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3 Things To Keep In Mind About IRS' Corporate Audit Changes

By **Natalie Olivo**

Law360 (January 30, 2026, 6:25 PM EST) -- The IRS' revamped audit process for corporate taxpayers will likely streamline examinations, but companies may now shoulder new responsibilities when presenting facts and face lingering uncertainties when weighing whether to participate in a broadened settlement program.

Practitioners have largely welcomed the audit efficiency measures put in place by the Internal Revenue Service's Large Business and International division at the start of the new year, including the elimination of the acknowledgment of facts, or AOF, process. While the U.S. Treasury Department had noted this step added time "but little value," specialists have cautioned that the onus is now on companies to ensure that IRS examiners have all the facts they need. Otherwise, there's a risk of delaying the appeals process.

The LB&I division's decision to broaden the fast-track settlement, or FTS, process has also been positively received, but practitioners have noted that clarity is needed now that settlement discussions are expanded. For example, uncertainties remain about the specific types of disputes that may be excluded from these talks and whether companies can rely on a federal evidence rule that insulates settlement discussions from appearing in any subsequent litigation.

In general, the greatest predictor of success of FTS is that both parties are prepared to settle, according to Ellen McElroy, a partner at Eversheds Sutherland. FTS is an important tool, she said, but companies shouldn't enter the process unless they're prepared to settle and believe the government is as well.

"If you have a very unique legal argument, you may not want to disclose that to the other side, and fast-track would mean that it's disclosed," McElroy said. "And the genie can never get put back in the bottle."

Here, Law360 examines three key issues for companies to consider under the new audit process.

Elimination of AOF

A key change in audit procedures entails the elimination of the AOF process, which practitioners and the government had come to see as a largely unnecessary extra step.

When announcing the removal of this step in a July memo, Treasury said that the purpose of AOF had been to ensure that all relevant facts, both favorable and unfavorable, were mutually agreed upon

before the IRS issued a notice of proposed adjustment, or NOPA. However, companies were reluctant to engage in the process because "it is difficult to evaluate the relevance or completeness of the facts apart from the government's intended application of the facts to the law," Treasury said.

The American Bar Association's tax section expressed a similar sentiment in a December letter to Treasury that supported the elimination of AOF. In practice, this process "often became adversarial," according to the letter.

The letter added that issue conferences — particularly when LB&I specialists and IRS counsel participate — are more effective in obtaining agreements regarding the legally relevant facts and determining whether those facts support the agency's theories of a case.

In announcing the removal of AOF, Treasury noted that a more efficient exam process reduces staffing burdens and preserves resources. The audit changes are happening as Congress considers bills that would provide the IRS with an $11.2 billion budget — a 9% annual cut — and cut $11.7 billion from the IRS spending boost included in the Inflation Reduction Act.

According to Crowell & Moring LLP partner S. Starling Marshall, AOF was "just another step" that didn't accomplish what the IRS had originally set out to do. However, there could now be situations in which companies receive NOPAs containing facts they didn't anticipate being relevant, and so they hadn't put anything in the record that would counter the agency's factual viewpoint, she said.

If companies try to introduce new facts after the NOPA, the dispute may be sent back to the exam stage before the internal appeals procedures can begin — further delaying the process, according to Marshall. She noted that companies are hesitant to volunteer information during an exam because they don't want to open up new areas of inquiry, but the risk is getting to an appeal only for the dispute to get sent back, she said.

"I think it's worth it to try to put forward the facts that you think might be helpful or you might want to cite in your appeal," Marshall said. "The onus is going to be on taxpayers to do that now that the AOF doesn't give you that opportunity."

Despite the potentially increased burden on taxpayers to volunteer facts, specialists say that the elimination of AOF is still a net gain — in part because some of these factual disputes emerged even when this extra step was in place.

When an exam team drafted the AOF information document request, or IDR, practitioners would often present a completely different set of facts in their response, according to Alina Solodchikova, principal and leader of the tax controversy practice in RSM US LLP's Washington national tax team. For this reason, it seemed an unnecessary and burdensome process, she said.

"Taxpayers ended up in situations where certain facts weren't developed, even when the AOF IDR process was in place," Solodchikova said.

Questions About FTS

Practitioners have also welcomed the expansion of the FTS program, but they are hoping Treasury will provide additional clarity about the new parameters for settlement talks.

In announcing changes to FTS as part of the larger audit revamp, Treasury said in its July memo that it would "facilitate broader use of the program," which was designed to resolve tax differences at the earlier stages of an exam.

In its December letter, the ABA's tax section said the memo "advances FTS in meaningful ways," including by making the program available throughout the exam process and providing taxpayers with ample opportunity to consider alternative dispute resolution options.

However, the letter also noted that additional factors could enhance the process, including clarity on exclusions. Issues that are generally excluded from exams — such as docketed cases and issues designated for litigation — can be "overly broad in practice" and are often applied inconsistently across exam teams, according to the letter.

Therefore, the letter said, the IRS should adopt a tiered approach that distinguishes issues fundamentally unsuitable for settlement talks — for example, constitutional challenges or challenges to regulations — from those appropriate for limited-scope mediation. The IRS should publish and regularly update a list of issues formally excluded from alternative dispute resolution, with explanations and sunset dates, the letter said.

According to Eversheds Sutherland's McElroy, it would be helpful if the LB&I division were to clarify the criteria for why something is accepted into FTS or why it's not, so that taxpayers would know whether the process is likely to be successful for them.

If the agency does so, "I think fast-track would be used more often," she said.

Evidence Rule Issue

Despite the expansion of FTS, companies may still hesitate to be candid during settlement discussions unless they have certainty that the IRS won't later cite their remarks during litigation if the parties fail to reach an agreement.

Accordingly, companies are looking for confirmation regarding the application of Federal Rule of Evidence 408, which generally blocks statements made during settlement negotiations from being admissible as evidence during litigation.

In its December letter, the ABA's tax section noted that a party may seek to introduce statements made in FTS negotiations in later proceedings. Accordingly, the IRS "should state that communications and materials prepared for and used during FTS are treated as compromise negotiations for purposes of FRE 408," the letter said.

Similarly, McElroy said it would be helpful if the IRS could clarify under the federal rules of evidence what FTS statements could be relied on and not relied on in later proceedings.

"I think that would help taxpayers perhaps to have more candid conversations in fast-track, which is really important if you want to use fast-track as a technique for finding ways to resolving issues," she said.

According to Marshall at Crowell & Moring, the FRE 408 issue needs to be clarified because, in general, the concern with FTS is that the exam team gets a preview of the arguments that the taxpayer is going

to make. If an issue doesn't get resolved, the IRS may change its NOPA in response to arguments that it has already heard, she said.

Marshall noted that while FRE 408 likely applies, "I think that needs to be clarified because as appeals gets longer and longer, people might just try fast-track as a way to get an appeals officer quicker."

--Additional reporting by Asha Glover. Editing by Aaron Pelc.
