the filing of the return. As most LB&I taxpayers have audited financial statements, another good place to start the examination preparation is with the tax provision information. The representative should also review all of the Service's issue- or industry-specific Audit Techniques Guide (ATGs)<sup>29</sup> Issues and IPGs guidance for domestic issues and IPNs for guidance on international issues (discussed below in more detail) to determine if they are applicable to the taxpayer and prepare for the examination accordingly. Review of the taxpayer's Transfer Pricing Policies and documentation, together with its information filings is another area that should be addressed and resolved prior to any LB&I examination. The taxpayer should also review all related-party transactions and foreign information filings, such as Form 5471 (Information Return of U.S. Person with Respect to Certain Foreign Corporations), Form 5472 (Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business) filed with the taxpayer's U.S. federal income tax return,<sup>30</sup> and Form 1042, Annual Withholding Tax Returns. Customs declarations, prior examination results, state examinations, and employment and excise tax issues are all areas of review that are invaluable for understanding during the preparation stage of an audit. The representative should also be familiar with any mandatory or standard LB&I IDRs that will be issued during the examination. For example, the Service currently requires its Revenue Agents to issue a mandatory IDR requesting information about any listed transactions.<sup>31</sup> If the company has potential Transfer Pricing issues, the first international IDR usually requests Treasury Regulation section 1.6662-6(d)(2)(iii)(B) documentation to support the company's Transfer Pricing methodologies.<sup>32</sup>

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29. [www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Audit-Techniques-Guides-ATGs](http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Audit-Techniques-Guides-ATGs).

30. Note: failure to report any such transaction may keep the statute of limitations on assessments open with respect to such transaction under I.R.C. § 6501(c)(8). See chapter 12, Major Civil Penalties, for more detailed discussion.

31. Available at [www.irs.gov/Businesses/Corporations/Abusive-Tax-Shelter-Mandatory-Information-Document-Request-\(IDR\)](http://www.irs.gov/Businesses/Corporations/Abusive-Tax-Shelter-Mandatory-Information-Document-Request-(IDR)). The Abusive Tax Shelter Mandatory IDR is required for all LB&I return examinations and extends to examination activities that originate from post-filing as well as pre-filing activities, such as the Compliance Assurance Program (CAP). This policy is part of LB&I's continuing commitment to the IRS initiative addressing abusive tax shelters.

32. IRS examiners have been given a specific directive to request and evaluate the taxpayer's transfer pricing documentation and specific instructions as to the action to take upon the receipt or in the absence of

If potential issues are identified with respect to return positions the company should ensure that proper documentation has been retained. For example, were there any acquisitions impacting the years under examination and does the taxpayer have the necessary support to establish the basis, transactional costs, appraisals of purchase price allocations, or documentation of acquired tax attributes? Does the taxpayer have contemporaneous documentation pursuant to section 6662 and can the taxpayer support its transfer pricing methodology—intercompany transaction policies, intercompany notes, overhead allocations, and documentation of compliance with policies? If the company does not have contemporaneous documentation consider gathering the necessary information before the exam to support the return position. Although it will not provide penalty protection it can support the transfer pricing return position. If there is no adjustment there will be no penalty. Did the taxpayer rely on third party opinions or internal research? If so, these documents should be gathered and maintained. Could the Service argue economic substance? If so, what documentation does the taxpayer have to support its business purpose? Did the taxpayer enter into any listed transactions? If so, gather all of the relevant documentation to support the deduction.

Another area of focus should be to identify any potential privileges such as attorney-client, federally authorized tax practitioner,<sup>33</sup> or work product with respect to any tax advice provided and make sure procedures are in place to protect and maintain any privileges. It should be noted that the federally authorized tax practitioner privilege has the same common law protections of confidentiality that apply to a communication between a taxpayer and an attorney, to the extent

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such documentation. Revenue Agents are instructed to request the taxpayer's I.R.C. § 6662(e) documentation and strictly to enforce the thirty-day statutory deadline for submission of such documentation. If a taxpayer has not prepared I.R.C. § 6662(e) documentation, Revenue Agent examiners are instructed to issue IDRs to gain all relevant information concerning the taxpayer's transfer pricing practices. Upon receipt of a taxpayer's I.R.C. § 6662(e) documentation, Revenue Agents are to refer such information to an International Examiner or IRS economist to assess and determine whether there are any transfer pricing adjustments. If the team proposes any transfer pricing adjustments that satisfy the threshold in I.R.C. § 6662(e)(1)(B) for applying the 20% substantial valuation misstatement penalty or the threshold in I.R.C. § 6662(h)(2) for applying the 40% gross valuation misstatement penalty, the relevant penalty must be proposed unless the IRS International Territory Manager agrees that such penalty is not warranted.

33. Congress provided a federally authorized tax practitioner privilege to accountants in the IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, by adding new I.R.C. § 7535, which is applicable to communications made on or after July 22, 1998.



the communication would be considered a privileged communication if it were between a taxpayer and an attorney. An “authorized tax practitioner” is defined as any individual who is authorized under federal law to practice before the Service.<sup>34</sup> More important than the extension of the privilege itself are the limitations to the privilege. First, the federally authorized tax practitioner privilege only extends to non-criminal tax matters. And second, the privilege does not apply to written communications between a federally authorized tax practitioner and a representative of a corporation in connection with the promotion of the direct or indirect participation of such corporation in any tax shelter.<sup>35</sup> For this purpose, a “tax shelter” is defined as any entity, plan, or arrangement having as a significant purpose the avoidance or evasion of federal income tax.<sup>36</sup>

### **§ 7:4.1 Preaudit Opening Meeting**

One thing to consider for any LB&I examination is the importance of the Preaudit Opening Meeting with the IRS, which generally serves as an introduction to the examination process and as a planning and communication tool for the IRS and the taxpayer. In large or complex cases, a series of pre-examination meetings may be necessary in order to cover all procedural and administrative issues.

By being prepared and having productive conversations at the preaudit or opening conference, the taxpayer should be able to achieve most of its administrative goals, which are in large part similar to those of the IRS. Needless to say, the taxpayer wants to understand the areas to be examined; the IRS examination team needs to discuss the areas it intends to audit, its use of experts, and timely advise the taxpayer of potential new areas of examination. The taxpayer wants to establish lines of communication to ensure an accurate and timely flow of information; the IRS needs to establish such lines of communication, and develop procedures for submitting, responding, and resolving questions concerning IDRs. The taxpayer wants to receive a draft of the Notice of Proposed Adjustments; the IRS should support procedures for the taxpayer to present documentation of items that may reduce its tax liability. The taxpayer wants an examination timetable that fits within its staffing and business planning cycle; the IRS needs to agree on the procedures and timing of examining off-site records and facilities and needs to efficiently use its resources. By focusing the preaudit and opening conference discussions on these

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34. I.R.C. § 7525(a)(3)(A). *See also* chapter 6, The Examination Function, Attorney-Client Privilege Extended to “Federally Authorized Tax Practitioners.”

35. I.R.C. § 7525(b).

36. I.R.C. § 6662(d)(2)(C)(iii).

points, the taxpayer should obtain useful information on the direction of the examination, establish some parameters, however broad, on the scope of the examination, and agree on a timetable within which the IRS may feel compelled to complete its examination.

Generally, preliminary meetings are intended to educate both parties about the resources, time table expectations, reach agreements, and obtain basic data needed for the preparation of the Examination Plan. For example, the taxpayer should try and reach agreement with the IRS on key procedural and administrative matters: determine the scope, depth, and time frame of the audit; establish lines of communication; method of communication, ascertain the potential technical issues which will be pursued; and communicate expectations not only at the early stages of the audit but throughout the process. During these initial meetings, many agents express concerns about their future accommodations. Typically, there are a number of discussions involving taxpayer provided workspace, access to photocopy machines, phone lines, locking filing cabinets and other logistics that impact the day-to-day operations of the agents. Most IRS agents do not have offices provided to them at a federal building, so the office the taxpayer provides may be their primary office space in which to work the examination. Although, there is little or no authority requiring a taxpayer to provide office space for the entire examination the agents push hard on this issue. At the end of the day it is a business decision as to how to approach this issue and one that should be carefully considered and internally discussed before providing permanent accommodations or access to copy machines, phones or fax machines and taxpayers should consider the additional cost as a result of housing the IRS team. The government provides most large case agents with computers, Internet access offsite (aircards), printers, and cell phones. It is up to the taxpayer as to what additional accommodations the company is willing to provide and what additional cost the company is willing to absorb.

**§ 7:4.2      *Other Factors to Consider for an LB&I Examination***

**[A]      *Regular Communications with the Team Manager (aka Case Manager)***

The Team Manager is the first line supervisor assigned to a particular examination and has the responsibility of overseeing the entire examination. Having the Team Manager participating in regular conferences can be an important aspect of handing an audit. Depending on the size of the company and the type of issues involved it may make sense to conduct weekly or monthly meetings. For smaller

companies monthly or quarterly meetings may be sufficient. Regular communications lead to fewer misunderstandings or misinterpretation of the facts. Conferences can be used to discuss administrative issues such as IDRs, IDR responses, progress of the audit, NOPAs, or to resolve any procedural issues as they may arise. Conferences can also be used to discuss the facts, law, and provide opportunity to resolve issues, or to classify issues as unagreed. Having the Team Manager involved in regular discussions typically brings a different perspective on the issue and they can be a useful asset during the examination process. Depending on the size of the company under audit, the Territory Manager or the Industry Director may also play an important role. Consider this a good thing and make use of the Service's management when necessary to keep the examination on track and to regularly raise issues of concern, such as overly burdensome IDRs, issues involving large or difficult production of documents, or the impact of the company's busy seasons during the examination.

### **[B] Communications with Other IRS Audit Personnel**

Various IRS personnel may be involved (all at once, or at different times) in the audit; although you may not have direct contact with all of them, you will generally want to preserve your ability to communicate directly with them should the need arise. Having the decision-maker at the table is very important in trying to resolve issues and narrow the scope of any disagreements. Ask the agent who is the decision-maker, who is involved behind the scenes, and ask to have a call or meeting with that person. Eliminating the middleman may eliminate misunderstandings or provide clarity to the facts or discussion of the issues.

### **[C] Communications with and Access to Taxpayer's Employees**

At the early stages of the audit the company should determine which of the taxpayer's employees, if any, the IRS should be permitted to have direct contact with and have an agreement that all communications will be with that one person whether it be with the company or its representative. Generally, it is not wise to allow the IRS to have unrestricted access to employees. If it is necessary to allow the IRS to deal directly with an employee, then you should first meet with the employee to go over likely questions and an agreed upon approach. To ensure consistency, it is important that the taxpayer appoint one person as the main contact with the examination team. This will typically be the tax director, tax manager, or international tax manager in the corporate tax department who should also be responsible for

coordinating all responses to IDRs and all meetings with the IRS, including interviews, site tours, and negotiations concerning facts or issues. Depending on staffing availability and budgets, it is not uncommon for taxpayers to engage an outside representative to assist in the process or possibly be the lead contact with the IRS. Taxpayers should do their research to ensure their outside advisors have the expertise to handle the issues and the examination.

There will be times when the agents will want to interview taxpayer's officers or employees.<sup>37</sup> Needless to say, most taxpayers would prefer not to have the IRS interviewing and disturbing their officers or employees. Consider discussing with the agent other possible options, consider providing alternative documents, or have the agent submit written questions. If the agent insists on setting up an interview try and narrow the scope of the interview, inquire as to the specifics prior to the interview, request a list of questions so that the officer or employee can familiarize themselves with the issues, rather than waste everyone's time. Make sure the officer or employee is the appropriate person to respond to the agent's inquiries. Needless to say, there are a host of issues involved and it is important to understand their legal and practical ramifications.

Another issue that comes up frequently is the "tour" of the taxpayer's facility. The regulations state: "regardless of where an examination takes place, the Service may visit the taxpayer's place of business to establish facts that can only be established by direct visit, such as inventory or asset verification. The Service generally will request a tour on a normal workday during the Service's normal tour of duty hours."<sup>38</sup> The IRM provides "[t]ours of business sites should be conducted during examinations of all business entities. Generally, the principal location, and any locations acquired during the period under examination, should be visited."<sup>39</sup> A tour may be important for the agent to understand the company's business or may provide some insight as to potential issues. Careful consideration should be given to who will provide the tour as well as possible access to taxpayer employees. Additional questions or IDRs may be triggered based upon what the agents see or hear during the tour. Depending on the type of business or location of its operations the IRS may request to travel to other cities, states, or even foreign countries to observe the business operation or interview employees. Needless to say, travel can

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37. I.R.C. § 7602 authorizes the Secretary or a delegate to examine books and records and to take testimony under oath. *See also* IRM 4.46.4.2.1 Interviews (03-01-2006).

38. Treas. Reg. § 301.7605-1(d)(3)(iii).

39. IRM 4.46.4.2.2 Tours of Business Sites (03-01-2006) and IRM 4.10.3.3.2 Conducting Tours of Business Sites (03-01-2003).

be expensive for both the Service and the taxpayer and as such careful consideration needs to be exercised prior to making any travel plans. If there is a key employee that the Service wants to interview consider whether it is beneficial to have the employee come to the taxpayer's offices rather than make the company's tax folks or its representatives travel. Also, with today's technology meetings or interviews can be conducted via the Internet. However, there are many strategic reasons for why this approach may or may not be favorable for the taxpayer and this should be carefully considered prior to reaching any accommodations with the Service.

#### **[D] Location/Retrieval of Records**

Identify the location(s) of records relevant to the examination years and determine how the records will be retrieved before the examination gets underway. Are there any known or anticipated problems? What time frame will be required for retrieving records? Are the records located within the tax department, finance department, or within other business units? Are the records located in the United States or located at an international subsidiary, branch or foreign parent company? If it will take several weeks to retrieve and review records then advise the IRS in advance. Remember communication is key during an examination. If the taxpayer has a lack of resources that will negatively affect the IDR response time, then so advise the IRS. If the taxpayer anticipates difficulty in retrieving some documents, then it may be advisable to alert the IRS in advance in order to preclude the assertion that the taxpayer is uncooperative. Agree with the IRS on general time frames for responses, but emphasize that each IDR request may require a different response time depending upon the request. Determine if any essential records have been lost or destroyed and then develop a strategy to deal with the problem. But keep in mind that an IDR response time is an administrative deadline and can be negotiated throughout the examination process.

#### **[E] IRS Requests for Documents and Information and Summonses**

Due to the complexity of large case examinations, numerous members of the IRS team, including various specialists, will issue IDRs. This is very typical in a large case examination and it should be coordinated right from the start. Taxpayers do not want to be inundated with numerous IDRs from different agents at the same time. The IDR Management Process gives the examination team a structured process for issuing IDRs and gathering information during an examination. The Service encourages collaboration between the taxpayer and IRS personnel to agree on and provide information needed

to support an examination.<sup>40</sup> This collaboration should begin at a pre-conference or at the latest the opening conference.

Without establishing an internal procedure for dealing with these IDRs, taxpayer's employees will quickly become overwhelmed.

**[E][1] The New Information Document Request Process: The Carrot and the Stick**

On November 4, 2013, Large Business and International (LB&I) announced its new procedures to enforce delinquent information document requests (IDRs), which went into effect January 2, 2014.<sup>41</sup> The new procedures are intended to bring discipline back into the process in the hope of increased transparency and good communication.

**[E][2] New IDR Process: The Carrot**

The new procedures provide a carrot by giving taxpayers the ability to be more involved in the drafting of the IDRs with the goal of establishing realistic production dates. Under the new procedure, agents will be required to issue focused IDRs rather than broad nonspecific ones.<sup>42</sup> In other words, the agent must identify and explain the issue that has led the agent to request the information included in the IDR. The agent must discuss the IDR with the taxpayer in advance of issuing it, and both parties must discuss and determine a reasonable time frame for response. It will be critically important that taxpayers or their representatives be actively engaged with the IRS team to ensure that each IDR is issue-focused and that both parties understand what information is being requested, and, more importantly, how and when it can be provided. Up-front communications will be key for taxpayers and their representatives.

Just as important, taxpayers need to understand the significance of determining a reasonable time frame for response and to communicate any production or timing challenges to the agents. Historically,

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40. IRM 4.46.4.4 Information Document Request Management Process (03-01-2006).

41. Available at [www.irs.gov/Businesses/Corporations/Large-Business-and-International-Directive-on-Information-Document-Request-Enforcement-Process](http://www.irs.gov/Businesses/Corporations/Large-Business-and-International-Directive-on-Information-Document-Request-Enforcement-Process). The LB&I Division issued Directives relating to IDRs; Directive LB&I—04-0613-004 issued on June 18, 2013, and Directive LB&I—04-1113-009 issued on November 4, 2013, and LB&I—04-0214-004 on February 28, 2014. These Directives reflect, in part, the best practices applicable to IDRs that are being utilized by LB&I examiners across the Division.

42. The authors anticipate the IRM Part 4. Examining Process, Chapter 46. LB&I Guide for Quality Examinations, Section 4. Inspection and Fact Finding being updated in 2014.

LB&I examiners often insisted on fourteen-day production believing that all taxpayers have comprehensive documentation readily available to support all positions taken on tax returns. In practice, however, even thirty days may not always be sufficient time for taxpayers to respond given the location of the requested information, complexity of requests, and competing resource demands on tax departments and their advisors. The only way this new procedure will work is by having the taxpayer understand and explain its challenges in timely producing the relevant documents and properly assessing a production date which is feasible. It is most important that the agent listens and agrees to a *realistic date* rather than imposing his or her judgment as to a production date. Unrealistic expectations generally lead to unsatisfactory consequences.

Under the new procedures it is vital that taxpayers realistically assess the time required to produce IDR responses and only agree to time frames that can be met. Any differences should be worked out at the front end, rather than after a response is overdue. If an agreement as to the scope of the IDR or the production date cannot be reached between a taxpayer and its IRS exam team, the matter should be elevated early in the process.

### **[E][3] Key Points of the New IDR Issuance Policy**

- Examiners should discuss the relevance of the issue related to the IDR and determine what information will ultimately be requested, and why it is necessary.
- Examiners should prepare a separate IDR for each issue using clear and concise language specifically customized for the taxpayer under exam.
- Examiners should provide a draft of the IDR and discuss its contents with the taxpayer and determine *with the taxpayer* a reasonable time frame for a response to the IDR.
- However, if agreement on a response date cannot be reached, the examiner or specialist will set a reasonable response date for the IDR. (This is an area the authors believe may be problematic.)
- The examiner should commit to a date by which the IDR will be reviewed and a response provided to the taxpayer on whether the information received satisfies the IDR and this date should be noted on the IDR.
- If the information requested in the IDR is not received by the response date, the examiner has the authority to grant a taxpayer an extension of up to fifteen business days before proceeding to the next step of the IDR Enforcement Process.

**[E][4] IDR Enforcement Process: The Stick**

The stick is a more rigorous policy for enforcing delinquent IDRs. Under the new procedures, the LB&I manager, examiners and specialists *must* ensure that all outstanding and future IDRs comply with the new requirements for issuing IDRs.<sup>43</sup> The new IDR Enforcement Process involves three graduated steps if production is delinquent: (1) a Delinquency Notice; (2) a Pre-Summons Letter; and (3) a Summons. Local discretion seems to be eliminated with this new procedure—this process is mandatory and has no exceptions. It requires LB&I managers at all levels to be actively involved early in the process and ensures that counsel is prepared to enforce IDRs through the issuance of a Summons when necessary.

**[E][5] Key Points of the New IDR Enforcement Process**

- Once an IDR response date is agreed to with the taxpayer, agents have the authority to grant a taxpayer an extension of up to fifteen business days before the Enforcement Process begins, however, an examiner or specialist may only grant one extension with respect to the same IDR.
- Once an IDR response is deemed delinquent, the exam team will contact the taxpayer to discuss the reason or reasons for the delay (ideally, according to the IRS, this contact should occur the day after the IDR due date).
- The exam team will then issue a Delinquency Notice to the taxpayer within ten calendar days of the original IDR due date regardless of the taxpayer's explanation for the delay.
- Unless approval for additional time is obtained from the IRS Territory Manager, the Delinquency Notice will provide the taxpayer a maximum of ten business days to respond to the delinquent IDR.
- If a taxpayer fails to respond within this period, the IRS will issue a Pre-Summons Letter (a final notice before the IRS issues a Summons) giving taxpayers another ten calendar days from the date the Pre-Summons Letter is issued to respond. The IRS will send this letter to the official within the taxpayer's organization who supervises those that originally agreed to the delinquent IDRs.

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43. An IDR that is issued at the beginning of an examination that requests basic books and records and general information about a taxpayer's business is not subject to this requirement. All other IDRs must state an issue in compliance with the requirements in Attachment 1 of the Directive.



- If a taxpayer does not provide a complete response to an IDR by the response date in the Pre-Summons Letter, the examiner or specialist will complete the next phase of the Enforcement Process, the issuance of a Summons.

As discussed in chapter 11, Summons Power and Third-Party Contacts, a Summons is an administrative order to produce the requested information. If a taxpayer fails to comply with a Summons, the IRS Office of the Chief Counsel may refer the Summons to the Department of Justice (DOJ) for enforcement. Typically, the Office of the Chief Counsel will issue a “last-chance” letter to the taxpayer before referring a Summons to the DOJ. However, with the issuance of the new IDR procedures it is not clear whether Counsel will continue to follow its prior practice of issuing a last change letter. If the DOJ decides to enforce a Summons, the DOJ or a U.S. Attorney’s office files a lawsuit in U.S. district court against the taxpayer, seeking an order from the court to enforce the Summons. Once a district court enforces a Summons, any continued failure by the taxpayer to respond to the Summons may constitute contempt of court. Of course, any proceeding in district court would necessarily involve counsel for the taxpayer.

It should be noted, however, that anywhere along this enforcement timeline the taxpayer has the ability to produce the requested information which would negate going forward on Summons enforcement. However, this new enforcement policy may change the tone of the examination and negatively impact working relationships between the taxpayer and the Service. Time will tell if this new policy helps or hurts the intended goal of bringing discipline back into the IDR process in the hope of increased transparency and good communication.

These new IDR enforcement procedures will apply to all IRS large-case examinations—including partnerships—with more than \$10 million in assets reported on the tax return balance sheet. As with any new procedure it may be painful to work through the changes but this is an area of the examination in which taxpayers and representatives must be proactive on the front end in order to avoid the stick.

Examination procedures used in IC and CIC examinations consist of the same basic information gathering process used for decades—issuing IDRs. The typical initial IDR will be broad and usually requests the following information: current and prior year tax returns; tax return workpapers; listings of internal audit reports; corporate minutes; organization chart of personnel; chart of accounts; books of original entry; annual report to stockholders; Securities and Exchange Commission (SEC) reports; capital structure changes; acquisitions, liquidations, or reorganizations; information on Transfer Pricing studies, requests for information about transactions that are either a listed transaction or substantially similar to a listed transaction; balance sheets; information about the gross profits or sales; cost of

goods sold; operating expenses; and M-1s, M-2s, and M-3s. Revenue Agents will typically review books of account, balance sheets, and profit and loss statements and follow detailed audit procedures for the analysis of balance sheet accounts, profit and loss statements (income and expenses), and special deductions and credits. These procedures are designed around a chart of account related to different parts of the tax return and keyed to the agent's workpapers with identifying numbers. It should be noted that the new IDR procedures do not apply in the same manner to the initial IDR requesting the company's book and records.

As the examination progresses, the agents will begin to focus on specific issues and the taxpayer should be involved in the information gathering process prior to the agent issuing the IDR. Having regular conversations with the agent will eliminate possible misinterpretations down the road or the receipt of an onerous or overbroad IDRs. The representative should know the taxpayer's records and documents and should be able to guide the agent during the IDR process in the hopes of easing the pain of compliance.

#### **PRACTICE POINTER**

One issue that comes up regularly involves an IDR request to create a document. For example, what should a taxpayer do if an agent requests a summary be produced or request that the information be provided in a particular format. Assume the taxpayer has never created such a document, but has the underlying, albeit voluminous, records. The taxpayer has options. The first option would be to respond to the agent that the taxpayer does not have the summary requested. The law is clear that the taxpayer does not have to create a document pursuant to an IDR or, more importantly, a summons.<sup>44</sup> One thing to keep in mind is that the IDR is not enforceable. However, even if the Service were to issue a summons requesting the taxpayer to create a document, it too would generally not be enforceable.<sup>45</sup>

The second option would be more of a practical answer—what does the taxpayer want to do in this situation? The quandary the taxpayer faces is whether to create the summary in an effort to assist in the examination or just respond that the summary does not exist.

44. IRM 5.17.6.2.1 Statutory Authority (10-15-2010); *see also* United States v. Euge, 444 U.S. 707, 718 (1980).

45. For a discussion on summonses, see chapter 11, Summons Power and Third-Party Contacts.

Another possible solution is to offer up the underlying documents. However, it may be better to wait until they are requested. Knowing whether the underlying documents are helpful or harmful may be key in your determination. Even if the documents may not be harmful or create any financial risk they could unnecessarily generate many other questions or the issuance of multiple new IDRs. If the underlying documents could lead to other possible issues or are in some way defective, it may be in the taxpayer's best interest to spend the time and money to create the summary per the IDR request. On the other hand, the taxpayer may want to turn over the voluminous documents and let the agents spend their time and efforts gathering the information requested rather than waste the company's resources. This is an example of where strategy enters into the IDR process and why it is important to have a knowledgeable person guiding the taxpayer through the examination process.

It is important for the taxpayer and its representatives to keep the lines of communication open during the IDR process, and if there are difficulties obtaining the information within the time frames set in the IDR they should be raised as early as possible to head off confrontations or possible discussions of summonses. Most agents are willing to work with taxpayers, but need to be informed of the difficulties and provided with a game plan as to when the information will be provided but under the new procedures they may not have the same flexibility to work with taxpayers.

### **[F] Affirmative Issue**

The term "affirmative issue" is not defined in the Internal Revenue Code ("Code") or regulations but is commonly used in LB&I examination cases and IRS guidance. An affirmative issue is basically an informal claim for refund in which the taxpayer is requesting the Service to consider an issue which is taxpayer favorable. Unlike a refund claim an affirmative issue may not trigger a refund; rather, it will reduce or offsets potential deficiencies resulting during an examination. During an LB&I examination the IRS requests that taxpayers raise any affirmative issues early during the examination providing the Service with the opportunity to review the facts and law surrounding the issue during the examination process. Typically, the work plan sets forth administrative deadlines in which taxpayers can raise affirmative issues. If an affirmative issue is raised at the end of the examination process the Service may inform the taxpayer it will not review the affirmative issue during this examination thereby forcing the taxpayer to file a claim for refund (for example, Form 1120X). If the Service does not include the claim during its current examination the Service will

be left with the options to grant the refund or subsequently examine the claim after the closure of the ongoing examination.

#### **PRACTICE POINTER**

One benefit of raising an affirmative issue with the team rather than filing an amended return is the impact to the taxpayer's state filings. Most states require taxpayers to file an amended state return within a specified period of time, some as short as thirty days and some as long as 120 days, after the filing of an amended federal return. Many large taxpayers file in multiple states and an amended federal return may trigger an administrative burden that could have been avoided by asserting an affirmative issue and waiting until the conclusion of the IRS examination to file amended state returns. Depending upon the taxpayer's situation, multiple amended federal returns may trigger multiple amended state filing requirements.

#### **[G] Issue Resolution/Notices of Proposed Adjustments (NOPAs)**

As the examination progresses, the IRS may propose an adjustment which is reflected in a Notice of Proposed Adjustment (NOPA), Form 5701 together with an Explanation of Items (Form 886-A). The NOPA summarizes the issue and sets forth the amount of its adjustment. Whereas the Form 886-A sets forth the Service's understanding of the facts and summarizes the Service's legal position and may also provide the computations in which the adjustment is based upon. The Form 5701 and Form 886-A are jointly referred to as a NOPA. Normally, the taxpayer and the IRS case manager will agree at the beginning of the examination as to when the taxpayer will need to respond to each NOPA. Typically, the Service requires the taxpayer to review the NOPA upon receipt and to identify any erroneous factual statements and provide its response to the adjustments supported by its factual or legal analysis. The work plan normally sets forth the parties' agreement as to the time in which the taxpayer is expected to respond to a NOPA. Remember that this is something to which the taxpayer should have input. All issues should be discussed with the team before any NOPAs are issued. Make sure to discuss the NOPAs early in the process and provide taxpayer's position and support for any arguments prior to the issuance of a NOPA. Some agents are willing to provide a draft for taxpayer's review and comment. Issuance and response time to a NOPA should be established and included as part of the work plan; typically, thirty days is provided for a response. The Service would like taxpayers to respond to NOPAs within a short time after issuance.

However, many taxpayers would rather respond at the end of the examination so that they can make an informed decision based upon the total amount of proposed adjustments. In determining whether to concede or settle an issue, taxpayers focus on the impact to the business just as much as on the merits of a particular issue. By forcing the taxpayer to make an early decision, by responding within thirty days of the issuance of the NOPA, the taxpayer may be more likely to contest the adjustment knowing the taxpayer can settle or concede at the end of the examination or in Appeals. Revenue Agents insisting on early responses may find themselves with many unagreed issues as many taxpayers do not want to agree or concede an issue without knowing the total financial impact on the entire examination. On the bottom of the NOPA form there are four boxes which taxpayers can check: "Agreed"; "Agreed in part"; "Disagreed"; or "Have Additional information to Submit." In addition, the form requests whether the taxpayer is interested in Fast Track Settlement as a means of resolving the issue.

#### **PRACTICE POINTER**

Before a taxpayer responds to a NOPA careful consideration should be given to the available strategy options. Is it in the taxpayer's best interest to provide a written response to the NOPA, or should the taxpayer first request a meeting to orally discuss the issue? Is it better to agree to disagree and request a thirty-day letter and move onto Appeals by filing a protest? Are there other issues that may impact the examination that the taxpayer wants closure on prior to deciding what approach to take on a particular issue? How will this impact the taxpayer's state returns? Are there other options available on how to resolve the issue before committing to the adjustment? Even if the amount is de minimis or will have little or no financial statement impact the taxpayer should consider the impact on other returns and how will this impact subsequently filed returns, state return, foreign or future returns. Is this a temporary or timing issue? Is it in the taxpayer's best interest to request a closing agreement or an accounting method change? Many multinational taxpayers have complex structures and what might appear to be a simple concession may trigger unexpected consequences and any resolution should be clearly thought out before agreeing.

#### **[H] Involvement of IRS Counsel, Specialists, and Technical Advisors**

The IRS will use a variety of specialists during a large case audit, and in a CIC case use of the specialist is mandatory. At the beginning of the examination the Service will assign a Computer Audit Specialist (CAS).

The CAS is trained as a Revenue Agent and in addition has received specialized training in computer systems and applications. They assist the team members in completing their assignments through use of computer applications. Within the framework of these large, complex accounting systems, the CAS is also familiar with the application of statistical sampling techniques. To fulfill this role, the CAS is involved in providing analyses of complex computerized accounting systems; determining/recommending the most effective method to provide audit data required by examiners; providing computer analyses of large volumes of data; designing, independently, applications using both standard and custom computer programs, and searching continually for creative and innovative ways to use computer assisted auditing techniques. Other team specialists could include an international examiner and his or her manager; an economist and his or her manager; an employment tax specialist and his or her manager; an excise tax specialist and his or her manager; an agent from the IPGs for domestic issues and IPNs for international issues; Technical Advisors; a Financial Products specialist; and an attorney with IRS Area Counsel.

Local Counsel is typically assigned to LB&I cases and is available to coordinate during the examination. Counsel is responsible for providing legal advice and advise the team relating to case development and other matters to their respective client organizations consistent with the Service's position. Depending upon the personalities of the examination team and the counsel attorney, as well as the needs of the team, you may have a very active Counsel attorney or you may never see the Counsel attorney. There are times when representatives should consider specifically requesting exams to involve Area Counsel and bring him or her to the table. Having a different perspective on the issue may bring a quicker resolution or help the parties focus on the issue. But there are times that the opposite is true and it is important to consider pushing back on exams decision and reminding IRS management that the final decision is in exams jurisdiction and they should overrule Counsel's recommendation. It may be a fine line to straddle, so be careful what you ask for.

One thing to keep in mind is that the specialists work separately from the case manager and develop issues within their expertise, and they issue their own IDRs and make their own determinations and recommendations to the team. As a result, the specialist can often delay the closing of the audit. There are times when the taxpayer should involve the case manager in pushing the specialist along or even overruling the specialist in an effort to reach an agreed case.

### **[I] Preliminary Strategies for Resolution**

Before the initial meeting with the IRS, the taxpayer should identify issues that it anticipates resolving at the examination level. Even before

the IRS formally commences its examination, the taxpayer and its representatives should start planning preliminary strategies for narrowing or resolving issues that are expected to arise during the examination. The taxpayer should plan on resolving issues and needs to determine whether it has any issues that will be contentious and difficult to narrow or resolve at the examination level and they should plan accordingly. Just as the IRS's Examination Plan is modified during the course of the audit, the taxpayer should continuously update its own plan and course of action as the examination unfolds.

### **[J] Accounting Method Issues**

Unlike Examination, IRS Appeals has the general authority to resolve contested issues on the basis of hazards of litigation. Revenue Procedure 2002-18<sup>46</sup> describes specific methods for resolving accounting method issues at Appeals or in litigation. The revenue procedure explains three basic ways for resolving accounting method issues. First, is the most obvious one, which is changing the taxpayer's method of accounting. Depending upon the taxpayer's facts and circumstance there may be different ways to resolve an accounting method issue such as what method to use and what year should the method be changed, can it be deferred to a later year or possibly reduce or defer the cumulative adjustment. Method changes are typically documented in closing agreements to bind the parties to the agreement. Taxpayers should consider the impact on subsequently filed returns in resolving accounting method issues. One thing to consider is requesting the agent or appeals officer to consent to filing a Form 3115, Application for Change in Accounting Method. Although, a taxpayer under examination may not be eligible to file a Form 3115 for a subsequent tax year, absent a window period, the Service can still consent to the taxpayer's request to change on its next filed return if currently under examination. Remember if taxpayers don't ask they won't receive and if the taxpayer is requesting a method suggested by the exam team and the team has not yet committed resources to developing the issue it may be in everyone's best interest to get the taxpayer on the correct method going forward rather than expend the resources in the year under examination.

The other two options covered in the revenue procedure are the "alternative-timing resolution" and "time-value-of-money resolution" which do not involve a change in accounting method. One of the key benefits of these alternative options is the possibility of foregoing the necessity of filing amended federal and state returns. As accounting methods involve timing issues companies are more concerned with the administrative burdens imposed by changing its method such as filing amended returns and possibly impacting the manner in which they

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46. Rev. Proc. 2002-18, 2002-13 I.R.B. 678.

maintain their books and records than actually changing the method. Representatives should not feel restrained solely to these three options. That is the beauty of Appeals. As long as the settlement is based upon a well reason resolution and reflects the hazards of litigation the parties may be creative in crafting a resolution.

Under the alternative-timing resolution, the parties enter into a closing agreement that sets forth when the disputed items shall be taken into account, without reference to the method of accounting rules. If a change in method is later imposed, amounts covered by the closing agreement will be excluded in computing the cumulative adjustment. Under the time-value-of-money resolution, the parties compute interest on a hypothetical over and underpayment that would result from the IRS's proposed method change. That amount is then multiplied by a hazard of litigation factor to obtain a specified amount payable to the IRS. The specified amount is manually assessed and treated as a "miscellaneous amount" collected. If a change of methods is later imposed, an appropriate portion of the specified amount will be treated as a prepayment of interest on account of the resulting underpayment. Typically, this is a great practical and administrative compromise.

### **[K] Impact on Future Years**

The taxpayer should keep in mind the potential effect of its strategy on future years for the federal, state, and foreign impact. This would include tax years that have concluded but for which returns have not been filed, as well as future tax years. Many taxpayers overlook the consequences of the resolution of federal issues on both current and future state tax returns. This could be an important component as to how you want to resolve your federal tax issues and should be assessed prior to agreeing with the IRS. Taxpayers should model out possible resolutions to determine the impact on both federal and state returns in determining how the resolution should be structured. Often there is more than one way to resolve an issue.

### **[L] Projected Audit Closing**

At the onset of the examination inquire as to the team's planned completion date for the examination—typically referred to as the ECD (estimated completion date). In most instances, the IRS has projected a closing date, including issuance of the last IDRs or date for preparing their final reports. Based on your preliminary evaluation, what do you think is a reasonable time frame for completion of the audit? If your time frame and the IRS's time frame differ materially, then you should discuss the matter further with the IRS early in the process. Typically, the IRS plans twelve months to twenty-four months to close an examination depending upon the size of the taxpayer and the number of years and related entities under examination. Continue to monitor the ECD and



determine the impact on the taxpayer's examination. Use the ECD to the Taxpayer's advantage.

### **[M] Statute of Limitations**

Taxpayer should determine its policy with respect to statute extensions. The statute of limitations is often the most potent weapon in managing the timing of an IRS audit. The taxpayer, not the IRS, should control statute extensions. Communicate your statute extension policy at the opening meeting. If you will not extend the statute beyond a certain date, then so advise the IRS. Seek an understanding that if the IRS anticipates the need for an extension, then you will be advised well in advance. As the examination progresses, you will be better able to evaluate the appropriateness of any requested extension. Generally speaking, most representatives advise the client to extend the statute of limitations, but consider the amount of time granted per the extension. Most agents routinely request one additional year on the statute or try and link all of the years under examination to the same extension date. For a three-year cycle that could be a three-year extension for the earliest year. Consider whether the additional year(s) is necessary or if an additional six months or less will satisfy both parties' needs. Think before agreeing to extend the statute and determine if the IRS should provide something in exchange for your agreement to extend such as limiting the scope of the examination, agreeing to a restricted consent, or issuance of a thirty day letter. What is important to the taxpayer?

Most public companies should also consider the impact of the statute extension on their financial statements and the representative should consider requesting a date that coincides with their quarter- or year-end date.

#### **PRACTICE POINTER**

Taxpayers are not required to extend the assessment statute and there may be a host of reasons why it is not in the taxpayer's best interest to agree to the extension but be aware of the consequences. Is the taxpayer prepared to receive a statutory notice of deficiency? Is there any possible tax due? What is the impact on net operating losses (either carryforwards or carrybacks) on the assessment statute for the year under examination or the loss year? Is there any risk of tax due if the taxpayer has large losses? How will this impact your state statutes? Is a restricted consent appropriate?<sup>47</sup>

47. For a more detailed discussion of the statute of limitations, see chapter 8, Statute of Limitations/Assessments/Summary Assessments.

**[N] Risk Analysis**

Be sure to review all significant transactions which occurred during the cycle under examination, disclosures on the returns, prior year or rollover issues, any public statements made regarding the years under examinations, and the impact of potential penalties.<sup>48</sup> Taxpayers have an advantage over the Service as the information should be more readily available to taxpayers in order to conduct their own robust risk analysis. See section 7:3 for additional discussion.

**[O] Agreements Reached During Prior Audits**

Determine if any informal agreements were made during the previous audit. For example, if the taxpayer was previously told that certain issues would not be raised, certain records would not be examined, or that the audit of subsequent years would not commence until a certain date the taxpayer should remind the team of the agreement. Informal agreements, while not binding, will generally be honored by the IRS absent compelling reasons. However, it is a good practice to confirm all informal agreements in writing.

**[P] Rollover Settlements**

Are there any continuing issues that were settled previously by IRS Appeals? If so, under Delegation Order No. 4-24, Revenue Agents in large cases have the discretion to adopt prior Appeals settlements—and agents in IC cases will consider doing so.

**[Q] IRS Accommodations**

If Revenue Agents will be on site, taxpayers should determine where the agents will be situated and what facilities they will be allowed to access. Arrangements can be made, if appropriate, for the use of telephones, fax machines, photocopy machines, etc. This may seem like a trivial point to the taxpayer, but to the Team Coordinator in a CIC case it is important. The Agent is looking to the taxpayer to provide their primary office space for the foreseeable future, possibly three to six years. Most Team Coordinators do not maintain a separate IRS office.

Taxpayers have had different approaches on providing office space to the team. The authors have seen taxpayers place the Team Coordinator in very nice accommodations, while others provide the bare minimum, while some have no option due to limited space. But whatever the situation do not make the mistake of having the agent sit near the tax or finance department. It may seem convenient at the

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48. See Rev. Rul. 94-69, 1994-2 C.B. 804.

time, but many agents have overheard conversations that some tax directors later regret. As stated above, there is little or no authority requiring a taxpayer to provide office space for the entire examination but the agents push hard on this issue and most LB&I agents expect office space. At the end of the day it is a business decision as to how to approach this issue. It should be carefully considered and internally discussed before providing permanent accommodations or access to things such as a copy machine, phone or fax access. How much additional cost is the taxpayer willing to incur as a result of housing the IRS team.

In today's electronic age there may not be a legitimate reason for agents to work at the taxpayer site on a regular basis especially for IC cases. Taxpayers should consider their options and not be afraid to push back on the examination team. In light of the ability to exchange data electronically, the taxpayer should consider establishing procedures whereby the company receives IDRs via email or fax and respond with pdf documents in return. Electronic media may reduce the time necessary for the agent to be physically located at the company's place of business. In light of disclosure concerns of section 6103 the Service has instituted a procedure whereby the parties can communicate via encrypted email. The taxpayer will be asked to execute a Memorandum of Understanding which sets forth an agreement to transmit sensitive or confidential tax-related information to accomplish certain authorized exchanged of information via email. In order to utilize this procedure taxpayer must have a secure messaging system<sup>49</sup> with digital signature certificate or it will be requested to obtain a Certificate of Authority from a third party. The process is relatively simple and typically the benefits of communicating via email substantially outweigh any potential disclosure issues. However, there are times in which a taxpayer may have concerns about sensitive information leaving the company's facilities. In such situations taxpayers may decide not to send such information via email and should require agents to come to the company's facilities to review sensitive data. Another issue that often comes up involves the size of the electronic files. Unfortunately, the Service's firewall has a restricted size limit which may cause issues with larger files or multiple attachments. Representatives should work with the examination team to determine what can and cannot be sent electronically.

### **[R] Security and Disclosure Concerns**

Identify any security concerns. Will the IRS have access to sensitive financial or trade secret data? While the IRS is precluded from

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49. The system is compatible with Outlook and Lotus Notes.

disclosing tax return information (including information acquired during the audit pursuant to section 6103), it is a good idea to identify any security concerns at the opening meeting and enter any appropriate agreements needed to safeguard relevant information.

### **[S] Power(s) of Attorney**

Identify who will have the authority to represent the taxpayer, and obtain the necessary powers of attorney. An IRS Form 2848, "Power of Attorney and Declaration of Representative," a limited power of attorney, authorizes the practitioner to represent the taxpayer for the types of tax (for example, individual, corporate, TEFRA, or employment) for the years at issue before the IRS. However, some representatives are not qualified to execute a Form 2848 and should consider whether a Form 8821, Tax Authorization Form, is appropriate. A Form 8821 authorizes any individual, corporation, firm, organization, or partnership that is designated by the taxpayer to inspect and/or receive taxpayer confidential information. However, a Form 8821 does not authorize the representative to advocate the taxpayer's position with respect to federal tax law, execute waivers, consents, or closing agreements or to otherwise represent a taxpayer before the IRS.<sup>50</sup>

### **[T] Audit Location**

Is there is any reason to ask for a change of audit location? If so, the taxpayer should evaluate the situation and immediately make a request in writing to request a change of venue. It is easier to change the audit site before the agent has begun working on the examination than after the audit has commenced. Some IC taxpayers do not have an in-house tax department and their accountants possess the taxpayer's books and records and it would be more appropriate to conduct the audit at their facilities. Some taxpayers have multiple locations and one location may be more appropriate based upon the location of their books and records as well as the appropriate personnel that may

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50. A taxpayer's designation of a third party (such as an accountant who is not acting as a taxpayer's representative) to request and receive returns and return information is sometimes confused with the Conference and Practice Requirements (Treasury Regulation 601.502 *et seq.*) and Treasury Department Circular 230, *Conference and Practice*, requirements overseen by IRS's Office of Professional Responsibility. Form 8821 permits a designated third party to receive returns and return information. It does not permit the third party to represent the taxpayer before the IRS. The third party cannot perform the acts specified in Treasury Regulations 601.502(c)(1) and (2). *See* IRM 11.3.3.3 Distinction Between Disclosure to Designees and the Conference and Practice Requirements (05-20-2005).

be able to assist in the examination. As the saying goes, if you don't ask you won't receive. But as a practical matter moving the place of the examination may not be an easy task and the taxpayer should have good reasons for requesting the change. For example, if the taxpayer has been acquired by another entity which is located across the country and the tax department and books and records are now with the acquiring company it might be more appropriate to move the examination to the new owner's location.

### **[U] Requests for Tax Returns of Corporate Officials— Compliance Check**

IRS agents may ask taxpayers to provide copies of tax returns for key corporate officials.<sup>51</sup> This is not a proper request of the entity under examination. As a general rule, officers' personal returns are not usually in the company's possession. As part of the due diligence process the representative or the taxpayer should notify the corporate officers about the IRS's established procedures whereby the agent will conduct a compliance review of the individual returns for key officers, key executives, or highly compensated employees in an effort to determine if those officers or executives have filed annual returns, have any outstanding balances, or other compliance issues. The IRS considers key corporate officers as those officers who have control or authority over corporate activities, or whose relationship with any segment of the case is close enough to significantly influence corporate management or tax results including: board chairman, chief executive officer, chief financial officer, officers in charge of subordinate operations, officers in charge of governmental activities, or any other officer with significant decision-making responsibility.<sup>52</sup> If the agent includes this request in an IDR, refer the agent to the IRM, which states that related shareholder/partner returns should be obtained using Corporate Files on Line (CFOL) or Midwest Automated Compliance System (MACS) first. If the CFOL and MACS information is insufficient, the agent can request the return from the corporate officer.

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51. Corporate and stockholder returns, as well as partnership and the associated partner returns, are considered related because the returns are for entities over which the taxpayer (stockholder or partner) has control and which the Service believes can be manipulated to divert funds or camouflage transactions.
  52. IRM 4.10.4.3.4.3 Required Filing Checks (Corporations and Other "Business" Returns) (08-09-2011); *see also* IRM 4.46.3.5.7 Corporate Officers' Returns (09-04-2013).

**PRACTICE POINTER**

IRS review of company officer returns is an area where representatives or tax directors should be proactive and try and get an agreement in advance that the agent will make every effort to perform the compliance check by requesting the information from the service center not from the corporate officers directly. Company officers should be put on notice that the IRS may perform a compliance check on their personal returns and provide them an opportunity to remedy any potential issues before the IRS looks at their personal tax information.

If the officers' information is not available from the service center the representative should request that the agent provide you with a heads-up before sending written correspondence to any officers. This will provide the tax director or representative an opportunity to provide the key officers with some additional background information before they are surprised when opening their personal mail from the IRS. Although IRS agents rely of the disclosure prohibitions of section 6103 as to notifying you who they are performing a compliance check on, they should be able to at least give you a heads-up without identifying the names of the officers being contacted. If the Company receives an IDR asking for five officers' Social Security numbers you can probably assume at least those individuals will be checked.

**[V] Be Familiar with Possible ADR Techniques**

The IRS continues to express interest in finding more efficient ways to resolve tax disputes by utilizing ADR techniques (discussed below).

**[W] Be Familiar with the Achieving Quality Tax Examinations through Effective Planning, Execution and Resolution Process**

Revenue Agents will incorporate the Achieving Quality Tax Examinations through Effective Planning, Execution and Resolution guidance into their opening conference and audit plan (discussed below). It is helpful to have an understanding of the document to properly prepare for the examination.

**[X] Closing Conferences**

This may be the last opportunity to resolve issues at the examination level with upper management. Representatives should come to the table in a cooperative manner in an effort to close the examination.

If the issues are still unresolved, the closing conference provides the taxpayer with the ability to understand the government's position and its understanding of the facts in an effort to draft a more effective protest to Appeals. In addition, the closing conference presents an opportunity to consider the impact of any open issues on the subsequent cycle. The taxpayer needs to consider its overall business, economic and tax needs not only for the years under examination but for future cycles. If the issue is timing, the taxpayer should consider the cost of moving forward versus the interest cost in resolving the issue including the cost of filing state returns, or whether a concession would create a tax benefit in a subsequent year. Another issue that should be addressed is the possibility of rolling issues into the next cycle on the same theory that the issue was resolved in the current examination. The taxpayer should consider whether a Form 906, Closing Agreement on Final Determination Covering Specific Matters, or the applicability of accelerated issue resolution under Revenue Procedure 94-67<sup>53</sup> is appropriate. In addition, representatives should be familiar with Delegation Order 4-25,<sup>54</sup> which provides the Examination Division settlement authority.<sup>55</sup>

One thing to keep in mind is the examination division is not to resolve cases based upon the hazards of litigation—that is the job of Appeals or Counsel. Rather they are to resolve issues based upon the facts and law. That said, the managers do have some discretion to drop issues if warranted or agree to allow the company to file a method change or other approach that aids in compliance on issues going forward. Although taxpayers may propose creative resolutions, the authors have not seen managers settle cases based upon hazards so taxpayers will need to work within the confines of their authority.

### **[Y] Settlement Considerations**

Whether resolving the case during the examination, appeals, or while the case is pending in a court proceeding, LB&I taxpayers have a number of key factors to consider in trying to determine whether and when to settle the issues. Typically, in resolving a matter, LB&I taxpayers focus on:

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53. 1994-2 C.B. 800.
  54. 1991-5 I.R.B. 6, D.O. No. 236, 1990 WL 323025 (IRS DLO), 1991-1 C.B. 313.
  55. Delegation Order No. 4-25 provides Team Managers with discretionary authority under I.R.C. § 7121 to accept settlements on any issue under their jurisdiction where Appeals has previously settled an issue with respect to the same taxpayer if the facts are substantially the same and the legal authority relating to such issue remains unchanged.

- What is the financial statement impact?
- Does the resolution impact the Company's deferred tax assets (DTAs)?
- What are the administrative burdens on the company's State and/or Foreign Tax Returns?
- What are the administrative burdens on the company's Federal, State and/or Foreign Tax Returns filed subsequent to the year under examination?
- What, if any, are the Cash Flow Considerations?
- Is the proposed adjustment a Timing or Permanent Adjustment?
- Is there Civil Penalty exposure?
- What are the interest ramifications?
- Should the company consider making an Advance Deposit or Other Payment?
- Is the company risk adverse and is an early resolution more important to the company culture?
- Are there confidentially concerns? Is the company willing to litigate in a public forum?
- What documents should be implemented to close the case, is a Closing Agreement appropriate?
- What type of waivers should be executed?
- How can the company minimize potential double taxation?
- Should the company consider an Advanced Pricing Agreement or Competent Authority?
- What is the cost of settling early verses the cost of going to Appeals or litigation?

The next key settlement consideration is how and when to settle the matter. Some of the possibilities are listed below:

- (1) Resolve the Issue Prior to filing tax return
  - Pre-Filing Agreement (PFA) for factual issues
  - Compliance Assurance Program
  - Method Change—Form 3115
  - Private Letter Ruling (PLR) for legal issues



- (2) Resolve the Issue Prior to IRS Examination
  - Superseded Return
  - Qualified Amended Return
- (3) Settle the Issue during the Examination
  - Revenue Procedure 94-69 Disclosures
  - Agreed Issues
  - Delegation Orders 4-24, 4-25
  - Fast Track Settlement
  - Accelerated Issue Resolution (AIR) Agreement
  - Early Referral
- (4) Settle the Issue during Appeals
  - Traditional Appeals
  - Post-Appeals Mediation
  - Post-Appeals Arbitration
- (5) Settle while the matter is pending in litigation
  - Tax Court
  - U.S. Court of Federal Claims (refund suits)
  - District Court (refund suits)

Another key issue taxpayers need to consider is the impact of the Joint Committee of Taxation on refunds. Whether the case is resolved in exams, Appeals, or during litigation there are many factors that come into play and one size does not fit all. Careful consideration should be given to the why's, how, when to settle, and whether the taxpayer should utilize one of the Service's alternative dispute resolution programs available to LB&I taxpayers. There is also number of strategy considerations that should also be considered:

- Should the taxpayer extend the statute of limitations?
- Should the taxpayer submit a robust response to the NOPA in an effort to resolve the matter or is it better to move forward to appeals and save the robust response for the Protest?
- Does educating the examination team help or hurt the taxpayer's position?
- Has the Service missed an issue during the examination?

- Should the taxpayer request a 30-day letter or a 90-day letter?
- What litigating forum is best for the taxpayer based upon its facts and the legal authorities?
- Should the taxpayer pay the tax and file a refund claim or refund suit?

## **§ 7:5 Appeals for LB&I Taxpayers**

For general discussion of Appeals, filing Protest, and Appeals strategy, see chapter 14, Administrative Appeal.

### **§ 7:5.1 Pre-Conference Meeting**

Unique to LB&I cases, the examination team has the ability to participate in a Pre-Conference Meeting<sup>56</sup> for LB&I cases with the assigned Appeals team. The conference is to discuss the issues, taxpayer's protest and the audit team's written response (rebuttal) to the protest. Most Appeals Officers encourage a frank discussion of the facts and issues during this session. The taxpayer is notified of, and given an opportunity to participate in any pre-conference in accordance with requirements involving ex parte communications. The examination team is encouraged to agree on the relevant facts, and to share its views on the disputed issues, including its assessment of litigating hazards and the strategies involved in setting up adjustments on particular issues. However, the pre-conference is not to be used as a vehicle for securing a commitment from Appeals to defend any particular issue, commit to particular settlement position, or otherwise "negotiate" the settlement posture of Appeals on the case with the examination team.

A Pre-Conference Meeting is scheduled on all cases designated as a team leader case.<sup>57</sup> However, the examination team may request a conference on other LB&I cases. If the examination team does not request a conference and Appeals believes a conference would be helpful, Appeals may initiate the conference. The team leader is responsible for arranging the conference on a date that is mutually agreeable for all of the participants.

The entire examination team may attend the Pre-Conference Meeting.<sup>58</sup> It is not surprising to see the case manager or group manager, revenue agents, international examiners or other specialists as appropriate to the issues in dispute. In addition, the exam team

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56. IRM 8.7.11.9.1 Purpose of Pre-Conference Meeting (10-01-2012).

57. IRM 8.7.11.9.2 Requesting a Pre-Conference Meeting (10-01-2012).

58. IRM 8.7.11.9.3 Who Participates in a Pre-Conference Meeting (10-01-2012).

may invite the local Area Counsel, IRS National Office attorneys or industry specialists to participate in pre-conferences.

Typically, the examination team prepares a PowerPoint presentation and walks the Appeals team through all of the facts and legal support for its adjustments. At times, Counsel may even be the lead presenter of the facts and legal arguments. In accordance with the guidance for ex parte communications, the taxpayer and its representatives are also given an opportunity to participate in the pre-conference meeting.<sup>59</sup> Although, a word of caution regarding the amount of taxpayer participation during the pre-conference meeting. The purpose of the pre-opening conference is for the examination team to summarize its adjustments and legal support. Typically, the reason the case is sent to Appeals is because the parties were not able to see eye to eye on the issues during the examination process and having a robust discussion with Appeals while the examination team is in the room tends not to be very productive for taxpayers. Currently, some Appeals Officers encourage the parties to, at the very least, agree with the factual representation during the pre-opening conference and at times Appeals Officers even try and mediate between the parties. It is the authors' experience that interacting with the examination team during the pre-conference meeting has not been productive but every case and situation is unique and the general rule may not be applicable.

Not only should the representative agree to attend the pre-conference meetings, it could be considered mismanagement not to attend and listen to the examination team's presentation of the facts and the law. If the parties have not resolved their differences at the examination level, it would be best to quietly listen to the revenue agent and/or case manager and provide any comments after the examination team has left the room. Generally, it does not serve any purpose to argue with the revenue agent in front of the Appeals Officer. The representative should present his or her case one-on-one with the Appeals Officer after the pre-conference meeting has concluded. It is doubtful at this point in the process that the representative will persuade the revenue agent as to the merit of the taxpayer's position, and the representative should instead focus on persuading the Appeals Officer during the taxpayer's Opening Conference. Typically, it is advisable to hold back your arguments until the team has completed its presentation and left the room.

### **§ 7:5.2 Opening Conference**

The Opening Conference is the taxpayer's second opportunity to educate the Appeals team as to its understanding of the facts in an effort

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59. Rev. Proc. 2012-18 and Notice 2011-62.

to convince the Appeals team on its interpretation of the law. The first opportunity to persuade the Appeals Officer is with the Protest.

Depending upon the city requested for the opening conference it may take as long as four to nine months from the submission of the rebuttal before the opening conference commences. Therefore, it is a good practice to start to prepare for the opening conference after receipt of the rebuttal to the protest when the information is still fresh. Many representatives prepare PowerPoint presentations setting forth the facts and legal authorities or other relevant information. At times the taxpayer may want to supplement the protest and provide additional support for its positions at the opening conference or as a follow up to points raised during the conference.

Appeals' conferences do not have any of the characteristics of judicial proceedings and, are very informal. The format may differ depending on the Appeals Officer as well as the size and number of the adjustments. It is a good practice to request a break between the pre-conference and the opening conference. Many times members of the Appeals team will have to travel to the conference city and as a result they usually do not want a large time gap between the two meetings. If there are multiple or complex issues the representative should request at least separate days for the pre-opening and opening conference and maybe even longer than the following day. This will provide adequate time to re-evaluate the taxpayer's presentation based upon the Service's pre-conference presentation and it may be necessary to adjust the taxpayer's presentation accordingly. However, depending upon the taxpayer's situation it might not be advantageous to wait an extended period of time between the Service's presentation and the taxpayer's presentation as the Appeals Officers will walk away hearing only one side of the argument and he or she may come to some initial conclusions without the taxpayer's input.

#### **PRACTICE POINTER**

One thing to consider is the timing of the pre-conference and the opening conference. Typically, the pre-conference and opening conference are scheduled within the same time frame (back to back over two days). However, there may be reasons that taxpayers want to separate the presentations by days or weeks. But keep in mind if you schedule the opening conference weeks after the pre-conference the Appeals Officers will be left with the examination team's arguments without your input. That span of time may or may not be advantageous for your client.

Although settlements are based upon the hazards of litigation, the federal rules of evidence do not apply to the presentation.<sup>60</sup> That said, in assessing the hazards taxpayers may want to point out what information would be admissible at trial in order to properly assess hazards based upon the record.

This informal process was intended to promote frank discussion, mutual understanding, and prompt settlement. As a consequence, there is no sworn testimony and no court reporter or other stenographer present. Representatives should come to the meeting prepared with all necessary documents (and possibly witnesses) needed to establish his or her case. Representatives should also come prepared with legal authority to support the position that should be in issue. It is also important to note that most Appeals Officers will do his or her research before the initial meeting. Representatives should, therefore, be prepared not only to present authority favorable to the taxpayer's position, but be able to distinguish and otherwise rebut authority favorable to the government's position. A good settlement will depend upon the representative's ability to be a strong advocate for the taxpayer's positions. In many large cases the opening conference may be spread over a number of days and the entire process may take as long as six to eighteen months to final resolution and closure. There is a lot of flexibility in the process and the taxpayers should be proactive from the first notice of the assignment of the Appeals Officer. The *ex parte* rules do not apply to taxpayers and, as such, as early as the first correspondence, taxpayers may reach out to the Appeals Officer and begin discussions. During their presentation taxpayers may consider leading with their strongest positions and based upon the resolution of that issue may consider being more flexible with the other issues. Generally, taxpayers have a settlement range in mind and might consider asking Appeals to address certain issues before conveying their offer. Most Appeals Officers are willing to work with taxpayers so long as the process continues to move forward. Like all settlements and negotiations there is a lot of strategy and various approaches which are beyond the scope of this book.

For additional information on the appeals process, protests, negotiations, settlement practices, closing agreements, and the hazards of litigation, see chapter 14, Administrative Appeal, and for a discussion of whether or not to proceed to litigation and the choice of forum (U.S. Tax Court, District Court, or U.S. Court of Federal Claims), see chapter 15, Tax Court Litigation and Claims for Refunds.

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60. However, it should be noted that FED. R. EVID. § 408 protects conduct, statements, and offers made during settlement negotiations.

### § 7:5.3 Appeals Case Memorandums (ACMs)

The ACM<sup>61</sup> is a report prepared by the Appeals Officer which sets forth the basis of the parties' settlement. Typically, the ACM consists of four sections: (1) Summary and Recommendation; (2) Brief Background; (3) Discussion and Analysis; and (4) the Appeals Officer's evaluation. The ACM is intended to both document the resolution and persuade the Appeals Team Manager that the Appeals Officer considered and analyzed all the important facts, arguments, and law in reaching an appropriate settlement.

The key element to the ACM is the discussion and analysis section which sets forth the essence of both sides' contentions, sets out any new information provided at the conference, analyzes the law and applicable case law arguments, and discusses the various factors considered in arriving at the settlement and why it was an appropriate resolution.

#### PRACTICE POINTER

Although the taxpayer is well aware of the outcome of the settlement, there are times that the ACM may be relevant to the same issue on a subsequent tax return. Pursuant to the manual, ACMs may be provided to taxpayers either informally or pursuant to the Freedom of Information Act (FOIA). They are not exempt in their entirety from disclosure.<sup>62</sup> That said, the authors have seen the ACM heavily redacted and as such may not be useful.

### § 7:5.4 Post-Settlement Conference

After an Appeals settlement, the examination team is given an opportunity for a post-settlement conference<sup>63</sup> to discuss the settlement reached and its subsequent impact on the taxpayer. The conference is intended to supply the examination team with information that may be helpful in the examination of the subsequent cycles of the taxpayer and to assist in identifying those issues that may be susceptible to resolution by application of settlement authority. As a general rule a post-closing conference will be held on all CIC cases

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61. IRM 8.6.2.1 Introduction to Appeals Case Memos (ACMs) (03-21-2012).

62. Due to the sensitive nature of the ACMs the manual suggests coordination with both Area Counsel and the local Disclosure Officer. *See* IRM 8.1.1.5.4 Requests for Appeals to Produce Records (02-10-2012).

63. IRM 4.46.7.2.7.6 Post-Settlement Conference (03-01-2006), IRM 8.7.11.11 Post-Settlement Conference (10-01-2012).

after final disposition by Appeals unless an exception is agreed to between LB&I and Appeals. Area Counsel will be invited to attend this conference on all docketed cases. Area Counsel may attend these meetings in non-docketed cases at the request of either the examination team or Appeals. Taxpayers are not invited to Post-Appeals Conferences.

The purpose of the post-settlement conference is not intended to be a critique of the settlement nor is it intended to replace LB&I's dissent procedures. It is solely intended to communicate the resolution of the case to the examination team. Although the IRM provides procedures for the examination team to dissent to the settlement and voice their concerns about an Appeals-settled case it does not provide a mechanism to revoke any prior settlement.<sup>64</sup> It is more of an internal administrative procedure to address or resolve significant concerns about the Appeals disposition of an issue(s).

### **§ 7:6 Rapid Appeals Process (RAP)**

Although not yet the subject of any published guidance, the IRS has created a new Rapid Appeals Process (RAP) designed to hasten what can sometimes be a very slow process for taxpayers. In fact, the average time to close an Appeals Team Case Leader (ATCL) Coordinated Industry Case (CIC) is approximately twenty-four months and IC case twelve–fifteen months. RAP is intended to bring the LB&I team, the taxpayer, and Appeals together and have open communications during the initial/pre-opening conference hearing before Appeals by providing a forum for a working conference to resolve tax issues by utilizing mediation techniques. In the past, the taxpayer and LB&I have given separate presentations to Appeals at the pre-opening conference, with little or no interaction between the parties, followed by one-on-one meetings between the Appeals Officer and the taxpayer and its representatives. The idea behind RAP is to have the taxpayer, LB&I exam team, and Appeals work together to coordinate during the first meeting to help the Appeals Officer focus on the differences between the taxpayer and LB&I. RAP is voluntary and requires the consent of the taxpayer.<sup>65</sup>

If the case is adequately developed, the Appeals Officer is to review all available information and, if necessary, request additional information before the conference in an effort to have a robust discussion at the opening conference that may lead to resolution of some or all of

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64. IRM 4.46.7.2.7.8 Dissent Procedures for Disagreements with Appeals Determinations (12-29-2009).

65. 2012 TNT 128-1 IRS Rapid Appeals Process Benefits Taxpayers, Appeals Deputy Says (Release Date: July 2, 2012) (Doc 2012-14037).

the issues. In fact, the Appeals Officers will be encouraged to draft an ACM prior to the meeting in an effort to determine any potential factual gaps or legal conclusions. If the case is not properly developed, Appeals Officers will be encouraged to return the case back to Exams for further development.

The Appeals Officer will be requesting a commitment from the taxpayer and the LB&I team that the parties intend to try and reach a settlement at the opening conference or agreed upon a proposed closing date for final resolution. RAP is intended to be a mutual settlement process and it appears to be a cross between mediation and Fast Track Settlement (FTS). However, unlike Fast Track, where the Appeals officer acts only as a mediator, the Appeals officer is the decision maker on the disputed issues for the IRS. LB&I and the taxpayer will discuss issues with Appeals during the joint pre-conference hearing and also during separate caucus sessions.

### **§ 7:7 Compliance Assurance Program (CAP)**

In an effort to reduce cycle time, the Service created the Compliance Assurance Pilot Program (CAP) for large business taxpayers.<sup>66</sup> CAP is intended to be a cooperative effort between the IRS and taxpayers to conduct real-time audits of businesses with assets of \$10 million or more, with a goal of determining the correct tax treatment of material activity prior to the filing of the tax return. Once the tax return is filed, there is a post-filing audit to determine if the tax return is consistent with the agreements made during the pre-filing process and whether there are any additional issues not identified that would require additional examination activity. Participation in the CAP program is voluntary with both taxpayers and the IRS and is determined on an annual basis and participation is re-evaluated each year. In 2005, the program began with seventeen taxpayers and by 2012 the number of CAP taxpayers reached 176. To be eligible for the CAP program, taxpayer must be an LB&I publicly held entity required to submit disclosure type forms (that is, 10K, 10Q, 20F) to the SEC or equivalent regulatory body. Privately held taxpayers are also eligible if they agree to provide certified, audited financial statements or the equivalent to IRS. Another criterion of eligibility is the company cannot be under investigation by, or in litigation with, the IRS or another federal or state agency such that the IRS would be limited in its ability to access the taxpayer's records.

Under the CAP program, the Service's LB&I Division works with large business taxpayers to identify and resolve issues prior to the filing

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66. Ann. 2005-87, 2005-50 I.R.B. 1144 (Dec. 12, 2005).



of their tax returns. The key objective of this program is to reduce taxpayer burden and uncertainty, while assuring the Service of the accuracy of tax returns prior to filing, thereby reducing or eliminating the need for post-filing examinations. In essence the Service will audit the return in somewhat real time—issues will be examined prior to the filing of the annual tax return. The Service contends that CAP will reduce taxpayer burden through the contemporaneous exchange of information about completed events and transactions that affect tax liability, rather than through the traditional examination process. Some of the key benefits for both taxpayers and the Service are the ability to shorten examination cycles and increase currency for taxpayers, while enhancing the accurate, efficient, and timely final resolution of increasingly complex corporate tax issues. Assuming the taxpayer is able to resolve all issues through the implementation of CAP, a key benefit will be the financial certainty achieved in a real-time fashion rather than waiting until after the return is filed for an examination to commence and several years later to be resolved.

### **§ 7:7.1 Pre-CAP Description**

Pre-CAP was established as a transition phase for taxpayers that have a series of tax years for which traditional post-filing audits have not been completed. Pre-CAP was designed to close all transition years except for one open year and one year for which the return is not yet due. During this phase, the taxpayer and the IRS will develop an action plan aimed at preparing the taxpayer to enter the CAP phase. Pre-CAP will take place in a traditional post return filing examination by a Team Coordinator, not an Account Coordinator. Taxpayers must meet the CAP eligibility criteria and can request Pre-CAP at any time. The taxpayer and the Service will develop an action plan in an effort to eliminate transition years within an agreed amount of time. The taxpayer will be required to sign a Pre-CAP memorandum of understanding (MOU), be willing to work in a CAP environment by exhibiting transparency and cooperation and be willing to identify issues within transactions and provide information in a timely manner to resolve the issues.

### **§ 7:7.2 CAP**

Once taxpayers have successfully navigated the Pre-CAP phase they will be eligible for admission into the CAP Program. As part of CAP, taxpayers will be expected to make full disclosure of their transactions and issues and provide comprehensive and contemporaneous facts and disclosures of their completed business transactions. Taxpayers are also expected to provide information on material items as defined in the MOU. Once issues are agreed to, the Service will not make any

adjustments to the filed return. If an issue is unresolved prior to the filing of the return, the taxpayer and the IRS will continue to resolve any issues still pending. See below for details on the program.

### **§ 7:7.3 CAP Compliance Maintenance**

The Compliance Maintenance Program is intended for taxpayers who have been successful with CAP, have fewer complex issues, have good internal controls, and have established a track record of working cooperatively and transparently with the Service with low risk transactions and limited controversy throughout the CAP. As part of the Maintenance program the exam teams will conduct a significantly reduced scope and depth pre-file review and post-file examination. The Service anticipates that taxpayers can move between Compliance Maintenance and CAP at any time depending on the complexity and/or volume of transactions in a given year. The requirements are as follows:

- (1) Non-complex issues anticipated for the CAP Year (that is, the Taxpayer is not considering any major new transactions during the year). Issues can be completed within approximately twelve–fifteen days per quarter.
- (2) No domestic team members are needed and the review will require no more than fifty–sixty staff days for the AC during the twelve-month pre-filing period.
- (3) Minimal due diligence work is anticipated and the annual significant calculations have been reviewed with little to no changes during prior CAP Years.
- (4) Specialist resources should be minimal: Issues can be completed within three–five days of specialist resources per quarter.
- (5) Taxpayer complied with the letter and spirit of the CAP in prior year(s) in that the assessments of Taxpayer transparency and cooperation in the prior CAP Year were optimal; the taxpayer disclosed all transactions having a material effect along with their proposed tax positions, and identified the tax issues within the transactions; taxpayer responses to written and/or oral IDRs were given within the time frame outlined in the requests and were complete; the taxpayer disclosed all material issues with regard to completed business transactions and no additional issues were identified by the CAP Team during the Post-File Examination; open communication procedures were/are established and abided to between the Service and the taxpayer personnel; taxpayer’s personnel familiar with the transactions were made available to the team in a timely

manner; taxpayer was proactive in advising the CAP Team of major transactions that required significant resource planning prior to the transaction date; a proven process was in place for disclosures that has worked on prior CAP reviews; there have been no changes in tax department personnel that would result in a significant learning curve regarding the CAP; no issues have gone into post-file on prior CAP Years as a result of inadequate time to develop; and no new issues have been discovered on the prior cycle when the return was filed.

The goal of any taxpayer entering into CAP is to be placed in the Compliance Maintenance Program or passed on all together.

#### **§ 7:7.4 Description of the CAP Program**

CAP requires extensive cooperation between the Service and participating taxpayers. Throughout the tax year, CAP taxpayers are expected to engage in full disclosure of information concerning their completed business transactions and their proposed return treatment of all material issues. Participating taxpayers that resolve all material issues will be assured, prior to the filing of the tax return, that the Service will accept their tax return, if filed consistent with the resolutions (described below), and that no post-filing examination will be required. If all issues cannot be resolved prior to the filing of the return, the program will identify the remaining items that will need to be resolved through traditional examination processes.

#### **§ 7:7.5 Aspects of the Program**

Significant aspects of the CAP include:

- Communication of information about completed transactions in a manner that is timely and allows a meaningful analysis of material items affecting the tax return;
- The review of significant transactions immediately after completion, while knowledgeable personnel and necessary records are most accessible;
- The sharing of all relevant data and positions between the Service and the taxpayer;
- The early identification of compliance issues in need of resolution;
- Access to and willingness to participate in issue resolution methods; and
- Determination of return acceptance prior to filing.

The program does not include providing participating taxpayers with guidance on or resolving prospective or incomplete transactions outside of existing procedures, such as a private letter ruling.

The Service will request that taxpayers provide the following information:

- industry overview;
- current organizational charts reflecting all related entities and the flow of relevant information involving those entities;
- financial performance information;
- outline of any anticipated significant events that will affect reporting for the tax year;
- access to accounting records and systems; and
- to make available the necessary resources for disclosure of requested information.

It should be noted that all information provided to the Service in connection with the CAP audit concerning the participating taxpayers' tax liability and all closing agreements entered into between the Service and the participating taxpayers, are return information protected from disclosure by the confidentiality provisions of section 6103, just as with a traditional examination.

While the CAP program may provide many benefits including financial certainty and closure to its participants, CAP participation may not work or be attractive to all taxpayers. As CAP requires disclosures and transparency it might limit some aggressive tax planning. As part of the program, CAP taxpayers must also confirm that there are no reserves for transactions that have not been discussed with the IRS and this may not be appealing for certain taxpayers. Other taxpayers may not have the resources to do real-time audits and therefore, CAP may not be a practical solution. The IRS will not extend a CAP invitation to a taxpayer if it believes that the taxpayer is not suitable or if it has an adversarial relationship with the taxpayer. But one key factor in deciding whether to enter into the CAP program is the significant administrative burden on the taxpayer and its tax department's resources. It is important for taxpayers to carefully weigh the benefits and burdens of CAP as well as the impact on its FIN 48 financial reporting before making any final decisions.

### **§ 7:7.6 Memorandum of Understanding**

At the initiation of the CAP, the parties will enter into a standardized Memorandum of Understanding (MOU), which sets the ground rules for the CAP. The MOU defines specific objectives for the program, sets

parameters for the disclosure of information, describes the methods of communication, and serves as a statement of the parties' commitment to good-faith participation in the CAP. Adherence to the processes established by the MOU is an integral part of resolving identified issues and assuring the Service of the accuracy of the tax return. Failure to comply with the terms of the MOU may result in removal of the taxpayer from the program.

### **§ 7:7.7 Assignment of Account Coordinator**

The Service will assign an Account Coordinator to each taxpayer participating in the CAP program. The Account Coordinator will serve as the primary point of contact with the Service for issue resolution. The Account Coordinator will review the taxpayer's audit history and prior tax issues and will become familiar with relevant industry trends and current business practices of the taxpayer. To ensure proper and accurate evaluation of all tax items, the Account Coordinator will consult with Service specialists, Appeals personnel, and Chief Counsel Advisors. Similarly, participating taxpayers will designate personnel to act as the primary contact for the Account Coordinator. The Account Coordinator and the taxpayer will work together during the process to identify and resolve issues. As issues are resolved, the Account Coordinator and the taxpayer will enter into Issue Resolution Agreements (IRAs) recording the resolutions. When necessary, the parties may use existing issue resolution processes, such as Fast Track Settlement. After the close of the tax year, the Account Coordinator will incorporate the resolution of the identified issues in Form 906 closing agreement(s), based on the completed IRAs. However, it should be noted that the CAP does not change or modify LMSB's current authority to resolve cases.

If, on the other hand, the taxpayer has fully complied with the terms of the MOU, but the IRS and the taxpayer cannot resolve all identified issues prior to filing the tax return, the IRS will provide the taxpayer with written confirmation that it will accept the taxpayer's return with respect to the resolved issues, as long as the return is filed in a manner consistent with any closing agreements and no post-filing examination of those resolved issues is required for that tax year. This type of written confirmation is known as a "Partial Acceptance Letter."

### **§ 7:7.8 Post-Filing Review**

After the return is filed, the IRS and the taxpayer will undergo a joint post-filing review to confirm that the issues are reported as agreed. This post filing review is expected to be completed within ninety days of the filing of the return. After the close of the tax year, the issues are incorporated into a Form 906 closing agreement. If all issues

are resolved, the IRS provides written confirmation in a “full acceptance letter” that, subject to a post-filing review, it will accept the taxpayer’s return if it is filed consistent with the closing agreement. If any issues are unresolved, the IRS issues a “partial acceptance letter” that only accepts the taxpayer’s return as it relates to the agreed-upon transactions; the remaining issues are subject to resolution with the traditional examination process. If necessary, the parties can also use alternative dispute resolutions such as Fast Track Settlement to resolve unagreed issues. If the return is accepted, the audit is closed and the IRS issues a “no change letter” concluding the examination of the taxpayer’s books for the purposes of section 7605(b). If items remain open or are inconsistent with the resolutions, they undergo the traditional examination or Appeals process. If the post-filing review reveals that the return is not consistent with the terms of the closing agreement(s), or reveals that there are items on the return presenting material issues that were not adequately disclosed, the Service will examine all inconsistent or inadequately disclosed issues through the traditional examination process. It should be noted that CAP does not preclude the taxpayer from disputing any unresolved issues through the traditional administrative process. However, the IRS can re-open the tax year if it concludes the taxpayer has violated the MOU by inconsistently or inadequately disclosing its issues.

Although the CAP review is not subject to the restrictions in section 7605(b), the Service will only reopen the year after the post-filing review has occurred and any traditional examination of inconsistent or inadequately disclosed issues has concluded if the circumstances set out in section 5 of Revenue Procedure 2005-32<sup>67</sup> apply.

#### **IMPACT ON TAXPAYER’S FINANCIALS**

A key benefit to CAP participants includes not only the ability to reduce or eliminate FIN 48 tax reserves but it can also resolve uncertain tax positions for which they may not be required to accrue FIN 48 reserves. Resolving those uncertain tax positions in the current period minimizes the risk of financial accounting restatements should the tax reserves prove to be inadequate to cover the audit adjustments. Another benefit of CAP is the taxpayer’s ability to recognize tax benefits immediately in the measurement of net income and, thereby, increase profits. Therefore, CAP can make good business sense if the current tax department has the resources to conduct real-time audits.

67. Rev. Proc. 2005-32, 2005-23 I.R.B. 1206.

### **§ 7:7.9 Key Considerations**

It is the authors' experience that most CAP taxpayers report their experience as an improvement over their traditional examination. However, the initial period may cause resource issues and strain on the company as it may have prior years in Exams as well as Appeals as they move from the Pre-CAP cycle into CAP. Some companies experience issues, trying to meet the compressed time schedule for certain issues that request a more detailed analysis such as transfer pricing, research and development, and large acquisitions. Although obtaining financial certainty appears to be a key determination, the taxpayer must consider the impact to the company. Will the company be able to modify its procedures and internal processes to be compliant with the MOU? What is the company culture on disclosures and transparency and is it consistent with the program? What are the resource constraints and will the company outside of the tax department be able to respond quickly enough to requests for information and just as importantly communication to keep the tax department in the loop throughout the year in order to provide timely information to the IRS? This program may require the company to change its culture, internal operations, and be willing to invest the time and resources to gain trust and meet the accelerated deadlines.

### **§ 7:8 LB&I Coordinated Issues**

One of the stated objectives of the LB&I Division's Issue Management Strategy is to identify, coordinate and resolve complex and significant industry-wide issues by providing guidance to field examiners and ensuring uniform application of the law. Prior to 2014, the Service initiated and relied upon the Industry Issue Specialist Program, Coordinated Issue Papers (CIPs), Tiered Issues, and we now have Issue Practice Groups and International Practice Networks.

#### **§ 7:8.1 Background**

By way of background, the IRS initiated the Industry Specialization Program to promote better identification and development of issues to be covered by its Examination personnel in examining tax returns and to ensure uniform and consistent treatment of issues throughout the examination period. The program was initiated when the IRS, in the late 1970s, recognized that its Examination personnel could not hope to be familiar with the many accounting and business practices peculiar to the different industries and saw the necessity of greater communication and coordination among the various IRS regions and individual examiners working similar cases. Since its inception, the program has been expanded to include international issues and issues

involving employee plans and exempt organizations. The Industry Specialization Program involved ISP Coordinated Issue Papers, Settlement Guidelines, Industry Specialists, a National Industry Coordinator, Industrywide Studies, Designated Industries, and Identified Industry Cases. The program was intended to provide a vehicle for continued industry coordination.

In the early 2000s, the Service began issuing Coordinated Issues Papers which were administrative guidance that identified key industry or cross-industry issues and set forth the position of the Service in an effort to ensure uniform treatment of taxpayers by providing guidance addressing compliance issues. The Coordinated Issues Papers were binding on all IRS examiners, and they could not deviate from the position(s) stated in the Coordinated Issue Paper without the concurrence of the Industry/Issue Team. In January 2014, the Service announced it was de-coordinating the coordinated issue papers,<sup>68</sup> but stated it will have no effect on whether the issue will continue to be pursued by LB&I in an examination or on whether the IRS's views regarding any transaction, including listed transactions, have changed.

In 2006, the Service announced its Tiered Issue Focus Strategy. The issue focus approach was intended to concentrate on what the Service perceives as high-risk tax issues and to ensure that the IRS employs a strategic approach to managing them. The Service believed that this strategy brought greater consistency to the resolution of compliance issues across industry lines and provided greater insight and accountability to the resolution of compliance issues and provides the Field with clear and consistent guidance for addressing significant compliance issues. There were three "tiers." Tier I was considered of high strategic importance and had significant impact on one or more Industries. Tier II issues were considered those of potentially high non-compliance and/or significant compliance risk to LMSB or an Industry. And Tier III issues were generally industry-related issues that should be considered by Examination when conducting their risk analysis.

The Service reviewed LB&I's Tiered Issue Process and determined that, while the Tiered Issue Process may have been well suited for the audit of tax-shelter-type issues, LB&I decided to discontinue the Tiered Issue Focus Strategy as of August 17, 2012. The Tiered Issue Process was replaced with the use of IPGs for domestic issues and IPNs for international issues.

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68. LB&I 04-0114-002 (Jan. 21, 2014).



## **§ 7:8.2 Issue Practice Groups and International Practice Networks**

In place of the Tiered Issue Process, LB&I developing a knowledge management network through the use of Issue Practice Groups (IPGs) for domestic issues and International Practice Networks (IPNs) for international issues. IPGs and IPNs were designed to provide examination teams the technical advice they need to manage their cases efficiently, consistently and with a high degree of technical proficiency. IPGs and IPNs were designed to foster effective collaboration and the sharing of knowledge and expertise across LB&I and Chief Counsel. LB&I views the IPGs and IPNs as a better mechanism than the Tiered Issue Process for balancing the need for consistency with the recognition that there is no “one size fits all” approach to examining and resolving issues.

The Service has recognized that no one employee has all of the answers so LB&I designed the IPGs and IPNs as a resource for examiners, managers and executives to use during audits and in managing their compliance priorities. Agents are to consult IPGs or IPNs, especially when they encounter issues with which they are not familiar or when dealing with complex technical issues. Frontline Managers, Territory Managers, DFOs and Directors are also encouraged to consult IPGs and IPNs when reviewing cases and considering the proper treatment of issues under their supervision.

Basically, IPGs are to function as internal resource or consultants for LB&I personnel who need assistance on particular issues. The IPG advisors will provide written advice and consult across all LB&I functions. The difference with the IPG and Tier I issue is their advice is just that, advice, and it is not mandatory. As currently designed the agents do not have to report back to the IPG after the consultation. It is too early to tell at this point but it appears the IPGs may assist in resolving issues earlier and with less mandatory reviews giving the local team, those knowledgeable about the taxpayer’s facts and business, the ability to make decisions. It is anticipated that IPGs will provide technical resources with IPNs responsible for international tax matters and IPNs are anticipated to cover individuals as well as businesses subject to U.S. tax regardless of their location and regardless of their size. International’s personnel work with other IRS personnel on audits and advisory efforts but International has areas of operations, such as transfer pricing and Competent Authority, that are very unique because they involve other jurisdictions’ taxation of U.S. taxpayers. Whereas IPGs will be aligned with many narrow specialty areas related either to a single Code section, a specific issue area or a specific industry, IPNs will reflect broader areas of international tax planning—such as income shifting (that is, transfer pricing), deferral

planning, and foreign tax credit management—that International considers important areas of strategic emphasis.

#### **PRACTICE POINTER**

In today's era of currency, ADR programs, IPNs and IPGs, LB&I management is looking for appropriate ways to resolve cases as soon as possible; work cases as effectively and efficiently as possible; trying to identify the highest compliance risks; and encourage more transparency and taxpayer assistance and cooperation during the examination. Representatives should consider taking a proactive approach and work with the IRS team, while pushing the client's own objections and time frame in an effort to reach a resolution at the earliest administrative level. Being prepared prior to the examination, being well informed throughout, and controlling the examination process will help eliminate unexpected or unnecessary surprises.

### **§ 7:9 Alternative Dispute Resolutions (ADRs)**

With the passage of the Administrative Dispute Resolution Act of 1998, Congress intended to expand the use of ADR techniques throughout the federal government in order to counter over-judicialization of the administrative process, including in the Internal Revenue Service. ADR is a means of resolving disputes with an alternative method and without litigation. Because of the large volume of disputes, the Service has begun relying on ADRs to meet its currency objectives and minimize its caseload. The use of an ADR can be very cost effective and provide different ways to approach complex or factually intense issues. One key benefit of the CIC program is the fact that case managers are given greater opportunity to resolve and settle issues arising in the course of the audit. These alternatives save valuable time and resources for both taxpayers and the government, as well as reduce the uncertainty and delay caused by pending court decisions. Three ADR procedures provide case managers with the authority to resolve and settle issues during a CIC audit:

- (1) Pre-Filing Agreement;
- (2) Delegation Order 4-24; and
- (3) Delegation Order 4-25.

Other ADR techniques are also available to CI and CIC taxpayers and, depending upon the facts and circumstances, may be worth

considering in trying to resolve issues with the Service and are discussed below.

### **§ 7:9.1 Pre-Filing Agreement Program**

The Pre-Filing Agreement Program (PFA) was designed as a component of the old LMSB Division's issue management strategy and effective January 1, 2009 the PFA program became a permanent feature of the LB&I Division.<sup>69</sup> The PFA Program enables LB&I taxpayers to voluntarily request a determination of tax issues prior to filing a return. Participation is limited to LB&I taxpayers for the current taxable year and for any prior taxable year in which a return has not yet been filed. The program encourages taxpayers to request consideration of an issue before the tax return is filed and thus resolve potential disputes and controversies earlier in the examination process. For whatever reasons, the PFA Process has not been utilized as much as the IRS anticipated or hoped for. Maybe the lack of support was a result of the increase in the filing fee of \$50,000, or maybe some taxpayers are hesitant to share their tax information if the taxpayer is not currently under examination. Whatever the reasons, the IRS would like to see this program utilized more and, based upon the authors' experience, once the PFA request is approved the program has been very beneficial in accomplishing taxpayer goals. But getting approval, however, appears to be more difficult than in prior years.

The effect of the PFA program is to reduce the cost and burden associated with the post-filing examination, to provide a desired level of certainty regarding a transaction and to make better use of taxpayer and IRS resources. Results of a survey conducted by the IRS demonstrates that taxpayers estimate they save 48% of auditing time by using this process instead of the traditional audit; the Service estimates savings of 30%. On a scale of 1 to 5, taxpayers reported an overall level of satisfaction with the program of 4.7 and 4.6 on the likelihood of recommending the process to others. One issue that has arisen is the ability to have a PFA request approved. As evidenced by the statistics below, only 64% of the requests are approved. In addition, it should be noted that there is a user fee of \$50,000 for participation in the program. However, the fee is paid only if the issue is accepted into the PFA program.

PFA's can cover the current tax year and up to four future tax years, but the transaction must be complete. They may also be used to determine the appropriate methodology for determining tax consequences affecting future tax years. PFA's are also available on

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69. Rev. Proc. 2009-14, 2009-1 C.B. 324 and IRM 4.30.1 Pre-Filing Agreement Program (01-09-2002) and 4.46.5.6.12 Pre-Filing Agreement (PFA) Program (03-01-2006).

international issues and the most common issues are worthless stock/bad debts, research credit, cost segregation studies, and disposition, acquisition of a subsidiary, and deduction of settlement costs, fines, and penalties.

If the taxpayer and the Service are able to resolve the issue(s), the parties will execute a Form 906 Closing Agreement setting forth the resolution. If the parties are unable to resolve the issue(s), the taxpayer may withdraw from the program, pursue an administrative appeal either by requesting Early Referral to Appeals, or by protesting any proposed deficiency related to the issue(s). Although the PFA Program is intended to resolve tax disputes prior to the filing of the return, in all practicality the resolution may not be finalized until after the return is filed. One thing to consider is to request up front an agreement that the Service will not assert accuracy-related penalties on that issue if the agreed upon resolution is different than the filing position.

PFA's are a great tool for taxpayers with concerns about financial certainty. Resolving the issue with a Form 906, Specific Matters Closing Agreement, provides a company with the ability to either book a financial benefit or eliminate the need to establish a reserve. Time will tell if in light of Announcement 2010-9, *Uncertain Tax Positions—Policy of Restraint*, taxpayers are more willing to enter into the PFA program to obtain financial certainty, thereby eliminating the need to include the position on a UTP disclosure statement. PFA's are intended to apply to factual issues and issues based upon well-established legal principles of law. Revenue Procedure 2009-14 does not contain a list of eligible issues; rather, it states that any issue that requires either a determination of facts or application of well-established legal principles to known facts that is not excluded by the revenue procedure is likely suitable for a PFA. The revenue procedure also sets forth eligible international issues, which require the Associate Chief Counsel (International) to concur.

### **[A] Exclusions**

The revenue procedures set forth thirteen areas that are specifically excluded:

- (1) Transfer pricing issues.<sup>70</sup>
- (2) Issues relating to change in method of accounting. However, there are some exceptions—(see section 3.09(2)). If the Service has issued a letter ruling granting consent to a change in

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70. See Rev. Proc. 2006-9, 2006-1 C.B. 278, Rev. Proc. 2008-31, 2008-1 C.B. 1133 and their successors.

method of accounting under Revenue Procedure 97-27<sup>71</sup> or its predecessor or successor, or of an application filed under automatic consent procedures such as Revenue Procedure 2008-52<sup>72</sup> or its predecessor or successor, a taxpayer may request, and the Service may enter into, a PFA with respect to the approved change in method of accounting.

- (3) Issues involving the annual accounting period.
- (4) Issues of reasonable cause, due diligence, good faith, clear and convincing evidence, or any other similar standard under Subtitle F (Procedure and Administration) of the Internal Revenue Code.
- (5) Issues involving the applicability of any penalty or criminal sanction.
- (6) Issues that are or will be the subject of a pending or proposed request for a determination letter, technical advice memorandum (TAM), or letter ruling issued to or regarding the taxpayer.
- (7) Issues for which the taxpayer proposes a resolution that are contrary to a private letter ruling, determination letter, TAM, or closing agreement previously issued to or regarding the taxpayer.
- (8) Issues for which the taxpayer proposes a resolution that is contrary to a position proposed by the Service in response to a request for a private letter ruling or determination letter that was withdrawn by the taxpayer.
- (9) Issues that are the subject of pending litigation between the Service and the taxpayer for an earlier taxable year.
- (10) Issues designated for litigation for an earlier taxable year of the taxpayer by the Office of Chief Counsel.
- (11) Issues that involve a tax shelter described in section 6662(d)(2)(C)(ii).
- (12) Issues that require the Service to determine whether the taxpayer, rather than another entity, is the common law employer.

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71. 1997-1 C.B. 680, *as modified and amplified* by Rev. Proc. 2002-19, 2002-1 C.B. 696, *and as amplified and clarified* by Rev. Proc. 2002-54, 2002-2 C.B. 432.

72. 2008-2 C.B. 587.

- (13) Issues relating to transactions that have not yet occurred, regardless of whether the issue otherwise would qualify as one on which the Service will issue letter rulings or other forms of written guidance as described in Revenue Procedure 2006-1<sup>73</sup> and successor revenue procedures.

The Service is required to make publicly available an annual report relating to the PFA program operations for the preceding calendar year. The Conference Report states that the report is to include the number of pre-filing agreements completed, the number of applications received, the number of applications withdrawn, the types of issues that are resolved by completed agreements, whether the program is being utilized by taxpayers who were previously subject to audit, the average length of time required to complete an agreement, the number, if any, and subject of technical advice and Chief Counsel Advice memoranda issued to address issues arising in connection with any pre-filing agreement, any model agreements, and any other information the Secretary deems appropriate.<sup>74</sup> The annual reports can be found at [www.irs.gov/Businesses/Pre-Filing-Agreement-Program](http://www.irs.gov/Businesses/Pre-Filing-Agreement-Program).

### **[B] PFA Statistics**

In calendar year 2013, the IRS received thirty-eight applications, accepted thirty-five, and completed closing agreements on twenty-two. Since the program's inception in 2001 through February 2014, the IRS has received 478 applications, accepted 326, and closed 230 with an agreement. The total time to complete a PFA was 415 days in calendar year 2013.<sup>75</sup>

### **§ 7:9.2 Delegation Order 4-24<sup>76</sup>**

One benefit of large case examinations is the ability to request that a case manager resolve an issue consistent with a taxpayer's prior Appeals settlement. Unlike the examination level, Appeals has the authority to settle cases based upon the hazards of litigation. Once the resolution of an issue is reached in Appeals, it is possible to take that settlement and apply it to other tax years still at the examination level. Delegation

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73. 2006-1 I.R.B. 1.

74. Conference Report for H.R. 4577 (Pub. L. No. 106-554), the Community Renewal Tax Relief Act of 2000.

75. For a year-by-year breakdown of the types of issues, length of time to close a case, and amount of PFAs received and accepted into the program, see [www.irs.gov/Businesses/Pre-Filing-Agreement-Program](http://www.irs.gov/Businesses/Pre-Filing-Agreement-Program).

76. Formerly DO-236, Rev. 3, 1991-5 I.R.B. 6, D.O. No. 236, 1990 WL 323025 (IRS DLO), 1991-1 C.B. 313, effective August 25, 1997.

Order 4-24<sup>77</sup> provides an examination case manager with limited settlement authority on issues previously settled in Appeals as long as they apply that same settlement to issues impacted from the prior Appeal settlement. For example, if the Appeals Officer determined basis and an inventory adjustment which impacts the year(s) under examination and the taxpayer sets forth the same legal arguments; the case manager may resolve the issue in the same manner as settled with Appeals and execute a closing agreement and Forms 870-AD to effect any final settlement with respect to any rollover or recurring issue. However, the facts and the legal authority must have remained substantially unchanged, and Appeals must have settled the underlying issue on its merits independent of other issues in the appeal.

Delegation Order 4-24 settlement authority may be exercised only if all of the following factors are present:

- (1) the issue is in an LB&I case under LB&I's jurisdiction;
- (2) a settlement has been effected by Appeals in the same, previous, or subsequent tax period;
- (3) the facts are substantially the same as the facts in the tax period settled by Appeals;
- (4) the legal authority is still valid;
- (5) the underlying issue was settled by Appeals independently of other issues; and
- (6) the issue was settled in Appeals, with respect to the same taxpayer (including consolidated and unconsolidated subsidiaries), or another taxpayer who was directly involved in the same transaction or taxable event in the settled tax period.<sup>78</sup>

The settlement authority guidelines are not meant to be all inclusive or to replace the judgment and discretion of the team manager. However, the benefits of Delegation Order 4-24 for both the Service and the taxpayer are so significant that this authority should be carefully considered before the manager denies the taxpayer's request to implement the settlement for the years under examination.<sup>79</sup> The team manager must weigh all the facts and circumstances and decide whether an issue will be resolved using this authority. However,

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77. IRM 4.46.5.5.2(5) Alternative Dispute Resolution (ADR) Tools and Procedures (07-22-2011).

78. Delegation Order 4-24; IRM 4.46.5.5.4 Conditions Required for Settlement Authority (07-22-2011).

79. IRM 4.46.5.5.5 Settlement Authority Guidelines (07-22-2011).

the taxpayer has no right to appeal the team manager's decision if the team manager declines to exercise their settlement authority.

#### PRACTICE POINTER

Typically, an examination of the subsequent cycle is currently underway while settlement negotiations with Appeals on the prior years are taking place. Practitioners should consider speaking with the team manager and requesting the same treatment prior to finalizing the Appeals settlement. If the team manager is not in agreement to apply the same basis of settlement to the subsequent cycle practitioners should consider elevating their concerns up to the territory manager or above in an effort to discuss the reasons why the team manager is not willing to exercise Delegation Order 4-24.

Delegation Order 4-24 provides the team manager authority to settle by executing closing agreements and/or Forms 870-AD with respect to issues previously settled in Appeals. In most circumstances, the use of the Closing Agreement is preferred as the Closing Agreement is binding and does not require an income tax calculation.<sup>80</sup> A closing agreement entered into under section 7121 provides finality and settles the issue addressed by that agreement. A Form 870-AD is an informal agreement, which standing alone, is not binding.<sup>81</sup>

#### § 7:9.3 Delegation Order 4-25

Pursuant to Delegation Order 4-25,<sup>82</sup> all examination Case Managers have the delegated discretionary authority to accept large case settlement offers with respect to coordinated issues within the Industry Specialization Program (ISP) and the International Field Assistance Specialization Program (IFASP) on which Appeals has coordinated

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80. IRM 4.46.5.5.7 Agreement Forms (07-22-2011).

81. It should be noted that when a Form 870-AD is used to secure agreement on a settlement authority issue that is a potential competent authority issue, it will not be treated as a binding agreement by the U.S. Competent Authority in subsequent negotiations with a treaty country. However, if a taxpayer executes a closing agreement with respect to a potential competent authority issue, the U.S. Competent Authority will endeavor to obtain a correlative adjustment from the treaty country and will not undertake any actions that would otherwise change the agreement. *See* Rev. Proc. 2006-54 (which superseded Rev. Proc. 2002-52).

82. IRM 4.46.5.6 Delegation Order 4-25, Settlement Authority for Coordinated Issues (07-22-2011).



issue papers containing settlement guidelines or positions. Prior to finalization, the proposed settlement, together with any related closing agreement and/or Form 870-AD, Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax, and supporting documentation, shall be reviewed and approved by the appropriate specialists/coordinators for ISP and IFASP within the Examination, International and Appeals functions. Recently, the Service utilized Delegation Order 4-25 in processing tax shelter settlements.

#### **§ 7:9.4 Accelerated Issue Resolution (AIR)**

The Accelerated Issue Resolution (AIR)<sup>83</sup> program was created to accelerate the resolution of the same or similar issues arising from the examination of a large case taxpayer from the current audit cycle to all years for which a return has been filed.<sup>84</sup> Case managers have the ability to accelerate the resolution of the same or similar issues arising out of the audit by extending the audit of the relevant issues from the current audit cycle to tax periods not currently under audit. AIR provides an avenue for the parties to resolve an issue affecting other tax years. Resolving an issue for later tax periods using the same examination team and taxpayer personnel ensures continuity and reduces the learning curve of a new team. Under the AIR program, the large case taxpayer will formally initiate the procedure with a written AIR request. In all likelihood, since the AIR process originates during an ongoing examination, there will have been substantial discussion, and the actual details of the AIR may have been worked out prior to the formal written request. An AIR request can originate with the Team Manager, team members, or the taxpayer. The AIR procedures are voluntary; therefore, the taxpayer and/or the IRS can withdraw from the process any time before execution of the AIR closing agreement. If successful, the parties will execute a Form 906, Closing Agreement on Final Determination Covering Specific Matters.

The taxpayer's request for an AIR agreement must be in writing and contain, at a minimum, the following items:

- A complete written statement of the issues, facts, law and arguments;

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83. Rev. Proc. 94-67, 1994-2 C.B. 800 and IRM 4.46.5.6.8 Accelerated Issue Resolution (AIR) (03-01-2006).

84. Although the AIR process applies to both CICs and ICs, the AIR process should be limited in IC examinations where it is not practical to include subsequently filed tax return years as part of the current examination cycle. *See* IRM 4.46.5.6.8 Accelerated Issue Resolution (AIR) (03-01-2006).

- A statement as to whether the taxpayer has ever applied for Competent Authority assistance for the AIR issues for the years under consideration or for prior years and whether the taxpayer intends to seek relief from double taxation for the AIR issues;
- True copies of all contracts and pertinent documents as well as certified English translations of any applicable foreign laws and copies of those laws;
- A statement that the inspection and/or examination of the books and records under the AIR procedures will not preclude or impede a later inspection or examination and that the IRS will not have to comply with the procedural reopening requirements for the later inspection/examination; and
- A perjury statement.

The following issues cannot be included in an AIR agreement:

- Issues in cases outside the jurisdiction of the director;
- Issues that are subject to an advance pricing agreement;
- Issues under the jurisdiction of the Commissioner, Tax-Exempt and Government Entities (TE/GE);
- Any partnership items as defined in section 6231, or any other issues subject to the procedures set forth in sections 6221 through 6234;
- Any issue if its resolution is contrary to a private letter ruling, TAM, or closing agreement previously issued to or entered into with the CIP taxpayer, or is contrary to any proposed position indicated by the IRS with respect to a private letter ruling request that was withdrawn following notification by the IRS that it would take a position adverse to that sought by the CIP taxpayer; or
- An issue that has been designated for litigation by the Office of Chief Counsel.

An AIR Agreement can be a great tool for taxpayers to obtain closure for a particular cycle for issues not yet examined.

### **§ 7:9.5 Revenue Procedure 94-69: Qualified Amended Return**

The Service has recognized that because CIC taxpayers are continuously under examination and they cannot avail themselves of the Accuracy Related Penalty protection typically provided to other

taxpayers in Treasury Regulations section 1.6662-2(c)(3)(A),<sup>85</sup> referred to as a Qualified Amended Return (QAR). A QAR is defined, in relevant part, as an amended return filed after the due date of the original tax return for the taxable year (determined with regard to extensions of time to file) but before the “date the taxpayer is first contacted” by the IRS concerning any examination (including a criminal investigation) with respect to the return. Revenue Procedure 94-69<sup>86</sup> provides special procedures for taxpayers that are subject to the CIC Program to voluntarily disclose additional tax due or make adequate disclosure with respect to an item or a position to avoid imposition of the substantial understatement penalty imposed under former section 6661 and the Accuracy-Related Penalty currently described in sections 6662(b)(1) and 6662(b)(2). Upon written notification at the beginning of a CIC examination, the taxpayer will have a period of fifteen days<sup>87</sup> to provide written statements, which will be treated as qualified amended returns or disclosure statements. Typically, there is a lot of discussion that takes place around the decision to disclose. Are the adjustments one of timing and could disclosing the adjustment shorten the examination time? Would the proposed adjustments establish good-will with the Service? What is the taxpayer’s appetite for controversy or is the taxpayer more interested in correcting its prior returns? If not disclosed, would the Accuracy Related Penalty be waived based upon reasonable cause or another statutory defense?

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85. The QAR must be filed before:

- (1) the IRS contacts any promoters with respect to investigation into a tax shelter activity in which the taxpayer participated directly or indirectly;
- (2) contact by the IRS with a pass-through entity (as defined in Treas. Reg. § 1.6662-4(f)(5)) regarding an examination of the return to which the pass-through item of the taxpayer relates;
- (3) service of a “John Doe” summons relating to the tax liability of a person, group, or class that includes the taxpayer with respect to an activity for which the taxpayer claimed any tax benefit on the return directly or indirectly; and
- (4) the Commissioner announces by revenue ruling, revenue procedure, notice, or announcement, of a settlement initiative to compromise or waive penalties, in whole or in part, with respect to a listed transaction for which the taxpayer has claimed any direct or indirect tax benefit.

86. 1994-2 C.B. 804.

87. It is not usual that upon a taxpayer’s request or a showing of reasonable cause an appropriate IRS official may delay issuance of the fifteen-day letter to provide the taxpayer additional time to disclose relevant information. It may be in both parties’ interest to resolve issues at the front of the examination rather than wait until the IRS discovers an issue.

Be aware however, that Revenue Procedure 94-69 does not include any possible Transfer Pricing adjustments since the revenue procedure only applies to section 6662(b)(1) and 6662(b)(2) penalties, whereas a QAR may provide penalty protection for issues not covered by Revenue Procedure 94-69.<sup>88</sup> Before deciding to make any disclosure, the taxpayer should carefully consider the pros and cons.

#### PRACTICE POINTER

Although Revenue Ruling 94-69 is specific to CIC taxpayers, all large case taxpayers may consider requesting similar treatment at the beginning stage of an examination. IC case managers are not required to follow this revenue procedure, but it has been the authors' experience that if a taxpayer comes to the opening conference and identifies or offers to identify possible issues, the Service may agree to forgo accuracy-related penalties to reward the taxpayer's show of good faith. But note, neither the agent nor the manager is required to follow this procedure and it is advisable to discuss this issue and solicit their views before making any voluntary disclosures.

Depending upon a taxpayer's situation, a qualified amended return might provide relief from the Accuracy-Related Penalty for a non-CIC taxpayer. A "Qualified Amended Return" or QAR is defined, in relevant part, as an amended return which is filed after the due date of the original tax return for the taxable year (determined with regard to extensions of time to file) and before the "date the taxpayer is first contacted" by the Service concerning any examination (including a criminal investigation) with respect to the return.<sup>89</sup> Although, the term "first contacted" is not defined in the regulations and there is no formal guidance on the meaning of first contacted. In *Perrah v. Commissioner*,<sup>90</sup> the Tax Court not surprisingly rejected the taxpayer's claim that he was entitled to penalty relief based on filing a QAR. The Tax Court determined that the amended return was not filed by the taxpayer until well into the course of the examination of the tax returns that were amended. In *Bergmann v. Commissioner*,<sup>91</sup>

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88. Rev. Proc. 94-69, 1994-2 C.B. 804. For additional discussion, see chapter 4, Tax Returns and Interest.

89. Treas. Reg. § 1.6662-2(c)(3)(A).

90. *Perrah v. Comm'r*, T.C. Memo 2002-283.

91. *Bergmann v. Comm'r*, 2014 U.S. App. Lexis 720,113 A.F.T.R.2d (RIA), 2014-1 U.S. Tax Cas (CCH) ¶ 50136 (9th Cir. 2014).

the Ninth Circuit affirmed the Tax Court decision in which the court held that the period in which to file a QAR terminated for the taxpayers when the IRS first contacted the promoter regarding a promoter investigation.

There is no provision in the statute that requires the filing of an amended return. The statute defines the obligation to file an original return and provides for the filing of subsequent claims for refunds of overpayments. The QAR procedure is an administrative variant on the government's former, long-standing voluntary disclosure policy wherein a taxpayer could obviate potential liabilities for criminal violations of the internal revenue laws by making a "voluntary disclosure" of the violation before he is "first contacted" by the government.

The IRM states that a voluntary disclosure for criminal purposes occurs when the taxpayer shows a willingness to cooperate and makes good faith arrangements to pay the tax, interest and any applicable penalties as long as the disclosure is timely. The IRM defines a timely voluntary disclosure as one made prior to the IRS initiating a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to commence such an examination or investigation. The IRM does not define what constitutes "notification" to commence an examination. At the end of the day one is left with applying common sense to the definition of "first contact" pursuant to the regulations.<sup>92</sup> For purposes of the QAR, first contact is generally presumed to mean the date when the Service notifies the taxpayer in some fashion that its income tax return for the year will be examined. In practice, this can occur by letter, by phone, or by personal contact.<sup>93</sup>

### **§ 7:9.6      *Superseded Returns Filed Prior to Expiration of Extended Due Date***

Another possible remedy for Large Case taxpayers to consider is the possibility of filing a superseded return upon discovery of an error, missing information or forms, or missing an election on the original filing. But the timing of filing a superseded return is very limited. A superseded return<sup>94</sup> is a tax return filed prior to the due date (including

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92. IRM 20.1.5.2 Common Features: Accuracy-Related and Civil Fraud Penalties (01-24-2012).

93. The regulations were amended to expand the universe of "first contracts" that would foreclose the opportunity to file a QAR by including various third parties such as tax shelter promoters and record keepers, and by including various pass-through entities such as partnerships and certain REITs, any of which would likely trigger a recognition by the taxpayer of a high likelihood of examination.

94. A superseded return is also referred to as a "timely amended return" in *Haggar* and its progeny.

extensions) which corrects or changes data reported on the original return.<sup>95</sup> A superseding return is generally treated as the taxpayer's "return" and the corrections provided in the superseding return are in effect incorporated into, and treated as relating back to, and modifying or superseding the original return.<sup>96</sup> This rule generally includes amendments filed within the time for filing original returns as extended.<sup>97</sup> A taxpayer, therefore, is allowed to file a superseding return after it originally files its return but prior to the extended due date of the return. For example, the filing of the Form 1120 on August 15 does not revoke the remaining extension of time to file that was granted until September 15, and the taxpayer can properly file a timely superseding income tax return on or before September 15 that supersedes the former return filed on August 15.<sup>98</sup> The superseded return will be treated as "the return" for that taxable year.

However, it is important to note that the filing of a superseded return may not impact the section 6501 statute of limitations. Section 6501(a) provides that, generally, tax must be assessed within three years after the return was filed, whether or not such return was filed on or after the date prescribed. Under section 6501(b)(1), a return filed before the last day prescribed for filing is deemed filed on the last day. A return filed on extension, however, is treated as filed on the day it is received, in the case of a return received on or before the extended due date, or on the postmark date, in the case of a return mailed before but received after the extended due date.<sup>99</sup> The statute of limitations on assessment under section 6501 begins only upon the filing of a valid return, in this case the first or originally filed return.<sup>100</sup> For an additional discussion on the statute issue, see chapter 15, Tax Court Litigation and Claims for Refunds.

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95. See, e.g., IRM 3.5.61.1.3 Definitions (01-01-2014).

96. See *Haggar Co. v. Helvering*, 308 U.S. 389, 395–96 (1940); see also *Mamula v. Comm'r*, *rev'g* 41 T.C. 572 (1964); *Reaver v. Comm'r*, 42 T.C. 72 (1964).

97. See *A.J. Crowhurst & Sons, Inc. v. Comm'r*, 109 F.2d 131 (3d Cir. 1940); Rev. Rul. 78-256, 1978-1 C.B. 438 (holding that an amended return filed before the due date (including extensions) constitutes the return for purposes of section 6655). On the other hand, an amended return that is filed late after the due date (including extensions) is a nullity, and does not incorporate anything into the original return. See *Badaracco v. Comm'r*, 464 U.S. 386 (1984); *Wm. B. Scaife & Sons Co. v. Comm'r*, 117 F.2d 572 (3d Cir. 1941).

98. In fact, there is nothing preventing the taxpayer from filing multiple superseding returns.

99. See *First Charter Fin. Corp. v. United States*, 669 F.2d 1342, 1346 (9th Cir. 1982).

100. See *Beard v. Comm'r*, 82 T.C. 766, 778–79 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

**§ 7:9.7 Limited Issue Focused Examination (LIFE)<sup>101</sup>**

Back in 2005, in another effort by the Service to increase the ability to conduct more efficient business examinations, the LMSB Division began the “Limited Issue Focused Examination” (LIFE) program.<sup>102</sup> LIFE was designed as a streamlined examination process which involved a formal agreement, a “Memorandum of Understanding,” between the Service and the taxpayer to govern key aspects of the examination. According to the IRS, it was hoped that LIFE will create, with the taxpayer’s assistance, an atmosphere where the examination process is less difficult, less time-consuming, less expensive and less contentious for all involved. Working in such an atmosphere it is envisioned that both the IRS and the taxpayer will focus their resources and time on the issues most significant to the return under examination.<sup>103</sup> In 2013, the Service updated its frequently asked questions on the LIFE program in an effort to clarify the program.<sup>104</sup>

In determining whether LIFE is appropriate the Service is to conduct a risk analysis identifying the material issues, prioritize these issues, and focus on large, unusual and questionable items. Once the key issues are identified, the Service and the taxpayer will determine a materiality threshold to be used during the examination. The IRM provides several key principles to determine materiality, including:

- (1) dollar amount;
- (2) permanency;
- (3) timing/deferral;
- (4) changes in accounting methods; and
- (5) specific activities of the taxpayer.<sup>105</sup>

The materiality thresholds are intended to provide some discipline around the scope of an examination and to keep all parties focused on completing the examination in a timely manner. The original vision for LIFE was to use the lowest dollar amount for each type of issue (timing, permanent, credits) selected for inclusion in the LIFE examination plan as the threshold in the MOU. However, based upon feedback from both internal and external sources, the Service

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101. In considering LIFE it is helpful to review “The Facts of LIFE” found at [www.irs.gov/Businesses/The-Facts-of-LIFE](http://www.irs.gov/Businesses/The-Facts-of-LIFE).

102. IRM 4.51.3.1.1 Introduction to the LIFE Process (01-01-2007).

103. IR-2002-133 (Dec. 4, 2002).

104. Available at [www.irs.gov/Businesses/Limited-Issue-Focused-Examination-\(LIFE\)](http://www.irs.gov/Businesses/Limited-Issue-Focused-Examination-(LIFE)); for an entertaining discussion of a review of LIFE, see William H. Quealy, Jr.’s article “Answers to LIFE’s frequently asked questions.”

105. IRM 4.1.5.1.5.1.1 Materiality Significance of the Issue (10-24-2006).

developed an alternative two-step process. First, once the risk analysis is complete the scope of the LIFE examination will be established. The scope is not determined or restricted by any dollar value threshold. The next step is separate and distinct. The team will determine thresholds to be used for any scope expansion by either party. This includes new issues raised by the Service and claims/affirmative issues raised by the taxpayer. The thresholds may be the lowest dollar value selected in the LIFE exam plan or another amount based on the examiner's professional judgment.

Once the risk analysis and materiality considerations are concluded the Service and the taxpayer enter into a formal agreement, the MOU. The MOU will contain dollar-limit thresholds (materiality), established on a case-by-case basis, below which the IRS will agree not to raise issues and the taxpayer will agree not to file claims. Regarding the MOU itself, if the taxpayer repeatedly breaches or a single "egregious" act occurs, this could be ground for termination of the LIFE process and a return to the traditional "broad-based" examination.<sup>106</sup> Clearly, it is in the interest of the parties to abide by the agreement. On the other hand, if the MOU is breached by the IRS and the team leader is unable to resolve the problem, the taxpayer may terminate the LIFE examination.<sup>107</sup> If the taxpayer's request for LIFE is denied it can be elevated up to the Team Manager or Territory Manager, but the taxpayer is not afforded a formal appeal with the IRS Appeals Office.<sup>108</sup>

The Examination Division wants LIFE to be considered on all Large Case examinations, even the largest CIC case. Materiality considerations, such as the timing versus permanent nature of an issue and its respective dollar value, will be utilized to select issues for the LIFE examination. Materiality thresholds do not need to be utilized for issue selection. Materiality thresholds do not impact whether an adjustment will be made after examining a LIFE issue. Thresholds do not apply to transactional or invoice level data an examiner will review in auditing a LIFE issue or the depth at which the issue will be examined. Materiality thresholds in the MOU will be utilized only to govern subsequent scope expansion after the Examination Plan is set. Expansion includes both the raising of new issues by the examiner and the filing claims and affirmative issues by the taxpayer. Unagreed rollover and recurring issues may be included in the LIFE Examination Plan regardless of any thresholds that will be established. Inclusion of these issues should be based on the risk analysis. This decision will be made before the thresholds in the MOU are determined. A full and

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106. IRS website, LIFE FAQs, question 7.

107. *Id.* at question 8.

108. Additional FAQs last updated Nov. 13, 2009.



robust risk analysis (a/k/a, pre-plan and preliminary audit steps) must be completed for the identification of large, unusual, and questionable items. The risk analysis and subsequent prioritization of issues are completed to determine if LIFE should be utilized, to set the scope of the exam, and to document the case file for quality standard purposes. LIFE may be used even when the examiner does not have a prior history with the taxpayer. If the risk analysis and taxpayer behavior at the beginning of the examination indicate the process is appropriate, then it can be utilized.

The MOU should not be entered into until the risk analysis process is complete and, for CIC cases, after the disclosure period is over. Claims and affirmative issues filed during the disclosure period and/or before the MOU is signed are not subject to materiality thresholds. Referrals to specialists must be made. All specialists will be involved in the risk analysis and the decision to use LIFE. LIFE does not dictate a specific cycle time (for example, eighteen months) for completion of the exam. LIFE focuses on examining the issues of greatest compliance risk and the cycle time needed to address only those issues. A thirty-day response time for IDRs is not a LIFE requirement. The response time can be more or less than thirty days; the examiner and the taxpayer must agree on a time frame. And finally, taxpayers who are examined under LIFE are not automatically entitled to a LIFE examination in the future—each year/cycle stands on its own and should be evaluated accordingly.

Since the inception of LIFE, agents are applying a “LIFE-Like” audit approach. In other words, the agents conduct a risk analysis and focus on the key issues without applying the formalities of the “LIFE” program. Although not technically sanctioned, it makes good practical sense and the key elements of LIFE can be extended outside of a formal MOU. Agents recognize that certain elements of a LIFE, such as establishing a limited focus of the examination, setting dates for submission of affirmative claims, getting commitments to complete the fact finding aspect of the examination, issue development by specific dates, and a commitment to pursue alternative dispute resolution are good business practices and can be incorporated into large case examinations. Whether formalized into the LIFE MOU, informally agreed to in the audit plan, or merely established by custom between the taxpayer and the exam team, the efficiency of the exam process in reaching a prompt conclusion depends in large degree upon maintaining a spirit of cooperation. The LIFE program formalizes many of the informal agreements and operating principles that have been the hallmark of successful exams. When conditions warrant, taxpayers who are willing to share a spirit of cooperation with their exam team should consider LIFE as a means to creating some efficiencies during the examination.

## **§ 7:9.8 Fast Track Dispute Resolution Program: Fast Track Settlement<sup>109</sup>**

### **[A] Overview**

FTS provides LB&I taxpayers the ability to resolve unagreed issues at the examination level with the assistance of an Appeals Officer. Working with the LB&I exam team and Appeals, taxpayers can request FTS which utilizes the settlement authority of Appeals to resolve factual and legal issues taking into account the hazards of litigation. The Fast Track process is intended to be completed within an average of ninety to 120 days.

One issue that previously caused agents and managers concern was the fact that an examiner's case was left open in the service's tracking system during the time it went to Fast Track Appeals—which was inconsistent with the currency initiatives and negatively impacted the closing date statistics. However, back in September 2010, the Service changed its internal procedures and used the closing date as of the time the case goes to Fast Track thereby providing additional incentives for agents and managers to request FTS. The Service has touted the FTS statistics of having a success rate in resolution of 80% or higher and believes that Fast Track is a win/win for the IRS and taxpayers.

### **[B] FTS Procedures**

In order to request Fast Track an issue has to be fully developed, the Service must have issued a NOPA (Form 5701) but not issued a thirty-day letter, and the taxpayer must have issued a written response to the NOPA. Either the taxpayer or the Service may request FTS; however, it requires mutual agreement and in light of the EDC change it is hopeful that more agents will agree. Once agreed to, the parties must submit a Fast Track Agreement form, the NOPA, and the taxpayer's written response to the NOPA. Historically, the Service has been encouraging its managers to consider ADRs, practically speaking; it has not been too difficult to get the local team to agree to participate in the Fast Track process. Large caseloads, overaged cases, and resource issues are all motivating factors encouraging FTS. A work of caution, however: it takes both sides to agree to a resolution and if the Revenue Agent and case manager are wed to their position and only going through the motions the taxpayer may be wasting its time and money in the

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109. Rev. Proc. 2003-40, 2003-25 I.R.B. 1044; *see* IRM 8.26.1 Fast Track Settlement for Large Business and International (LB&I) Taxpayers (09-24-2013).

process. Remember the decision maker for the Service is the exam team. The exam team does not have to agree to the settlement proposals or the Appeals Officers recommendations. Do not make the mistake of taking the wrong case to Fast Track. If the case manager and agent have strong views on the issues or the relationship between the parties is volatile or distrusting the taxpayer may not be able to get the exam team to agree to anything let alone a favorable settlement. It is important throughout the process to get the local exam team to buy into the process to achieve the desired result of an agreed case. There are times to request upper management involvement in an examination—this may be one time you should consider getting their input before moving forward with FTS.

At the initiation of the Fast Track process the Appeals Officer will explain the procedures he or she will follow during the process. Both parties will have the opportunity to present their facts, witnesses (if any) and legal positions. The Appeals Officer will have an opportunity to ask questions of either side. In practice the process is very informal and the Appeals Officer and the parties can agree ahead of time as to the process, such as which side will present its arguments first, possible use of witnesses or experts or presentation of documentation. After an opening session, it is typical for the parties to separate into different rooms and the Appeals Officer will move from room to room to discuss the issues, hazards of litigation and potential settlement. Often the Appeals Officer will point out weaknesses and explore possible settlement proposals until it becomes clear that the parties have reached or cannot reach agreement. The Appeals Officer will first attempt to facilitate an agreement between the parties, but in Fast Track Settlement the Appeals Officer has the authority to ultimately make a recommendation regarding the settlement of any or all issues.

It is important to note that both the taxpayer and the Service must have someone in the room with decision-making authority that can authorize the settlement. Having the ultimate decision-maker from both sides sitting in the room and listening to the presentations, creates a change in the dynamics that tends to alter the course of settlement discussions. Typically, the IRS focuses on the legal and factual issues, whereas the taxpayer takes a more practical and business approach and looks toward the financial impact of a potential resolution or potential impact on staffing, impact on state or foreign returns, and other non-tax matters as well as the merits of the issue. If the settlement is acceptable to both parties, the Appeals Officer will draft a written settlement agreement for the parties' execution. Typically, the parties document the basis of settlement followed by a Form 870-AD or 906, Closing Agreement on Final Determination Covering Specific Matters, once the tax computations have been agreed upon. However, it should be noted that if the case is subject to Joint

Committee review, the examination team will prepare a report to apprise the Joint Committee of the Appeals evaluation and settlement of the LB&I Fast Track issues. Historically, the Fast Track program has been very successful. If, however, the settlement is not acceptable, the taxpayer retains all the traditional rights of Appeals consideration. Many practitioners view Fast Track as a second bite of Appeals consideration.

As with any dispute resolution program, there are pros and cons for taxpayers and Fast Track may not be the best choice. For example, if the taxpayer expects a full concession on the issues, having the examination team sitting in the room during the negotiations may not generate that result. Fast Track involves having all of the relevant IRS personnel in the room with the Appeals Officer. Not only will the Revenue Agent and Case Manager be present and actively involved, but the IRS may also bring in its specialists, economists, Technical Advisors, engineers and/or its counsel. Depending upon the facts and law this may be a good or not so good thing.<sup>110</sup>

After an opening session, in which each side presents their interpretation of the relevant facts and law together with a brief joint session discussing the case, it is typical for the parties to separate into different rooms and the Appeals Officer will move from room to room to discuss the issues, hazards of litigation, and potential settlement. Often the Appeals Officer(s) will point out weaknesses and explore possible settlement proposals until it becomes clear that the parties have reached or cannot reach agreement. In contrast, submitting a Protest and requesting traditional Appeals affords the taxpayer the ability to have a more traditional one-on-one conversation with the Appeals Officer without the input or participation of the exam team throughout the process.

In FTS, an Appeals Officer can settle both legal as well as factual issues in Settlement. Taxpayer will have the opportunity to learn from the Appeals Officer's opinions and conclusions based upon the information presented during the process. In FTS, the Appeals Officer can recommend a settlement based upon his or her views of the hazards of litigation. It is important to note that this is a voluntary non-binding process on all parties, the examination team, the taxpayer, and the Appeals Officer. The Appeals Officer's settlement offer is also non-binding and the IRS or the taxpayer may decline the offer and request a thirty-day letter. If the FTS is unsuccessful or terminated or any reason the taxpayer still retains its rights to request Appeals

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110. Ex parte communications as discussed in chapter 14, Administrative Appeal, must be waived as part of the Fast Track process.

consideration for any unagreed issues. If the parties are unsuccessful in resolving the matter and the taxpayer is happy with the Appeals Officer, the taxpayer can request that the case be assigned to the Appeals Officer after the thirty-day letter and protest are prepared. Although there are no procedures in place requiring Appeals to assign the same Appeals Officer, it is discretionary. If the taxpayer would prefer to have a different Appeals Officer they would just file the protest and it should be assigned to another Appeals Officer.

Fast Track can save both time and money and provides a confidential forum and flexible process to reach resolution. FTS is a program that provides a confidential forum to air tax disputes where sensitive financial information or privacy issues are at stake and is covered by the confidentiality provisions of section 6103. Since Fast Track takes place prior to the issuance of a thirty-day letter, early resolution eliminates the potential of “hot interest.”<sup>111</sup> Remember, Fast Track is non-binding and either party can terminate the process at any point in the process. Based upon experience, with the right set of facts and law, FTS can be highly successful and worth considering for taxpayers.

### § 7:9.9 Post-Appeals Mediation

Post-Appeals Mediation<sup>112</sup> is available to all taxpayers.<sup>113</sup> Its objective is to assist the parties, through mediation, in resolving issues remaining unresolved after traditional, yet unsuccessful Appeals consideration of the case. Similar to FTS, the process is voluntary, optional, nonbinding, nonprecedential, and confidential. It is commenced by the taxpayer’s submission of a written request, which must be approved by an Appeals Team Case Leader or Appeals Team Manager.

Issues eligible for mediation include legal issues, factual issues, industry specialization issues, Compliance Coordinated Issues (CCI) or Appeals Coordinated Issues (ACI),<sup>114</sup> early referral issues, issues for

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111. “Hot interest” is defined as the additional accrual of increased interest on large corporate underpayments under I.R.C. § 6621(c).

112. Rev. Proc. 2009-44, 2009-40 I.R.B. 462 *supersedes* Rev. Proc. 2002-44, 2002-2 C.B. 10, which established the mediation procedure for cases in Appeals. The procedure, which expands and clarifies the types of cases that may be mediated in Appeals, is effective October 5, 2009. *See also* IRM 8.26.5.1 Introduction to Post-Appeals Mediation Procedures for Non-Collection Cases (Mediation) (08-27-2010).

113. For additional information, see chapter 14, Administrative Appeal.

114. Caveat: Post-Appeals Mediation is not available where the taxpayer has declined the opportunity to discuss the CCI or ACI issue with the Appeals CCI or ACI coordinator during the course of regular Appeals settlement discussions.

which a request for Competent Authority assistance has not yet been filed, cases in which attempts to enter into a closing agreement under section 7121 have been unsuccessful, and Offer in Compromise and Trust Fund recovery penalty cases as provided for in Announcement 2008-111,<sup>115</sup> or any subsequent guidance issued by the IRS.

Issues that are ineligible include collection issues, issues for which mediation would be inconsistent with principles of sound tax administration, and issues with respect to which the taxpayer did not act in good faith during the normal appeals process. Ineligible issues include those designated for litigation; docketed cases; collection cases, except for certain offer in compromise and trust fund recovery penalty cases as provided for in Announcement 2008-111 or any subsequent guidance issued by IRS; issues for which mediation would not be consistent with sound tax administration; frivolous issues; “whipsaw” issues, such as issues for which resolution with respect to one party might result in inconsistent treatment in the absence of the participation of another party; cases in which the taxpayer did not act in good faith during settlement negotiations; and issues that have been otherwise identified in subsequent guidance issued by the IRS as excluded from the mediation program.

If Appeals approves the request, the parties are expected to sign a mediation agreement within three weeks setting forth the issues for mediation and the ground rules of the mediation, and mediation must commence within sixty days thereafter. The use of an Appeals mediator is mandatory. However, at the taxpayer’s option and with IRS consent, a third-party co-mediator may also be employed at the taxpayer’s expense.

Prior to the mediation, the parties provide the mediator(s) with a pre-mediation submission, consisting of a brief discussion of facts and law and accompanied by exhibits, if any. The mediation typically involves one or more sessions. Similar to the Fast Track process, the parties make opening statements in a joint session and then have an opportunity to conference privately with the mediator(s).

As with Fast Track, the mediation process is very informal and flexible, and the mediator and the parties can agree ahead of time as to the process, such as which side will present their arguments first, and the possible use of witnesses or experts or presentation of documentation. After an opening session, it is typical for the parties to separate into different rooms and the mediator will move from room to room to discuss the issues, hazards of litigation and potential settlement. Often the mediator(s) will point out weaknesses and

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115. Ann. 2008-111, 2008-48 I.R.B. 1224.

explore possible settlement proposals until it becomes clear that the parties have reached or cannot reach agreement.

It is important to note that both the taxpayer and the Service must have someone in the room with decision-making authority that can authorize the settlement. Typically, the IRS focuses on the legal and factual issues, whereas the taxpayer tends to focus on the bottom line impact and takes a more practical and business approach by considering the financial impact of a potential resolution, potential impact on staffing, impact on state or foreign returns, and other non-tax matters in reaching the decision. In Post-Appeals Mediation the taxpayer has the option to select an outside mediator (non-IRS Appeals Officer) that will be a co-mediator with the Appeals Mediator. If the taxpayer chooses to go with an outside Mediator, the taxpayer will incur the expense of any mediator fees and other costs.<sup>116</sup> The working relationship between the IRS Appeals Mediator and the Outside Mediation is important for a successful resolution. Therefore, the taxpayer's selection is an important element in the success or failure of the process.

As with any dispute resolution program, there are pros and cons to consider for Post-Appeals Mediation. One of the key issues is litigation. If the parties are unable to settle, the parties will have no other option but to litigate their positions. However, this is usually a concern for the taxpayer not the government. Typically, taxpayers do not want to incur the additional cost of litigation and the potential for having the issue remain unresolved for many years to come, whereas the Appeals Officer is usually indifferent to the prospect of future litigation. If the issue is unresolved, the Appeals Officer will close the case and the litigation will be assigned either to an Area Counsel attorney or Department of Justice (DOJ) attorney. There is little incentive for the Appeals Officer not to litigate.

Litigation is usually a lengthy and costly process for taxpayers. An administrative appeal through mediation can be a good alternative to litigation. As with any settlement, however, the parties need to take a reasonable approach and properly assess the hazards of litigation before starting the process.

One key consideration for large companies is the issue of confidentiality. Appeals Mediation provides a confidential forum and any discussions are protected by section 6103, whereas litigation is a public forum and the company's tax returns and other business

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116. See 2009 TNT 175-8, *Why Post-Appeal Mediation Isn't Working and How to Fix It*, by Carolyn Miller Parr (former Tax Court Judge), August 24, 2009. Judge Parr provides her perspective and opinions on how post-appeal mediation can be improved at the IRS.

information will be part of the public record. This factor alone has caused companies to administratively resolve their tax matters.

At the conclusion of a successful mediation, the mediator(s) prepares a report indicating which issues, if any, have been resolved. Normal Appeals case-closing procedures apply. If the mediation was unsuccessful, the taxpayer can expect to receive either a ninety-day letter (deficiency notice) or claim disallowance.<sup>117</sup> Even if the parties were not able to reach a resolution the mediation process is very helpful in gauging the hazards of litigation and discovering the parties' strengths and weaknesses—sort of a preview into litigation.

### **§ 7:9.10 Appeals Arbitration**

On October 18, 2006, the Service announced that its pilot Appeals arbitration process was to become permanent.<sup>118</sup> Notice 2000-4<sup>119</sup> previously established a pilot program for cases in Appeals in which a taxpayer and the IRS could jointly request binding arbitration on certain unresolved factual issues. When a limited number of factual issues remain unresolved during the course of an appeal, the taxpayer or the IRS can request arbitration and jointly select an Appeals or a non-IRS Arbitrator from any local or national organization that provides a roster of neutrals.

The permanent arbitration procedure may be used to resolve issues while a case is in Appeals, after settlement discussions are unsuccessful and, generally, when all other issues are resolved except specific factual issues for which arbitration is being requested.

Arbitration is a voluntary procedure and is only available for factual issues. It is not available for legal issues, issues already in any court, issues in a taxpayer's case designated for litigation, and collection cases, with certain exceptions. Revenue Procedure 2006-44<sup>120</sup> sets forth the requirements and procedures. The key distinction between mediation and arbitration is the fact that arbitration is final and the parties may not appeal the decision. This fact alone has scared most parties away from the use of arbitration.

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117. Keep in mind that all is not lost; mediation is also available for docketed Tax Court, U.S. Court of Federal Claims and District Court cases. T.C. Rule 124 and CCDM 35.11.1-118 (Model Agreement to Mediate) (02-28-2014). *See also* chapter 15, Tax Court Litigation and Claims for Refunds.

118. Ann. 2008-111, 2008-48 I.R.B. 1224; IRM 8.26.6.1 Introduction to Appeals Arbitration Procedures for Non-Collection Cases (08-07-2009).

119. 2001-1 C.B. 313.

120. Rev. Proc. 2006-44, 2006-2 C.B. 800. *See also* Ann. 2008-111, 2008-48 I.R.B. 1224, IRM 8.26.6.1 Introduction to Appeals Arbitration Procedures for Non-Collection Cases (08-07-2009); and IRM 35.5.5.1 Voluntary Binding Arbitration (12-14-2010).



**§ 7:9.11 Early Referral Program**

The Early Referral Program<sup>121</sup> allows LB&I taxpayers to request an Appeals Officer to review and determine a particular issue even though the examination of the taxpayer's return is not yet complete. In order to qualify for this program, the issue must be fully developed and, if resolved, can be reasonably expected to result in a quicker resolution of the entire case. Early referral is available on an issue-by-issue basis, whereas Fast Track Settlement requires that all issues have been concluded at the time of the request for FTS. Also, once an issue is sent to Appeals under the Early Referral program, the issue leaves the jurisdiction of Examination and is assigned to Appeals, whereas in FTS, Examination retains jurisdiction throughout the process.

The taxpayer needs to submit a written request to the Case Manager setting forth the issue(s) and positions of both the taxpayer and the Service. The Case Manager will notify the taxpayer within fourteen days if the request is accepted or rejected. Once accepted, the NOPA and the taxpayer's response will be sent to Appeals for consideration and resolution. Appeals will then take jurisdiction over the issues accepted for early referral. All other issues remain in Examination. The revenue procedure provides that the taxpayer's written response generally serves the same purpose as an Appeals protest.

If an agreement is reached with respect to an early referral issue, generally, a Form 906, Closing Agreement on Final Determination Covering Specific Matters, is prepared. It should be noted that any issue settled and paid prior to the issuance of a thirty-day or ninety-day letter under this early referral procedure will be resolved without hot interest. This may be a huge benefit to a taxpayer if the adjustments are large. If early referral negotiations are unsuccessful and an agreement is not reached with respect to an early referral issue, Revenue Procedure 99-28 allows a taxpayer to request mediation for the issue, provided the issue(s) meets the requirements for mediation. If the taxpayer does not request mediation, the Appeals Officer will close the file and return jurisdiction over the issue to Examination. It should be noted that Appeals will not reconsider an unagreed early referral issue if the entire case is later protested to Appeals, unless there has been a substantial change in the circumstances regarding the issue. If the issue remains unagreed the Service will issue a Statutory Notice of Deficiency.

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121. Rev. Proc. 99-28, 1999-2 C.B. 109, which superseded Rev. Proc. 96-9, 1996-1 C.B. 575, and IRM 8.26.4.1 Overview of the Early Referral (ER) Program (10-26-2007).

**§ 7:9.12 Comprehensive Case Resolution (CCR)<sup>122</sup>**

Although this program is still on the books, it is not commonly used. The goal of the Comprehensive Case Resolution (CCR) program is to help LB&I taxpayers that have tax years under examination and in Appeals (including docketed cases under Appeals jurisdiction) resolve all open issues in all such years through a CCR process.<sup>123</sup> The effect of this program will be to expedite the resolution of all years under examination, in Appeals, and in docketed status before the Tax Court, through an IRS team process. The CCR process will constitute the taxpayer's formal administrative appeal for the LB&I years. The program's goal is to resolve all tax controversies, without litigation, on a basis that is fair and impartial to both the government and the taxpayer. The CCR process typically involves aggressive timelines for completion, with a target of closing all years within six to twelve months. If agreement cannot be reached using the CCR process, Appeals will not reconsider the unagreed issues from the years under examination by LB&I.

CCR is a voluntary process. LB&I taxpayers that have substantially completed their examination may request to participate in this program.<sup>124</sup> "Substantially complete" means: (1) audit work on all significant issues is complete and the taxpayer has indicated agreement or disagreement with each proposed adjustment; and (2) all claims and affirmative issues have been raised by the taxpayer and audited. For taxpayers accepted into the program, the IRS will not issue a "thirty-day letter," for the years currently under examination by LB&I upon commencement of the program. Accordingly, for those years, the accrual of increased interest—hot interest—on large corporate underpayments under section 6621(c) will not begin at that time. However, if those years are not resolved within twelve months after the initial issue discussion conference is held under the pilot program, the IRS will issue a thirty-day letter to begin the accrual of interest at the

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122. Notice 2001-13, 2001-1 C.B. 514.

123. In some situations it may also be appropriate to include tax years which are docketed before the Tax Court and not under Appeals' jurisdiction.

124. Taxpayers may withdraw from the pilot program by submitting a written request, but only within thirty days after acceptance into the program or twenty days after the initial planning meeting, whichever is later. Thereafter, with respect to the years under LMSB jurisdiction at the time of application for the pilot program, the process will be completed with a total or partial agreement or issuance of a statutory notice of deficiency. A taxpayer's withdrawal from the pilot program returns each open year to the jurisdiction of the IRS function it was under prior to acceptance into the pilot program. Taxpayers will be afforded administrative appeal on the years under LMSB jurisdiction as if the taxpayer had not applied for the pilot program.

increased rate. The program is intended to reduce costs, burden, and delays by expediting completion of these cases through a cooperative effort.

### **[A] Industry Issue Resolution Program**

The Service developed the Industry Issue Resolution (IIR) Program<sup>125</sup> to work with business taxpayers, industry associations, taxpayer representatives, and other interested parties to identify frequently disputed tax issues common to a significant number of business taxpayers and to resolve those issues through published or administrative guidance. IRS solicits suggestions for issues from taxpayers, representatives and associations for the IIR Program. The Pilot Program<sup>126</sup> first began in 2000 and in 2002 was made permanent<sup>127</sup> and expanded the Program to identify and resolve frequently disputed issues common to any size business taxpayers and to address opportunities to reduce burden for all business taxpayers. The LB&I and the Small Business and Self-Employed Division (SB/SE) share operational responsibility for the IIR Program.<sup>128</sup> (10-28-2010)

Business tax issues appropriate for the program must have at least two of these characteristics:

- The proper tax treatment of a common factual situation is uncertain.
- The uncertainty results in frequent, and often repetitive, examinations of the same issue.
- The uncertainty results in taxpayer burden.
- The issue is significant and impacts a large number of taxpayers, either within an industry or across industry lines.
- The issue requires extensive factual development, and an understanding of industry practices and views concerning the issue would assist the Service in determining the proper tax treatment.

Whereas the IIR Program is not appropriate for resolving the following types of business tax issues:

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125. IRM 32.4.3.1 Industry Issue Resolution Program (10-28-2010).

126. Notice 2000-65, 2000-2 C.B. 599.

127. Notice 2002-20, 2002-17 I.R.B. 796.

128. Revenue Procedure 2003-36, 2003-18 I.R.B. 859, sets forth the procedures for business taxpayers, industry associations, and other interested parties to submit issues for consideration under the IIR program. See Notice 2005-59 provides information about additional criteria that will be applied in considering proposals regarding accountable plans for the Internal Revenue Service's Industry Issue Resolution (IIR) program.

- Issues unique to one or a small number of taxpayers.
- Issues that are primarily under the jurisdiction of the Operating Divisions of the Service other than the LB&I and SB/SE Divisions.
- Issues that involve transactions that lack a bona fide business purpose, or transactions with a significant purpose of improperly reducing or avoiding federal taxes.
- Issues involving transfer pricing or international tax treaties.

**[A][1] How the IIR Process Works**

Business taxpayers, industry associations, and other interested parties may submit issues for resolution at any time. LB&I, SB/SE, Appeals, Chief Counsel and Treasury screen, evaluate and select the issues. Factors that influence the decision may include the appropriateness of the issue for the program and whether the requested guidance promotes sound tax administration. Issues reviewed and IIR projects selected are announced publicly.

Once approved, an IIR team is formed. The IRS's team's role includes fact-finding, evaluating input, and recommending guidance to resolve the issue. Team members typically include representatives of SB/SE, LB&I, Chief Counsel, Appeals, and Treasury. The industry representative and other interested parties will provide the relevant facts and support and provide suggested resolutions to the issue. The industry representatives will work with the IRS team in development of the issue and discuss proposed guidance. Resolution of an issue is generally through IRS published guidance, typically a revenue ruling and/or revenue procedure, but may include administrative guidance.

**[A][2] Practical Aspects of IIR**

Putting together a coalition of taxpayers—industry members—to come together with a unified goal, then approaching and working with the Service, can be a difficult task. There are many challenges such as whether the industry has similar enough facts and goals to make the resolution feasible. In addition, there are logistics to work out such as who will take the lead, if there will be one or more representatives, how will the cost be divided among the group, and what is in the best interest of the group as a whole versus a minority of the group, and what proposal will the coalition offer to the Service. Another factor that should not be overlooked is whether the industry members will be willing to disclose specifics to the Service and other coalition members in a pre-filing environment in order to obtain certainty about the transaction or issue.

**§ 7:9.13 Advanced Pricing Agreements (APA)<sup>129</sup>**

Intercompany pricing disputes can be very time-consuming and expensive both within the United States and globally. The Advanced Pricing Agreements (APA)<sup>130</sup> process allows taxpayers and the Service to agree on intercompany pricing (Transfer) Pricing issues pursuant to section 482 and relevant income tax treaties to which the United States is a party, and in addition, gives the taxpayer certainty of tax treatment for future tax years. Taxpayers may negotiate a unilateral APA (involving only the taxpayer and the IRS) or a bilateral or multilateral APA (agreement between the taxpayer and one or more foreign tax administrations under the authority of the mutual agreement procedure (MAP) specified in income tax treaties). In a unilateral APA, the two parties negotiate an appropriate Transfer Pricing Method for U.S. tax purposes only. Should the taxpayer be involved in a dispute with a foreign tax administration regarding the covered transactions, the taxpayer may then seek relief by requesting that the U.S. Competent Authority initiate a mutual agreement proceeding. This assumes, of course, that there is an applicable income tax treaty in force with the foreign country. Bilateral or multilateral APAs would include agreements between the taxpayer and one or more foreign tax administrations under the authority of the MAP specified in income tax treaties. The taxpayer benefits from such agreements, since it is assured that income associated with covered transactions is not subject to double taxation by the IRS and relevant foreign tax authorities. The IRS encourages taxpayers to seek bilateral or multilateral APAs where competent authority provisions exist. The APA process can be lengthy and costly, but provides certainty on usually large-dollar issues.

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129. The IRS website contains APA relevant Program Documents (Annual Report Summary Form, Issue/Industry Coordination Teams, Announcement 2004-98: APA Program Public Hearings, APA Program Public Hearings—Written Comments, Training Materials, APA Case Management Procedures, Annual APA Statutory Reports, Quarterly Reports), which is a good reference source.
130. Since 1991, with the issuance of Rev. Proc. 91-22, 1991-1 C.B. 526, the Service has offered taxpayers, through the APA Program, the opportunity to reach agreement in advance of filing a tax return on the appropriate transfer pricing method to be applied to related party transactions. In 1996, the Service updated and superseded Rev. Proc. 91-22 with the release of Rev. Proc. 96-53, 1996-2 C.B. 375. On July 1, 2004, the Service updated and superseded Rev. Proc. 96-53 by issuing Rev. Proc. 2004-40, 2004-2 C.B. 50. On December 19, 2005, the Service again updated the procedural rules for processing and administering APAs with the release of Rev. Proc. 2006-9, 2006-1 C.B. 278, *superseding* Rev. Proc. 2004-40, 2004-2 C.B. 50 and on June 9, 2008, the Service issued Rev. Proc. 2008-31, 2008-1 C.B. 1133.

The APA process allows the taxpayer and the Service to agree on intercompany transactions and appropriate Transfer Pricing methods to be applied to allocating income, deductions, credits or allowances among two or more controlled organizations. It provides for an expected range of results from applying the agreed upon Transfer Pricing methodology to a company's transactions. The APA is a binding agreement between the taxpayer and the Service for the taxable years and transactions covered by the agreement. However, the APA agreement only applies to the taxpayer requesting the APA and only for the years and transactions covered by the agreement. Another key benefit for taxpayers is that the APA process is confidential and protected by section 6103.

The primary benefit of seeking an APA is certainty with respect to an identified set of transactions for a defined term of years. As long as the taxpayer complies with the terms and conditions of the APA, the IRS will treat the results as satisfying the arm's-length standard, and will not contest the matters covered by the APA. With regard to transactions, taxable years, and entities not covered by the APA, the APA has no legal effect, and the taxpayer remains subject to potential exposure. A bilateral or multilateral APA will be binding between the taxpayer; any covered affiliates, the IRS, and identified foreign taxing jurisdictions. The scope of the certainty given by the APA includes:

- (1) the predictability of the tax treatment of covered transactions, both as to the amount and characterization of items of income;
- (2) avoidance of time consuming U.S. or foreign tax examination and controversy procedures for the covered transactions;
- (3) elimination of the risk of potential penalties applicable to substantial tax understatements;
- (4) a narrowing of record-keeping obligations that might otherwise apply;
- (5) elimination of exposure to whipsaws relating to different U.S. and foreign tax law provisions governing the payment of interest on deficiencies or refunds and to statute of limitations problems that can arise in Competent Authority (CA) negotiations; and
- (6) reduction of tax reserves on financial statements that might otherwise apply to the covered transactions.

#### **[A] The APA Process: Pre-Filing Conference**

Taxpayers may request a pre-filing conference to explore the possibility of an APA and determine whether the process is appropriate

for their situation either on a no name or named basis (with full disclosure of the taxpayer's identity). However, before initiating a pre-filing conference, the taxpayer should carefully consider whether its facts are suitable for an APA as well as the consequences of requesting a pre-filing conference and the filing of an APA. Many taxpayers have concerns about making voluntary disclosures to the IRS prior to receiving any commitments as to the approach. Once initiated the APA process requires a taxpayer to voluntarily come forward and make numerous disclosures with no assurance there will be an agreement. The taxpayer may be exposing itself to adjustments for all open years and handing the IRS a case on a silver platter. Other taxpayers have a strong corporate environment for privacy, especially with regard to sensitive business information that may be regarded as trade secrets.<sup>131</sup> There is a lot of strategy involved in determining whether an APA is the best choice for a taxpayer. Taxpayers should consider all of their options for both U.S. tax law and foreign jurisdictions as well as any business implications before making a final determination as to how to proceed.

Prior to moving forward with an APA the company and its advisors should carefully consider what the scope of the APA will entail including:

- (1) What will be the covered transactions;
- (2) What transfer pricing methodology will it be proposing;
- (3) Whether that methodology will be acceptable to the Service;
- (4) Will there be any material changes to the company's business structure that will impact the covered transactions at issue for the term of the APA;
- (5) Will the company be able to monitor the result of the APA in order to file Annual Reports;

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131. Concerns about the disclosure of sensitive commercial data or trade secrets are expressly addressed in Rev. Proc. 2006-9, 2006-1 C.B. 278 *as modified* by Rev. Proc. 2008-31 (*see* the proposed Rev. Proc. issued on November 22, 2013). Section 13 of Rev. Proc. 2006-9 states that the IRS considers information submitted pursuant to the APA process to be tax return information protected from disclosure by reason of I.R.C. § 6103 to the same extent that information submitted by the taxpayer as part of an IRS examination would be protected from disclosure. In addition, any information disclosed to a treaty partner as part of the APA process would be subject to the further confidentiality requirements imposed by the U.S. treaties. Most treaties generally provide that information exchanged by the competent authorities under the treaty shall be considered secret and may be used by tax officials of the country receiving the information solely for purposes of administering that country's tax laws. *See, e.g.*, U.S. Model Income Tax Convention, Article 26.

- (6) Does the company want to expand the scope of the APA to include any rollback years (open taxable years prior to the initiation of the APA);
- (7) Upon what Critical Assumptions will the APA be predicated; and
- (8) Does the company have the time and resources to commit to the APA process?

Before initiating a pre-filing conference, a taxpayer should carefully consider the information that it intends to present. This consideration includes defining the factual as well as non-factual matters that will need to be submitted. Since there is no protection for factual matters submitted by the taxpayer, the taxpayer should carefully determine in advance the factual matters to be submitted at each stage of the proceeding and limit such submissions to those that are necessary to explain and justify the taxpayer's position. The lack of protection for factual matters stems from the IRS's view that the IRS would have the authority, under section 7602, as part of an examination of the taxpayer's return, to obtain any factual information that may be relevant to determining the taxpayer's liability. Some taxpayers in the APA process have experienced situations where the international examiners and IRS economists often focus on factual issues that taxpayers believe are irrelevant to a determination of the proper tax liability. As a result, some taxpayers believe that they can obtain a better result at Appeals or in litigation by responding solely to IRS requests for information. Yet, having control over the initial presentation of facts in the APA process provides many taxpayers with an opportunity to resolve issues that might not be resolved in the other contexts.

At the conclusion of the Pre-Filing Conference, the taxpayer should always document its understanding of the discussions and any agreements reached with the APA team. That document may be used for internal purposes or with the intent of exchanging with the APA team as a basis of the submission that will be forthcoming. Although not legally binding it sets the groundwork for the next stage.

### **[B] The APA Process: APA Submission**

After the pre-filing conference, a taxpayer submits a formal APA request supported by relevant facts and data. It should be noted that a taxpayer is not required to request a pre-filing conference, rather they can choose to file the APA submission directly. The APA request must also contain detailed information relating to the parties to the transactions and the proposed Transfer Pricing method. During the APA process, the taxpayer proposes a methodology to the Service with regard to



specific transactions with its affiliates and provides substantial data, including comparable pricing data from independent transactions, showing that the methodology will produce arm's-length results, the parties enter into a written APA applying the Transfer Pricing methodology to the specific transactions. In addition, the APA can cover the expected results of the application of the methodology to the specific transactions.

#### **PRACTICE POINTER**

Although costly, making an investment on the front end to gather relevant facts, interview key company individuals, and obtaining a comprehensive understanding of the company's business and the impact on the covered transactions will pay off in the end as it will increase the ability to achieve a successful and cost-effective result. It is important to present a solid functional analysis (functions performed, assets employed and risks relating to the covered transactions) of relevant business operations of the taxpayer and its related party entities. In addition, applying defensible criteria for selecting comparables, establishing accounting protocols used in any segmenting data, and providing a rationale for any Critical Assumptions which could affect the methodology used for the Covered Transactions are all key factors in presenting an acceptable APA.

The APA can also be extended to a third country with which the United States has an income tax treaty. The APA is binding on the parties, usually for three years, but possibly for a longer or shorter period as set forth in the agreement. The APA process will consist of multiple meetings and negotiations and the APA team typically requests follow-up submissions. Don't be surprised if the APA team pushes back and requests taxpayers to represent why the company is requesting a unilateral APA rather than a bilateral APA. Historically, the Service has accepted the position that the treaty country is reluctant to participate in bilateral negotiations, the magnitude of the amount of countries impacted, and the small size of the company (in other words, a bilateral would significantly increase the cost, making the APA process prohibitive to the requesting taxpayer).

If successful, the parties will memorialize the terms in a written agreement and may enter into a Form 906, Closing Agreement on Final Determination Covering Specific Matters, setting forth the parties to the agreement, the transactions covered in the agreed-upon Transfer Pricing method, a range of expected arm's-length

results, a means of testing compliance during the APA term, and will incorporate the Critical Assumptions which could cause the parties to reexamine the appropriateness of continuing the APA.<sup>132</sup> If unsuccessful, the taxpayer may withdraw from the process and the Service may initiate a traditional examination.

### **[C] The APA Process: APA Annual Report**

For each year covered by the APA, the taxpayer must submit an annual report describing the taxpayer's actual operations for the year and demonstrating compliance with the APA. The report should include any requests for renewal, modification, or cancellation the APA. Failure to timely file the annual report is grounds for the IRS's decision to cancel the APA.

### **§ 7:9.14 APAs: Rollback of Transfer Pricing Method**

A taxpayer's analysis of its Transfer Pricing practices and the decision to seek an APA should involve not only future impact, but also the impact on all open years. The taxpayer should be aware that by entering into the APA Program it may be risking raising any weaknesses in its past open tax years. Taxpayers should carefully consider the benefits and risks to all open years. After a thorough analysis, the taxpayer may request a rollback of the Transfer Pricing method in connection with its APA request to prior year tax years where the U.S. statute of limitations remains open. Additionally, the Service may determine that the agreement's Transfer Pricing method should be applied to the earlier years, even though the taxpayer has not made a rollback request. Typically, a local international revenue agent is assigned to the APA team and can make recommendations regarding the rollback years. Adjustments to reflect different facts, economics, and rules and regulations for the rollback period may be made whether the taxpayer or the Service initiated the rollback request. The taxpayer's rollback request may be made any time before the execution of the agreement. This request must be made on a case-by-case determination and can be a double-edged sword if the treatment in the APA years would not be beneficial in the back years.<sup>133</sup>

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132. See Appendix A of Rev. Proc. 2006-9 as modified by 2008-31.

133. Rollbacks requested for bilateral or multilateral agreements are applications for accelerated competent authority consideration, as described in Rev. Proc. 2006-54, Section 7.06, 2006-2 C.B. 1035, and must include all required information. Such requests involving a taxable year under the jurisdiction of Appeals constitute an application for simultaneous Appeals and competent authority consideration, as described by Rev. Proc. 2006-54, Section 8. Rev. Proc. 2006-9, 2006-9 I.R.B. 278 as modified by Rev. Proc. 2008-31.

### **§ 7:9.15 Advance Pricing and Mutual Agreement Program<sup>134</sup>**

On March 27, 2012, the Service announced an organizational and administrative change with the creation of the APMA program.<sup>135</sup> Previously the APA program was part of the IRS Office of the Associate Chief Counsel (International) and the functions of the U.S. Competent Authority were generally exercised by the office of the Director, Competent Authority & International Coordination within the LB&I Division of the IRS. However, effective February 26, 2012, the APA program and Competent Authority functions (including mutual agreement procedures) related to transfer pricing and other allocation issues as well as determinations of permanent establishment status were realigned and consolidated into APMA which is a single program within the LB&I division.

The Director of APMA reports to the Director, Transfer Pricing Operations. Under this IRS function realignment, the administration of requests for Competent Authority assistance is shared by two separate units within LB&I.

- Requests for APAs or regarding other transfer pricing, permanent establishment and allocation issues are addressed by APMA.
- Competent Authority requests regarding non-allocation issues are addressed by the LB&I Treaty Assistance and Interpretation team.

### **§ 7:9.16 Competent Authority Process**

U.S. income tax treaties provide for mutual agreement procedure (MAP) authorizing the government representatives to resolve cases of double taxation resulting from different applications of the treaty provisions resulting in double taxation. There are two possible means to eliminate double taxation. The first is the ability to receive bilateral treaty relief and the second is to receive unilateral relief through the foreign tax credit system. Taxpayers can receive relief by requesting the competent authorities to negotiate the proper allocation of income between the related parties within their respective countries or request relief solely to obtain a correlative relief to offset an allocation.

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134. Pending issuance of future IRS guidance, taxpayers are directed to continue to follow and rely on Rev. Proc. 2006-9, as modified by Rev. Proc. 2008-31, with respect to requests for APAs and Rev. Proc. 2006-54, with respect to requests for Competent Authority assistance. *Note:* the Service released a draft revenue procedure on November 22, 2013.

135. IR-2012-38 (Mar. 27, 2012).

A Competent Authority Agreement is a bilateral agreement between the United States and the treaty country partner to clarify or interpret treaty provisions. The United States has concluded bilateral tax treaties with over sixty countries around the world. These treaties typically include an administrative provision called the MAP, through which the competent authorities of the two treaty partners may consult together to mutually resolve differences in interpretation or application of the treaty and to prevent double taxation of the residents or nationals that are covered by the treaty. A taxpayer should make its request for Competent Authority consideration as soon as it has been denied treaty benefits or the actions of both the United States and the foreign country which have resulted in double taxation or will result in taxation not intended by the treaty. Except where otherwise provided in an applicable treaty, taxpayers have discretion over the time for filing a request; however, delays in filing may preclude effective relief. Taxpayers should take the necessary measures to protect their right to a review of their case by the competent authorities, such as filing a timely protective claim for credit or refund of U.S. taxes in accordance with section 9 of Revenue Procedure 2006-54 and taking appropriate action under the procedures of the foreign country to avoid the lapse or termination of their right of appeal under the foreign country's tax law. It is important to keep an eye on all of the relevant statute of limitations.

Within nearly all income tax treaties, a mechanism is available to address double taxation issues. Under these tax treaties, the taxpayer may apply to the U.S. Competent Authority (USCA) for assistance under the MAP article of the applicable tax treaty. Competent authority relief is only available if a tax treaty is in place that contains a MAP article. Other treaty countries designate their own Competent Authority representative. The CA serves to assist taxpayers and to protect government interests in matters relating to international double taxation. The principal role of the USCA is to act as the official liaison with his or her counterpart overseas. As such, the USCA is responsible for administratively interpreting and applying the tax treaties and attempting to determine the proper allocation of income between multi-jurisdictional taxpayers.

Taxpayers have the option to seek CA relief either after participation in the Appeals process or concurrent with Appeals by initiating a Simultaneous Appeals Procedure (SAP). In SAP, an Appeals officer will work with the taxpayer and the USCA in an effort to resolve unagreed issues before the USCA presents its position to the foreign competent authority. Any agreement reached with Appeals through the SAP will be non-binding, and the terms of that tentative agreement will serve as the basis for the USCA's negotiating position in the MAP process. The SAP process permits the taxpayer to negotiate directly with an

Appeals officer while still taking advantage of the added benefits of the USCA's unique expertise and international perspective.

A taxpayer still has the option of requesting CA after participating in Appeals however, it should be noted that the MAP options may be more limited. USCA's mission is to seek a correlative adjustment on behalf of the U.S. taxpayer. As long as the case has not reached a final resolution, the USCA is not precluded from granting unilateral relief. Tax treaties are intended to avoid an unjust result and should not permit supportable IRS-initiated adjustments. One word of caution, if a taxpayer has executed a closing agreement with Appeals or reached a final determination through litigation (including a settlement), the USCA may only seek a correlative adjustment from the treaty partner. This means the USCA will only attempt to elicit a corresponding adjustment from the foreign tax authority in the same amount. Depending upon the taxpayer's facts and circumstances this may not be a favorable resolution.

If a taxpayer suffers double taxation, it may solicit CA assistance. In that situation, the USCA in many respects acts as the taxpayer's advocate and is not bound by determinations made during the IRS examination that gave rise to the adjustment. There is no guarantee, however, that the USCA will find the issue suitable for a Competent Authority proceeding. Upon submission of the CA request, the case is assigned to a Competent Authority analyst. Based on the facts provided by the taxpayer and other information supplied by the IRS or the foreign taxing authority, the analyst will evaluate the merits of the issue in light of applicable domestic and foreign law to determine if the CA will proceed. In addition, the USCA may contact the examining agents to obtain background information. If successful, taxpayers are relieved of double taxation, but as with an APA the process can be both lengthy and costly.

The USCA has been successful in resolving transfer pricing disputes, whether initiated by the U.S. or foreign tax authorities. In addition to transfer pricing, the USCA also handles a small percentage of cases involving such issues as permanent establishment or withholding taxes. In December 2011, the Service released its annual Competent Authority statistics. Consistent with the prior years the report supports its efforts to be beneficial to U.S. taxpayers. Double taxation was eliminated for over 79% of the total dollar adjustments in dispute and 55% of adjustments were fully withdrawn. In 2011, 85% of the request involved foreign initiated transfer pricing adjustments. One down side to CA is the amount of time it takes to resolve the matter. Over the past five years the average length of time to completion has ranged between 653 days to 903 days. In 2011, CA completed forty-three APAs (including one amended APA) and forty-seven recommended negotiating positions (RNPs), down from totals of

sixty-nine APAs and fifty-eight RNPs in 2010. The average time to complete an APA increased from 37.2 months in 2010 to 40.7 months in 2011.<sup>136</sup> With the global emphasis on transfer pricing enforcement it is anticipated that there will be an increase with both U.S. initiated and foreign initiated adjustments putting additional strains on the USCA.

## § 7:10 Policy of Restraint—Tax Accrual Workpapers (TAW)

### § 7:10.1 Overview

One area large corporate taxpayers should be aware of is the interplay between Accounting Standards Codification 740-10 (ASC 740-10) previously and popularly known as FIN 48 and large case examinations.<sup>137</sup> On September 24, 2010, IRS issued the revised Schedule UTP (Form 1120), Uncertain Tax Position Statement, the revised Instructions for Schedule UTP, Announcement 2010-75, Announcement 2010-76, and a Directive by the IRS Deputy Commissioner. This guidance supplemented a series of Announcements the IRS issued announcing a draft schedule requiring certain taxpayers to report uncertain tax positions (UTPs) on their tax returns (see Announcement 2010-9,<sup>138</sup> Announcement 2010-17,<sup>139</sup> and Announcement 2010-30<sup>140</sup>). In order to understand the magnitude of these Announcements and its impact on taxpayers, a discussion of the tax accrual workpapers and the long-standing policy of restraint prohibiting IRS agents from requesting these workpapers is set forth below.

On July 13, 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (“FIN 48”), Accounting for Uncertainty in Income Taxes. FIN 48 is an interpretation of FASB Statement No. 109<sup>141</sup> regarding the calculation and disclosure of

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136. See Announcement and Report Concerning Advance Pricing Agreements, dated Apr. 2, 2012 at [www.irs.gov/Individuals/International-Taxpayers/Competent-Authority-Assistance](http://www.irs.gov/Individuals/International-Taxpayers/Competent-Authority-Assistance).

137. For purposes of this discussion we will use the more commonly used and pre-codification citation “FIN 48.”

138. Ann. 2010-9, 2010-7 I.R.B. 408.

139. Ann. 2010-17, 2010-13 I.R.B. 515.

140. Ann. 2010-30, I.R.B. 2010-19.

141. FASB 109 is now Accounting Standards Codification 740 “Income Taxes” (ASC 740). Accounting Standards Codification (ASC) 740-10, previously and popularly known as FIN 48 (Financial Accounting Standards Board Interpretation No. 48), requires that associations with financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) must determine if the organization has any uncertain tax positions (UTPs).

reserves for uncertain tax positions.<sup>142</sup> FIN 48 applies to material income tax return positions taken (or expected to be taken) by *all* entities that prepare financial statements according to Generally Accepted Accounting Principles (GAAP).<sup>143</sup> FIN 48 established a “more likely than not” threshold to be met before an entity may recognize a tax benefit in its financial statements. FASB indicated that it issued FIN 48 to provide consistency in the criteria used to recognize, derecognize, and measure benefits related to income taxes for financial statement purposes,<sup>144</sup> but what does this mean for a taxpayer’s IRS examination?

The implementation of FIN 48 caused significant activity in the Large Case taxpayer community regarding the handling of uncertain tax positions and, as a result, taxpayers may consider using a different approach in managing their examinations. Some of the issues triggered by FIN 48 included controlling the statute of limitations, especially if there is a motivation to release the contingent tax liabilities into earnings. Another Fin 48 consequence involves the need for closing agreements on specific subject matters on a more regular and expedited basis in order to avail the company of the effectively settled positions under FIN 48, triggering the release of reserves. But the biggest area of taxpayer concern has been whether or not the company’s FIN 48 documentation is considered part of its Tax Accrual Workpapers (TAW) and whether the FIN 48 documentation is covered by the Service’s current “Policy of Restraint.”<sup>145</sup>

An accountant typically prepares two types of workpapers during an engagement: workpapers made in connection with the preparation of a return (tax workpapers) and TAW (prepared with respect to an entity’s Financial Statements). A Revenue Agent’s request for production of tax workpapers usually does not present a problem. For a LB&I taxpayer, the workpapers usually reflect its books of account, adjustments of entries, and development of an income statement and balance sheet. TAW of an independent accountant, on the other hand, are compiled not for the purpose of preparing a tax return but for financial

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142. Statement of Financial Accounting Standards No. 109: Accounting for Income Taxes, Summary (1992).

143. *Id.*

144. FASB, [www.fasb.org/st/summary/finsum48.shtml](http://www.fasb.org/st/summary/finsum48.shtml).

145. Although the Supreme Court recognized the Service’s right to obtain tax accrual workpapers in *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984), the Service announced that it would continue its policy of restraint and would not request tax accrual workpapers as a standard examination technique. Ann. 84-46, 1984-18 I.R.B. 18. Note that the *Arthur Young* case involved a request for the accounting firm’s workpapers, not the taxpayer’s workpapers.

statement purposes. As part of the TAW the taxpayer prepares the tax provision workpapers that are incorporated into the TAW. The TAW may contain information relating to a tax reserve and reflect the opinions and estimates of the taxpayer, the tax adviser, and the accountant of questionable items on the return. Production of these workpapers may create the obvious hazard that the reverse amount may in turn become the starting point of the agent's adjustments. Companies and their auditors may limit their communications if such communications would result in possible tax adjustments.

Under current IRS policy certain documentation held by the taxpayer or its financial statement auditors is generally considered "protected" by the policy of restraint and does not need to be produced during an examination. This prohibition would apply to its audit workpapers, tax accrual workpapers, and FIN 48 workpapers and documentation.<sup>146</sup> However, the Service has taken the position that other types of documentation may be requested as a routine matter, such as tax reconciliation workpapers,<sup>147</sup> effective tax rate (ETR) workpapers, required compliance forms, schedules, and other documentation necessary to establish positions taken on the tax return. With respect to documentation covered by the IRS policy of restraint, it is important to note that there are exceptions to the policy.<sup>148</sup>

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146. IRM 4.10.20.2(1) Audit Workpapers, Tax Accrual Workpapers, and Tax Reconciliation Workpapers Defined (07-12-2004) defines Audit Workpapers as workpapers created by or for the independent auditor.

147. IRM 4.10.20.2(3) Audit Workpapers, Tax Accrual Workpapers, and Tax Reconciliation Workpapers Defined (07-12-2004) defines Tax Reconciliation Workpapers as workpapers as used in assembling and compiling financial data preparatory to placement on a tax return. These papers typically include final trial balances for each entity and a schedule of consolidating and adjusting entries. They include the information used to trace financial information to the tax return. Any tax return preparation documents that reconcile net income per books or financial statements to taxable income are also tax reconciliation workpapers. Tax reconciliation workpapers do not become tax accrual workpapers when they are used in the preparation of tax accrual workpapers or are attached to tax accrual workpapers.

148. IRM 4.10.20.3.2.3 Returns Filed on or After July 1, 2002 (01-15-2005) for returns filed on or after July 1, 2002.

If a listed transaction was properly disclosed on the return, in the manner prescribed by Treas. Reg. § 1.6011-4, the Service will routinely request tax accrual workpapers that pertain only to the listed transaction for the year under examination. In these circumstances, the Service may also request tax accrual workpapers pertaining to the disclosed listed transaction for a year(s) not under examination, if such workpapers may be directly relevant to the Service's audit for the year under examination, such as those described in paragraph (iii). If, however, a listed transaction was not timely and properly disclosed in the manner described by Treas.



These exceptions<sup>149</sup> are listed in the IRM: “If ‘unusual circumstances’<sup>150</sup> exist, then during an examination IRS may request audit, tax accrual, and FIN 48 workpapers”<sup>151</sup> or “If the taxpayer claims a tax

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Reg. § 1.6011-4, the Service will routinely request all tax accrual workpapers for the year under examination. In these circumstances, the Service may also request tax accrual workpapers for years not under examination, if such workpapers may be directly relevant to the Service’s audit of any known listed transactions for the years under examination.

As a discretionary matter, all tax accrual workpapers for the year under examination will be requested if: the Service determines that the taxpayer claimed tax benefits from multiple listed transactions that were all properly disclosed; or in connection with the examination of a return claiming tax benefits from a single listed transaction that was disclosed, there are reported financial irregularities with respect to the taxpayer.

149. Upon determining that a request for audit and/or tax accrual workpapers should be made, the examiner will prepare an IDR for the workpapers. The examiner should work with Field Counsel in preparing the IDR. Branch 3 of the Collection, Bankruptcy, and Summonses (CBS) Division in the Office of the Associate Chief Counsel (Procedure & Administration) is also available to provide assistance to Field Counsel on IDRs. Coordination with Field Counsel will be treated as a high priority matter by Field Counsel so as not to delay the examination.

150. IRM 4.10.20.3.1 Unusual Circumstances Standard (07-12-2004). In unusual circumstances, the Service may request audit or tax accrual workpapers. Examiners should keep in mind that the taxpayer’s records are the primary source of factual data to support the tax return. Audit or tax accrual workpapers should normally be sought only when such factual data cannot be obtained from the taxpayer’s records or from available third parties, and then only as a collateral source for factual data. Audit or tax accrual workpapers should be requested with discretion and not as a matter of standard examining procedure. Such a request should generally be made first to the taxpayer, but may be directed to the taxpayer, the taxpayer’s accountant, the independent auditor, or all three, based on the Service’s determination as to the location of the workpapers sought. The request should be limited to the portion of the workpapers that is material and relevant to the examination. Whether an item is considered to be material is based upon the examiner’s judgment and an evaluation of the facts and circumstances of the case.

Unusual circumstances for this purpose exist under the following conditions:

- (1) A specific issue has been identified by the examiner for which there exists a need for additional facts;
- (2) The examiner has sought from the taxpayer and available third parties all the facts known to them relating to the identified issue; and
- (3) The examiner has sought a supplementary analysis (not necessarily contained in the workpapers) of facts relating to the identified issue and the examiner has performed a reconciliation of the taxpayer’s Schedule M-1 or M-3 as it pertains to the identified issue.

151. Ann. 84-46, 1984-18 I.R.B. 18, and IRM 4.10.20.3(2) Service Policy for Requesting Workpapers (07-12-2004).

benefit from a listed transaction or a transaction substantially similar to a listed transaction, then it is mandatory for the IRS agents to request this documentation from the taxpayer.”<sup>152</sup>

In 2002, the Service announced it was modifying its historical policy of restraint with respect to TAW. Under the modified policy, the Service will, and in fact has, under certain specific circumstances, seek tax accrual workpapers relating to a taxpayer if the taxpayer has claimed the benefits of a listed transaction<sup>153</sup> on a return. However, before a Revenue Agent can proceed with an IDR request under the modified policy, the Revenue Agent must have a reasonable belief that the taxpayer engaged in a listed transaction or a transaction that is substantially similar to a listed transaction. Such a belief may arise from any number of sources of information that an examination team may receive during the course of a taxpayer examination. If the taxpayer has filed a disclosure form with the Office of Tax Shelter Analysis (OTSA) or otherwise acknowledged that it has engaged in a listed transaction, the examiner should proceed with a request for tax accrual workpapers under the procedures set forth in IRM 4.10.20. In general, the taxpayer should be given an opportunity to explain why it believes the transaction is not a listed transaction or substantially similar to a listed transaction.<sup>154</sup>

IRM 4.10.20.2(2) defines tax accrual workpapers as “those audit workpapers, whether prepared by the taxpayer, the taxpayer’s account or the Independent Auditor, that relate to the tax reserve for current, deferred and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to footnotes disclosing those tax reserves on audited financial statements.” These workpapers reflect an estimate of a company’s tax liabilities and have been referred to as the tax pool analysis, tax liability contingency analysis, tax cushion analysis, or tax contingency reserve analysis. Needless to say, the name given to the workpapers is not determinative

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152. Ann. 2002-63, 2002-2 C.B. 72.

153. A listed transaction is defined in Treas. Reg. § 1.6011-4 and specifically includes transactions that are “substantially similar” to a listed transaction.

154. Upon determining that a request for audit and/or tax accrual workpapers should be made, the examiner will prepare an IDR for the workpapers. The examiner should work with Field Counsel in preparing the IDR. Branch 3 of the Collection, Bankruptcy, and Summonses (CBS) Division in the Office of the Associate Chief Counsel (Procedure & Administration) is also available to provide assistance to Field Counsel on IDRs. Coordination with Field Counsel will be treated as a high priority matter by Field Counsel so as not to delay the examination. *See* IRM 4.10.20.4 Procedure for Requesting Audit and/or Tax Accrual Workpapers (07-12-2004).

and the scope and the quality of the workpapers will vary between taxpayers.<sup>155</sup>

Taxpayers and their representatives should review the IRM and other IRS pronouncements before responding to any IRS request for tax accrual workpapers. In light of the litigation of *Regions Financial Corp. v. United States*,<sup>156</sup> *Massachusetts Commissioner of Revenue v. Comcast Corp.*,<sup>157</sup> *United States v. Adlman*,<sup>158</sup> *United States v. Roxworth*,<sup>159</sup>

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155. IRM 4.10.20.2(2) Audit Workpapers, Tax Accrual Workpapers, and Tax Reconciliation Workpapers Defined (07-12-2004) also provides that the total amount of the reserve established on a company's general ledger for all contingent tax liabilities of the company for a specific reporting period is not considered part of the company's tax accrual workpapers. A Revenue Agent may ask a taxpayer about the existence and total amount of a reserve for all contingencies as a matter of routine examination procedure, without a showing of unusual circumstances and without seeking executive approval for the request. The IRM provides that a request to reveal the existence or amount of a tax reserve established for any specific known or unknown transaction, however, is the same as asking for a description of the tax accrual workpapers. Requests for a description of the contents of the tax accrual workpapers are covered by the same policy of restraint as requests for the actual documents that make up the workpapers.
156. *Regions Fin. Corp. v. United States*, 101 A.F.T.R.2d 2008-2179 (N.D. Ala. 2008). Regions hired outside counsel to analyze the tax impacts of a transaction. The memoranda produced by outside counsel expressed opinions, evaluated legal theories, and analyzed possible IRS attacks on Regions' tax reporting of the transaction. These opinions were provided to Regions' accounting firm, which created documents that discussed, quoted, or explained the documents in connection with the tax accrual analysis. The court found that both the documents expressing the opinions of outside counsel and documents created by accountants that discussed, quoted, or explained the opinions were prepared in anticipation of litigation under either the because of test or the more stringent primary motivating purpose test. Notwithstanding that the documents may have had some utility outside litigation, they would not have been created were Regions not primarily concerned with litigating with the IRS concerning the transaction. Moreover, the court found the rationale for protecting these documents especially strong because Regions was only seeking to withhold the mental impressions and legal theories of its counsel. However, the IRS dismissed its appeal to the Eleventh Circuit following a settlement of the underlying tax dispute. Therefore, the Circuit Court did not address this issue.
157. No. SJC-10209 (Mass. Mar. 3, 2009). The Commissioner sought to compel production of withheld documents from tax accounting consultant, Arthur Andersen, which the cable company claimed were protected by the attorney-client doctrine. Following appeals by the Commissioner, the Massachusetts Supreme Judicial Court upheld that the memoranda between in-house corporate counsel and Arthur Andersen are protected from disclosure by the work-product doctrine.
158. *United States v. Adlman*, 134 F.3d 1194, 1202 (2d Cir. 1998).
159. *United States v. Roxworth*, 457 F.3d 590 (6th Cir. 2006).

*United States v. Textron*,<sup>160</sup> *Wells Fargo v. United States*,<sup>161</sup> and Announcement 2010-9, the status of the Policy of Restraint may change and the impact of privilege on this issue is still pending.

### **[A] Summary of Relevant Cases**

On August 13, 2009, in a divided decision, the First Circuit reversed itself and held en banc that *Textron* pursuant to an IRS summons could not withhold its tax accrual workpapers under the work-product doctrine and shield its tax accrual workpapers from disclosure.<sup>162</sup> The issue before the court was whether *Textron's* tax accrual workpapers, prepared by its inside counsel, were subject to discovery by the Service or whether they were protected by the work-product doctrine due to the fact they were provided to its outside auditors. The lower court and panel determined that the workpapers were protected by work-product privilege because the documents were considered to have been prepared in anticipation of future litigation and thus were improper for the government to access. But a majority of the circuit believed otherwise, holding that “there is no evidence in this case that the work papers were prepared for such a use or would in fact serve any useful purpose for *Textron* in conducting litigation if it arose.”

The majority opinion observed that *Textron* was required as a publicly traded corporation to have its public financial statements certified by an Independent Auditor. As part of that process, the Independent Auditor must calculate reserves for contingent tax liabilities. Independent Auditors prepare tax accrual workpapers to support the tax reserves in the financial statements, which the majority found as “one step in a process whose outcome is a certified financial statement for the company.” In its opinion, the court adopted a new

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160. *United States v. Textron*, 577 F.3d 21 (1st Cir. 2009). In late December 2009, *Textron Inc.*, together with its subsidiaries, petitioned for a writ of certiorari to review the judgment of the U.S. Court of Appeals for the First Circuit.

161. *United States v. Wells Fargo & Co.*, 2013 U.S. Dist. LEXIS 79162 (D. Minn. 2013).

162. *Id.* at 30. The work product doctrine finds its origins in the Supreme Court decision *Hickman v. Taylor*, 329 U.S. 495 (1947). In *Hickman*, the Court granted protection from disclosure of materials prepared by a party “in anticipation of litigation.” *Hickman* involved summaries of witness statements gathered by an attorney in preparation of his case. The opposing party sought those statements and other related documents during discovery, which the attorney opposed. The *Hickman* Court determined that both tangible and intangible work product of an attorney, which can be found in “interviews, statements, memoranda, correspondence, briefs, mental impressions, [and] personal beliefs,” should be protected.

standard for determining whether dual-purpose documents, such as tax accrual workpapers, are protected by the work-product doctrine. Instead of applying the “but for” standard (the standard that had been previously applied by the First Circuit to dual-purpose documents) the court created a new standard based upon the intended use of the documents. Under the court’s new approach, documents are protected by the work-product doctrine only if they are prepared for use in potential litigation. The majority stated that under the holding in *Maine v. U.S. Dep’t of Interior*<sup>163</sup> the work-product doctrine did not extend to “documents that are prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation.” The majority found that Textron’s workpapers were prepared in the ordinary course of business and concluded that the work-product doctrine was intended to protect the litigation process and therefore held they were not protected.

Judge Torruella’s dissent went to the heart of the matter: “In straining to craft a rule favorable to the IRS as a matter of tax law, the majority has thrown the law of work-product protection into disarray.” The dissent stated that the proper test continues to be the “because of” test and under that test Textron’s tax accrual workpapers are protected under the work-product doctrine. The dissent argued that the presence of a business or regulatory purpose does not somehow override a litigation purpose, if one properly exists. Thus, dual-purpose documents may be protected.

The Supreme Court on May 24, 2010, denied a petition for certiorari to reconsider the First Circuit’s ruling that allowed the IRS access to a company’s tax accrual workpapers despite objections that the work product doctrine applied. While taxpayers were hoping that the U.S. Supreme Court would weigh in on this complex issue, the IRS and state taxing authorities will continue to rely on the First Circuit decision. The IRS will continue its policy to seek tax accrual workpapers when appropriate under its published guidelines relating to situations where taxpayers have engaged in listed transactions. The question is whether the IRS will expand its guidance to include other situations and in light of Announcement 2010-9 it appears the Service is narrowing its policy.

On June 8, 2009, a federal district court held a taxpayer’s claim of work-product privilege was not waived by disclosure of the documents to its accounting firm;<sup>164</sup> putting into sharp focus the high stakes the

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163. *Maine v. U.S. Dep’t of Interior*, 298 F.3d 60 (1st Cir. 2002).

164. *See United States v. Deloitte & Touche USA LLP*, No. 08-411 (D.D.C. June 8, 2009); *but see United States v. Deloitte, LLP*, 610 F.3d 129 (D.C. Cir. 2010).

government has riding on the First Circuit's en banc review in *Textron*. The U.S. District Court for the District of Columbia issued an order granting Dow Chemical Company's third-party petition to quash the government's motion to compel production. The Justice Department sought to force Deloitte & Touche LLP, Dow's auditor, to hand over documents connected to the taxpayer's civil tax refund case involving its Chemtech subsidiaries. The court held that most of the documents the government sought were protected from discovery under the work-product doctrine, as the documents had been created in anticipation of litigation. The government, however, argued that disclosing the documents to Deloitte waived Dow's privilege claim.

The court, in a footnote, stated that the content of a document determines the application of work-product protection, writing that Deloitte had created an internal memo that recorded "thoughts and impressions of Dow's attorneys concerning tax issues" in the context of expected litigation. Although Deloitte created the memo, "its contents record the thoughts of Dow's counsel regarding the prospect of litigation," the court said. Consequently, as in the analysis provided in *Regions*,<sup>165</sup> the district court said that "communicating those thoughts to Deloitte USA did not waive" the work-product privilege.

In 2010, the D.C. Circuit held in *United States v. Deloitte, LLP*<sup>166</sup> that a document prepared by an independent auditor containing the impressions of the taxpayer's attorneys was protected by the work-product doctrine because "the question is not who created the document or how they are related to the party asserting work-product

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165. *Regions Fin. Corp. v. United States*, 101 A.F.T.R.2d 2008-2179 (N.D. Ala. 2008). *Regions* hired outside counsel to analyze the tax impacts of a transaction. The memoranda produced by outside counsel expressed opinions, evaluated legal theories, and analyzed possible IRS attacks on *Regions'* tax reporting of the transaction. These opinions were provided to *Regions'* accounting firm, which created documents that discussed, quoted, or explained the documents in connection with the tax accrual analysis. The court found that both the documents expressing the opinions of outside counsel and documents created by accountants that discussed, quoted, or explained the opinions were prepared in anticipation of litigation under either the because of test or the more stringent primary motivating purpose test. Notwithstanding that the documents may have had some utility outside of litigation, they would not have been created were *Regions* not primarily concerned with litigating with the IRS concerning the transaction. Moreover, the court found the rationale for protecting these documents especially strong because *Regions* was only seeking to withhold the mental impressions and legal theories of its counsel. However, the IRS dismissed its appeal to the Eleventh Circuit following a settlement of the underlying tax dispute. Therefore, the Circuit Court did not address this issue.

166. *United States v. Deloitte, LLP*, 610 F.3d 129 (D.C. Cir. 2010).

protection, but whether the document contains work product—the thoughts and opinions of counsel developed in anticipation of litigation.” In addition, in *Adlman*<sup>167</sup> the Second Circuit held that a memorandum from a tax advisor assessing the litigation risk associated with undertaking a proposed corporate transaction was prepared in anticipation of litigation, notwithstanding the memorandum was primarily intended to inform a business decision.

In June of 2013, the U.S. District Court for the District of Minnesota<sup>168</sup> ruled that Wells Fargo’s measurement of and analysis with respect to its uncertain tax positions is entitled to work product protection, but that the identification of the types of UTPs is not. Wells Fargo requested the District Court to quash a summons issued by the IRS to Wells Fargo’s outside auditor, KPMG LLP, seeking all tax accrual workpapers. The Summons sought “any and all analyses, computations, opinions, notes, summaries, discussions, and other documents relating to such [tax] reserves and any footnotes.” The court determined that the IRS had a legitimate purpose, verification of the accuracy of Wells Fargo’s returns, for issuing the summonses and dismissed concerns that the IRS had violated its published “policy of restraint.” The court reasoned that whether or not the IRS violated its policy of restraint was irrelevant in determining whether the summonses lacked a legitimate purpose because “the policy of restraint does not purport to be an interpretation of the law or a definition of ‘legitimate purpose.’”

The *Wells Fargo* court reviewed the different standards for determining when the material is considered “prepared in anticipation of litigation,” established by various circuit courts. In *El Paso Co.* the U.S. Court of Appeals for the Fifth Circuit applied a narrow test of requiring that the “primary motivating purpose” of creating a document be to aid in possible future litigation.<sup>169</sup> Other circuits have adopted a “because of” standard. In *United States v. Adlman*,<sup>170</sup> the court held that is broader and protects more documents under the work product doctrine. This test asks whether a document can fairly be said to have been prepared because of the prospect of litigation. The “because of” test is particularly helpful to taxpayers when a dual purpose exists for preparing the legal analysis (i.e., there are both business and legal purposes for the document).

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167. United States v. Adlman, 134 F.3d 1194, at 1200 (2d Cir. 1998).

168. United States v. Wells Fargo & Co., 2013 U.S. Dist. LEXIS 79162 (D. Minn. 2013).

169. United States v. El Paso Co., 682 F.2d 530 (5th Cir. 1982).

170. United States v. Adlman, 134 F.3d 1194 (2d Cir. 1998).

In *Wells Fargo*, the district court applied the “because of” test as this is the standard set by the Eighth Circuit in *Simon v. G.D. Searle & Co.*<sup>171</sup> In *Simon*, information closely related to an attorney’s legal thinking about an individual case including the attorney’s estimates of anticipated settlement values was protected by the work product doctrine even if disclosed within business documents. However, certain factual data that did not reveal an attorney’s legal opinions was not protected from discovery.

Applying the *Simon* standard, the *Wells Fargo* court found that factual information related to UTPs is not protected because it was created in the ordinary course of business and not in anticipation of litigation. The court expressed doubt that the UTPs were first identified by attorneys, but stated that the attorneys were acting more as business advisors helping to structure business transactions associated with tax positions than as attorneys offering legal advice or preparing for litigation. The court declined to accept Wells Fargo’s explanation that it anticipated or prepared for litigation each time it identified a UTP. Thus, the court ruled that Wells Fargo and KPMG must disclose Wells Fargo’s identification of the UTPs, the process for identifying UTPs, and other factual information surrounding the UTPs.

But the court found that Wells Fargo had established that the recognition and measurement analysis reflected in the TAWs was prepared in anticipation of litigation. While the TAWs were not prepared in anticipation of litigation, the recognition and measurement analysis in them was not prepared at the beginning of the transaction, but rather appeared to have been created when Wells Fargo anticipated litigation. The analysis included settlement figures, the strengths and weaknesses of the case, and assessment of Wells Fargo’s chances of prevailing in litigation. Allowing the IRS to access the recognition and measurement analysis in the TAWs would provide a window into the legal thinking of Wells Fargo’s attorneys on the active litigation strategy, running counter to the purpose of the work product doctrine. The court cautioned that its ruling was limited to the taxpayer’s unique circumstances; the court did not adopt the position advocated by Wells Fargo and the amicus curiae briefs that all TAWs, by their nature, are prepared in anticipation of litigation.

For the TAWs created by non-lawyers at KPMG, the court cited *Simon* for establishing that information closely related to an attorney’s legal thinking—even if disclosed within business documents

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171. *Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987).



drafted by non-lawyers—is protected. The court determined that KPMG’s analysis of the recognition and measurement steps was closely tied to the analysis of Wells Fargo’s attorneys. KPMG’s TAWs evaluated the analysis of Wells Fargo’s attorneys and discussed whether the reserves and assessments were reasonable. Accordingly, KPMG’s measurement and recognition analysis was protected by the work-product privilege.

One important note is that the court rejected the government’s argument that Wells Fargo had waived its privilege by disclosing work product to a potential adversary, its auditor KPMG. The court was persuaded by the fact that Wells Fargo and KPMG had never opposed each other in litigation and there was no evidence that any non-litigation dispute then existed. In *Deloitte*, the D.C. Circuit stated that the only relevant litigation in determining whether work product has been disclosed to an adversary is “the sort of litigation” described in the documents at issue.<sup>172</sup> The court further held that eight of Wells Fargo’s documents were protected by the attorney-client privilege and that the government had failed to show how certain state and local tax accrual workpapers were relevant to the federal income tax examination. Although the *Wells Fargo* decision represents a significant defeat for the IRS it was not a complete loss for the government as the court determined that the work product doctrine did not protect from disclosure the identification of UTPs and related factual information because that information is created in the ordinary course of business.

Until the dust finally settles, representatives should take a conservative approach in an effort to protect tax accrual workpapers. Things that should be considered include keeping the workpapers self-contained and the company should refrain from making references to documents outside the tax provision workpaper files. All tax accrual workpapers should be separated from internal memoranda and correspondence prepared with respect to specific issues. File copies should not contain handwritten notes. Memoranda should be prepared with an eye toward possible disclosure to the IRS. Drafts should not be retained and each issue should have a separate memorandum. Legal analysis should be separate from the workpapers and the taxpayer should establish internal controls and workpaper policies. The taxpayer should set up policies to protect confidentiality, determine which documents are relevant and should be made a permanent part of the workpaper file, and most importantly maintain procedures to prevent inadvertent disclosures.

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172. United States v. Deloitte, LLP, 610 F.3d at 140 (D.C. Cir. 2010).

**§ 7:10.2      *Announcements 2010-9, 2010-17, 2010-30, 2010-75, and 2010-76***

Announcement 2010-9<sup>173</sup> proposed a new schedule that would have required (i) a concise description of each uncertain tax position for which the taxpayer or related entity has recorded a reserve under FIN 48 or other accounting standards in its financial statements and (ii) the maximum amount of potential federal tax liability attributable to each uncertain tax position (determined without regard to the taxpayer's risk analysis regarding its likelihood of prevailing on the merits). In addition, the proposed schedule would require disclosure of uncertain tax positions for which a taxpayer or related entity has not recorded a reserve because either the taxpayer expects to litigate the position or has determined that the IRS has a general administrative practice not to litigate the position. The new schedule would be filed by a business taxpayer with total assets in excess of \$10 million if the taxpayer has one or more uncertain tax positions, and would apply to a taxpayer who prepares financial statements or is included in the financial statements of a related entity that prepares financial statements. The proposed schedule would be filed with the Form 1120 or other business tax.

The proposed schedule required a concise description of each uncertain tax position in "sufficient detail" so that the IRS could determine the nature of the issue. Such concise description would include the rationale for the position and a concise general statement of the reasons for determining that the position is an uncertain tax position, including the Code sections potentially implicated by the position; a description of the tax year(s) to which the position relates; a statement that the position involves an item of income, gain, loss, deduction, or credit against tax; a statement that the position involves a permanent inclusion or exclusion of any item, the timing of that item, or both; a statement whether the position involves a determination of the value of any property or right; and a statement whether the position involves a computation of basis.

The draft schedule also required a taxpayer to specify for each uncertain tax position the entire amount of federal income tax that would be due if the position were disallowed in its entirety on audit. This would be the maximum tax adjustment for the position reflecting all changes to items of income, gain, loss, deduction, or credit if the position is not sustained.

On September 24, 2010, the IRS announced the revised Schedule UTP (Form 1120), Uncertain Tax Position Statement, the revised

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173.      Ann. 2010-9, 2010-7 I.R.B. 408.

Instructions for Schedule UTP, Announcement 2010-75, Announcement 2010-76, and a Directive by the IRS Deputy Commissioner.

In Announcement 2010-75, the IRS announced the release of the final Schedule UTP and related instructions. In response to comment letters received, the finalized Schedule UTP and related instructions reflect a number of changes and clarifications. First, the Service provided for a phased-in implementation of Schedule UTP for Corporations with Assets under \$100 Million.<sup>174</sup> The instructions to the final Schedule UTP provide for a five-year phase-in for filing Schedule UTP. Specifically, certain corporations with \$100 million or more in assets that have audited financial statements (or are included in the audited financial statements of a related party) will be required to file Schedule UTP beginning with 2010 tax years. Corporations with \$50 million in assets must file Schedule UTP beginning with 2012 tax years. Finally, corporations with \$10 million in assets must file Schedule UTP beginning with 2014 tax years.<sup>175</sup>

Second, Announcement 2010-75 eliminated the maximum tax adjustment calculation from the final Schedule UTP. The final Schedule UTP generally requires the reporting taxpayer to rank its reportable tax positions (“reportable TPs”) from highest to lowest based on the size of the position’s reserve amount computed for audited financial statement purposes. Thus, the reporting entity is not required to disclose the amount of the reserves but rather to rank the exposure items. As an exception to the general rule of ranking based on size of reserve amount, the final instructions state that “expectation to litigate” positions do not have to be sized and can be assigned any ranking number of the reporting corporation’s choice. In addition, the final instructions clarify that corporations are not required to report tax positions that are either immaterial under applicable financial accounting standards or are sufficiently certain so that no reserve is required under those standards.

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174. The final instructions state that a foreign corporation that files Form 1120-F satisfies the \$100 million threshold test if the higher of the beginning- or end-of-year total worldwide assets of the corporation reported on Form 1120-F, Schedule L, Line 17, would be at least \$100 million if the corporation were to prepare a Schedule L on a worldwide basis.

175. The final instructions do not exclude CAP or CIC taxpayers from the Schedule UTP filing requirement. However, Announcement 2010-75 states that the IRS will address Schedule UTP compliance in upcoming CAP permanence guidance (to be released shortly). Announcement 2010-75 states further that the IRS will consider whether to extend all or a portion of Schedule UTP reporting to other taxpayers (*e.g.*, partnerships and tax-exempt entities) for 2011 or later tax years.

Third, the IRS eliminated from the finalized Schedule UTP the requirement to disclose positions for which a reserve was not established due to an administrative practice of the IRS.

Fourth, the final instructions to the final Schedule UTP clarified the reporting taxpayer must disclose tax positions for which no reserve for income tax was recorded if the tax position is one which the corporation or a related party determines the probability of settling with the IRS to be less than 50% and, under applicable accounting standards, no reserve was recorded in the audited financial statements because the corporation intends to litigate the tax position and has determined that it is more likely than not to prevail on the merits in litigation. Shulman explained that this clarification responds to concerns that the category of reportable tax positions specific to intent to litigate could have been read more broadly than it was intended and could require disclosure of highly certain or immaterial positions.

Fifth, the IRS eliminated some of the disclosure requirements originally proposed for inclusion with the concise description that explains a reportable tax position. The requirement that the reporting taxpayer disclose the “rationale” for the reportable tax position and the requirement that the reporting taxpayer provide a description of the nature of the uncertainty related to the reportable UTP were both removed. According to the final instructions to the Schedule UTP, the reporting taxpayer must include a description of the relevant facts affecting the tax treatment of the position and information that reasonably can be expected to apprise the IRS of the identity of the tax position and the nature of the issue. The instructions state that, in most cases, the description need not exceed a few sentences. The instructions also state that stating “Available on Request” is not an adequate description.

The final instructions clarified that the concise description does not need to include information related to the reporting taxpayer’s assessment of the hazards of a tax position or an analysis of the support for or against the tax position. According to Commissioner Shulman, these changes were made in response to comments expressing concerns that the disclosure of tax positions on Schedule UTP could enable adversaries to raise questions of waivers of privilege with respect to confidential communications related to the disclosed tax positions.

Sixth, the final instructions clarified that Schedule UTP does not require reporting of foreign or state tax positions. However, according to the final instructions, a corporation must report, for example, a U.S. federal income tax position taken in a return that arises out of uncertainty with regard to a foreign tax position (for example, effect of foreign tax positions on U.S. earnings and profits and foreign tax

credits) if a reserve for U.S. federal income tax was recorded to reflect that uncertainty.

Seventh, the final instructions clarified that tax positions taken in years before 2010 need not be reported in 2010 or a later year. This is the case even if a reserve is recorded in audited financial statements issued in 2010 or later.

Eighth, the final Schedule UTP instructions stated that a taxpayer will be treated as if it filed a Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement, with respect to a tax position, providing there is a complete and accurate disclosure of such tax position on the appropriate year's Schedule UTP. In the event that there is such complete and accurate disclosure, a corporation does not need to file a Form 8275 or Form 8275-R regarding the tax position in order to prevent certain accuracy-related penalties with respect to the tax position.

Ninth, Announcement 2010-75 states that in the case of a transaction that is not a reportable transaction, the IRS will treat a complete and accurate disclosure of a tax position on Schedule UTP as satisfying the section 6662(i) disclosure requirements. The IRS rejected commentators' requests that the IRS provide a so-called angel list that excludes certain tax positions from Schedule UTP filing requirements. For example, some commentators requested that the following tax positions not be subject to disclosure: (1) tax position relating to whether a foreign entity's activities in the United States constitute a permanent establishment under a treaty; (2) tax positions regarding equity versus debt classification; and (3) whether or not a transaction constitute a tax-free combination. In Announcement 2010-75, the IRS stated that the IRS believes exclusion of these types of tax positions from Schedule UTP reporting would be inconsistent with the purpose and objectives underlying Schedule UTP.

Tenth, a number of commentators recommended that the Service expressly state that penalties will not be imposed, either permanently or during a transition period, for reporting failures regarding Schedule UTP. The final instructions did not provide specific instructions regarding penalties. The Service intends to review compliance regarding how the schedule is completed by corporations and to take appropriate enforcement action, including the possibility of opening an examination or making another type of taxpayer contact, in those instances in which there appears to be a failure to complete the schedule or a failure to report whether the corporation is required to complete the schedule.

Announcement 2010-76 set forth three key changes to the IRS policy of restraint which were incorporated into IRM 4.10.20. First, Announcement 2010-76 clarified that disclosure of issues on Schedule UTP does not otherwise affect the protections afforded under the

policy of restraint. Second, a taxpayer may redact the following information from any copies of tax reconciliation workpapers relating to the preparation of Schedule UTP that it is asked to produce during an examination: working drafts, revisions, or comments concerning the concise description of tax positions reported on Schedule UTP, the amount of any reserve related to a tax position reported on Schedule UTP, computations determining the ranking of tax positions to be reported on Schedule UTP or the designation of a tax position as a so-called Major Tax Position. And third, it announced an adoption of a policy that the IRS will generally not seek documents that would otherwise be privileged (for example, privileged under the attorney-client privilege, the tax advice privilege in section 7525, or the work-product doctrine), even though the taxpayer has disclosed the document to a financial auditor as part of an audit of the taxpayer's financial statements.

However, the IRS reserved the right to assert waiver of the noted privileges if the taxpayer has engaged in any activity or taken any action other than providing privileged documents to an independent auditor. The Announcement also stated that the Service reserves the right to request tax accrual workpapers under IRM 4.10.20.3 when unusual circumstances exist or the taxpayer has claimed the benefits of one or more listed transactions. The IRS believed these modifications would provide guidance to IRS examiners and other personnel regarding how the IRS will implement Schedule UTP reporting. In Commissioner Shulman's view the modifications not only clarified the policy of restraint but also strengthen it. Shulman stated that these modifications to the IRS policy of restraint were designed to reassure taxpayers that the IRS is not seeking their legal analysis or risk assessments, and he further stated that he remains committed to the protections afforded by the IRS policy of restraint and existing privilege laws.

The September 24, 2010, field directive<sup>176</sup> provided initial guidance to IRS personnel who will be on the front lines administering the new Schedule UTP reporting requirements and indicated that IRS examiners will receive special training on the handling of Schedule UTP over the next year. The IRS will not automatically share information reported on Schedule UTP with foreign governments pursuant to treaties or information exchange agreements. Since U.S. treaties and/or information exchange agreements do not require disclosure in cases in which there is no reciprocity, Commissioner Shulman stated that it would be a very rare occasion that the IRS would exchange

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176. "Directive for All Large Business and International (LB&I) Personnel," Steve T. Miller, Deputy Commissioner for Enforcement and Services, dated Sept. 24, 2010.

information disclosed on Schedule UTP unless the requesting government has similar information it can make available to the IRS. In situations when reciprocity does exist, Shulman stated that the IRS would consider other factors in determining whether to disclose the information (factors such as relevance of the information to the foreign government—Shulman stated that in many cases such relevance would not be present). In addition, Shulman explained that the IRS will establish a centralized process or triage team to review reportable tax positions and to determine their proper treatment. Specifically, he said that the triage team will be responsible for identifying trends of areas of uncertainty. As a measure of success, Shulman stated that he envisions collaboration between the IRS and Treasury to publish guidance that clarifies uncertain areas based on what the IRS learns from Schedule UTP.

The field directive outlined the various uses of the information reported on Schedule UTP. According to the field directive, the initial processing of Schedule UTP information will be centralized to facilitate reviews of whether disclosures are in compliance with the Schedule UTP instructions, assist with the selection of issues and returns for IRS audit, identify trends and areas requiring further guidance to address uncertainty, and may also include referral to appropriate personnel to determine the correct legal analysis or to assure fair and consistent treatment across examinations.

On November 1, 2011, the LB&I Commissioner released guidance that required LB&I personnel to complete a UTP training session and the prerequisite tax reserve training before reviewing any return that includes a Schedule UTP or examining an issue disclosed on a Schedule UTP. This training requirement applied to all examiners and specialists and their respective team and territory managers. Some of the points addressed included:

- When auditing a return with a Schedule UTP, examiners should conduct the risk analysis and planning activities consistent with *Achieving Quality Examinations through Effective Planning, Execution and Resolution*, the *Quality Examination Process Reference Guide*, and *IRM 4.46*.
- The examination of a return with a Schedule UTP is not mandatory. The presence of the Schedule UTP should, in and of itself, not be the sole factor used to determine whether or not to proceed with an examination.
- As with any issue identified for potential examination, the decision to select an issue for audit is contingent upon the findings from the risk analysis, discussions with the taxpayer, materiality considerations, and other steps outlined in the

planning phase of the QEP. Therefore, examiners should apply regular procedures to a return containing a Schedule UTP when determining whether to examine an issue or the return and/or whether to decide to survey a return after assignment.

- For issues that are disclosed on the Schedule UTP, the team may ask the taxpayer for information about the relevant facts affecting the tax treatment of the position and information about the identity of the tax issue. The team cannot ask the taxpayer to explain their rationale for determining that the issue was uncertain, or for information about the hazards of the position or an analysis of support for or against the tax position.
- The team cannot ask the taxpayer why a Schedule UTP issue is uncertain, nor can the team ask the taxpayer for copies of workpapers used to prepare Schedule UTP, any Tax Accrual Workpapers, or for any documents privileged under the modified policy of restraint.
- The fact that an issue disclosed on the Schedule UTP was present on a prior year audit is not sufficient to automatically roll over an issue from one year to the next. The examiner should review the issue in the current year, verify the facts, and determine whether the issue merits examination.
- The fact that an issue disclosed on a 2010 Schedule UTP is selected for examination is not sufficient to automatically raise the issue in a prior year whether or not that prior year is already under examination. In fact, as part of a regular examination, it is unusual to open an issue in a prior year, especially if the examination has reached the resolution phase of QEP. In most situations, the case would be closed as planned, and a determination made as to whether the issue should be addressed in the subsequent year based on the risk analysis and materiality.
- However, if during the planning or execution phase of QEP, a team thinks that an issue disclosed on the Schedule UTP should be addressed in a prior year that is under examination, the approval of the team manager is required before the issue is included in the audit plan or a discussion occurs with the taxpayer. Further, if the team thinks that an issue disclosed on the Schedule UTP should be addressed in a prior year not under examination, the approval of the team manager is required to order a prior year return. The involvement of the territory manager will vary depending on the nature of the issues disclosed on the Schedule UTP, the relationship with the taxpayer, audit history, etc.



**[A] Schedule UTP Filing Statistics<sup>177</sup>**

**Schedule UTP TY2012 Filing Statistics  
(as of December 2013)**

<b>Taxpayer Information:</b>	<b>TY 2012</b>	<b>TY 2011</b>	<b>TY 2010</b>
Sch. UTP filers	1,743	2,190	2,143
Percent of Repeat filers (filed Sch. UTP in multiple years)	55%	77%	–
Percent of UTP filers that are Publicly Traded	55%	56%	58%
<b>Tax Position Information:</b>	<b>TY 2012</b>	<b>TY 2011</b>	<b>TY 2010</b>
Total Uncertain Tax Positions reported	4,166	5,980	4,882
Uncertain Tax Positions reported on Part II (Prior Year Positions)	1,269	1,178	–
Average Uncertain Tax Position per Taxpayer	2.4	2.6	2.4
Percent of UTP Filers reporting only one Tax Position	42%	41%	48%
Most commonly reported Uncertain Tax Positions (% of total):			
1) Research Credit—IRC 41	22%	24%	21%
2) Transfer Pricing—IRC 482	19%	22%	22%
3) Capitalization—IRC 263 (*)	4%	6%	7%
(*) Based on FDRA analysis of UTP concise descriptions, IRC 263 “capitalization” is the 3rd most common tax position reported. However, IRC sections reported by taxpayers on Sch. UTP indicate that IRC 162 “trade or business expenses” was the 3rd most common tax position.			

177. Available at [www.irs.gov/Businesses/Corporations/UTPFilingStatistics](http://www.irs.gov/Businesses/Corporations/UTPFilingStatistics).

For the 2012 tax year, the top three sections reported by UTP filers were section 41 (research tax credit), section 482 (allocation of income and deductions among taxpayers, or transfer pricing), and section 263 (capitalization); however, analysis of UTP filers' concise descriptions revealed that the third highest primary section was actually section 162 (trade or business expenses). These were also the top three Code sections reported by UTP filers for the 2011 tax year.

## **§ 7:11 Joint Committee on Taxation (JCT)**

A large percentage of LB&I taxpayers have refunds in excess of \$2 million and, as a result, have experienced the Joint Committee on Taxation (JCT) process. Some become very familiar with the process, while others remain confused. With the current economic situation, a large percentage of companies have net operating losses in excess of \$2 million or expect to have large losses in the future, generating the ability to carryback the loss and free up refunds, which will trigger Joint Committee review pursuant to section 6405.

### **§ 7:11.1 Background**

In 1926, Congress enacted legislation providing for a Congressional Joint Committee on Internal Revenue Taxation. The name of this committee was changed in 1976 to the JCT. The JCT<sup>178</sup> monitors the operation of the Service and its administration of the tax laws. The JCT's duties are set forth in section 8022, which provides for Joint Committee consideration of possible changes in the tax laws leading to their clarification, simplification or revision to prevent undue hardships or the granting of unintended benefits. In addition, concerns over the potential for corruption and favoritism prompted the enactment of section 6405, which provides the JCT with oversight (as opposed to approval) authority of refunds of income, estate and gift taxes, and certain excise taxes in excess of a statutorily prescribed amount. An important function of the Joint Committee Staff is to evaluate whether provisions of the tax law operate as intended or cause unintended administrative, interpretive, or statutory results. Two ways in which this is accomplished are, first, the refund review mechanism, which statutorily requires the submission of reports by the IRS in cases involving refunds of tax in excess of \$2,000,000, and,

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178. The Joint Committee formally consists of ten Members of Congress: five from the Senate Committee on Finance (there are three from the majority and two from the minority); and five Members from the House Committee on Ways and Means (also three from majority and two from the minority).

second, the post-review program, under which the IRS submits reports on large deficiency cases that they closed prior to submitting them to the Joint Committee.

The IRS prepares a written report for the Joint Committee Staff for each refund case. The report contains a brief history of the taxpayer and an explanation of the reasons for any refunds. Attached to the report are supporting documents prepared by the IRS. These documents discuss the amount of, and reason for, all the adjustments considered by the IRS for taxable years under review.

The Joint Committee Staff review of these reports focuses on the technical aspects of the case and the IRS's resolution of the issues presented. This review enables the staff to become familiar with specific issues in individual industries and to find problems in the administration of the law. Of particular concern to the Joint Committee Staff are transactions in which taxpayers obtain unintended benefits. If the problem emanates from the statutory language, the Joint Committee Staff may recommend an amendment to the Code. When the problem comes from IRS pronouncements, such as rulings or regulations, the Joint Committee Staff may request that the IRS clarify or reconsider its published position. When the problem is lack of uniform application of the law, or lack of authority, the Joint Committee Staff may request that the IRS publish guidance on the issue.

The Joint Committee Staff refund review also permits identification of issues that, as a technical matter, were not handled correctly by the Examination or Appeals. In these instances, the Joint Committee Staff recommends adjustment to the amount of the refund when the tax effect in the case is significant. Adjustment also is recommended when, as a result of the correction, loss or credit carryforwards will be reduced significantly even though there is no effect on the proposed refund. When the impact in a given case is small, no adjustment is recommended, but the staff still transmits the concerns to the IRS for consideration in future cases.

Although the statute does not require that the IRS comply with Joint Committee Staff requests for reconsideration of adjustments as a matter of policy, the IRS will not pay any part of a refund until the Joint Committee Staff and the IRS conclude their review of the case. The conclusion of a case can be that the IRS initial position was correct; that the IRS concurs with the Joint Committee recommendation; or that no change will be made because the IRS does not agree with the Joint Committee recommendation.

### **§ 7:11.2     *Joint Committee Criteria***

A refund or credit subject to Joint Committee review can arise from either a survey of the return, an examination or the service center

forwarding to the field unpaid claims or tentative allowances<sup>179</sup> in excess of the jurisdictional amount. This reporting requirement also extends to refunds arising from the settlement of refund suits by the Tax Division of the Department of Justice as well as settlements entered into by the IRS. Typically, the Revenue Agent is responsible for determining whether a case falls under Joint Committee jurisdiction. The fact that a return or examination must be reported to the JCT does not alter the nature of the examination that may be conducted, nor does it limit the examiner's ability to survey the returns if this is the action deemed appropriate.<sup>180</sup> The present jurisdictional amount is \$2 million, the aggregate of the net amount of the refund(s), and previously assessed interest attributable thereto.<sup>181</sup>

There are two types of refunds that require a JCT report and review. The first, section 6405(a), applies to an examination of an original return, refund claim (Form 1120X) or an affirmative adjustment raised during an examination. The Code provides that no refund or credit in excess of \$2 million will be made until after the expiration of thirty days from the date a report is submitted to the JCT. As discussed below, Joint Committee review is not necessary for a refund or credit of estimated or withheld income tax, regardless of amount. The second, section 6405(b), applies to tentative adjustments. Joint Committee review is *not* required *before* issuing a refund with respect to a tentative carryback adjustment claim pursuant to section 6411 (Form 1139 or 1045—Application for Tentative Carryback Adjustment). Thus, if a Form 1139 carryback refund adjustment exceeds \$2 million, the IRS will issue the refund or credit *before* reporting it to the Joint Committee (unless there are material errors or omissions). If the ultimate refund (determined by reducing the refund by any subsequently determined deficiency) exceeds the statutory dollar threshold, a report will be required to be sent to the Joint Committee.

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179. The IRS must act on the application for tentative allowance within ninety days after the application is filed or within ninety days after the last day of the month that the return for the loss year is due (including extensions), whichever is later. See I.R.C. § 6411(b). If the IRS does not pay the tentative allowance within forty-five days after the last day prescribed for filing or forty-five days after the return is filed, it bears interest at the overpayment rate. I.R.C. § 6411(e). Generally, payment is made prior to sending the report to the Joint Committee.

180. IRM 4.36.3.4 Survey After Assignment (05-04-2010).

181. I.R.C. § 6405(a), and IRM 4.36.2.4.1 Inclusion of Interest in Jurisdictional Amount (05-04-2010).

**EXAMPLE:** ABC Corporation has a NOL for 2010. In 2011, ABC Corporation files a Form 1139 and carries back the 2010 NOL to 2008, requesting a refund of \$2.1 million. The Service will issue the tentative allowance prior to Joint Committee review. If, after survey or an examination, the IRS makes no adjustments to the NOL or to the carryback year, a report to the Joint Committee will be required. However, if after examination, the IRS makes an adjustment resulting in a deficiency of \$600,000 resulting from the tentative allowance (section 6504(b)), thereby causing the ultimate refund to be less than \$2,000,000 (\$2,100,000–\$600,000), a report to the Joint Committee will not be required.

Some things to keep in mind in determining whether the refund meets the jurisdictional amount:<sup>182</sup>

- (1) If a refund or credit of an overpayment was previously reported to the Joint Committee (resulting in payment of the refund), and subsequently, a further overpayment for the same open source years is determined, the case is not reportable unless the subsequently proposed refund or credit exceeds \$2 million. An overpayment of penalty or interest is included in determining whether an overpayment exceeds \$2 million.
- (2) Section 6405(a) and section 6405(b) refunds or credits are not aggregated to determine the JCT amount. In other words, if the taxpayer has a refund of \$1,200,000 pursuant to the section 6405(b) tentative allowance and an additional \$900,000 resulting from a refund on the original return under section 6405(a), the amounts are not aggregated in determining whether the taxpayer meets the jurisdictional \$2,000,000 limit.
- (3) Refunds with respect to distinct tax entities are not combined (that is, Parent and its unconsolidated subsidiary).
- (4) Prior refunds paid will be considered in computing the jurisdictional limit.
- (5) Prior examination refunds are not considered whether or not they met the threshold.
- (6) In computing the section 6405 jurisdictional amount, proposed refunds of penalties and previously assessed and paid interest are combined with proposed tax refunds.

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182. IRM 4.36.2.4 Determining Jurisdictional Amount (05-04-2010) and 4.36.2.4.1 Inclusion of Interest and Penalties in Jurisdictional Amount (05-04-2010).

- (7) In multiple-year examinations with a net deficiency (that is, the sum of deficiencies exceeds the total of all section 6405 refunds), no report is required.

**EXAMPLE:** If a case involves an overpayment of tax of \$1,800,000 and an overpayment of previously assessed (and paid) interest of \$220,000 for the same open source year, it will exceed \$2M and must be reported to the Joint Committee.

An overpayment of penalty or interest is included in determining whether an overpayment exceeds \$2 million.

In determining if the threshold is met, a deficiency against one taxpayer will not be offset against an overpayment of another taxpayer, even though the changes resulted from the allocation of income or deductions from one taxpayer to the other.<sup>183</sup> Concerning the same taxpayer and the same examination, a deficiency for one taxable year should be offset against an overpayment for another taxable year for the same type of tax. However, if an overpayment in one year results in a deficiency in another (type of) tax for the same taxpayer for the same taxable year, the deficiency should not be used to offset the overpayment (this could occur with estate and gift taxes). If a year is under examination and the taxpayer files a NOL carryback claim sufficient to bring the examination of that year within the jurisdiction of the Joint Committee, the examination will be extended to include the loss year.

#### **PRACTICE POINTER**

When an IRS agent informs a representative that the matter has been sent to JCT, don't start spending the money yet. Most agents are referring to the IRS internal Joint Committee Specialist review group that reviews and processes the case before sending to the actual JCT. The IRS Joint Committee Specialist program is part of the Planning, Quality, Analysis, and Support function of the LB&I. The program is based in Chicago with specialists located in various posts of duty around the country that review cases before a matter is sent to the JCT. Joint Committee specialists oversee the preparation

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183. IRM 4.36.2.4.2 Treatment of Deficiencies (05-04-2010).

of Joint Committee reports for all examined/surveyed cases, regardless of the business operating division. A specialist reviews the case files for procedural and technical accuracy and prepares the report that is submitted to the JCT. It is not uncommon for the reviewer to contact the revenue agents with questions or areas that need to be corrected before a case can be processed. This may delay the processing of the refund and may trigger additional IDRs or possibly other adjustments. Once approved, the report is transmitted to the Refund Office of the Joint Committee on Taxation. Typically, the time delay is not with the JCT review but the internal IRS review by the specialists. Historically, it could take as much as three to six months for the entire internal review to be complete before even sending the case to the JCT.

Taxpayers can be proactive and reach out to the local agent and the joint committee specialist and address any issues quickly to assist in the IRS internal JCT processing.

### **§ 7:11.3 Cases Not Required to Be Reportable to the JCT**

The Joint Committee review of a refund or credit made under section 6411, which relates to carryback adjustments, is provided for in section 6405(b). An amount overpaid with an original return is not considered a refund and not subject to Joint Committee review. Tentative allowances will be refunded prior to reporting. After the correct amount of tax is determined by examination or survey action, the refund will be reported. If such determination results in a deficiency, but a net refund or credit exceeding \$2 million remains (that is, partial recoupment of the tentative allowance), the net refund will be reported.

The review by the JCT is limited to certain types of taxes. Excluded from review are certain excise taxes, employment taxes, trust fund recovery penalty cases, and windfall profit taxes. The following cases are not reportable, either because they do not fall within the definition of “refund” or because their processing lacks the potential for the type of abuse or favoritism the statute was enacted to prevent:

- (a) A refund or credit of estimated or withheld income tax, made without first examining the return.
- (b) A refund or credit of an unassessed advance payment or deposit made before determining a taxpayer’s tax liability, or a refund or credit of an amount paid on a tentative return in excess of the amount of the tax liability reported by the taxpayer on a final return. A final return is defined as the last return filed by the due date for that return.

- (c) Prior reports submitted to the JCT are not considered in determining whether the case meets Joint Committee criteria. In addition, if a case which was previously closed did not exceed \$2 million, such amount should not be combined with any subsequently determined refund or credit in computing Joint Committee jurisdiction.
- (d) A case of any type involving overassessments (as distinguished from overpayments) in excess of \$2 million. For example, an abatement of an unpaid portion of an assessment under section 6404, regardless of the amount, is not a “refund or credit” under section 6405.
- (e) An overpayment determined by the U.S. Tax Court or any other court of competent jurisdiction as a result of the trial of a case (rather than by a stipulation of settlement).<sup>184</sup>

The IRS Joint Committee Specialist group is headquartered in Chicago, with additional specialists located in Oakland, Evansville, Boston, Phoenix, Philadelphia and other cities throughout the United States. Recently, the Service has been placing specialists in more cities to help speed up the review process. These groups oversee the preparation of Joint Committee reports for all examined/surveyed cases, regardless of the business operating division. A specialist reviews the case files for procedural and technical accuracy and prepares the report that is submitted to the JCT. Once the approving official has signed the report, it is forwarded to the Joint Committee Program Analyst in LMSB Performance, Quality and Audit Assistance for processing and transmission to the Refund Counsel Office of the JCT. Although the JCT turns cases around within a short period of time, usually less than thirty days, the time the case is pending within the IRS Joint Committee Group may take two to six months. Although uncommon, in some situations, the case may be returned to the field to address questions. Once reviewed, the Joint Committee Specialist will issue a letter stating that the JCT has “completed its consideration of our special report . . . and have taken no exception to the conclusions the Internal Revenue Service reached.”

In light of the amount of large loss tax returns filed for 2008 through 2011, it remains to be seen how much of a bottleneck will occur or whether the Service will be able to process the claims in a timely manner.

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184. IRM 4.36.2.3 Cases Not Reportable to the Joint Committee on Taxation (05-04-2010).



**§ 7:11.4 Assessment Statute of Limitations and JCT**

The IRM<sup>185</sup> requires the Revenue Agent or the Appeals Officer assigned to the Joint Committee case to make “every effort . . . to obtain consents to extend the statute of limitations so that at least 12 months remain on the statute for both source and carryback years when the case is submitted to the Joint Committee Specialist group. If the taxpayer will not extend the statute and there are less than nine months remaining, the appropriate Joint Committee Specialist group must be contacted immediately.” Depending upon whether the refund is pending due to an amended return or whether the refund has been paid pursuant to a tentative allowance there may or may not be a deficiency in one of the years. Regardless of the recommendation in the IRM taxpayers should consider whether it is in the taxpayer’s best interest to extend the assessment statute under section 6501(c)(4) while the Joint Committee considers the appropriateness of the refund. In theory, the parties have reached a resolution of the underlying issues and the amount of the refund. If, however, the taxpayer will be required to pay back part of the tentative allowance, the Service will need to protect the assessment statute to assess and collect the deficiency. Whereas, situations involving no deficiencies and only overpayments it may not be in the taxpayer’s best interest to extend the assessment statute to assess any deficiencies. The Joint Committee review is more of an administrative review and it is unlikely that the JCT will return the case for further development. That said, the JCT has established criteria to return cases back to exams (discussed below).<sup>186</sup>

Neither the Code nor the regulations require the assessment statute pursuant to section 6501 to remain open during the joint committee review. It is solely a requirement in the IRM. When a case is sent to the Joint Committee for review the taxpayer will have signed the necessary documentation (Form 870, and/or Form 906), but the Service will not countersign until after Joint Committee review. If the overpayment is the result of an examination rather than a claim filed, the taxpayer can always file a claim for refund to protect the refund statute rather than agree to sign an assessment extension. Typically, an assessment statute extension protects the IRS and allows the IRS to seek to recover a deficiency on other issues or a previous paid tentative allowance. If the refund is as a result of a timely claim there is no legal benefit to a taxpayer to sign a statute extension. The practical question is whether there is potential exposure on the return

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185. IRM 4.36.3.5 Statute of Limitations (05-04-2010).

186. 185 IRM 4.8.2.8 Returning Cases to the Field (03-30-2012).

and whether for business reasons the taxpayer wants to agree separate and apart from the legal reason to extend the statute. Taxpayers tend to feel obligated to extend the statute due to their relationships with the local IRS team, but the filed claim should protect the taxpayer's refund statute of limitations. There is often confusion between the assessment (section 6501) and refund statutes (section 6511). Taxpayers should take caution and understand the consequences of agreeing to extend the assessment statute if there is no legal requirement to do so or any tax due. However, the Service takes this request seriously and depending upon the facts and circumstances and if there is a potential deficiency situation, it may consider drastic measures such as the issuance of a statutory notice of deficiency. Practitioners need to understand the rules and the consequences of not extending the assessment statute.

### **§ 7:11.5 JCT Pending in Appeals**

Once an Appeals Officer and the taxpayer reach an agreement generating a refund in excess of \$2 million, the same procedural requirements apply for a case pending in Appeals. The Appeals Officer will prepare the necessary report and forward it to JCT. When the JCT notifies Appeals that it has not taken exception<sup>187</sup> to the Appeals determination, the case will be closed. In a docketed JCT case, similar procedures apply: a stipulated decision is secured, a report is filed with the Tax Court requesting the case be continued pending JCT review. After the JCT has notified Appeals that the review is completed, the decision document will be filed with the Tax Court and the case will be closed pursuant to normal processes.

### **§ 7:11.6 JCT Review**

JCT staff attorneys (also known as Refund Counsels) will review the Joint Committee report, the Revenue Agent's report and other documentation, as deemed necessary. Should the Refund Counsel have questions, they are usually resolved informally through phone calls or emails to the Joint Committee Specialist. In some instances, a written inquiry may be issued. Upon being notified that the staff attorney has no further questions or concerns, the case is released and the unpaid jurisdictional overpayments are processed. In the event the JCT disagrees with or questions the position taken in the report, the refund

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187. Once reviewed, the Joint Committee Specialist will issue a letter stating that the JCT has "completed its consideration of our special report . . . and have taken no exception to the conclusions the Internal Revenue Service reached."

is generally, as a matter of agency policy, not processed pending the resolution of the dispute.

### **§ 7:11.7 Claims Rejected by Joint Committee**

Normally, the review of the JTC is an administrative review and it is unlikely that cases which are properly prepared will be returned to the field for additional development. The JTC has established “Case Return Criteria,”<sup>188</sup> which identifies errors that are significant enough to warrant return of the case to the group for correction. Cases returned under this criterion must reflect a clear error of substantial magnitude and not merely a “possible” or “potential” error. Cases will be returned to the group only after concurrence between the Joint Committee Specialist and the Joint Committee Team Manager.

The following are examples of when a case should be returned to the group:

- (a) Substantial error:<sup>189</sup>
  - (i) A substantial error may involve a misapplication or misinterpretation of the law, a clear misapplication of facts or the clearly erroneous omission of an issue or item. In determining whether substantial error exists, reference should be made, not only to the overall dollar value of the item, but also its materiality. Materiality encompasses timing issues and other considerations in identifying those items most relevant and consequential in determining the correct tax.
  - (ii) Because it is not the function of the Joint Committee Review Specialist to re-audit the case, evidence of substantial error will generally be confined to the Revenue Agent’s Report (RAR) and the workpapers relevant to those issues. However, where there is reason to believe, beyond mere suspicion, that a substantial error exists, the Joint Committee Specialist must obtain the consent of the Joint Committee Team Manager before expanding the review to other areas.
- (b) There is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation by the taxpayer or representative.
- (c) The existence of other circumstances indicating that failure to return the case would be a serious administrative omission. Cases should be returned if:

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188. IRM 4.8.2.8 Returning Cases to the Field (03-30-2012).

189. IRM 4.8.2.8.1.1 Substantial Error (03-30-2012).

- (i) Failure to do so could potentially lead to serious criticism of the Service's administration of the tax laws,
  - (ii) The position, if left uncorrected, would establish a precedent that would seriously hamper subsequent attempts by the Service to take corrective action, or
  - (iii) Would result in inconsistent treatment of similarly situated taxpayers.
- (d) The case cannot be processed by CPS and the errors cannot be corrected by the Joint Committee Specialist without significant effort (that is, case requires new agreements, AIMS establishment, etc.).
- (e) The correction of the error is favorable to the taxpayer.

Every effort should be made by the IRS to resolve inquiries informally.