

IRS Tax Controversy Audits, Appeals, & Litigation

2019 Presentation



LINCOLN

Agenda

- IRS
 - Current Environment
 - Organization of IRS
 - Strategic Plan



Agenda

- Audit / Examination
 - How Returns are Selected
 - Type of IRS Audits
 - Practical Aspects of an Audit
 - How to Handle an IRS Audit
 - Conclusion of an IRS Audit
 - 30 Day & 90 Day Letters
 - Extending the Statute of Limitation
 - Audit Reconsideration
 - Large Case Exam
 - Partnership Exam
 - Audit Notices, Info Requests, Determinations



Agenda

- Appeals
 - Organization of the Appeals Office
 - When Can Taxpayers Appeal
 - How to Appeal
 - Negotiation and Settlement
 - Agreement Forms
 - Issues Not Resolved in Appeal
 - Forms



Agenda

- Collection
 - Liens & Levies
 - Resolution Options
 - Forms
- Litigation



IRS

Current Environment

- In 2017, Congress passed the Tax Cuts and Jobs Act of 2017.
- In March 2018, Congress allocated \$320 million to help the IRS implement tax reform.
- In FY 2016 the IRS answered only 53% of taxpayer phone calls, as opposed to 71% in FY 2014. The wait time for an IRS business call is around 70 minutes and the disconnect rate is 30%.
- In FY 2017 a total of 138 million tax returns were filed with the IRS, and a total of 5.1 million returns were reviewed.
- Overly broad fraud detection filters resulted in high false positive rates, causing refund delays for hundreds of thousands of taxpayers.

IRS

Organization of IRS

- Four primary IRS Divisions:
 - Wage and Investment
 - Individuals who are employees
 - Small Business/Self-Employed
 - Individuals investing in S Corporations, and partnerships
 - Taxpayers with rental properties
 - Serves corporations, S Corporations, and partnerships, < 10M Assets
 - Large Business and International (“LB&I”)
 - Serves corporations, S Corporations, and partnerships, > 10M Assets
 - Certain high net worth individuals
 - Tax-Exempt and Government Entities

IRS

Organization of IRS

- Other principal offices:
 - Office of Chief Counsel
 - Taxpayer Advocate Service
 - Criminal Investigation
 - Appeals
 - Return Preparer Office
 - Office of Professional Responsibility (OPR)
 - Communications and Liaison
 - Whistleblower Office
 - Privacy, Governmental Liaison and Disclosure
 - Equity, Diversity and Inclusion

IRS

Strategic Plan

- Expanded use of soft notices and other non-audit contacts
- Aggressively target areas of significant risk
- Enhanced coordination with treaty partners and international organizations
- All LB&I Counsel lawyers have been trained in the fundamentals of international taxation
- Revise & enhance case selection procedures to better identify high-risk transactions
- Identify & pursue misuse of tax-exempt organizations
- Continue focus on corporations, high-income individuals, business income, and flow-through entities
- Implement a comprehensive non-filer program
- Increase criminal investigations of existing and emerging high-risk areas
- Identify & pursue promoters of tax schemes
- Develop & implement a coordinated preparer plan across the IRS and preparer community
- Diligently administer a system of preparer sanctions
- Leverage research to identify areas of abuse and non-compliance by return preparers

Audit / Examination

How Returns Selected

- Computer Scoring - The Discriminate Inventory Function (DIF Score)
- Manual Selection
 - Taxpayer Disclosures
 - Schedule M-3
 - Industry Issues
- Large corporations
- Information Matching
- Related Examinations
- Claims for Refund
- Other Exam Priorities

Audit / Examination

Types of IRS Audits

- Discriminant Inventory Function (“DIF”)
- Campus Reporting Compliance Programs
 - Correspondence Audits
 - Automated Under Reporter
- Taxpayer Compliance Measurement Reporting
 - National Research Program
- Project Audits
- Large Case Examinations
- Partnership Audits

Audit / Examination

Types of IRS Audits

- How Conducted
 - Office Audit
 - Correspondence
 - Meeting at IRS Office
 - Field Audit

- Exams by
 - Wage & Investment (“W&I”)
 - Small business / Self Employed (“SB/SE”)
 - Large Business and International (“LB&I”)
 - Tax Exempt Government Entities (“TE/GE”)

Audit / Examination

Practical Aspects of An Audit

- How Audit is Initiated
- Location of Audit
- Interview
- IRS Methods of Obtaining Information
 - Information Document Request (IDR)
 - Third-Party Contacts
 - Formal Document Request (FDR)
 - Tour of Taxpayer Business
 - Accountants' Work Papers

Audit / Examination

How to Handle an IRS Audit – Best Practices

- BE PROACTIVE!
- Communicate often
- Manage
 - IRS Agent Relationship
 - Potential Adjustments
 - Scope
 - Information Flow
 - Client

Audit / Examination

How to Handle an IRS Audit – Best Practices

- Manage IRS Agent Relationship
 - Establish Credibility and Trust
 - _ Timely provide information
 - _ Keep promises
 - _ Know the facts and the law
 - _ Gather relevant facts and verify accuracy prior to providing to agent
 - Remain respectful and professional
 - Try to make agent look good while achieving best result
 - Understand Taxpayer Bill of Rights
 - Understand entire process and limitations
 - Do not get riled up too easily, know when to elevate an issue
 - Understand that agent is under time pressure

Audit / Examination

How to Handle an IRS Audit – Best Practices

- Manage Potential Adjustments
 - Review returns early for potentially sensitive issues
 - Try to always know what the agent is working on
 - Be prepared, know the facts and the law
 - Should be prepared to demonstrate error in agent's position
 - Elevate issues to a manager if needed

Audit / Examination

How to Handle an IRS Audit – Best Practices

- Manage Scope (Length of time, Questions Asked, and Information Reviewed)
 - Make reasonable attempts to limit scope of questions asked and information provided
 - Location
 - Use to your advantage knowledge that agent is under pressure to resolve the case
 - Have workpapers and notes prepared early
 - Establish taxpayer positions at the start
 - Concede losing points when appropriate
 - Attempt to terminate audit as quickly as possible

Audit / Examination

How to Handle an IRS Audit – Best Practices

- Manage Flow of Information
 - Establish one point of contact for the agent
 - Try to avoid audit occurring at business. If not possible, instruct everyone not to answer any questions about the business.
 - Maintain copy of IDRs, responses, and documents produced
 - Do not provide confidential/privileged documents
 - Ask agent to provide all interview questions in written format
 - Determine whether client should participate in interview
 - Consider best approach for presenting taxpayer arguments
 - Location

Audit / Examination

How to Handle an IRS Audit – Best Practices

- Manage Client
 - Make sure taxpayer understands
 - _ What they say can be used against them
 - _ They should be forthright in responses to IRS

Audit / Examination

How to Handle an IRS Audit – Proposed Adjustments

- Notice of Proposed Adjustments (Form 5701 with Form 886-A)
 - Taxpayer should respond in writing pointing out erroneous factual statements and response to legal arguments
- Revenue Agent Report –
 - Form 4549 (For Field Audit) / Form 1902-B (For Office Audit)
 - Agreed and Unagreed

Audit / Examination

How to Handle an IRS Audit – Agent's Authority to Settle

- Agent's Settlement Authority
 - An agent has no settlement authority regarding legal issues
 - With respect to questions of fact, an agent has a lot more latitude

Audit / Examination

Conclusion of an IRS Audit

- No Change
- Agreed Case
 - Form 870
- Unagreed Case
 - Informal closing conference
 - 30 Day Letter
- Partially Agreed Case

Audit / Examination

30-Day and 90-Day Letters

- 30 Day Letter
 - Taxpayer has 30 days to pay tax or appeal
 - Extension request
 - If do neither – 90 Day Letter is issued
- 90 Day Letter (aka “Statutory Notice of Deficiency”)
 - Taxpayer has 90 days to pay tax or submit tax court petition
 - Can request appeals conference after tax court petition filed
 - Can pay tax and file claim for refund and sue in US Court of Federal Claims
 - What if adjustment does not result in tax due

Audit / Examination

Extending the Statute of Limitations

- SOL is generally three years
- IRS will request extension if less than six months left
- Taxpayer options: Sign unconditional consent, negotiate consent terms, refuse to sign consent
- If Taxpayer Refuses:
 - Deductions in question may disallowed or questionable income may be added
 - Taxpayer will have to petition the tax court within 90 day period or pay tax and file refund claim

Audit / Examination

Audit Reconsideration

- May apply in the following situations:
 - Taxpayer did not respond to audit
 - Taxpayer did not received audit notice (e.g., moved)
 - Taxpayer has new documentation to support position
- The IRS doesn't require you to complete a special form to request audit reconsideration, however, Form 12661, Disputed Issue Verification, is recommended to explain the issues you disagree with.

Audit / Examination

Large Case Exam – New Structure

- New Structure - September 17, 2015
- Single Deputy Commissioner – eliminate domestic and international designation
- Eliminate industry designations
- Streamlined, issue focused audits
- Centralized risk model for issue selection
- Develop “Compliance Campaigns” to address current and emerging compliance concerns

Audit / Examination

Large Case Exam – Shifting Focus

- Past: large taxpayer audits were traditionally:
 - Comprehensive “team” examinations
 - Focused on entire enterprise
 - Typically covered 2-3 tax year “cycles”
 - Focused primarily on 1000 largest taxpayers
- Future: shift from enterprise audits to issue-focused
 - Some very large corporations will still have coordinated examinations
- Objective: make all audits more issue focused and efficient; redeploy resource savings to:
 - Middle market -- \$10-250 million in assets
 - Cross-border transactions
 - Flow-through entities

Audit / Examination

Large Case Exam – Exam Process

- Publication 5125
 - Risk-based audit process
 - LB&I effort to increase efficiency and timeliness of examinations
 - Premised on mutual cooperation, responsiveness, and transparency
 - Recognition of limited IRS resources

- Three Phases
 - Planning
 - Identification and prioritization of issues and development of issues teams
 - Preparation and evaluation of audit plan; mid-cycle risk analysis
 - Execution
 - Factual development through IDRs
 - Acknowledgement of agreed facts
 - Resolution
 - Fast Track
 - Appeals/AJAC

Audit / Examination

Large Case Exam – Exam Process (Planning)

- Taxpayer expected to assist in identification of issues and participate in IRS issue teams
- Joint development of audit plan
 - Will include timelines, audit steps, risk analysis, and methods for monitoring the progress of the examination
- Regular meetings between issue team and Taxpayer personnel

Audit / Examination

Large Case Exam – Exam Process (Execution)

- Reinforcement of LB&I IDR directive
 - Manage timeline of issuance and responses in order to ensure currency
 - Maintain threat of enforcement

- Refund claims
 - 30-day window at beginning of audit for informal claims
 - All other claims must be through 1120X (which will then be risk assessed)

- Written acknowledgement of facts
 - Create record for future proceedings

Audit / Examination

Large Case Exam –Exam Process (Resolution)

- Fast Track Mediation
 - Appeals mediation between taxpayer and Exam after 30-day letter and prior to Appeals process
 - Effective for fact-specific issues (valuation, R&D credit, bad debts)

- Appeals
 - Subject to AJAC procedures
 - Hazards of litigation standard applies to settlement

Audit / Examination

Large Case Exam – Rules Re: IDR Process

- Three separate LB&I Directives defined terms of new rules and practices, dated June 18, 2013
- **Original directive** – (June 18, 2013)
 - Defines joint involvement in drafting and timing of IDR
- **First follow-up directive** – (November 4, 2013)
 - Mandatory 3-step enforcement process introduced
- **Second follow-up directive** – (February 28, 2014)
 - Examiner/specialist authorized to provide one extension before triggering enforcement step
 - Enforcement process effective – March 3, 2014

Audit / Examination

Large Case Exam - LB&I Directive re IDR Process

- IRS IDR Guidance Directive - LB&I-04-0214-004, February 28, 2014
- Directive intended to make IDR process more efficient and reduce need to enforce IDRs through summonses
- Mandatory IDR training held for all LB&I examiners and specialists
- Sets forth required actions in issuing IDRs after March 3, 2014
- Three new mandatory procedures
 - IDRs must be **issue focused** (i.e., issue leading to request must be identified and stated)
 - IDR issuance must be **discussed** with taxpayer in advance – draft IDR provided to taxpayer
 - Taxpayer and examiner must discuss and determine **reasonable timeframe for response** - specify date by which examiner must notify taxpayer regarding sufficiency of response

Audit / Examination

Large Case Exam - LB&I Directive re IDR Process

- Taxpayer and Exam Team will agree on IDR due date
 - if no agreement, the date will be set by Exam Team
 - the date must be reasonable and take into account the complexity of the issue and the process for gathering the documents
- If taxpayer does not respond by due date, Exam Team will meet with taxpayer within 5 days to identify reason for failing to respond – may get one informal extension up to 15 days
- Exam will then issue a Delinquency Notice to the taxpayer requiring a response within a time determined solely by Exam Team
 - which may not exceed 15 days
 - if taxpayer wants more time approval is required by Territory Manager but such additional time would be extremely rare
- No exceptions to issuance of the Delinquency Notice if deadline missed - it is mandatory

Audit / Examination

Large Case Exam - LB&I Directive re IDR Process

- If taxpayer fails to comply with IDR within timeframe of Delinquency Notice, Exam Team and Territory Manager will meet with taxpayer's management about the failure
- Exam Team will then issue a Pre-Summons Notice (prepared by IRS counsel) for which the taxpayer will have 10 business days to respond and comply with the IDR
- If no compliance with Pre-Summons Notice, Exam Team will issue a Summons upon approval of Director of Field Operations (DFO) - the scope of the summons may be different and broader than the IDR
- Historically, Summons have been used sparingly
- Mandatory nature of the enforcement process will likely trigger increased activity

Audit / Examination

Large Case Exam – IDR Practical Advice

- Anticipate government interest
- Utilize alternatives that result in need for fewer IDRs
- Concentrate on getting the front-end correct
- If cannot agree on focus or timing – challenge early
- Track and monitor all facets of IDR process
- Ask for and expect feedback on sufficiency of response
- Hold team coordinator accountable for rationalizing specialists' information (IDR) needs
- Escalate when appropriate
- Once the IDR becomes delinquent on either the original due date or any extended date, the mandatory three-step enforcement process must be implemented
- Clarify duties for each member of TP exam team – who is responsible for each IDR, establish internal timelines and review procedures
- Document each IDR response

Audit / Examination

Partnership Exam

- Bipartisan Budget Act of 2015 repealed TEFRA and instituted a new partnership audit regime
- The new regime applies to tax years after December 31, 2017
- A Partnership that issues 100 Schedule K's or less can opt out of the BBA rules so long as the partners are all individuals
- Under the new regime, the Tax Matters Partner is replaced with the Partnership Representative, who has far more power to bind the partnership and the partners to audit determinations with the IRS
- Tax deficiencies are collected at the partnership level, unless the partnership is eligible to elect to push out the deficiency to the partners

Audit / Examination

Audit Notices, Information Requests, Determinations

- Audit Notices
 - Letter 566
 - Letter 2202
 - Letter 2205
 - Notice CP75A
 - Letter 3572
 - Letter 2201A
 - Letter 2566
 - Letter 1912

Audit / Examination

Audit Notices, Information Requests, Determinations

- Information Requests
 - Form Form 4886A
 - 564
 - Notice CP75A
 - Notice CP87A
 - Letter 525

Audit / Examination

Audit Notices, Information Requests, Determinations

- Determinations
 - Form 4549
 - Form 5278
 - Letter 3219
 - Letter 531-T
 - Letter 692

Audit / Examination

Audit Notices, Information Requests, Determinations

- Return Errors: Notice CP2000, Notice CP05, Notice CP10, Notice CP11, Notice CP12, Notice CP16, Notice CP19, Notice CP21, Notice CP22, Notice CP23, Notice CP24, Notice CP27, Notice CP31, Notice CP60, Notice CP87A, Notice CP2057, Notice CP2501, Letter 105C, Letter 106C

Appeals

Organization of the Appeals Office

- Three Operating Divisions
 - Domestic
 - International
 - Appeals Team Case Leader
- Numerous Offices Across Country
- Appeals Hearing Officer
 - Appeals Officer
 - Settlement Officer
 - ATCL

Appeals

When Can Taxpayers Appeal

- Examination
- Tax Court
- Refund Claim Disallowance
- Collection

Appeals

How to Appeal

- Procedural Requirements
- Written Protest
- Rebuttal to Taxpayer Protest
- Appeals Conference

Appeals

Negotiation and Settlement

- Appeals Officers job:
 - Evaluate the facts gathered at the examination, analyze the law, apply the facts to the law and reach a conclusion.
 - Apply hazards of litigation
 - Reach settlement, if in the best interest of the IRS
- Flexibility with a well-reasoned and well-supported presentation is key
- Know what facts have been provided at exam. Keep log or copies of all documents provided during the exam phase.
- Rules of evidence do not apply

Appeals

Agreement Forms

- Three forms used by Appeals that waive restrictions on assessment and collection of any deficiency that results from assessment.
 - Forms 870 and 870-AD
 - Form 8566 and 906 (“Closing Agreements”)
 - Settlement Agreement in Docketed Case

Appeals

Issues Not Resolved in Appeal

- The Statutory Notice of Deficiency sets forth the tax deficiency and provides the taxpayer ninety days to file a petition with the Tax Court for a redetermination of the deficiency .
- The taxpayer will have three options:
 - (1) file a petition with the U.S. Tax Court;
 - (2) pay the tax and then file a claim for refund with the district court or the U.S. Court of Federal Claims; or
 - (3) agree to an assessment of the deficiency and just pay the tax and interest.

Appeals Forms

- Form 9423 “Collection Appeal Request”
- Form 12153 “Collection Due Process”
- Form 12203 “Request for Appeals Review”
- Form 13369 “Agreement to Mediate”
- Form 13711 “Request for Appeal of Offer in Compromise”
- Form 14017 “Application for Fast Track Settlement”

Collection

Liens & Levies

- If a taxpayer has received an assessment, it can be subject to the IRS's collection process which can include liens and levies
- A lien is a right to property.
- A levy is the taking of property.

Collection Resolution Options

- Installment Agreement
- Offer in Compromise
- Collection Due Process Hearing
- Audit Reconsideration
- Taxpayer Assistance Order -Temporary
- Currently Not Collectible - Temporary

Collection Forms

- Collections
 - Form 433-A “Collection Information Statement for Wage Earners and Self-Employed Individuals”
 - Form 433-A(OIC) “Collection Information Statement for Wage Earners and Self-Employed Individuals”
 - Form 433-D “Installment Agreement”
 - Form 433-F “Collection Information Statement”
 - Form 656 “Offer in Compromise”
 - Form 656-L “Offer in Compromise (Doubt as to Liability)”
 - Form 656-PPV “Offer in Compromise - Periodic Payment Voucher”
 - Form 9465 “Installment Agreement Request”

Collection Forms

- Identify Theft
 - Form 14039 “Identity Theft Affidavit”
- Liens
 - Form 12277 “Application for Withdrawal of Filed Form 668(Y)”
 - Form 14134 “Application for Certificate of Subordination of Federal Tax Lien”
 - Form 14135 “Application for Certificate of Discharge of Property from Federal Tax Lien”
- Penalty Abatement
 - Form 843 “Claim for Refund and Request for Abatement”

Litigation

- Options
 - Tax Court
 - Federal District Court or US Court of Federal Claims
- Factors to Consider
 - Payment of Deficiency (Do not have to pay if going to Tax Court)
 - Trial by Jury (Only available in federal district court)
 - Cost (Tax Court generally less costly due to less extensive discovery)
 - Precedent

Thank You



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