

31st Annual High Technology Tax Institute

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IRS Examination Developments for High Tech Firms

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Running an Audit under IRS Budget Constraints

Agenda

- IRS Resource Constraints and Why It Matters for You
- The Constraints– Let's Do the Numbers
- Impact on Tax Administration
- Impact on LB&I and Your Audits
- A Changing LB&I Audit Process
- IPGs and IPNs– Dealing with One Size Fits All Audits
- AJAC Calling
- Major Changes for LB&I Audits Announced for 2016

IRS Resource Constraints and Why It Matters for You

- LB&I is a highly structured organization
- Some changes are not readily adopted in the field (IDRs, faster audit process, CAP, Fast Track Settlement, early decision making), while others are readily adopted (complete factual records, AJAC)
- Biggest catalyst for change at LB&I is budget constraints
- If you understand LB&I's constraints, you will be better prepared to manage your audits:
 - What are the challenges for you?
 - What are best practices for addressing those challenges?
 - How do you manage expectations within your organization?

The Constraints – Let's Do the Numbers

- Budget Cuts

- FY15 \$10.9 billion – reduction of \$1.2 billion or 10% since FY10
- Reduction of 3,000(+) employees in FY15 and 13,000 since FY10
- Training and travel reduced by \$248 million or 74% since FY10

- Cutbacks and Impact

- Decline in taxpayer call service –
 - Less than 50% of calls get answered – down from 64% in FY14
 - Call wait times over 30 minutes / over 45 days to answer letters
- Fewer

The Constraints on LB&I Locally

- Attrition losses in LB&I domestic agents in SF and SJ by 50%
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Impact of Budget Constraints on Tax Administration

The IRS is:

- Engaged in fewer large business continuous audits, audits will be based on issues not size of entity – getting away from coordinated industry case (CIC) distinction
- Facing challenges to maintain historical audit coverage, voluntary compliance and currency rates
- Leveraging new technology to deliver taxpayer services due to diminished employee resources
- Placing a

Impact of Budget Constraints on Tax Administration – cont'd

The IRS is:

- Revising its examination approach and process for large business and flow through entities with an increased audit focus on specific tax issues that require greater specialization and knowledge sharing
- Placing more focus on engaging in joint enforcement activities and collaborating with treaty partners and other governmental agencies, resulting in increased information sharing



Impact on LB&I

- Organizational Leadership Changes
 - 6 top executives departures including Commissioner, Deputy Commissioner (International, Domestic, Transfer Pricing Director, Director APMA, Director International Strategy)
 - New cadre of LB&I executive appointments
- Budget affect on exam resources
 - Significant headcount reduction and limited attrition hiring
 - LB&I reorganization announced on Sept. 17, 2015



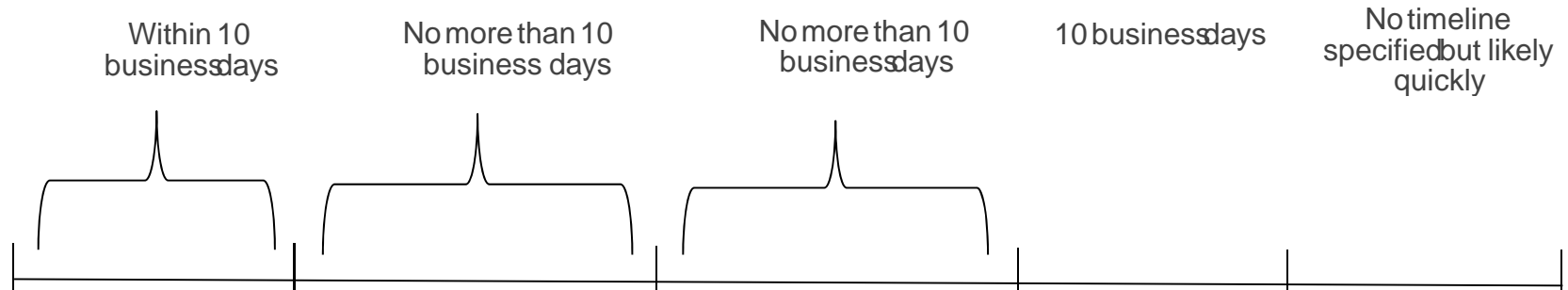
Current LB&I Organizational Chart



Changing LB&I Exam Process

- Replacing current “Quality Exam Process” by incorporating recent changes
 - Information Document Request Enforcement Directive timeline
 - Appeals Judicial Approach and Culture (AJAC)
 - Establishment of Issue Practice Groups (IPG) and International Practice Networks (IPN) to promote knowledge sharing
 - Process for centralized and

Changing LB&I Exam Process – IDRs



Changing LB&I Exam Process – Agreement on the Facts, Fast Track, and Informal Claims

- Require formal acknowledgement of the facts
 - Taxpayer opportunity to provide statement on disputed facts
- Fast Track Settlement (FTS) must be considered on all unagreed issues before sending to Appeals
 - 365 days required on statute of limitation when sent to Appeals
- Will require Informal claims to be submitted to the exam team within the first 30 days after the opening conference, after which the taxpayer must file formal claim
 - Fully documented claims will be risk assessed similar to other issues
 - The claim could be accepted or worked separately from the current examination



LB&I Coordinated Industry Cases (CIC) Pilot

- LB&I initiated a CIC pilot on April 30, 2014
 - Pilot to run for 18 months – ending October 2015
- Currently, CIC cases are:
 - Front end staffed into the LB&I compliance plan
 - Limits Above 100% P, > 100% P, > 100% P, > 100% P

Issue Practice Groups (IPG) – an IPG is...

- Focused on domestic issues replaced the tiered issue process
 - Comprised of an IPG coordinator, one or more full time subject matter experts (SMEs), supplemented with a number of part time SMEs who spend 25% or less of their time on the IPG, and an IPG analyst
 - SMEs can be field agents, technical specialists or managers. In addition, each IPG includes representatives from LB&I Counsel and National Office Counsel with jurisdiction over the issue
- Accessible to LB&I managers and examiners – both can participate on periodic IPG calls to discuss issues or consult with SMEs about the issues
- LB&I's process for knowledge sharing



Current List of Domestic IPGs

- Partnerships and TEFRA
- RICs, REITs and REMICs
- S Corporations and Cooperatives
- Non Life Insurance
- Compensation and Benefits
- Penalties
- Deductible and Capital Expenditures (DCE)
- Corporate Distribution and Adjustments
- Corporate Income and Losses
- Business Credits
- Energy Credits
- Life Insurance
- Financial Instruments
- Inventory and 263A
- Methods of Accounting and Timing

International Matrix - foundation for the LB&I Integrated International Program

Matrix



International Practice Network (IPN) and International Practice Units (IPU) - continued

- LB&I publicly released the IPUs which were developed through internal collaboration and serve as both job aids and training materials on international tax issues
 - [http://www.irs.gov/Businesses/Corporations/International Practice Units](http://www.irs.gov/Businesses/Corporations/International_Practice_Units)
- LB&I welcomes feedback on the IPUs via email
- LB&I is publishing additional units at a fast clip:
 - July 2015: 3 new IPUs dealing with Subpart F issues
 - August 2015: 14 new IPUs, including section 482
 - September 2015: 2 new IPUs, including accounting for intangibles and services associated with the sale of tangible property (outbound)
- Best Practice: Read the IPU for issues before audit starts!



Managing Challen

AJAC Calling

- Major changes for Your Audits

- Statute of Limitations – Must have 1 year remaining for Appeals
- No new issues raised by Appeals
- Issues previously agreed to by taxpayer and Examination will not be reopened
- Appeals will attempt to settle a case on factual hazards when case submitted by Examination is not fully developed and taxpayer presents no new information or evidence
- If a taxpayer provides Appeals with new information, Appeals will return the to

With a View Toward Appeals: Strategically Managing Unagreed Issues in Exam



Agenda

- Introductions
- Managing Unagreed Issues in the New Appeals Judicial Attitude and Culture (AJAC) Environment
- Managing Challenges Outside Your Exam

Managing Unagreed Issues in the New Appeals Judicial Attitude and Culture (AJAC) Environment



What is AJAC?

- AJAC Phase 1: Key examination changes (effective 7/18/13)
 - Revised Policy Statement 8 2 – Appeals will not raise new issues or reopen issues agreed to by taxpayer and Compliance (except in the case of fraud or malfeasance)
 - Appeals will attempt to settle a case on factual hazards when case submitted by Compliance is not fully developed and taxpayer presents no new information or evidence
 - Compliance obtained a centralized formal dissent procedure



What is AJAC, cont'd

- AJAC Phase 2: Key

Appeals Judicial Approach and Culture

Appeals/LB&I Matrix

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What Does AJAC Mean to You cont'd

More Favorable	Less Favorable

How Do You Add to the Factual Record?

- Strategic use of IDRs
- Some tips for adding information after IDRs:
 - AJAC rules can help
 - Managing expectations
 - Protest as the last opportunity to set out the factual record
- Which additions are easier ... more difficult?
- Alternatives: Is it ever a good strategy to wait until you are in Appeals?
- How do you document your disagreement on the facts?



How Do You Handle Disagreements About the Factual Record?

- There is a difference between disagreements about the facts and disagreements about what the facts mean
 - Therefore, many or most Appeals cases can be properly positioned as having agreed facts
- Use the procedures for disagreed facts to reduce the chances of a remand by Appeals
 - List of unagreed facts
 - Review to determine if you or even Appeals will want more facts
- You may need to employ a rule of reason about disagreed facts

How Do You Introduce a New Argument?

- Many “new” arguments are variations on a prior argument
 - Golden Rule to test if an argument is truly new
 - Your credibility may be implicated by how you handle
- Keep it simple
 - Do you want to align it with a prior

How Far Should You Go in Your Protest?

- Protest must effectively advocate without triggering a re-
engagement with the Evms

But LBI Won't Release Your Case Why? ...

- Avoiding additional work with Exam
- Do you disclose new facts to exam as part of your protest?
 - Exam holds protest and then issues new IDRs
 - Happening w/surprising frequency
 - Sometimes rescinding 30 Day Letter; sometimes they don't
- "Facts warranting additional consideration"
 - ~~What if you have a new fact that you didn't disclose in your protest?~~

When and How to Escalate in Exam?

- Insufficient issue development
- Misapplication of the law
- Challenging penalty assertion
- Minimizing friction with Exam Team in escalation
 - Follow the “rules of engagement”
 - Involve the Team whenever possible
 - Drafting memos for IRS management review



Managing Challenges Outside Your Exam Team



Alternative Dispute Resolution

- When Exam offers Fast Track (Rev. Proc. 2003 40)
- Delegation Orders 4 24 and 4 25
- Accelerated Issue Resolution (AIR) (Rev. Proc. 94 67)
- When should you request Early Referral of an issue in your case? (Rev. Proc. 99 28)
- What is the Rapid Appeals Process (RAP) and why does my ExamTeam want me to use it in Appeals? (IRM 8.26.11.1)



Thank you!

