

Federal Tax Controversies – Technical Issues and Strategies

Tax Executive Institute -
San Jose State University
High Tech Tax Institute
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Introductions

- ❖ Paul Curtis, Director (acting), Western Compliance Practice Area
- ❖ Gloria Sullivan, Director, Enterprise Activities Practice Area
- ❖ Eric Slack, Director, Field Operations, West
- ❖ Nora Beltran, Territory Manager
- ❖ Robert J. Kovacev, Partner, Norton Rose Fulbright US LLP
- ❖ C. Cabell Chinnis, Partner, Mayer Brown LLP
- ❖ Heather Maloy, U.S. Tax Controversy Leader, EY
- ❖ Jean Pawlow, Partner, Latham & Watkins LLP
- ❖ Christopher P. Murphy, Counsel, Skadden

Panel Discussion Topics

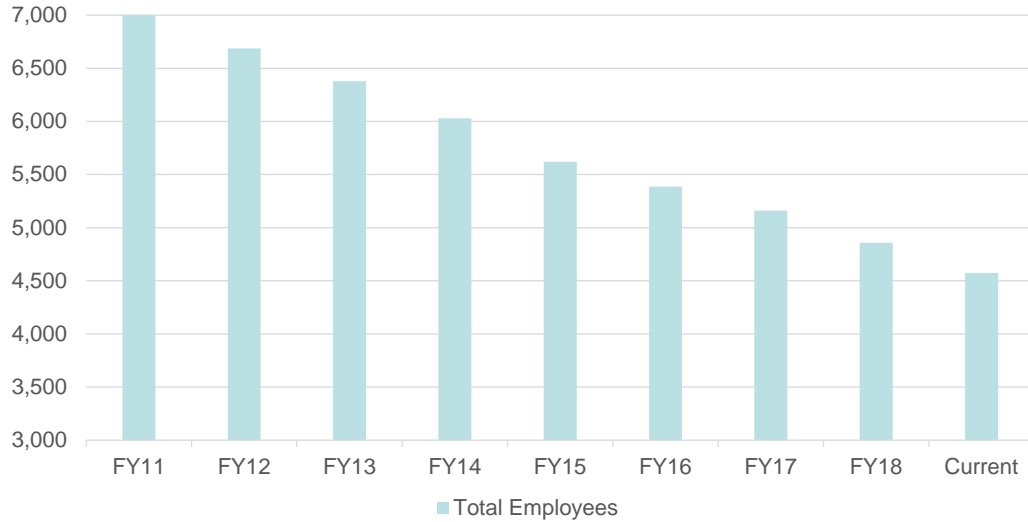
- ❖ Challenges raised by resource constraints
- ❖ LB&I Campaigns
- ❖ Compliance Assurance Process
- ❖ Use of Data Analysis in Audits
- ❖ R&E Directive
- ❖ Effect of TCJA on Controversy, including 965

LB&I Guiding Principles

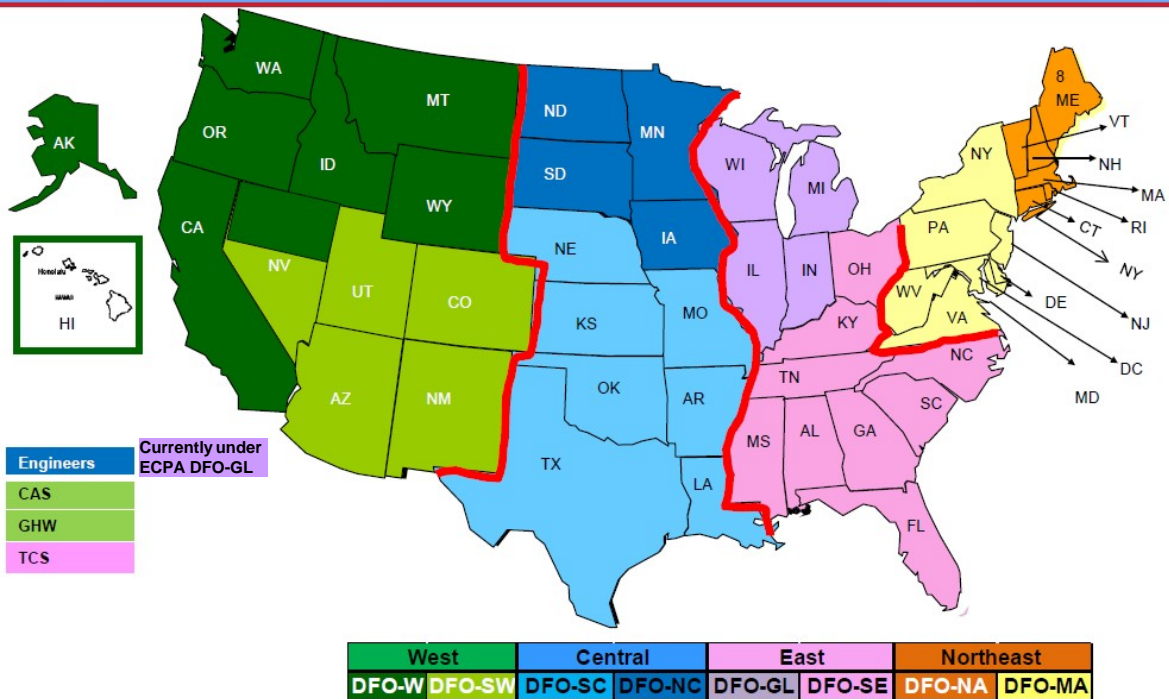
1. Cultivate an environment of **continuous learning** to support a **flexible workforce** with focused training, foundational skillsets, specialized knowledge, and dynamic tools.
2. Use data analytics and examiner feedback to select better work with **intended** compliance outcomes.
3. Employ an integrated set of tailored treatment streams to **improve flexibility** to address current and emerging issues and to **achieve compliance** outcomes.
4. Drive continual collection and **analysis of data and feedback** to enhance ability to focus, plan, and execute work, and promote innovation and feedback-based improvement.

IRS Resources – Challenges: Diminishing LB&I Staffing

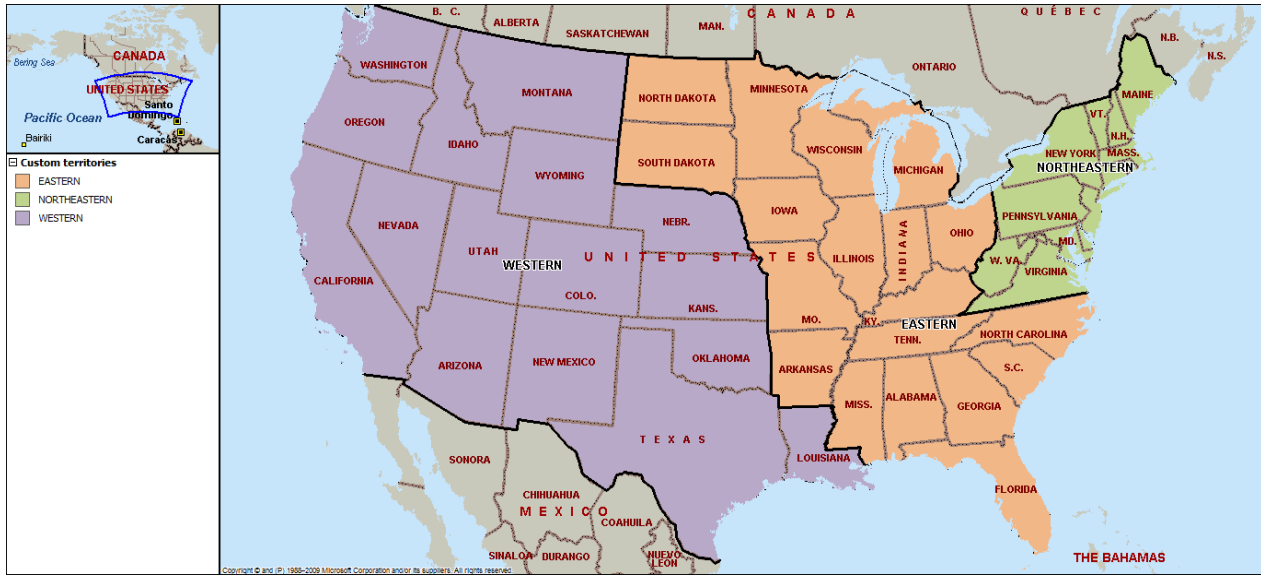
Total Staffing by Fiscal Year (numbers as of start of FY)



LB&I Geographic Practice Area Map – Pre-October 2018

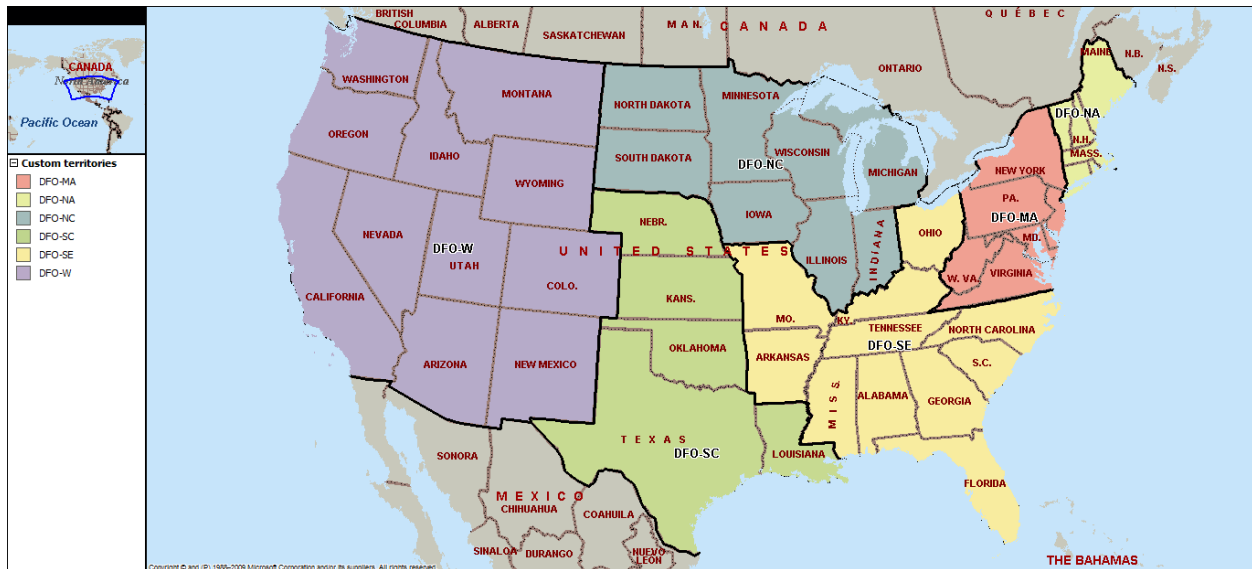


Geographic Practice Area Footprint (10/2018)



Note: Alaska and Hawaii are part of Western

DFO Geographic Practice Area Footprint (10/2018)



Notes: The 7th DFO, DFO Engineering has a national footprint and is not reflected on the map. Alaska and Hawaii are part of DFO-W.

- ❖ Issue-based examinations
- ❖ Strategic focus on issues representing a risk of non-compliance
- ❖ Use of data analysis to identify areas of risk
- ❖ Achieve compliance objectives through alternative treatment streams
- ❖ Capitalize on knowledge of IRS employees
- ❖ Deploy the right resources to address compliance issues

Addressing Resource Constraints: Campaign Process and Function

- ❖ Campaigns are the culmination of an extensive effort to redefine large business compliance work
- ❖ Build a supportive infrastructure inside LB&I
- ❖ Apply strategic planning and deployment of resources, training, tools, metrics and feedback.
- ❖ Invest the time and resources necessary to build well-planned and well-run compliance campaigns.

Addressing Resource Constraints: Campaign Process and Function

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- ❖ Fundamental change in the way we've been selecting and performing work.
- ❖ LB&I decides which potential compliance risk will be responded to and how.
- ❖ Harnessing the combined intellect of our team to make intentional decisions about those potential compliance risks we will respond to and how we will know success.
- ❖ Improve upfront decisions about deploying resources to respond to potential compliance risk.
- ❖ Focus our limited resources in the right areas to drive specific compliance objectives.

Recap of Campaigns

- ❖ Definition of Campaign
 - A campaign is a holistic response to an issue of known or potential compliance risk. Campaigns apply the proper type and amount of resources and combination of treatment streams to achieve intended compliance outcomes. LB&I will use campaigns to identify, prioritize and allocate resources to issue-based compliance risks within the Large Business & International filing population.

❖ 45 Campaigns Announced (as of Sept. 2018)

- September 2018 5 Campaigns
- July 2018 5 Campaigns
- May 2018 6 Campaigns
- March 2018 5 Campaigns
- November 2017 11 Campaigns
- February 2017 13 Campaigns

Campaigns – Treatment Streams

❖ A campaign treatment stream could include:

- Examinations
- Soft letters
- Outreach
- Industry Issue Resolution program
- Tax form changes, or
- Published guidance

Where We Are Alternative Treatment Streams Used

- ❖ Of the 45 Campaigns with alternative treatment streams there are a total of 57 alternative treatments broken down as:

Alternative Treatment Stream	Quantity
External Events	23
Soft Letters	21
Tax Forms and Pubs	7
IIR	1
Admin. Guidance	1
Published Guidance	2
New Legislation	2
Total	57

Data current as of October 1, 2018



Campaign development materials relate to examination selection standards; examination selection standards and the underlying data for determining such standards are protected under the law from disclosure. Access to these materials should be restricted, and in all cases these materials should not be shared beyond anyone that has a need to know. **15**

Harnessing our Collective Knowledge and Experience

- ❖ Every LB&I employee is encouraged to submit compliance issues for evaluation to determine whether LB&I should expend further resources to develop a particular issue into a campaign.
- ❖ This effort recognizes the importance of LB&I capturing and relying upon the vast knowledge and expertise of our work force to best use our resources to maximize compliance amongst LB&I's taxpayer population.



Compliance Assurance Process: Comprehensive Assessment

- ❖ LB&I completed a comprehensive assessment of the three phases of the Compliance Assurance Process (CAP) program.
 - Pre-CAP,
 - CAP and
 - Compliance Maintenance.
- ❖ The assessment included stakeholder (internal and external) input to inform recommended changes

Compliance Assurance Process: Comprehensive Assessment

- ❖ The CAP assessment was necessary given today's environment of:
 - limited resources
 - Interest in CAP has grown; however, since the inception of the program, the LB&I workforce has declined more than 25 percent
 - budget constraints, and
 - business need to evaluate existing programs to ensure they are aligned with LB&I's strategic vision

Compliance Assurance Process: Proposed Changes (Overview)

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- ❖ Designed to improve operation of the program,
- ❖ Make the best use of limited government resources
- ❖ Ensure the sustainability of the program
- ❖ Changes will be effective for the upcoming 2019 application period
- ❖ Additional changes expected the following year and into the future.

Compliance Assurance Process: Proposed Changes (Planning)

- ❖ As part of the application, taxpayers will be required to provide a preliminary list of material issues for the year, and, if applicable, specified transfer pricing issue information and research credit information.
- ❖ Resources devoted to CAP program will be allocated as part of annual planning.
- ❖ Taxpayers to provide a representation letter within 30 days of return filing and timeframes will be implemented for IRS post-file review.

Compliance Assurance Process: Proposed Changes (Resolution)

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❖ Issue Resolution Strategies:

- Certain transfer pricing issues may be required to be resolved via the Advance Pricing Agreement program. LB&I will establish a 90-day goal for issue resolution.
- Disagreements will be sent to Appeals on a timelier basis to encourage quick resolution of issues.

Compliance Assurance Process: Proposed Changes (Maintenance)

- ❖ A Compliance Maintenance phase of CAP will continue, but will be modified. As part of Compliance Maintenance, some taxpayers determined to be lowest risk may continue in the program without IRS review of a particular year.

Compliance Assurance Process: Application

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- ❖ 2019 Application Period Extended and will close 11/30/2018
- ❖ No New Entrants
- ❖ CAP Taxpayer Participation
 - 2018 CAP Year
 - 169 Taxpayers
 - 169 returning taxpayers (no new TPs accepted in 2018)
 - 99 Compliance Maintenance
 - 4 Pre-CAP taxpayers (not included in 169 above)

Compliance Assurance Process: Future

- ❖ In the future, CAP will be open to additional taxpayers who meet eligibility criteria and program requirements.
- ❖ For future years, taxpayers will be required to provide certification of a tax control framework.
- ❖ Consistent with LB&I's strategic vision, LB&I is considering whether issue-based resolutions may be appropriate as the program is expanded.
- ❖ Modifications will be made as appropriate.

❖ Data Science Applications in Compliance

- Use Data sets available to IRS, (regardless of format or location), to better understand and identify compliance risks across LB&I filing population
- Goal to obtain an improved understanding of the presence and magnitude of evolving compliance risk, leveraging it to improve effectiveness in compliance operations and inform us on the allocation of our limited resources

❖ Data Science Applications in Compliance

- Combining talent from office of Data Solutions, (ADCCI), Research, Applied Analytics & Statistics and Information Technology
- Converge the fields of computer science, statistics, and tax/business expertise to develop tools to identify and understand risk profiles
- Move from a backward looking reactive concept to a forward looking predictive concept

❖ Data Science Applications in Compliance

- Initial efforts adopted an iterative Data Science model and demonstrated proof of concepts of our ability to identify compliance risk
- Continuing to build out and perfect these efforts
- Broadening our approach and initiating other opportunities to use/develop additional tools with internal and external research partners

ASC 730 R&D Directive

Reference Materials

- ASC 730 R&D Directive
 - [Activities under I.R.C §41 for Taxpayers that Expense Research and Development Costs on their Financial Statements pursuant to ASC 730](#)
- ASC 730 R&D Directive—FAQs
 - [Frequently Asked Questions \(FAQs\)](#)
- Practice Units
 - [ASC 730 Directive - Computing Qualified Research Expenses](#)
 - [ASC 730 Research and Development - How It Relates to IRC 41 and 174](#)

R&D Directive – 1-Year Later

- ❖ Reasons for the Safe Harbor
- ❖ Feedback received by the IRS
- ❖ Feedback from the Panel and Audience

Effect of TCJA on Controversy: What's changed?

- ❖ The Tax Cuts and Jobs Act (TCJA) affects several areas applicable to business taxpayers:
 - **Income (including Gains and Losses)**
 - **Deductions and Depreciation**
 - **Credits**
 - **International provisions**
 - **Taxes**
 - **Accounting Method Changes**
 - **Opportunity Zones**

Effect of TCJA on Controversy: Section 965 Transition Tax

- ❖ Imposition of new filing and payment obligations.
- ❖ Transition tax on untaxed foreign earnings of foreign corporations owned by U.S. shareholders by considering those earnings repatriated.
 - Foreign earnings held in the form of cash and cash equivalents are taxed at a 15.5 percent rate, and the remaining earnings are taxed at an 8 percent rate.
- ❖ The transition tax generally may be paid in installments over an eight-year period.

Effect of TCJA on Controversy: Section 965 – What do I need to know?

- ❖ Taxpayers should be aware of their income tax obligations under Section 965.
- ❖ Section 965 applies to the last taxable year of specified foreign corporations beginning after December 31, 2017, and the tax is includible in the U.S. shareholder's tax year in which or with which the specified foreign corporation's year ends.
- ❖ See proposed regulations and IRS.gov for guidance on computations.

Effect of TCJA on Controversy: Section 965 – What do I need to know?

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- ❖ For 2017, U.S. shareholders of one or more CFCs or other specified foreign corporations must take the following actions (among other provisions):
 - Decide if you held an interest in one or more specified foreign corporations whose tax year ends with or within your 2017 taxable year.
 - Figure the amount, if any, of previously untaxed earnings and profits to include in income on your 2017 tax return.
 - Pay the tax per the election. See IRC Section 965(h).

Effect of TCJA on Controversy: Section 965 – What do I need to know?

- ❖ Failure to properly follow the reporting and payment obligations could result in the imposition of interest and/or the assertion of tax penalties.
- ❖ Keep adequate records to support the calculation of tax per Section 965.
- ❖ The IRS plans to monitor compliance with the provisions of Section 965. Follow-up inquiries may occur if the IRS determines that the required filings and/or payments are not made.
- ❖ Check IRS.gov for news and updates

Tax Cuts and Jobs Act: Public Service Announcement (PSA)

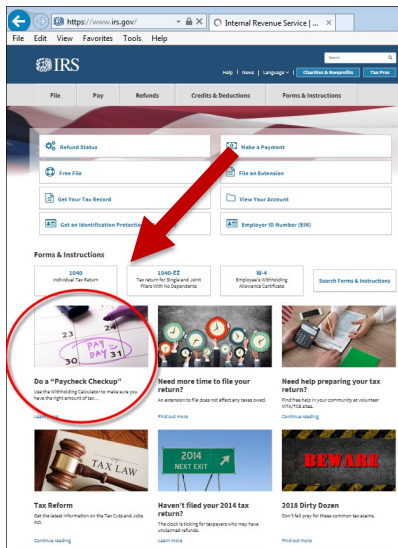
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- ❖ IRS urges individual taxpayers to check their withholding soon to avoid an unexpected tax bill or penalty when they file their 2018 federal income tax return in 2019.
- ❖ TCJA made major changes including:
 - Increasing the standard deduction,
 - removing personal exemptions,
 - increasing the Child Tax Credit,
 - limiting or discontinuing certain deductions and
 - changing tax rates and tax brackets.

Tax Cuts and Jobs Act : Public Service Announcement (PSA)

- ❖ Any of these far-reaching changes could have a big effect on the tax refund or balance due on the tax return taxpayers file next year.
- ❖ That's why the IRS encourages every individual taxpayer to do a "paycheck checkup" soon to check that they're having the right amount of tax taken out of their pay.
- ❖ The IRS [Withholding Calculator](#) and [Publication 505](#), Tax Withholding and Estimated Tax, can help.

Withholding Calculator



- ❖ Updated to reflect changes to withholding tables
- ❖ Recommended for a quick “paycheck checkup”
- ❖ More important this year due to tax law changes
- ❖ Helps taxpayers check if they’re having the right amount of tax withheld from their paychecks
- ❖ Use updated *Form W-4 Employee’s Withholding Allowance Certificate* if changes to withholding are needed

Fast Track Settlement Program

Joint LB&I Division/Appeals program offers a customer-driven approach to resolving tax disputes at the earliest possible stage in the examination process.

- ❖ This program is designed to:
 - Provide an independent Appeals review of the dispute in an environment where all parties to the dispute have a "voice" in the dispute resolution process,
 - Utilize the mediation skills and delegated settlement authority of Appeals, and
 - Reduce the length of a taxpayer's overall IRS experience.
- ❖ Applying for Fast Track Settlement is quick and easy - simply complete a one-page application.

Fast Track Settlement Program

❖ FY18 through June:

- 51 Fast Track cases accepted
- 46 Fast Track cases resolved
- 16 Fast Track cases in-process
- 2 Fast Track cases withdrawals

❖ FY17:

- 38 Fast Track cases accepted
- 35 Fast Track cases resolved
- 17 Fast Track cases in-process

Note: Fast Track cases can cross fiscal years in terms of when they are accepted and resolved. For example, a case accepted into Fast Track in one FY may not get resolved until the next FY.

Questions

