Managing Tax Audits and Appeals

October 5-6 2017

David B. Blair

Welcome and Introductory Remarks

Developments at IRS

Change in Administration and IRS

Not a match made in heaven

- Current budget proposals would cut IRS budget
  - IRS budget down 10% over 7 years
  - Trump Administration proposed IRS budget cut = $250 m.
  - House Appropriation Committee proposed IRS budget cut = $149 m.
- Congress proposes to restructure IRS
- Trump Administration's "two-for one" directive on agency rulemaking
- Impacts on IRS mission unknown
  - Guidance slowed
- LB&I continues rollout of new audit paradigm
  - Many audits proceeding much like before, except slower
- Appeals is in trouble

IRS and Congress – Could it get any worse?

IRS's deteriorated relationship with Congress

House Blueprint –

"Over the past three decades, the IRS has become a prime example of executive branch overreach, blatant misconduct, and government waste."

“Abolish” the IRS

- Ways & Means hearings on IRS reform/restructuring
- Legislation to revamp IRS promised for April 2018
- House Blueprint
  - “Taxpayer Service Agency” with three major units:
    - Families and Individuals
    - Business
    - Small Claims Court
  - Service First mandate – measured against Taxpayer Bill of Rights
  - Administrator appointed by President, confirmed by Senate
    - Three year term
    - Two-term limit

IRS Faces Leadership, Manpower Crises

- Exceptions only hiring freeze since 2011
- IRS FTEs down 14% since 2012:
  - 89,520 FTEs in 2012
  - 77,400 FTEs in 2016
- Enforcement personnel down 24% since 2012, 35% since 2010:
  - 17,206 FTEs in 2010
  - 14,829 FTEs in 2012
  - 11,195 FTEs in 2016
- By 2019, 34% of IRS employees will be eligible to retire
- Management ranks already depleted. Various leadership positions filled by "acting" personnel, who traditionally limit their exercise of discretion

- Administration has yet to name new Chief Counsel.
- Commissioner Koskinen's term is up in November. Administration has not indicated whether Koskinen will stay, or who will replace him.

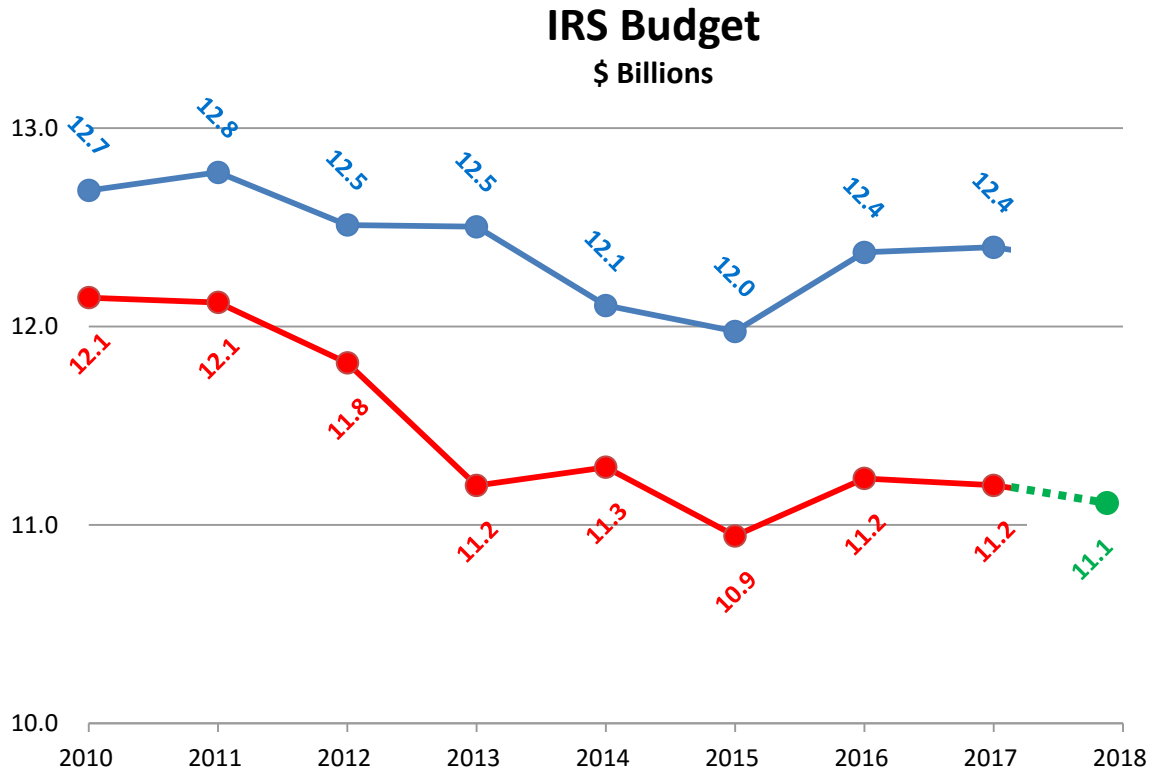
IRS Budget Challenges

"I am concerned that continued erosion of the IRS workforce will threaten the agency's effectiveness and its ability to provide appropriate taxpayer service, enforcement of the tax laws, and ultimately, our ability to collect the revenues the government depends on for operations."

Testimony of Commissioner John Koskinen Before the Senate Appropriations Committee Subcommittee on Financial Services and General Government (July 26, 2017)

Current State of IRS Enforcement

Doing Less with Less

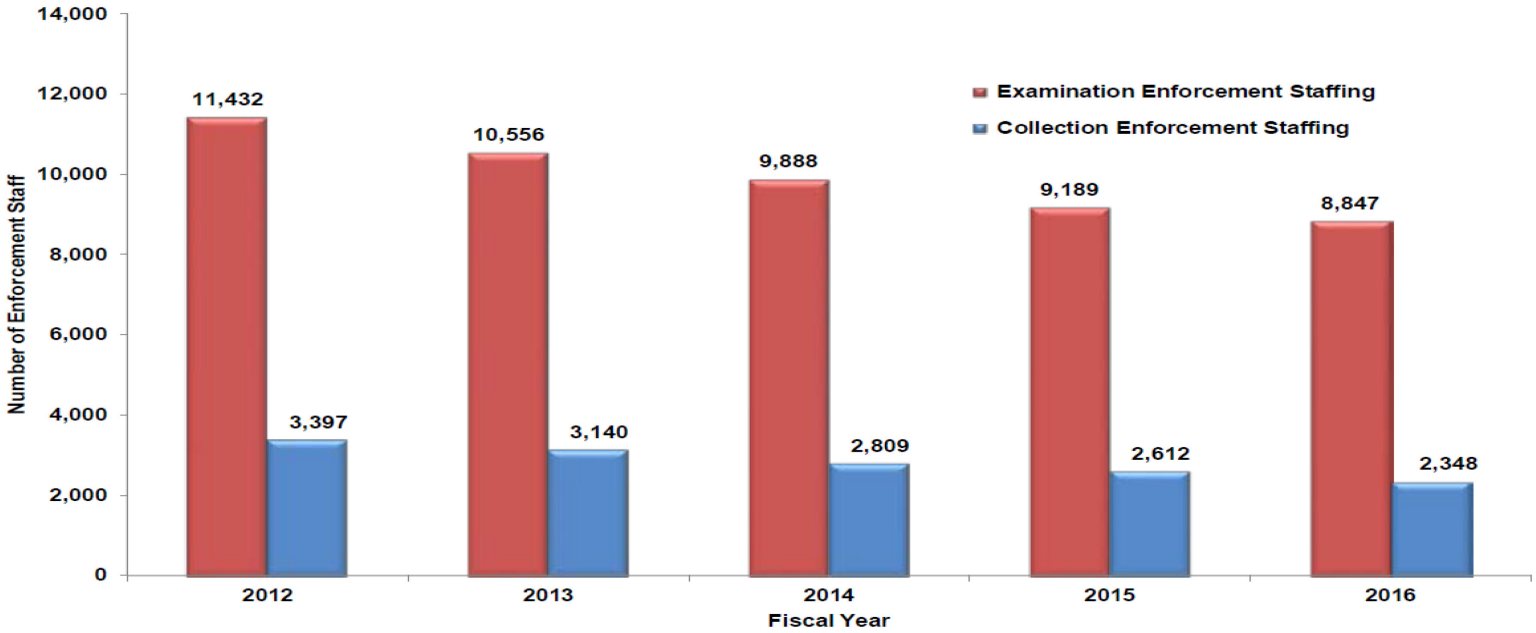


- Since 2010
  - $1 billion decrease
  - 10% decrease

- House Appropriations
  - $111 million decrease
  - 1% decrease

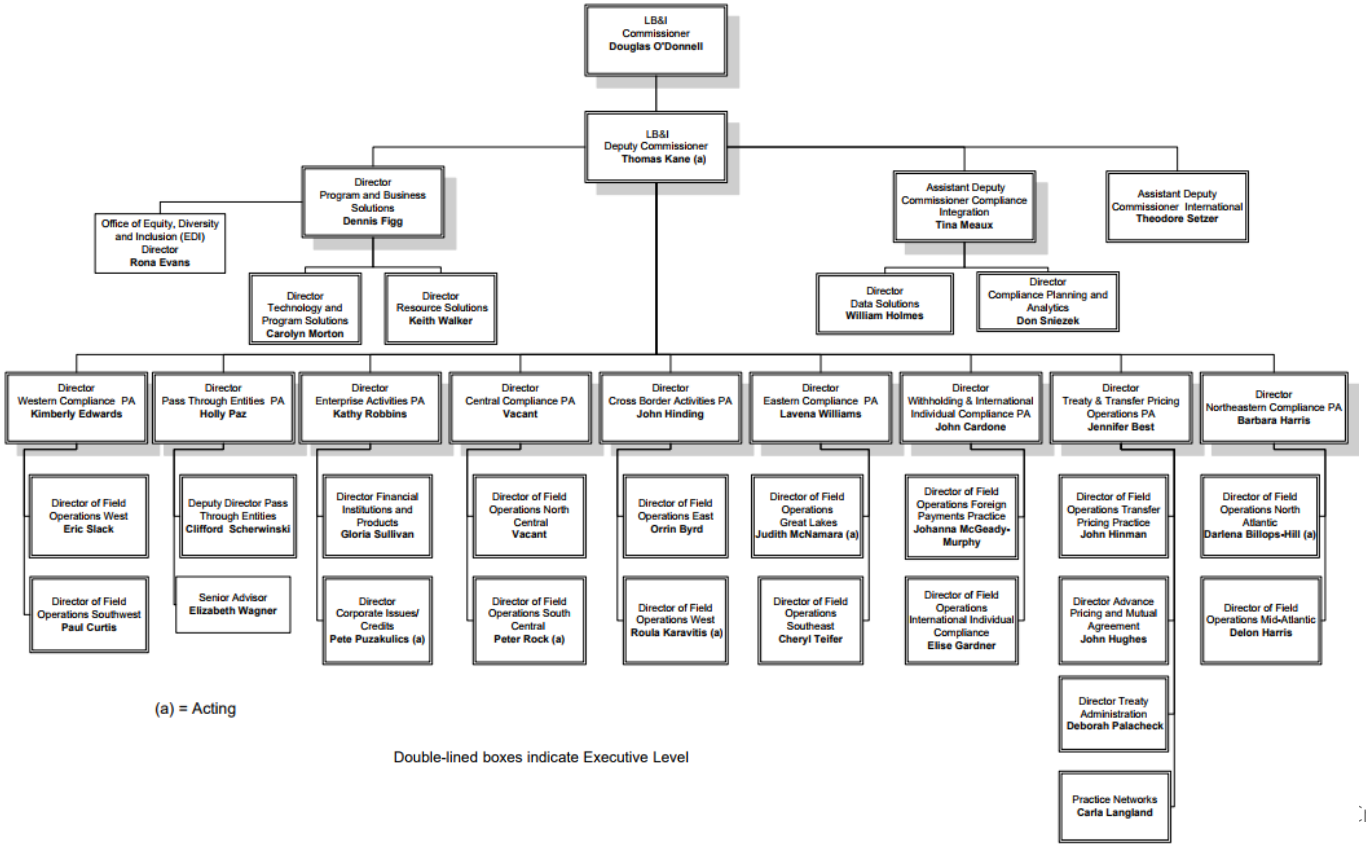
Doing Less with Less

Figure 2: Enforcement Personnel by Fiscal Year



Source: TIGTA analysis of Collection Activity Report 5000-23 and Table 37 Examination Program Monitoring

Doing Less with Less



Current State of IRS Workload

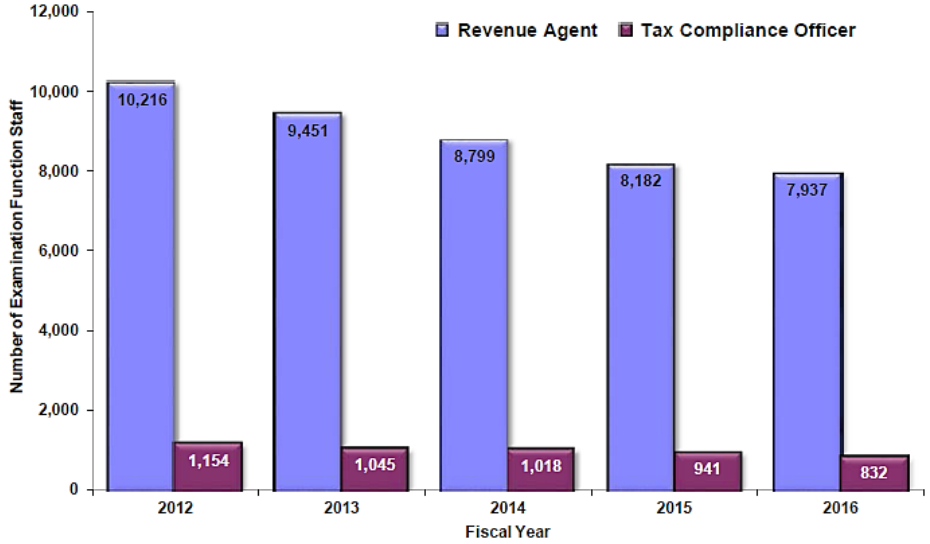
- Normal workload increases
  - Keeping up with new laws
  - FATCA
- New partnership audit regime added in late 2015, effective 2018
- New challenges
  - Identify theft
  - International pressures
    - BEPS – Country-by-Country Reporting

New Partnership Audit Regime

- 4 possibly applicable regimes
- Bipartisan Budget Act of 2015 (effective 2018)
  - Proposed Regulations January 2017 caught in regulatory freeze, Executive Order 13771
  - Even after Proposed Regulations, many open questions
    - Extensions of time, Appeals procedures
    - Procedures for modification of imputed underpayment
    - Affected items / allocations among partners

Current State of IRS Enforcement

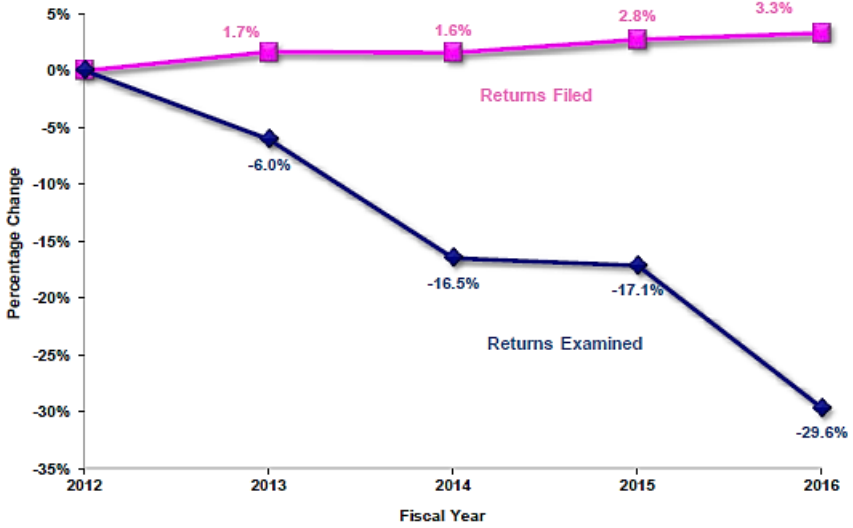
Figure 25: Number of Examination Function Staff Conducting Examinations of Tax Returns at the End of Each Fiscal Year



Source: TIGTA analysis of Table 37 Examination Program Monitoring.

Current State of IRS Enforcement

Figure 27: Percentage Change From FY 2012 of All Tax Returns Filed and Examined



Source: TIGTA analysis of the IRS Data Book.

Current State of IRS Enforcement

- Individual audit rates:
  - Face-to-face: 0.0016 %
  - Correspondence: 0.007 %
- Corporate audit rate:
  - Largest (assets > $250 m.): 19.3 %
  - Overall: 1.02 %
- Passthrough audit rate: 0.0028 %

Sources – TIGTA , Trends in Compliance Activities Through Fiscal Year 2016 (Sept. 11, 2017); http://trac.syr.edu/tracirs

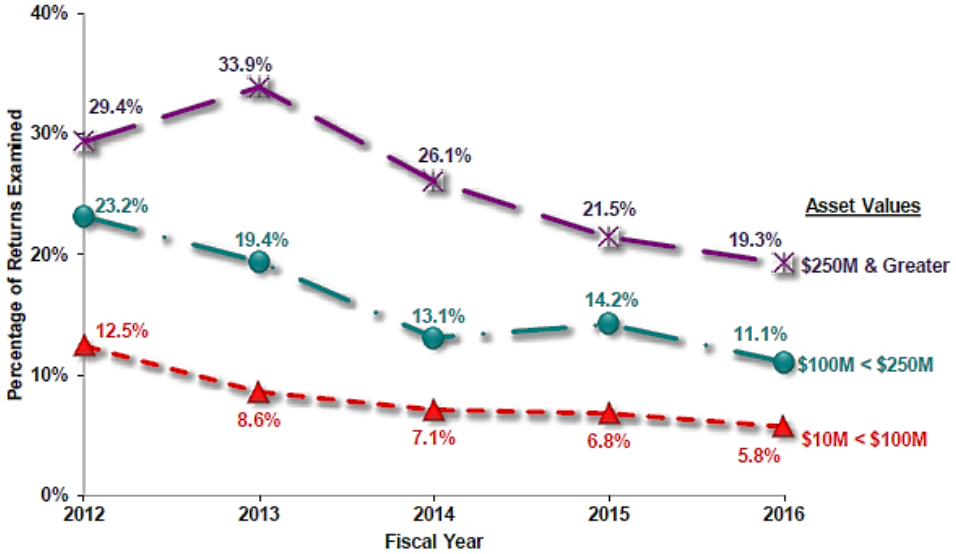
Audit Coverage Rates

Business Returns	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Corporations < $10 Million	21,164	17,604	17,257	16,460	14,136
Coverage Rate	1.12%	0.95%	0.95%	0.92%	0.80%
Corporations $10 Million and Greater	10,752	9,876	7,858	7,410	6,453
Coverage Rate	17.78%	15.84%	12.23%	11.15%	9.53%
S Corporations (Forms 1120S)	21,658	18,670	16,317	18,595	15,869
Coverage Rate	0.48%	0.42%	0.36%	0.40%	0.34%
Partnerships	16,691	14,870	15,779	19,212	14,645
Coverage Rate	0.47%	0.42%	0.43%	0.51%	0.38%
Fiduciaries	5,070	4,501	3,694	5,288	3,284
Coverage Rate	0.17%	0.15%	0.12%	0.16%	0.10%
Employment	66,997	60,801	57,123	54,214	54,652
Coverage Rate	0.23%	0.20%	0.19%	0.18%	0.18%
Excise	22,014	16,509	13,779	13,153	13,440
Coverage Rate	3.26%	1.61%	1.50%	1.34%	1.35%

Source: TIGTA Analysis of IRS Data Book

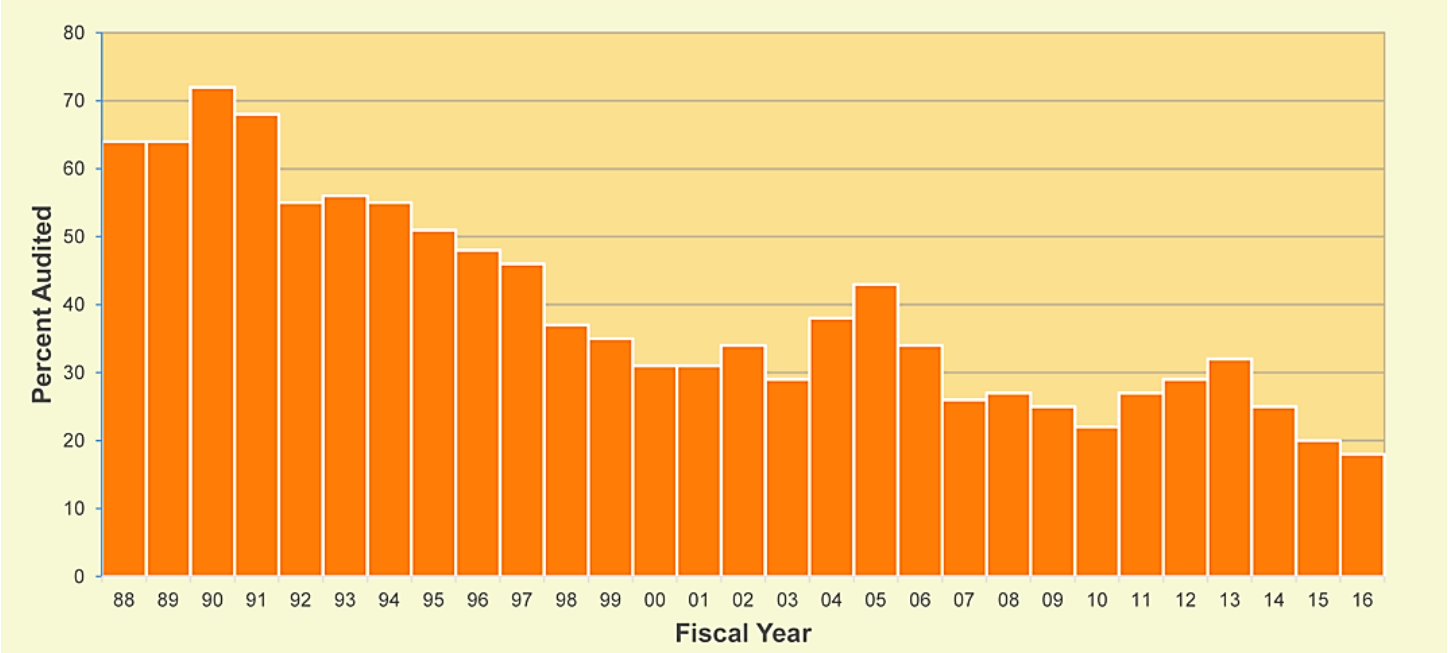
Audit Coverage – Large Corporations

Figure 46: Percentage of Corporate Income Tax Returns Examined – Corporations With Assets of $10 Million and Greater



Source: TIGTA analysis of the IRS Data Book.

Audit Rates for Largest Corporations (Assets $250 Million or More)



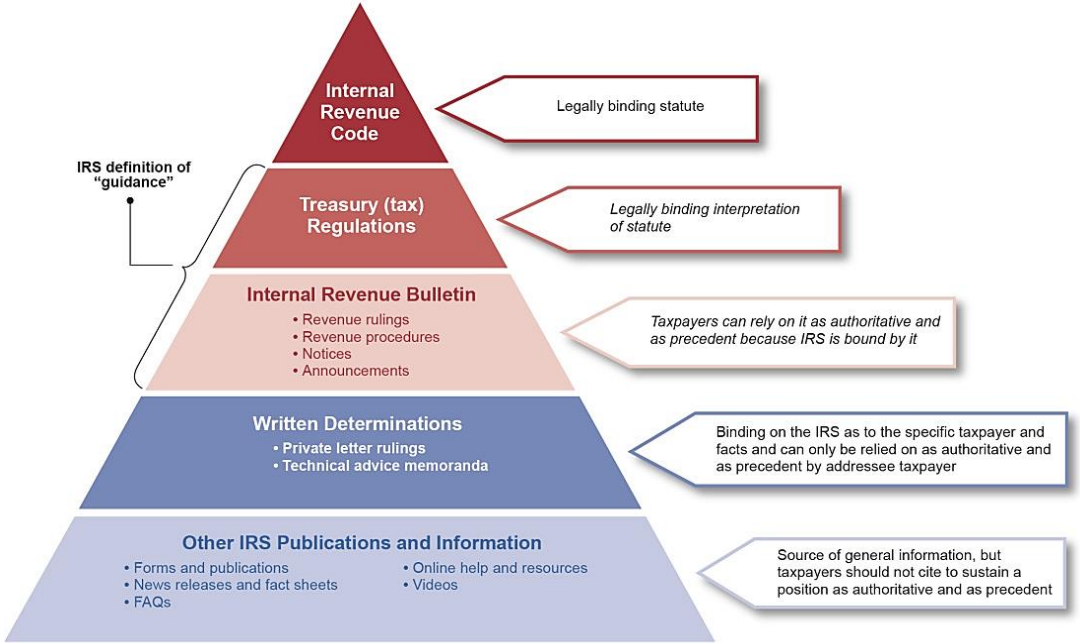
Current State of IRS Guidance

Current State of IRS Guidance

- Guidance process already slow
  - Resource constraints
  - APA challenges proliferating. After *Mayo*, *Altera*, *etc*. IRS and Treasury must take more time to build file, explain decisions, and respond to comments
- IRS's unique position on issuing regulations
- Trump Administration's Executive Orders

IRS Guidance

Hierarchy of IRS Guidance



Source: GAO analysis of IRS documents. | GAO-16-720

Background Controls on Agency Rulemaking

- Administrative Procedure Act, 5 U.S.C. § 552
- Executive Order 12866

5 U.S.C § 553: APA Notice and Comment Requirements

(b) General notice of proposed rule making shall be published in the Federal Register, ... The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply—

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except— (1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

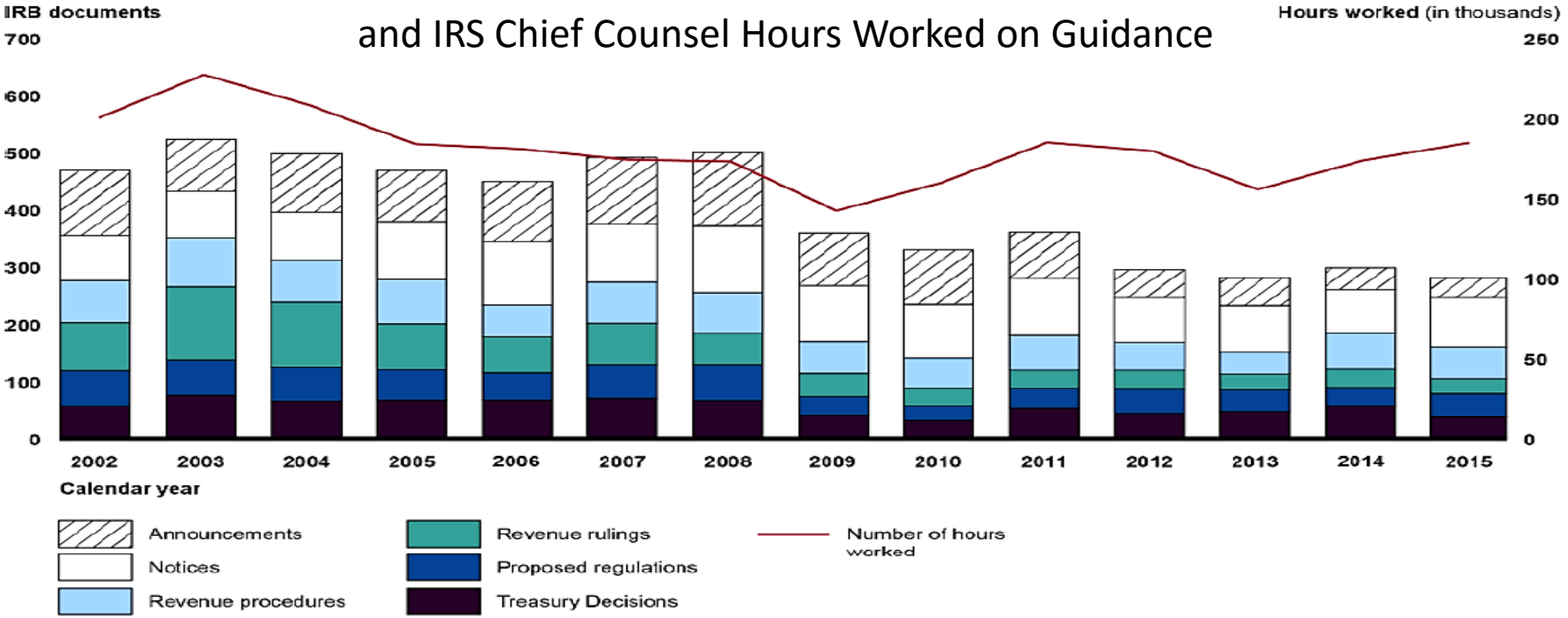
(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

(Pub. L. 89–554, Sept. 6, 1966, 80 Stat. 383.)

IRS Guidance

Guidance Documents in the Internal Revenue Bulletin and IRS Chief Counsel Hours Worked on Guidance



Source: GAO analysis of Internal Revenue Bulletins (IRB); IRS data on chief counsel hours worked. | GAO-16-720

APA Litigation on the Rise

- *Mayo* (S. Ct. 2011): Treasury Regulations subject to APA, entitled to Chevron deference
- *Home Concrete* (S. Ct. 2012): Rejects regulation under Chevron Step 1 because statute (§6501(e)), as interpreted in prior S. Ct. case, left no gap for agency to fill
- *Dominion Resources* (Fed. Cir. 2012): Invalidates interest capitalization regulation under Chevron Step 2 and reasoned decision-making requirement of State Farm
- *Altera* (T.C. 2015): Cost sharing regulation on stock options, which was legislative regulation, was invalid because Treasury's notice and comment process failed under State Farm's reasoned decision-making standard (on Appeal to 9th Cir.)
- *Chamber of Commerce* (W.D. TX Sept. 29 2017): Temporary anti-inversion regulation invalid due to IRS failure to follow APA's notice and comment procedures

APA Notice and Comment Requirements

- Notice published in Federal Register
- Opportunity for comment
- Reasoned decision-making
- Exceptions for
  - Favorable regulations
  - Interpretive regulations
  - For good cause shown and published with regulation

State Farm, Altera

- Reasoned decision-making requires:
- Basis in facts
- Rational connection between choice made and facts found
- Response to significant comments
- Regulation consistent with evidence before Treasury

IRS Position on APA

IRM § 32.2.5.4.7.5 – IRS guidance on drafting Regulations

- Most IRS Regulations not subject to APA notice and comment requirements
- Most IRS Regulations not “legislative,” but “interpretive”
- Yet, IRS interpretive regulations still have “force and effect of law”

IRS Has Long Been Exposed on APA

- 2007 Kristen Hickman (U. Minn.) study of 232 IRS Regulation projects:
  - Few qualified for “interpretive” regulations exception
  - 61% based on section 7805
  - 39% based on specific rulemaking grant
  - 60% followed notice and comment procedures
  - 36% issued Temp. Regs. without notice and comment
  - 80% claimed APA did not apply without explanation
  - 10% claimed APA did not apply based on good cause

Executive Order 12866 (Sept. 30, 1993)

- Established procedures for planning and review of “significant regulatory action” by Office of Management and Budget’s (OMB) Office of Information and Regulatory Affairs (OIRA)
- Requires cost/benefit analyses of proposed regulations
- Significant regulatory action means:
  - Annual impact of $100 m or more, or adversely affected economy, productivity, competition, jobs, environment, public health/safety, state and local government
  - Created inconsistency with another agency’s actions
  - Altered budgetary impacts of entitlements, grants, etc.
  - Raised novel legal or policy issues

IRS Position on Exec. Order 12866

IRM § 32.2.5.4.7.5 – IRS guidance on drafting Regulations

- Most IRS Regulations outside Executive Order 12866 because not significant regulatory actions
  - Taxes do not count towards $100 m. impact test
  - Code, not Regulations, impose taxes

Trump Executive Order 13771 (Jan. 30, 2017)

- 2 for 1 order on new regulations
- Total incremental costs of all new regulations in fiscal 2017, including repealed regulations, shall not exceed $0
- Director OMB can make exceptions
- Regulatory repeals must go through APA process
- Going forward:
- Agency annual regulatory plans under Executive Order 12866 must identify offsets for each proposed regulation that will increase costs
- No regulation can issue unless included in Unified Regulatory Agenda for the coming fiscal year
- Director, OMB will specify the total incremental costs allowed to each agency for the coming fiscal year
- Definition of “regulation” or “rule” broader than “significant regulatory action” in Executive Order 12866

Trump Executive Order 13789 (April 21, 2017)

"The purposes of tax regulations should be to bring clarity to the already complex Internal Revenue Code . . . and to provide useful guidance to taxpayers. Contrary to these purposes, numerous tax regulations issued over the last several years have effectively increased tax burdens, impeded economic growth, and saddled American businesses with onerous fines, complicated forms, and frustration. Immediate action is necessary to reduce the burden existing tax regulations impose on American taxpayers and thereby to provide tax relief and useful, simplified tax guidance."

Trump Executive Order 13789 (April 21, 2017)

- Directs Treasury, in consultation with OIRA, to identify "significant tax regulations" issued since January 1, 2016 that:
  - Impose undue financial burden
  - Add undue complexity
  - Exceed IRS statutory authority
- Earlier determinations of whether a regulation is "significant" under Executive Order 12866 "shall not be controlling"
- Directs Treasury and OMB to:
  - *"reconsider the scope and implementation of the existing exemption for certain tax regulations from the review process . . . in Executive Order 12866 . . . ."*
  - Revise IRM § 32.2.5.4.7.5, if necessary, to ensure such review

Regulatory Reform – IRS Response

- June 2017 – Treasury invites public comment on regulations to be eliminated, modified, or streamlined to reduce burden
- Emphasizes regulations that
  - Eliminate or inhibit jobs
  - Outdated, unnecessary, or ineffective
  - Costs exceed benefits
  - Inconsistency or interference with regulatory reform
  - Implement rescinded Executive Orders

IRS Notice 2017-38 (July 7, 2017)

- 105 regulations since January 1, 2016; only 1 previously treated as “significant” (§385 Regulations)
- Review under Executive Order 13789; IRS treated 52 as “potentially significant”
- IRS identified 8 regulations for potential reform, including:
  1. §103 Regulation on definition of political subdivision for tax exempt bonds
  2. Temp. §337(d) regulation on transfers by C corporations to RICs, REITs
  3. §7602 regulation allowing participation in IRS interviews by outside IRS counsel
  4. §2704 regulations on valuing entity for estate and gift taxes
  5. Temp. §752 regulation on partnership recourse liabilities in disguised sales
  6. Final and Temp. § 385 regulations on treating corporate interests as debt or equity
  7. §987 regulations on branch income and currency gains and losses
  8. §367(d) regulations on transfers to foreign corporations, including foreign goodwill
- Regulations not rescinded, only request for comments

What Happens Going Forward?

- Will IRS become more diligent in its APA notice and comment procedures?
- Will IRS become more diligent in following OIRA's procedures?
- How will changes affect the pace of formal IRS guidance?
- Will IRS increase reliance on informal guidance?

Role of Informal Guidance

- IRS often addresses issues through informal guidance:
  - Notices, press releases, FAQs, publications, forms/instructions, web site
  - Internal Revenue Manual (IRM)
- LB&I Practice Groups or Appeals Technical Specialists also adopt positions
- Over-reliance on informal guidance leads to problems:
  - “Zombie Notices”
  - Sudden unexplained changes to IRM, FAQs, forms/instructions, web site
- Practice Group or Technical Specialist positions:
  - Typically, retroactive
  - May effectively “tie hands” of Exam Team, Appeals

IRS Examination Changes

"Bob, do you have time for a tax audit?"

LB&I's Rollout of New Audit Paradigm

- New LB&I Examination Process
- Campaigns
- Role of practice groups, subject matter experts
- Agreement on Facts IDR
- Informal Claims

Risk Identification

- Centralization of issue selection
  - Governance Board decides issues to address and how
  - Issues pre-identified for examiners
  - Separation of classifiers from examiners
- Role of Compliance Planning and Analytics (CPA)
  - Brings all workload selection areas into one office
  - Increased focus on data analytics
  - More data becoming available (e.g., country-by-country reporting)
- Goal is to move from a reactive return-focused risk approach to a more proactive position

Publication 5125: LB&I Examination Process

- To be provided to taxpayers at opening conference
- Goal: To complete exam in an efficient and effective manner through collaborative efforts
- Provides expectations for both IRS and taxpayers
- Outlines 3-Phase Exam process
  - Planning Phase
  - Execution Phase
  - Resolution Phase
- Details set forth in IRM 4.46.1, .3, .4, and .5, all updated in March 2016

Issue-Focused Exam Process

- Issue Team to take responsibility
- Collaboration with taxpayer emphasized
- Resolve issues at earliest appropriate point
  - Exam to seek taxpayer agreement on facts before NOPA
  - Exam Team required to consider Fast Track Settlement
- Rules of engagement
  - Prior system relied on domestic chain, which failed to resolve problems on international issues
  - New system allows moving up substantive, geographic chains, no one decision maker for all of the issues
  - Accountability is diffused

Roles and Responsibilities (IRM 4.46.1)

- Case Manager – holds overall responsibility of the examination; but is not granted “51% control” over the case
- Issue Manager – oversees planning, execution, and resolution of the issue; one issue manager per issue under examination
- Other member – Team Coordinator; Issue Team member
  - Principles of Collaboration (IRM 4.46.1.4) replace Rules of Engagement (formerly IRM 4.51.1)
- Emphasis on collaboration among all parties and timely elevation of concerns
- Provides guidelines for when internal elevation may be appropriate

Campaign Approach

Campaign Approach

- Identify areas of greatest non-compliance
  - Data analytics
  - Feedback from Field
  - Feedback from tax community
- Deploy resources to those areas
- Transparent to taxpayers
- Focus on mid-market companies

Initial Campaigns

1. Section 48C Energy Credits
2. Offshore Voluntary Disclosure Program
3. Section 199 and multi-channel video packages
4. Micro-captive insurance companies (Notice 2016-66)
5. Transfers from corporations to related passthrough entities
6. Life insurance reserves for deferred variable annuities and life insurance products
7. Basket transactions (Notices 2015-73 and 2015-74)
8. Completed contract method for land developers
9. TEFRA – Identify, link, and assess terminal investors in partnerships
10. S-Corporation shareholders claiming losses in excess of basis
11. Repatriation strategies
12. Foreign corporate non-filers (1120F)
13. Section 482 and inbound distributors

Campaign Approach

- 13 initial campaigns reveal emphasis on
  - International Issues
  - Mid-market taxpayers
  - Alternative techniques to auditing
- Low-hanging fruit
  - Not top enforcement priorities
- LB&I continuing discussions with tax community to Identify future campaigns

How IRS Develops Campaigns

- Campaign Development Portal
  - LB&I employees submit a recommendation for a campaign
  - LB&I evaluates proposals and designs campaigns using tailored treatment streams and integrated feedback loops
  - LB&I received hundreds of campaign suggestions in 2016
- Employ data analytics to uncover anomalies, hidden patterns, correlations and other insights
  - E.g., Lead Classification Repository (LCR), stores and manages unstructured data to facilitate sampling for workload classification

How IRS Develops Campaigns

- Data analytics to support identification and evaluation of potential campaign issues
- Consider potential treatment streams
- Decide what resources to deploy
- Identify training, mentoring, networking, and tools needed

Role of Subject Matter Experts

- Issue Practice Groups (IPGs), International Practice Networks (IPNs)
  - Facilitated knowledge management, collaboration
  - Developed practice units on various issues
- International practice units (IPUs) are available
  - https://www.irs.gov/businesses/corporations/international-practice-units
- Domestic Industry Director Guidance units also published
  - https://www.irs.gov/businesses/corporations/large-business-and-international-lbi-industry-director-guidance

Impacts in the Field

- Practice Group's pre-audit investment in campaign may inhibit settlement at the field level
- Centralization of issue selection means less field-level discretion
- Multiple issue teams, coupled with relatively powerless Case Manager, may create havoc
- So far, we have seen audit progress slow down

IDR Process (IRM Exhibit 4.46.4-1)

- Requirements for issuing IDRs
  - IDRs to be single issue, “issue focused”
  - The issue, the information sought, and how the information relates to the issue to be discussed with the taxpayer prior to issuance
  - “Reasonable timeframe” to be discussed with taxpayer, set by exam
- Timely review and follow-up by Exam concerning responses once submitted

Acknowledgment of Facts (AOF) (IRM 4.46.4.9)

- IRS is required to prepare a statement of facts on Form 886-A as part of its consideration of each issue
- IRS is also expected to issue a pro-forma IDR to seek to obtain a written AOF from the taxpayer and to incorporate any additional facts in the write-up
- IRM provides instructions to Exam if the taxpayer
  - Agrees with the facts,
  - Provides additional facts,
  - Identifies disputed facts, or
  - Does not respond to the AOF IDR

Acknowledgment of Facts: Form IDR

Form 4564 (Rev. September 2006)	Department of the Treasury — Internal Revenue Service **Information Document Request**	Request Number

To: *(Name of Taxpayer and Company Division or Branch)*

Subject

SAIN number | Submitted to:

Dates of Previous Requests *(mmddyyyy)*

Please return Part 2 with listed documents to requester identified below

Description of documents requested

The purpose of this IDR is to ensure that all relevant facts, whether favorable to the taxpayer or LB&I, are being considered before the Form 5701, Notice of Proposed Adjustment (NOPA) is issued.

Please review the attached Form 886-A and respond accordingly in writing to the LB&I issue team by the agreed upon date, (MM/DD/YYYY).

(a) Taxpayer agrees to the facts as written.

(b) Taxpayer provides additional relevant facts and supporting documentation.

(c) Taxpayer identifies disputed facts and provides clarification and/or supporting documentation.

Appeals will return the case to exam if the taxpayer presents new information during the Appeals process that was not shared with LB&I during the examination. Therefore, the taxpayer has the primary responsibility to ensure all relevant facts are provided to the LB&I issue team.

While the interpretation of the law or the amount of the proposed adjustment may be unagreed, all relevant facts should be included in the Form 886-A.

Your response to the facts does not indicate agreement to the issue or any proposed tax adjustment. It is only to acknowledge that all of the relevant facts have been identified.

Your response or lack of response to the IDR will be included in the Form 886-A when the NOPA is issued.

Claim for Refund Procedures (IRM 4.46.3)

- Informal claims within first 30 days
  - Should include factual support so that no IDRs necessary
  - Discuss deficiency in claims and provide opportunity to correct
  - Claims risk assessed like other issues
  - Claims can extend audit timeline
- Later claims require formal amended return
  - Form 1120X with supporting documentation

Questions?

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Managing Tax Audits and Appeals 2017

Washington, D.C.

October 5-6, 2017

International Tax Update

International Tax Developments 2017

David Fischer, Crowell & Moring

LB&I Transfer Pricing

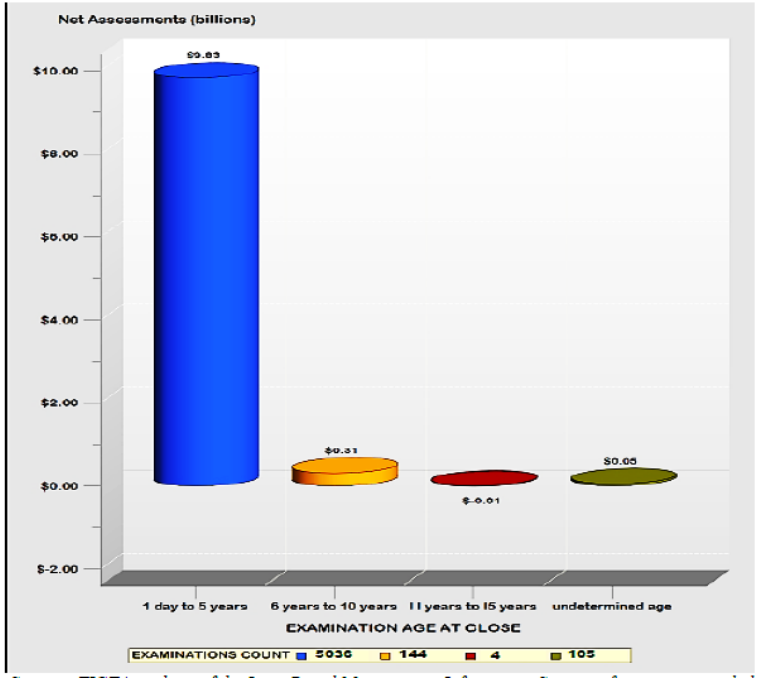
- Last year:
  - Transfer pricing issues included in 46% of LB&I international inventory
  - Transfer pricing issues were 71% of amount at stake in LB&I international inventory
- Announced working on update to Transfer Pricing Audit Roadmap, but no significant change this year
  - Survey: 81% of Examiners use the roadmap sometimes
- Transfer Pricing Issue Assessment Report
  - Supposed to track all transfer pricing issues
  - Not public, TIGTA says does not yet exist
- Training for drafting NOPAs

LB&I Transfer Pricing

Should IRS speed up transfer pricing audits?

- 2012-2014:
  - 5000 cases closed in 5 years, $10 billion assessments
  - 600 cases closed after 5 years, less than $500 million assessments

Figure 4: Net Total Assessments by Age for Examinations That Included at Least One Transfer Pricing Issue Closed in Calendar Years 2012 Through 2014



LB&I Transfer Pricing

Appeals Settlement of Transfer Pricing Issues

- Appeals sustains less than 20% of transfer pricing adjustments
  - 2012-2014, studied 213 cases resolved in IRS Appeals with transfer pricing issues
  - $10.5 billion in adjustments proposed by Exam
  - $2 billion assessed after Appeals
  - Only $321 million finally posted?
- 54% of Agents did not know their proposal was reduced
- 14% knew adjustment was reduced, but did not know the reason
- TIGTA argued need to educate Agents; may have been used to centralize Appeals review

(Source: TIGTA Report, Barriers Exist to Properly Evaluating Transfer Pricing Issues)

Trends in Transfer Pricing Litigation

- Taxpayers are winning
- Use of the Administrative Procedures Act to challenge regulations
- IRS prefers broad-based profits methods; Courts prefer Comparable Uncontrolled Transactions
- Existence of a prior agreement with the IRS helps taxpayer
- IRS wants to use Section 367(d) to attack intangibles transfers
  - Attempting to construct transfer of intangibles through analysis of “substance”
  - Attempting to include goodwill in intangibles covered by Section 367(d)

Altera

Administrative Procedures Act

- Administrative Procedures Act applies to Tax Regulations
  - Whether stock option expenses are included in cost sharing
- Tax Court reviewed decision on Appeal to the Ninth Circuit
  - Briefs filed, awaiting oral argument (perhaps a year out)
- Arguments on Appeal concede that Administrative Procedures Act applies
  - Focus on whether cost sharing regulations can provide including stock option expenses is arm's length as a matter of law, or whether it must be proven unrelated parties share stock option expenses
  - Important issue whether regulation is tested based on arguments at time, rather than arguments by lawyers on Appeal, *SEC v. Chenery Corp. (*S. Ct. 1943)
- *Chamber of Commerce v. IRS* (W.D. Tex 2017), this week

Chamber of Commerce v. IRS

Administrative Procedures Act

- Last week, W.D. Texas invalidates Anti-Inversion Temporary Regulations
- Legislative Temporary Regulations failed to meet Notice and Comment requirements of APA and were invalid
  - IRS argued Notice and Comment not required under Section 7805 for temporary regulation – rejected
  - IRS argued regulation was interpretive – rejected
- Court:
  - Temporary Regulation cannot immediately effective, in spite of Section 7805
  - Under APA, IRS must issue as proposed regulation and follow Notice and Comment procedures
  - Section 7805 did not state intent to override APA

Amazon

- Rejects IRS “investor method” valuation of Buy-In payment under cost sharing arrangement
- Follows *Veritas*
  - Was test case Designated for Litigation by IRS to attempt to reverse result in *Veritas*
- Goodwill is not intangible asset under Section 936(h)(3)(B) (“other similar assets”) included in section 367(d)
- Decision entered July 5, 2017, appeal by October 3

Medtronic

- Medtronic develops and sells medical devices (Cardiac)
- Manufacturing by Puerto Rico subsidiary (2001)
- MOU after 2002 audit had comparable uncontrolled transactions (CUT) with residual profit split
- Taxpayer position on return followed MOU, took more aggressive position in Tax Court
- IRS asserted comparable profits method required “total profits chain”
- Tax Court: accepted Taxpayer position, with adjustments
  - Rejected total profits chain CPM
- On Appeal to Eighth Circuit
  - Unusual to appeal heavily factual issue
  - IRS contends best method issue

Eaton

- Retroactive revocation (not prospective cancellation) of Advance Pricing Agreement and assertion of transfer pricing adjustments
- 2013: Tax Court holds test under abuse of discretion standard, denying summary judgment on basis that APAs were enforceable contracts
  - Viewed as Taxpayer loss
- 2017 : Tax Court holds cancelation of APA was abuse of discretion
- Eaton still has later years to resolve
- IRS 2016: No APAs cancelled or revoked

Eaton

- APA may be cancelled only in accord with Revenue Procedures
- Test was whether fact errors were made with intent to deceive and were material to results
- Court found
  - Errors were not material (IRS may have presented nitpicky errors)
  - Eaton acted in good faith
  - IRS had opportunity to find out (and agreed to renewal)
  - Not required to provide information not requested, not believe material
  - Difference of opinion is not misrepresentation
  - Mistakes did not uniformly favor Eaton
- Lesson: APAs are strong

Coca-Cola

- Coke's transfer pricing was based on a 1996 Closing Agreement, resolving prior years
  - 10% routine return, 50/50 profit split
- Coke had relied on Closing Agreement from 1987 through 2004, accepted by the IRS
- Transfer pricing case for 2007-2009, docketed in Tax Court
  - Spring 2018 trial
  - Discovery dispute includes information from IRS about 1996 Closing Agreement negotiations
- IRS moved for summary judgment to exclude Closing Agreement from evidence, motion denied

IRS Use of Section 367(d)

- Section 367(a) imposes tax on otherwise tax-deferred transfers to foreign affiliates
- Section 367(d) imposes commensurate with income royalty on similar transfers of intangibles
- IRS arguing as backup argument in transfer pricing cases:
  - If so much profit is offshore, must have been transfer of intangible
  - Construct intangibles transfer and create new deemed royalty under section 367(d)
- So far has been rejected

Grecian Magnesite

Rev. Rul. 91-32 Overturned

- Rev. Rul. 91-32: applies aggregate (rather than entity) theory to gain on sale of partnership interest by non-resident partner
  - Gain on the sale of US partnership interest by non-resident partner is treated as effectively connected to the extent gain on sale of all the assets of the partnership would be ECI
- Grecian Magnesite Mining: Tax Court holds that gain on redemption of partnership interest is not effectively connected income
  - Section 741 clear that treated as sale of capital asset
  - Overrules Rev. Rul. 91-32:
- Decision entered September 21 – Appeal period until December 20, 2017
- Will Congress change?

Analog Devices

Impact of Secondary Adjustments under Rev. Proc. 99-32

- Rev. Proc. 99-32 permits taxpayer to set up receivable / payable to reduce tax consequences of payments required to address cash imbalance after transfer pricing adjustments
- *BMC Software* (Tax Court 2013), reversed (5th Circuit 2015) refuted IRS argument that debt created under Rev. Proc. 99-32 reduced dividends received deduction (by increasing related-party indebtedness), causing taxable dividends
- *Analog Devices* (Tax Court 2015): Tax Court follows *BMC Software*
- Dissent: "for all Federal income tax purposes" in standard Rev. Proc. 99-32 includes for DRD purposes
  - Majority says did not contemplate, no intent
  - Closing Agreement in BMC did not include "all"
  - Caution: future Closing Agreements

“Quick Peek” Procedure

- Disputes re Attorney-Client / Federally Authorized Tax Practitioner privileges, Work Product doctrine
- Opposing Counsel permitted to review documents under Fed. R. Evid. 502 (pending discovery dispute)
  - Permits parties to focus or eliminate disputes
- Used in transfer pricing disputes
  - *Microsoft* (Summons enforced, case pending)
  - *Guidant* (taxpayer obtained 26 of 4,000 documents for which IRS claimed privilege, case settled)

Questions?

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Managing Tax Audits and Appeals 2017

Washington, D.C.

October 5-6, 2017

Transfer Pricing Update

Developments in APMA and the IRS Transfer Pricing Practice

John Wall, Assistant Director APMA

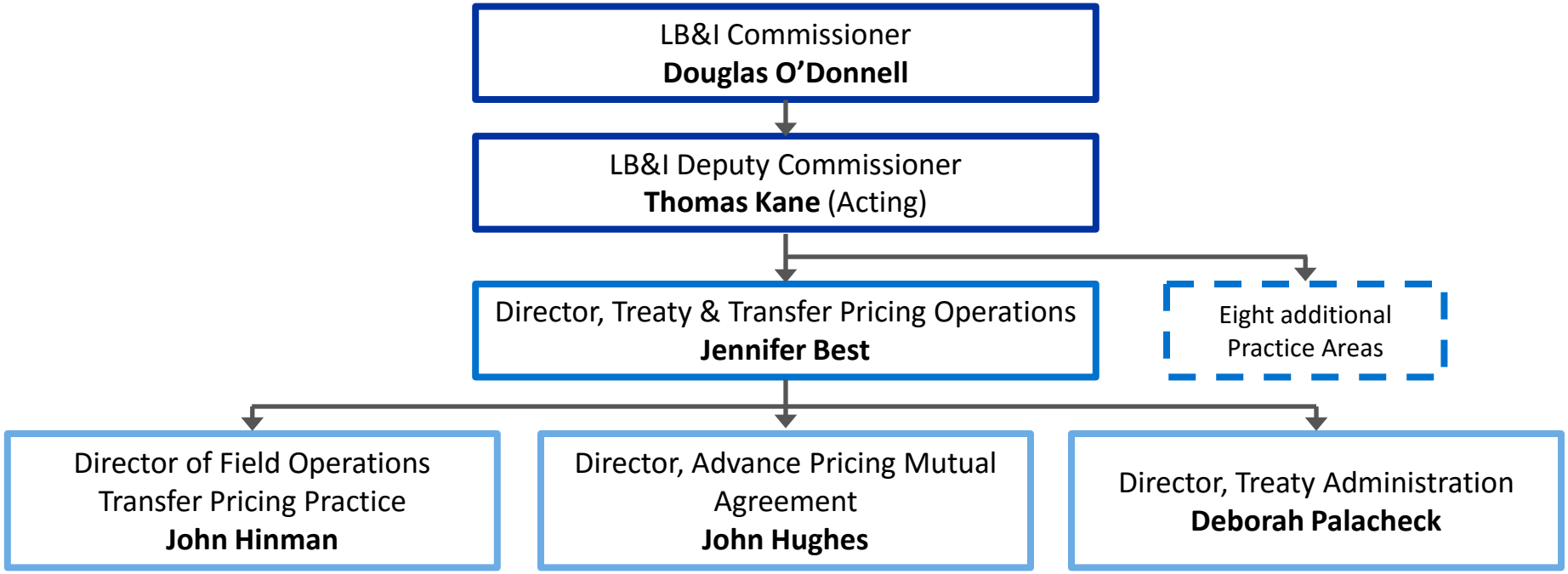
Anthony Ferrise, Acting Assistant Director APMA

Agenda

- Introduction to IRS Treaty and Transfer Pricing
  - Competent Authority Procedures
  - APA Procedures
- LB&I Transfer Pricing Practice Developments and Practice
- Competent Authority Developments and Practice
- Advance Pricing Agreement Developments and Practice
- BEPS Developments

IRS Treaty and Transfer Pricing Operations

IRS Practice Area Responsible for Transfer Pricing



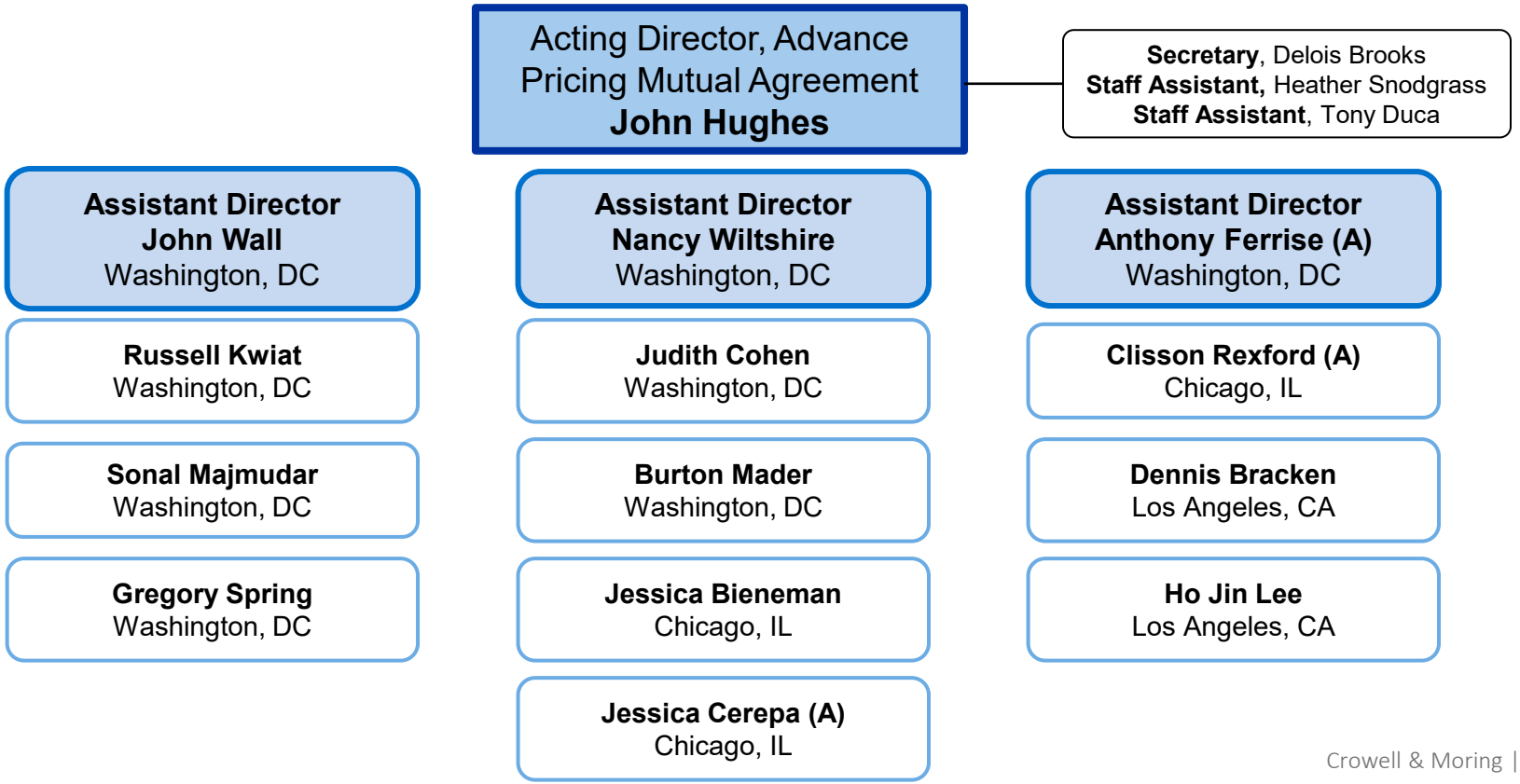
IRS Treaty and Transfer Pricing Operations

- Transfer Pricing Operations
  - Strategic case selection
  - Audit campaigns
- Treaty Assistance and Interpretation Team (TAIT)
  - Competent Authority matters other than double taxation
- Advance Pricing and Mutual Agreement (APMA)
  - Competent authority in business profits and associated enterprises double taxation cases (Article 9 transfer pricing and Article 7 allocation)
  - Advance Pricing Agreement program

Introduction to APMA

- Responsible for Advance Pricing Agreements and Mutual Agreement Procedure (MAP) cases as US Competent Authority representatives
- Staff generally assigned by Country
  - See https://www.irs.gov/businesses/corporations/apma-contacts
- Offices in Washington D.C., New York City, Chicago, San Francisco, San Jose, Los Angeles, Laguna Niguel

APMA Organization



Competent Authority Procedures

See Revenue Procedure 2015-40

- Intended to resolve "taxation not in accordance with" the treaty under the Mutual Agreement Procedure (MAP) article (e.g., in the US-Japan treaty it is Article 25)
  - Double taxation, correlative adjustments
- May be a US- or foreign-initiated adjustment, or taxpayer-initiated (with restrictions)
- Request filed with both governments to resolve past years (tax returns filed)
- *See* Rev. Proc. 2015-40, Section 3 and Appendix, regarding filing requirements
- No filing fee for transfer pricing disputes
- Treaty arbitration processes may apply depending on the specific treaty involved (*e.g.* Canada)

Competent Authority Procedures

See Revenue Procedure 2015-40

- Statutes of limitations remain critical: Taxpayer should protect domestic and foreign statutes of limitations
  - Protective claim may be made to the Competent Authority by letter or as part of the Competent Authority Request
  - If before the Competent Authority request, annual notification of status is required
- May be notification or filing deadlines
  - Most tax treaties allow for MAP to resolve an issue despite any time limits or other procedural limitations (i.e., statutes of limitation)
  - Most tax treaties have time notification limits, and unless the competent authorities are notified in time, then no MAP is available for those years past the time limit (e.g., with Japan and Canada)
  - A treaty notification may be made to the U.S. Competent Authority by letter or as part of the Competent Authority request

APA Procedures

See Revenue Procedure 2015-41

- Taxpayers may request Advance Pricing Agreement under which IRS and taxpayer agree to transfer pricing method that will be accepted for the application year and in the future
  - Unilateral, Bi-lateral, Multi-lateral
- Cooperative process, both parties have an interest in establishing an accurate and workable transfer pricing method
- Conservation of resources for both parties in long run

APA Procedures

See Revenue Procedure 2015-41

- Rev. Proc. 2015-41, process from IRS viewpoint
  - APA request is filed (pre-filing requirements met, complete submission filed, and fee paid)
  - Due Diligence process (APMA team formed, questions, responses, meetings, etc.)
  - APMA and taxpayer (and treaty partner) discuss results of analysis
  - Bilateral APA: Negotiations with other government(s), mutual agreement reached, bilateral case closed
  - Unilateral APA: Negotiation and agreement reached with taxpayer
  - US domestic agreement executed between the IRS and taxpayer

LB&I Transfer Pricing

Practice Developments

- LB&I Competent Authority Business Unit
  - Guidance to IRS Examiners concerning Competent Authority availability and practice for US-initiated adjustments
- Transfer pricing campaigns
  - Repatriation: Structures and Reporting
  - Form 1120F Non-Filers
  - Inbound Distributors
- Updates to Transfer Pricing Audit Roadmap

Competent Authority Practice

Accelerated Competent Authority Procedures (ACAP)

- A taxpayer may request Competent Authority assistance for an adjustment for a past year through the treaty MAP process (not an APA)
- If there are intervening years, the taxpayer may be able to request accelerated competent authority procedure (ACAP) consideration
- Example: The IRS proposes an adjustment related to 2010 and 2011, but the same issue or transaction exists in 2012 – 2015. ACAP may possibly be used to resolve the later years in the same process as 2010 and 2011.
- Availability of ACAP may be limited by the other country involved
- *See generally* Rev. Proc. 2015-40, Section 4

Competent Authority Practice

Developments

- Arbitration
  - Canada, Belgium, France, Germany
  - Trends: treaties and practice
- Important strategic relationships

Competent Authority Practice

- Role of Taxpayer in management of case
  - Best practice to provide each Competent Authority information provided to other Competent Authority
  - Failure to provide information can jeopardize case resolution
- Impact of Examination on Competent Authority
  - Should taxpayer address each issue raised on Exam as part of Competent Authority request?
  - If taxpayer made concession on Exam to pursue case resolution, is Competent Authority bound by that concession? Is taxpayer bound

APA Practice

- Increase in informal consultations with APA
  - Important where US and foreign have known disagreements on principles
- New proposed APA agreement template
  - Comments due October 31, 2017
  - Purpose: easier, quicker drafting and review
  - More uniformity
  - Experience with Rev. Proc. 2015-41 – up-front work led to more efficient review
- Exchange of APAs with other countries
  - Concern over disclosure / leaks

APA Practice

APA Inventory 2015-2016

	Unilateral	Bi-Lateral	Multi-Lateral	Total
Filed				
2015	52	127	4	183
2016	14	84	0	98
Executed				
2015	30	80	0	110
2016	21	65	0	86
Pending				
2015	85	316	9	410
2016	67	322	9	398

APA Practice

Processing Times

- Median time to complete an APA increased slightly from 31.9 months in 2015 to 32.8 months in 2016
- Median time to complete new APA increased from 34.2 months in 2015 to 46.7 months in 2016

Table 7: Months to Complete New and Renewal APAs Executed in 2016

	Unilateral		Bilateral		**Unilateral & Bilateral**	
	Average	Median	Average	Median	**Average**	**Median**
New	33.9	23.4	50.5	48.8	**48.7**	**46.7**
Renewal	21.8	12.0	34.2	32.1	**29.9**	**23.2**
New & Renewal	**24.1**	**15.4**	**42.4**	**35.6**	**37.9**	**32.8**

Table 7: Months to Complete New and Renewal APAs Executed in 2015

	Unilateral		Bilateral		**Unilateral & Bilateral**	
	Average	Median	Average	Median	**Average**	**Median**
New	28.0	23.7	40.6	41.9	**37.2**	**34.2**
Renewal	20.2	14.4	42.4	35.5	**36.3**	**31.6**
New & Renewal	**23.4**	**17.3**	**41.7**	**38.2**	**36.7**	**31.9**

APA Practice

Transfer Pricing Methods

- CPM / TNMM used in 89% of cases 2016 (79% 2015)
- Operating Margin used as Profit Level Indicator in 67% of cases 2016 (62% 2015)
- Comparable Uncontrolled Transaction methods approximately 10% of cases
- Profit split less than 10% of cases

Method Issues

- Differences in selection of tested party
  - US prefers party with least complex functions, some countries insist on US parent
- BEPS emphasis on location of resources
  - People, including decision-makers
  - Ability to perform in addition to bearing risk

BEPS

MAP Peer Review

- Participating countries have agreed to attempt to meet minimum standards:
  - Action 14: Effective Dispute Resolution
  - Action 6: Treaty Shopping
- First set of Peer Review reports re Action 14: Effective Dispute Resolution released September 26, 2017
  - United States, United Kingdom, Canada, Belguim, Netherlands, Switzerland

BEPS

MAP Peer Review

- Areas of favorable performance
  - Access to MAP available
  - Pragmatic approach to resolution of cases
  - Rollback available for bi-lateral APAs to minimize disputes
  - MAP agreements implemented timely
- Areas for improvement
  - Resolution within target 24 months
  - Treaty implementation
    - 51 of 60 US treaties include MAP, 11 do not meet all BEPS terms, 40 match BEPS suggestions

Country-by-Country Reporting

- Country-by-country reporting by taxpayers underway
- Impact of country-by-country reporting on Competent Authority and APA Negotiations
- Exchange of country-by-country reports
  - 65 countries have signed on to exchange, US has not
  - US requires Treaty to exchange country-by-country reports
    - Executed bi-lateral agreements with 12 countries (Netherlands, Norway, Iceland, New Zealand, South Africa, Canada, Denmark, Guernsey, Ireland, South Korea, Latvia, Slovak Republic)
  - Announced Model Competent Authority Arrangement
  - Concern over disclosure / leaks
  - Impact of country-by-country reporting on taxpayer behavior

Questions?

crowell moring

Employee Benefits

Scratch the Tax
Health Savings Accounts (HSAs) Move Over 401(k)s!

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Agenda

- Health Savings Accounts (HSAs) – **The Best Tax Deal Going**
- Archer Medical Savings Accounts (MSAs) – Out With The Old
- HSA/MSA Similarities
- HSA/MSA Differences
- HDHP – Why All the Fuss?
- Proposed Reform
- Exposure – ERISA, IRC, Litigation
- Key Take Aways

HSA's – The Best Tax Deal Going

TRIPLE TAX FREE – ONLY EMPLOYEE BENEFIT THAT WORKS THIS WAY

- Employer contributions — EXCLUDED FROM EMPLOYEE'S INCOME
- Employee contributions — PRE-TAX
- Unlike 401(k) contributions — NO MEDICARE/SOCIAL SECURITY TAXES WITHHELD
- Interest, dividends, capital gains — TAX FREE
- Distributions — TAX FREE
  - May be taken any time
  - Must be used for qualified medical expenses which include certain insurance premiums (otherwise 20% penalty unless death, disability, age 65)
  - After age 65 – can be used for non-medical expenses without penalty (taxed at individual's normal rate).

HSA's – The Best Tax Deal Going

- No Forfeitures — ACCOUNTS ROLL OVER EACH YEAR (unlike Flexible Spending Accounts (FSA))
- Fully Portable — INDIVIDUALLY OWNED
- Minimum Distributions?! — NO MANDATORY AGE 70 ½ MINIMUM DISTRIBUTIONS (unlike 401(k)/IRA)
- Example as a retirement strategy:
  - Age 26
  - Make maximum family contribution to age 65 including catch-up
  - Invest in stock market with average rate of return
  - Do not make withdrawals for medical expenses
  - HSA Account worth $2 million at age 65
- Consider it a retirement investment tool, not a special checking account.

HSA's – The Best Tax Deal Going

- Authority - HSAs are IRA-type accounts authorized by IRC s. 223
- Reporting by Trustee/Custodian (Form 5498-SA and Form 1099-SA)
- Reporting by Employer (W-2-Box 12, Code W)
- Reporting by Employer (Form 8889 and Form 5320 attachments to Form 1040)
- Note of caution – if employer activity causes HSA to be subject to ERISA, fiduciary liability risk imposed personally on board, officer, others (ensure D&O ERISA coverage)

HSA's

Current State of HSA's – The Next "Big" Thing

- 2003 - Created following brief MSA period ("Medicare Prescription Drug, Improvement, and Modernization Act of 2003)
- 2007 – 5 million accounts*
- 2017 – 18 million accounts. $34.7 billion in assets **
- 2018 - Projected 27 million accounts. $50 billion in assets **
- 2016 - 50 million HDHP (CDHP)***
- 2011-2016 – Deductibles increased 86%
- Will be competition for retirement savings (tax-deductible/tax deferred)

* AHIP ** Kaiser Foundation ***NY Times 2016

HSA's

Current State of HSA's – The Next "Big" Thing

- HDHP must have:
  - Annual deductibles of at least $1300 for self coverage/$2600 for family
  - Out of pocket maximum must not exceed $6550 for self coverage/$13100 for family (with deductible counting towards the limit)
  - Both annual deductibles and out of pocket maximums are indexed to inflation
  - Employer may offer but is not obligated to contribute to HSA (80% do)
  - If employer does contribute, amounts are excluded from employees taxable income.
  - Employer contributions must be same % of deductible or same dollar amount for all employees (certain exceptions for HCE and matching contributions made through a cafeteria plan)

MSA's

Current State of MSA's – Out with the Old

- Early 1990s - Fear of over-insurance use. Patients to save/pay for own services
- 1996 – Federal MSA pilot (Congressman Archer "Archer MSAs")
- 1998 – 25 states passed legislation
- 2004 – HSA's impact MSA's
- Dying product
- Medicare Advantage MSA's – tied to HDHP Medicare Advantage Plan (certain funds deposited into MSA by Medicare)

HSA's/MSA's

Similarities

- Arguably deters abuse of medical services – skin in the game
- Pre-tax contributions through employer
- After-tax deduction if not made through employer
- Not subject to withholdings – most states allow deduction (not CA, NJ, Alabama)
- Fixed contributions limits (IRS)
- Assets investable - stocks, bonds, mutual funds, bank accounts (consider FDIC/SEC issues)
- Earnings sheltered

HSA's/MSA's

Similarities

- Withdrawals tax-free (qualified expenses only)
- Not linked to IRA/401(k)
- Age 65 and those with disabilities
    - No 20% penalty for non-qualified withdrawals
    - No longer able to contribute post-65
- Portable
- Death – succession (spouse – tax free transfer)
- Certain other health coverage permitted (disability, dental, vision, long-term etc.)
- Rollovers (not to 401(k))

HSA's/MSA's

Differences

- Qualification Differences
  - HSA – HDHP (employed, unemployed, self-employed)
  - MSA - Employee/spouse of small employer (50 or less) or self-employed/spouse.
  - MSA - Pre-2008 participant. Post-2007 need HDHP.
- Contribution Differences
  - HSA's (employer, employee and 3rd party same year)
  - MSA's (employer or employee same year)
  - HSA 2018 ($3450/$6900) ($1000 catch-up if 55 and not enrolled in Medicare)
  - MSA 2017 (75% of annual deductible of HDHP or 65% if self-only plan) + Income limit
  - Age 55 and older ($1000)

HSA's/MSA's

Types of Permitted Expenses – Hundreds of Qualified Medical Expenses

- Medical
- Prescription
- First aid supplies
- Chiropractic
- Dental
- Vision
- Mental Health
- Certain insurance premiums (COBRA, USERRA, Qualified Long-Term Care Insurance Contract)
- Prenatal vitamins, breast pumps, glucose monitors
- See IRC Section 213(d)

HSA's/MSA's

The Unusual

- Lead-based paint removal
- Special phone equipment
- Wigs
- Auto adaption
- Closed captioning
- Braille
- Guide dogs
- Smoking cessation
- Transportation
- Defibrillators, wearable blood pressure monitors

Proposed Reform

American Health Care Act/Better Care Reconciliation Act
Proposed 2018 Provisions for HSA's/MSA's

- Repeal of exclusion of over-the-counter medications (HSA's/MSA's)
- ACA penalty for non-medical uses reduced:
  - 20% to 10% (HSA's)
  - 20% to 15% (MSA's)
- Double amounts contributed – i.e., HSA's to 2017 out-of-pocket limit ($6,550 self or $13,100 family)
- Allow both spouses to make catch-up contributions to same HSA
- HSA's may cover medical expenses incurred 60-days prior to HSA commencement
- Tax credits not allowed to fund HSA's

Proposed Reform

American Health Care Act/Better Care Reconciliation Act
Proposed 2018 Provisions for HSA's/MSA's

- GOP proposed HSAs be used for:
  - Health insurance premiums for individual-market plans,
  - Health insurance premiums for Medicare-supplemental/Medigap health plans,
  - Medical expenses of nondependent adult children covered under parent's health plan.
- Not included in the proposed legislation but being talked about - allowing HSAs to pay for health services under **all** types of health plans (eliminating rule that HSAs must be tied to HDHPs).
- Draft Executive Order – permit services and benefits related to management of chronic diseases to be excluded from HDHP deductible.

HDHP's – Why All the Fuss?

- 2001- High Deductible Health Plan (HDHP) (also referred to as Consumer Directed Health Plan (CDHP)) is combination of:
  - Health insurance coverage
  - High deductible
  - Individual savings or reimbursement account (pay out of pocket costs for health care)
- 29% of workforce enrolled in HDHP (2016) *
- 61% of employers with more than 500 employees offer HDHP with HSA or HRA *
- By 2019 expected growth to 72%*
- Expectation - those choosing HDHP/HSA would make more cost and quality-conscious health care decisions
- Concern - younger and healthier employees opt for this type of coverage.

- * Mercer, 2016 National Survey of Employer Sponsored Health Plans

Exposure – ERISA, IRC, Litigation

- ERISA
  - Covered?
    - HDHP – Yes
    - HSA - Depends on level of control by employer in HSA
  - Fiduciary?
- IRC
  - Increased Reporting?
  - Audits?
  - Penalties?
- Litigation
  - Fiduciary?
  - Plan assets?

Exposure – ERISA, IRC, Litigation

Are HSA's Governed by ERISA?

- Field Assistance Bulletins 2004-1 and 2006-02
- Employer contributions to HSAs would not give rise to ERISA-covered plan where establishment of HSA is completely voluntary on part of employees and employer does not:
  - limit ability of eligible individuals to move funds to another HSA beyond restrictions imposed by the IRC;
  - impose conditions on utilization of HSA funds beyond those permitted under the IRC;
  - make or influence investment decisions with respect to funds contributed to an HSA;
  - represent that HSAs are employee welfare benefit plans established or maintained by employer; or
  - receive any payment or compensation in connection with an HSA

Exposure – ERISA, IRC, Litigation

- To avoid ERISA, HSA must meet one of two safe harbors:

  1) Voluntary plan safe harbor (not available if employer makes HSA contributions), or

  2) HSA safe harbor (employer can make contributions):

    - employer must not take active role in HSA investments, restrict use of contributions, accept payment or compensation, endorse participation
    - Employer communications/education about HSAs does not rise to level of endorsing
    - Employer should be cautious regarding nature of investment education (to much = influence?)
    - If investment options and trustee is same as employer's 401(k) - may raise questions re ERISA

Exposure – ERISA, IRC, Litigation

- Related IRS Guidance on aspects of HDHP/HSA
  - IRS Information Letter 2017-0003
  - IRS Information Letter 2017-0005
  - IRS Information Letter 2016-0082
  - IRS Information Letter 2016-56

Exposure – ERISA, IRC, Litigation

- Recent Trends
  - Continued obsession with HSAs as cure-all
  - Little or no transition guidance, last administration:
    - increased administrative enforcement actions
    - indicated need for increased rulemaking and administrative guidance
  - No news regarding agency or administrative policies going forward:
    - expected to decrease enforcement efforts
    - expected to identify for removal current “costly” regulations
    - expected to decrease rulemaking and administrative guidance

Exposure – ERISA, IRC, Litigation

ERISA - Which Health/Welfare Plans Covered?

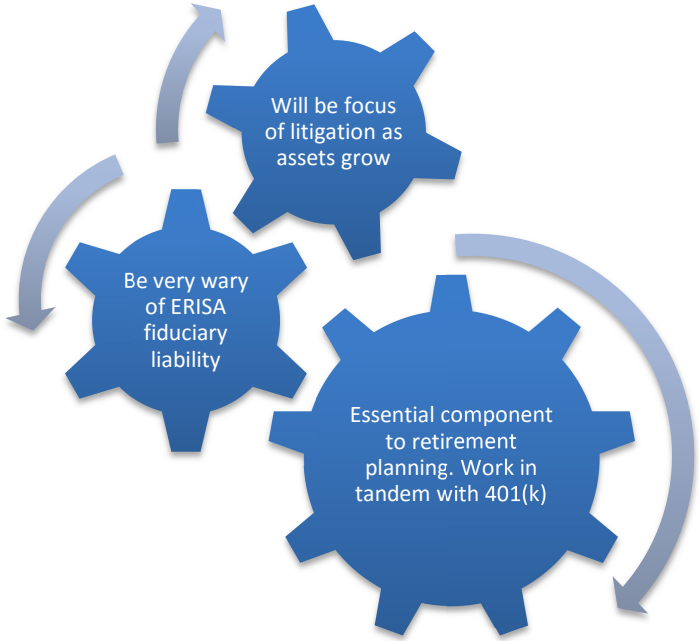
- Medical, surgical, hospital, HMO plans (including HDHPs)
- HRAs, FSAs
- HSAs - **maybe**
- Dental Plans
- Vision Plans
- Prescription Drugs Plans
- Sickness, Accident, Disability and EAPs (if providing counseling, not just referrals)
- Life and AD&D

Exposure – ERISA, IRC, Litigation

ERISA, IRC, Litigation – Where We Are Now

- U.S. Department of Labor
  - Previously suggested need for additional guidance with regard to fiduciary issues under health and welfare plans
    - Who is a fiduciary
      - Plan sponsor
      - Plan administrator
      - Third-party service provider
  - Plaintiff's attorneys are expected to seize upon the uncertainty to attempt to bring lawsuits that would significantly expand who may be found to be a fiduciary with respect to health and welfare plans expected to decrease enforcement efforts

Key Takeaways



Questions?

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Thank you

Prospects for Fundamental Tax Reform Legislation

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James Flood, Crowell & Moring
Rick Grafmeyer, Capitol Tax Partners©

LEGISLATIVE AND POLICY OUTLOOK 2017

Rick Grafmeyer
Capitol Tax Partners©
October 4, 2017

Budget Reconciliation

- Must first pass a budget resolution between House and Senate
  - Will be partisan; not as easy as it sounds (e.g., will overall spending targets be addressed?)
    - Senate - - $1.5T deficit increase from taxes plus dynamic scoring (but not sure it can be used). $4T in unspecified direct spending cuts, only $1B in reconciled cuts
    - House - - repeal of health reform assumed, assumes $203B in reconciled cuts
    - Both bills assume about $1.5T in economic growth
- If resolution passes, any reconciliation bill meeting established spending or revenue targets will have procedural protections on the Senate floor
  - Only need 50 votes; 20 hours for debate; vote-a-rama.
  - Amendments offered must be germane or subject to a 60-vote point of order
- Byrd rule – six definitions of items that can give rise to points of order requiring 60 votes to overcome
  - No fiscal effect; not in compliance with instruction; outside jurisdiction; fiscal effect merely incidental relative to the policy change; adds to long-term deficit; affects social security
  - May need to sunset provisions (a la Bush tax cuts)
    - Try to avoid out-year effects
    - Extend budget window or change the rules?
- PAYGO rules
- Approx. 35 legislative days left

Remaining key dates for 2017

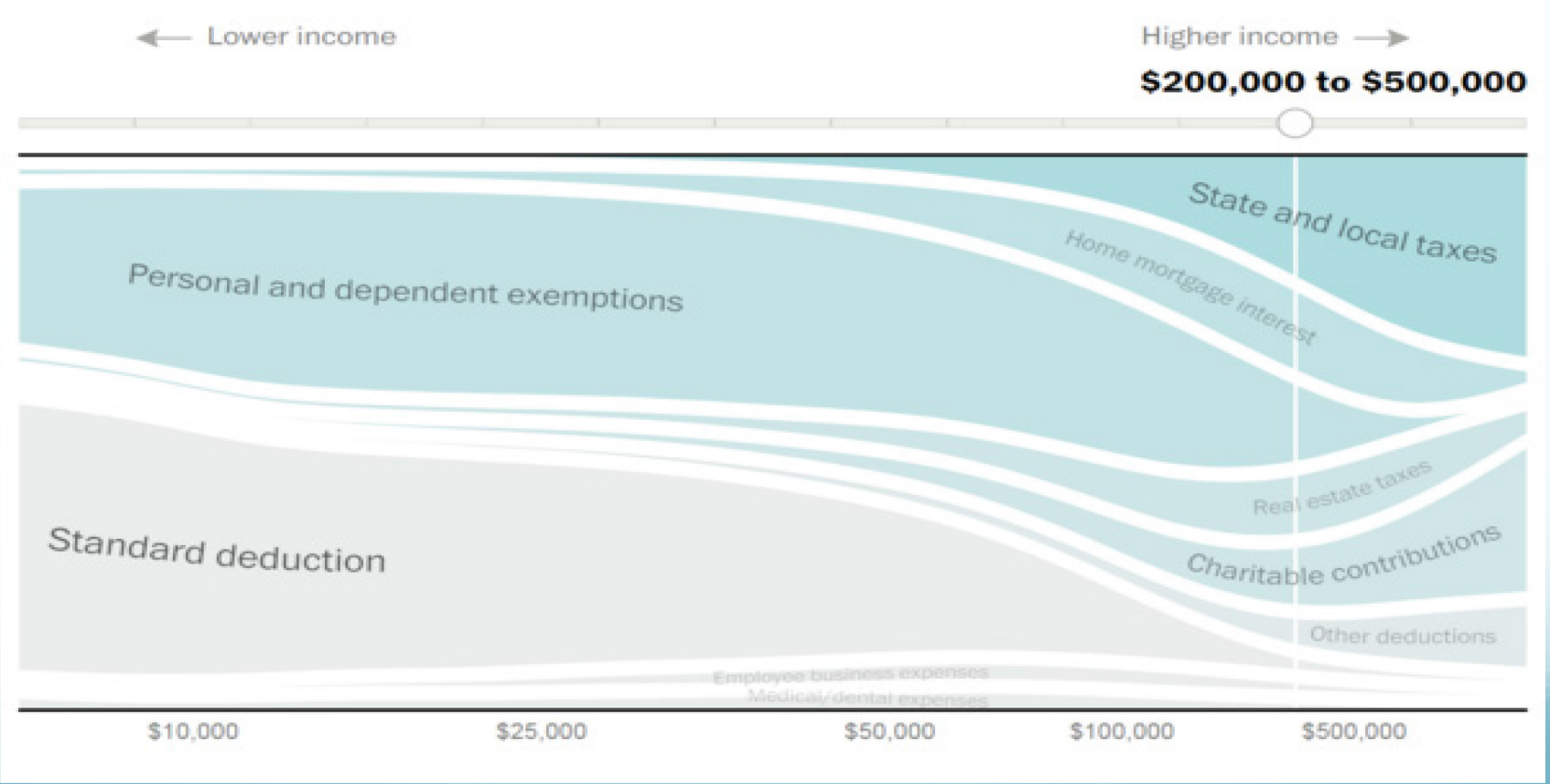
- Sept / Oct - - CHIP reauthorization (60 votes)
- Oct - - 2018 Budget Resolution
- Dec. 8 (but could slide to Mar.) - - Debt Ceiling (60 votes)
- Dec. 8 - - Flood insurance, Potential FY2018 CR (60 votes)
- Dec. 31 - - FISA, mini-tax cliff (device tax, health insur. tax, tax extenders) expire
- Mar. 31 - - FAA reauthorization

Cost of Principal Tax Reform Proposals

- Individual rate cuts - - $1.7T over ten years
- Increase standard deduction - - $.7T over ten years
- Increase child credits - - $.4T over ten years
- Corp. rate cut to 20% and AMT- - $2.7T over ten years
- Repeal estate tax - - $200B over ten years
- Offsets
  - Repeal item. ded. (other than mort. int. and charities.) - - $1.6T over ten years
  - Repeal exemptions - - $1.6T over ten years

All proposals subject to phase-ins and outs for scoring reasons

Use of Deductions by Income



Other Tax Issues

- Estate tax repeal, incl. repeal of basis step-up
- Retirement savings -- >$200 billion over ten years
- Fringe benefits - - commuting ($55 billion over ten years) and misc. benefits ($80 billion over ten years)
- Limit interest deductions for corporations

Impediments to Tax Reform Remain

- Winners and losers/Sacred cows
- No agreed framework between House, Senate, and Administration
- Timing issues - - December passage or first Q 2018
- Can only lose two GOP Senators

Partnership Audits

Crowell & Moring, LLP

Jennifer Ray
Teresa Abney

October 5, 2017

Partnership taxation

- Partnership is not subject to income tax
- Audits Regimes
  - TEFRA (1982)
  - ELP (1997)
  - BBA (2015)
  - Partner level audit

Bipartisan Budget Act of 2015 ("BBA")

- General rule = IRS will make adjustments, assess, and collect tax at the partnership level
- Congress estimates new rules will raise $9.3 billion
- Proposed regulations released in June 2017

BBA effective date

- Effective for partnership years beginning after 2017
- Under proposed and temporary regulations, may elect in for partnership years beginning after November 2, 2015

Electing out of the BBA

- Which partnerships can elect out?
  - Must have 100 or fewer partners
  - Partners must be individuals, C corporations, any foreign entity that would be treated as a C corporation were it domestic, and S corporations
- Partnership makes the election on partnership's timely filed tax return
  - Must include the name and TIN for each partner in the partnership
  - Must notify each partner of the partnership election
- The election must be made each taxable year

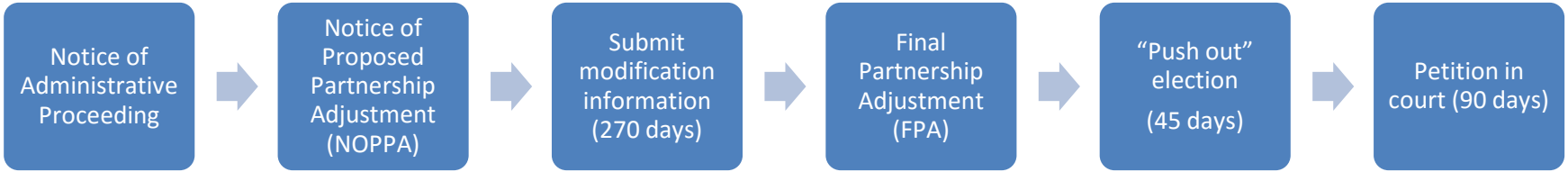
Electing out of the BBA

- Is election out a good idea?
  - Potential whipsaw issues (allocable share of profit or loss, whether a person is a partner)
  - Potential inconsistent adjustments if statute of limitations is not open for all partners or partners appeal in different litigation forums
  - Partner may not have records supporting items on K-1

Partnership representative

- Audit still commenced at the partnership level
- TMP replaced with “Partnership Representative”
  - No need to be partner but must have a substantial presence in the United States
  - Exclusive right to take action with respect to audit—no concept of “Notice Partner”
- Partnership Representative designated on tax return for each year

Stages of BBA audit



Payment of Tax

- Three ways tax can be paid
  - By partnership on current year return (“imputed underpayment”)
  - By partners on amended returns for reviewed year
  - By partners on returns for current year (“push out election”)

Imputed underpayment

- General rule is that imputed underpayment imposed on the partnership rather than on the partners
- Liability computed by netting all adjustments and multiplying by highest individual tax rate (39.6%), unless partnership can show rate should be lower
- Payment is made for the tax year in which the adjustment is final, not for the tax year audited
- Imputed underpayment is not deductible
- Interest and penalties assessed at partnership level
  - Any penalty defense must be raised at the partnership level

Example: Imputed underpayment

In 2020, XYZ's 2018 partnership tax return is audited and the IRS increases the partnership's income by $1 million. In 2018, XYZ had three equal partners: A, B, and C. In 2020, XYZ has three equal partners: A, B and D.

- Imputed underpayment = $1 m x 39.6% = $396,000
- XYZ pays the $396,000 tax

	Imputed Underpayment	Amended Return	Push Out Election
Who pays?	A, B, and D		
On which return?	2020		
Interest rate	General underpayment rate		

Imputed underpayment: modification

- Imputed underpayment modified in certain situations, including:
  - Adjustment where partners are tax-exempt entities that would not have been subject to tax on their share of income or gain
  - Adjustment for rates applicable to C corporations or individuals earning qualified dividends or capital gain
  - Reviewed year partners file amended returns and pay additional tax due for understated income
- Information must be provided to IRS (or amended returns must be filed) within 270 days after NOPPA

Example: Imputed underpayment

In 2020, XYZ's 2018 partnership tax return is audited and the IRS increases the partnership's income by $1 million. In 2018, XYZ had three equal partners: A, B, and C. In 2020, XYZ has three equal partners: A, B and D. **B is a tax-exempt entity.**

- Initial Imputed underpayment = $1 m x 39.6% = $396,000
- Partnership representative submits information establishing that B is tax-exempt and that the income is not UBTI
- Adjusted Imputed underpayment = $666,666 x 39.6% = 264,000

	Imputed Underpayment	Amended Return	Push Out Election
Who pays?	A, B, and D		
On which return?	2020		
Interest rate	General underpayment rate		

Example: Amended returns

In 2020, XYZ's 2018 partnership tax return is audited and the IRS increases the partnership's income by $1 million. In 2018, XYZ had three equal partners: A, B, and C. In 2020, XYZ has three equal partners: A, B and D.

- A, B, and C amend their 2018 tax return to include $333,333 of income

	Imputed Underpayment	Amended Return	Push Out Election
Who pays?	A, B, and D	A, B, and C	
On which return?	2020	2018	
Interest rate	General underpayment rate	General underpayment rate	

Push out election

- Partnership may avoid paying the adjustment if it elects to issue the partners revised K-1s
  - Partners pay the adjustment on their return for the year in which the revised K-1 is issued
  - Partnership must make election within 45 days of receiving the FPA
  - Partners have no right to administrative or judicial review
- Interest determined at partner level and underpayment interest rate is increased by two percentage points
- Penalties and additions to tax determined at partnership level, but imposed on reviewed year partners

Example: Push out election

In 2020, XYZ's 2018 partnership tax return is audited and the IRS increases the partnership's income by $1 million. In 2018, XYZ had three equal partners: A, B, and C. In 2020, XYZ has three equal partners: A, B and D.

- A, B, and C report $333,333 of income on their 2020 return

	Imputed Underpayment	Amended Return	Push Out Election
Who pays?	A, B, and D	A, B, and C	A, B, and C
On which return?	2020	2018	2020
Interest rate	General underpayment rate	General underpayment rate	General underpayment rate **PLUS** 2%

Imputed underpayment vs. push out election

- Could be a difference in the amount due
  - Rates applicable to partnership and reviewed year partners
  - Ability to use partner attributes (and effect on partner attributes in later years).
  - Different interest rates

Statute of limitations

- Statute of limitations is generally three years from date the partnership return is filed (or when due, if later)
- Limited exceptions when NOPPA issued
- FPA suspends adjustment period

Considerations for LLC agreement

- Most partnership agreements provide rules for dealing with TEFRA audits
  - E.g., appoint a tax matters partner, outline how the tax matter partner is to act, how the audit may be conducted, what rights other partners have, etc.
- Agreements should be revised before January 1, 2018

Considerations for LLC agreement

	TEFRA	BBA
Person in charge	Tax matters partner	Partnership representative
Required to provide information to other partners?	Yes	No
Can other partners bring suit?	Yes	No
Can TMP/PR bind other partners to a settlement?	Generally no	Yes

Considerations for LLC agreement

- Partnership representative
  - Who will it be?
  - What does it have to tell the other partners?
    - Only the representative receives notice from IRS and has sole power to act (extend SOL, file suit, or settle case).
  - How much power will it have?
    - Can other members participate in audits?
    - May wish to restrict representative from taking action without consent from partners or to compel action in certain situations (e.g., file suit)
  - Recourse if partnership representative acts in a manner

Considerations for LLC agreement

- Indemnification for liability for actions taken by partnership representative?
- Address cooperation of partners
  - In calculating imputed underpayment
  - Agreeing to file amended returns?

Considerations for LLC agreement

- Process for deciding whether partnership pays imputed underpayment or pushes the adjustment out
- Address effect of imputed underpayment
  - How allocated to partners
  - Do previous partners agree to indemnify partnership?
- Will the partnership elect in early

Purchasing a partnership interest

- Once BBA is effective, partnership itself could have tax liability
  - Need to allocate risk between buyer and seller
  - Additional due diligence will be necessary
  - Additional reps and indemnity
- New partner should understand its rights under the LLC agreement

Purchasing a partnership interest: example

- In 2018, partnership AB takes excessive depreciation deductions of $1 million, allocated 50% to A and 50% to B (both corporations). The IRS makes an audit adjustment in 2020. After modification to account for the 35% rate applicable to corporations, the imputed underpayment is calculated as $350,000.
- Assume that, in 2019, A sold its partnership interest to C.
- Is A on the hook?
  - Under the partnership agreement?
  - Under the agreement to sell the interest to C?
- If so, how is the payment by A treated?
  - Is A deemed to contribute the funds to the partnership and receive an allocation of its share of the underpayment?
  - Or does A's payment to the partnership cause the partnership to have taxable income?
  - Can A file an amended return claiming less gain or more loss on the 2019 sale? Or does A take a capital loss in 2020?
  - If A pays C directly, is that treated as an adjustment to purchase price, resulting in a capital loss in 2020?

Purchasing a partnership

- If 100% of the partnership interests are purchased, a partnership is generally treated as ceasing to exist
- If partnership ceases to exist prior to assessment, the historic partners are generally liable for underpayment

Questions?

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State Perspectives: The Quest for Clarity and Uniformity in Reporting Federal Tax Adjustments

Presented by:

- Crowell & Moring
  - **Jeremy Abrams, Counsel (moderator)**
- Multistate Tax Commission (MTC)
  - **Sheldon Laskin, Counsel**
- Council On State Taxation (COST)
  - **Fred Nicely, Sr. Tax Counsel**

Overview

Overview

The Problem:

- Federal legislation has changed the way the IRS will audit partnerships and collect resulting assessments after 2017
- States must amend their State tax codes to address the new federal partnership procedures
- State and local jurisdictions lack a uniform method to report federal audit changes generally, resulting in inefficiencies and errors

Overview

The Goal:

- Address how taxpayers should report federal partnership audit adjustments to States under the new partnership audit rules
- Improve taxpayer compliance by establishing a uniform method to report all federal audit adjustments

Overview

- The interests of the States and industry are similar:
  - Improve efficiency of tax administration
- That can be accomplished through:
  - Uniformity,
  - Clarity, and
  - Simplification
- Ultimately, the goal is to improve compliance and lower costs for both the States and taxpayers

Overview

Next Steps:

- Obtain feedback on Draft Model Uniform Statute and Regulation for Reporting Federal Audit Adjustments (Draft Model Statute)
- Update Draft Model Statute
  - Based on State and taxpayer input
  - Achieving workable solution for States and taxpayers alike
- Adopt the Model Uniform Statute at state and local level

Reporting Federal Audit Adjustments

Reporting Federal Audit Adjustments: Background

- Federal (IRS) audits can take years – audits generally extend beyond normal federal and state statute of limitations
- IRS audit issues are often resolved at different times, with some issues creating refunds and others creating liabilities
- Some IRS audit adjustments have no impact at the state level (*e.g.,* some federal credit adjustments)

Reporting Federal Audit Adjustments: Background

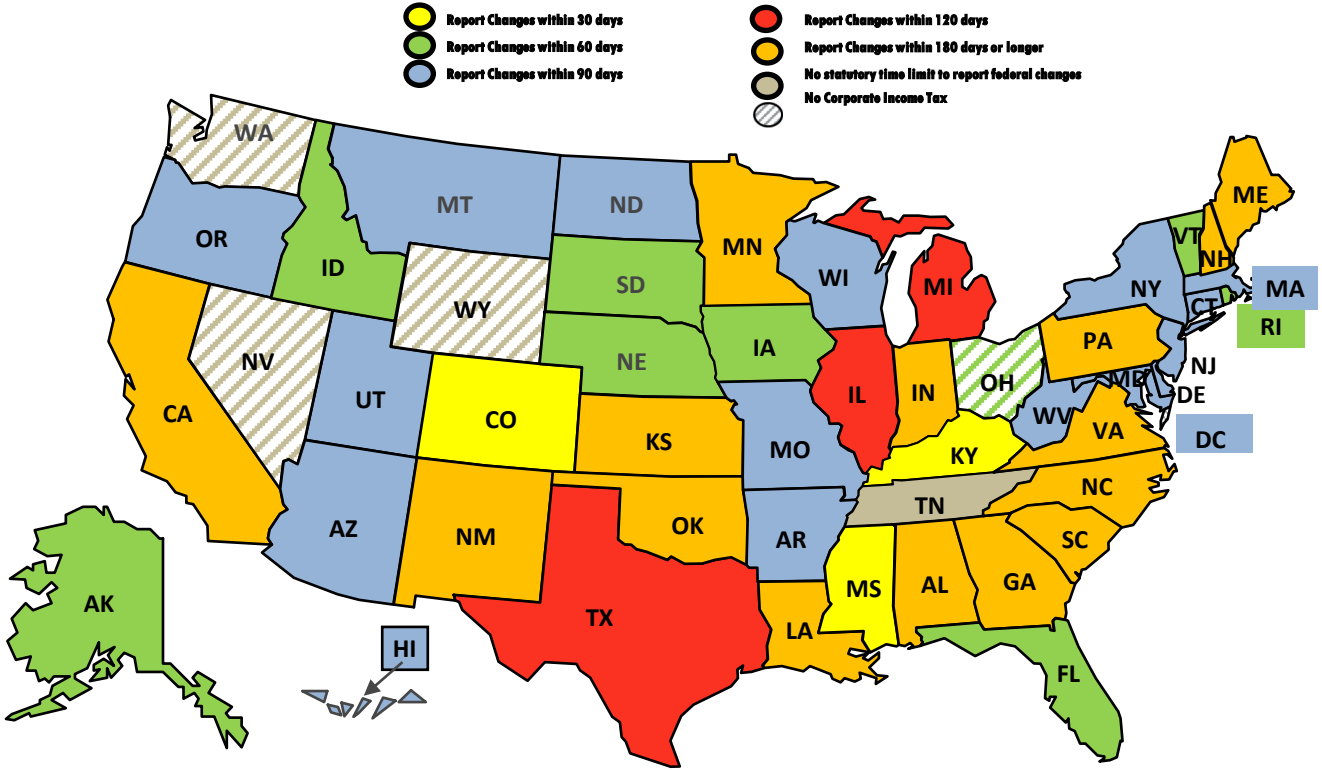
- The MTC's 2003 model for reporting federal adjustments has not been adopted by States
  - Model needs updated to address changes in IRC and IRS audit procedures
  - State legislators need engaged in process to make them aware of the need for uniformity from:

    Tax Agencies

    Taxpayers

    Tax Practitioners
- The time to report federal audit adjustments to states varies widely - ranges from no set date to one year

When Do Taxpayers Have to File



Notes
CA: Within 6 months
IA: 60 days for payment, 180 days for refund
NH: Within 6 months
NY: 120 days **for** combined reports
OH: No state CIT; post-TY 2015, 60 days for amended municipal income tax returns
OK: Within one year
OR: 60 days if Portland/Multnomah County
PA: Within 6 months (Tax Years pre-2013, 30 days)
VA: Within one year.

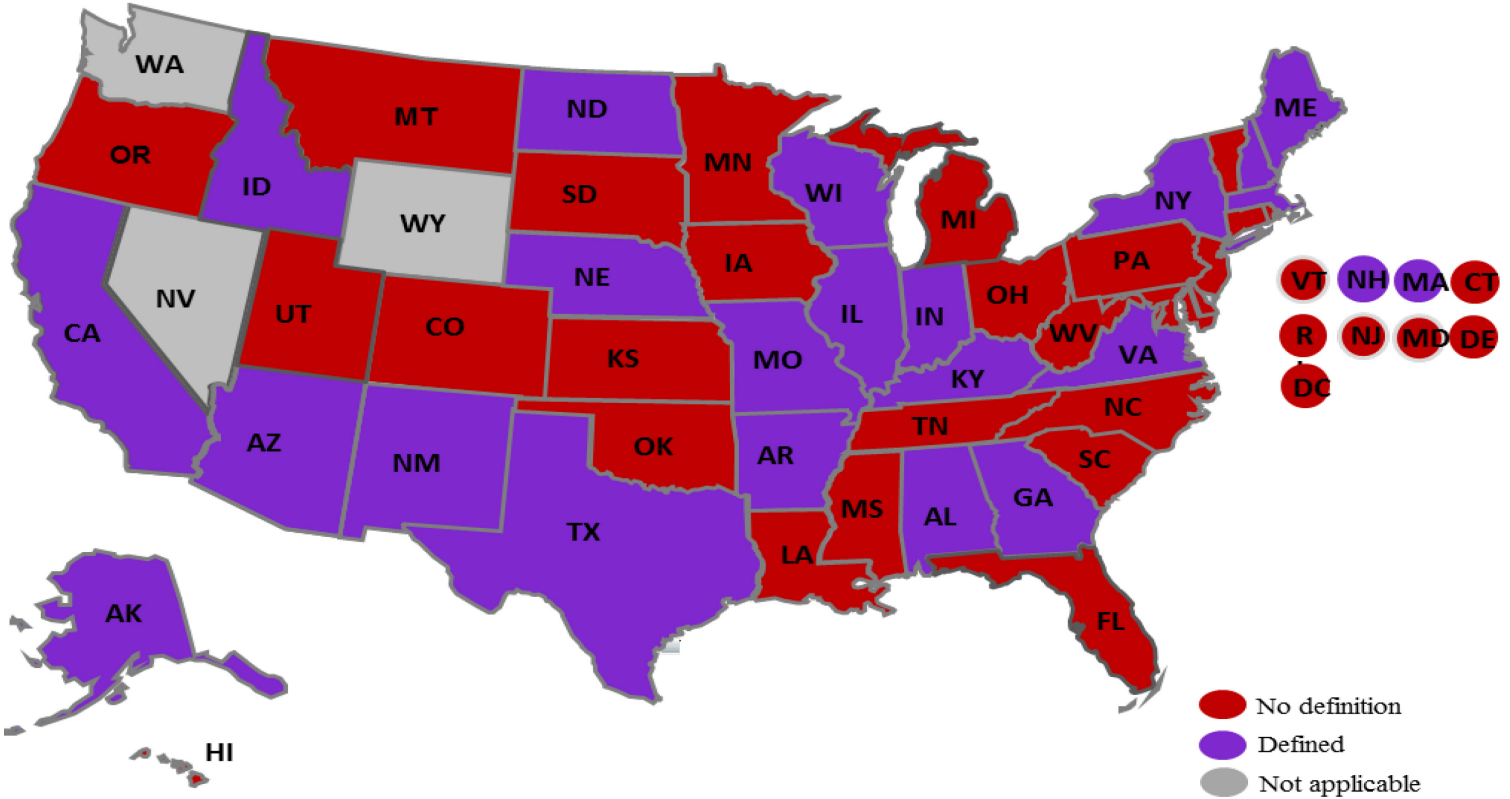
Source: COST Updated State Tax Administration Scorecard

Reporting Federal Audit Adjustments: Background

"Final Determination"

- The events triggering the reporting of federal audit adjustments varies widely
  - Definition of final determination varies
  - Some States require adjustments to be reported as settled – serial reporting
  - Other States only require reporting after all adjustments are final
- The method to report federal audit adjustments varies widely
  - Full amended return
  - Other state specific notice requirements (*e.g.* simplified amended return or other written notification)
  - State specific spreadsheet or template

States with Definition of a “Final Determination”



Source: COST Administrative Scorecard, December 2016

Reporting Federal Audit Adjustments: Opportunities for Enhancements

- Uniformity alone would aid taxpayers and improve compliance
  - 180 days allows for more accurate reporting
  - Clear Final Determination Date that requires reporting federal tax changes once is more efficient for tax agencies and taxpayers
- Many federal audit adjustments are *de minimis;* however, most States still require full reporting
- Difficult for taxpayers to make “estimated payments”
  - States must wait for tax revenues agreed to by taxpayers
  - Taxpayers are subject to interest on under-remitted amounts
- Streamlined reporting would enable taxpayers to report adjustments more quickly and accurately

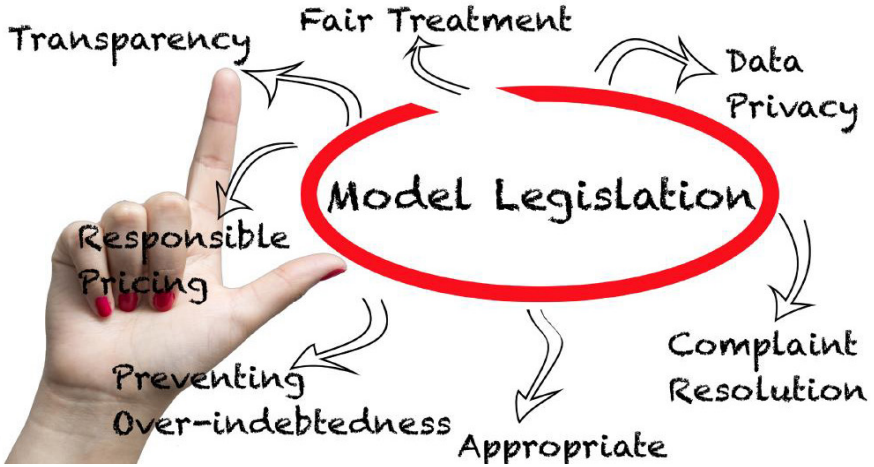
New Federal Partnership Audit Rules: State Implications

- Unlike IRC tax base changes, most state laws do not automatically conform to the federal tax law changes
- The majority of States do not recognize a partnership as “taxpayer” for purposes of assessing tax at the state-level following a federal partnership audit under the new regime
- Most States do not have clear partnership audit procedures
- States have constitutional restraints that are different than that at the federal level:
  - Partnership’s apportionment in the reviewed year (year under audit) likely different than the adjustment year (year tax must be paid)
  - Partnership’s partners’ residency in the reviewed year may be different residency in the adjustment year

New Federal Partnership Audit Rules: State Implications

- MTC has an ongoing “Partnership Project” to study -
  - Do the States need to amend their tax laws to address new partnership audit procedures?
  - If so, how should those laws be revised?
  - How should the States deal with multiple-tiered entities?
- Only Arizona has enacted legislation conforming to new federal legislation
  - Arizona’s legislation does not comprehensively address federal changes (e.g., fails to address tiered partnership)
- Five states (CA, GA, MN, MO and MT) proposed legislation this year
  - None of the proposals took the same approach nor were as comprehensive as the Draft Model Statute

Draft Model Legislation



How It's Accomplished: Interested Parties

- **The Organizations working on this Draft Model Statute are:**
  - **ABA Section of Taxation SALT Committee Task Force**
  - **American Institute of CPAs (AICPA)**
  - **Council On State Taxation (COST)**
  - **Institute for Professionals in Taxation (IPT)**
  - **Tax Executives Institute (TEI)**
  - **Multistate Tax Commission (MTC)**
- **Note**: This Draft Model Statute has not yet been formally endorsed by the Interested Parties - it is a draft *for discussion purposes only*

How It's Accomplished: Draft Model Statute - Overview

Section A—Definitions
Section B—Reporting Adjustments to Federal Taxable Income – General Rule
Section C—Reporting Adjustments to Federal Taxable Income – Partnership Level Audits
Section D—Assessments of Additional [State] Tax, Interest, and Penalties Arising from Adjustments to Federal Taxable Income
Section E—Estimated [State] Tax Payments During the Course of a Federal Audit
Section F—Claims for Refund or Credits of [State] Tax Arising from Federal Adjustments Made by the IRS
Section G—Scope of Adjustments and Extensions of Time
Section H—Effective Date

How It's Accomplished: Important Definitions

- **Federal Adjustments Report (FAR)**
  - An amended State tax return,
  - The [Multistate Tax Commission's] model report of federal audit adjustments, or
  - Any other method or form authorized by the State agency
- **Final Determination Date—**Date on which all adjustments made by the IRS to the federal taxable income of a taxpayer for the taxable year have become final and all appeal rights under the IRC are exhausted or waived
  - Streamline reporting by creating one final determination date for each tax year under audit, which eliminates the requirement to file multiple amended returns

How It's Accomplished: Optional Final Determination Date Regulation

- States have the option to have a more expansive Final Determination Date definition that can be put in the State's law or placed in a regulation
  - More description of what constitutes a Final Determination date along with and cites to IRC provisions
  - Examples of Final Determination Dates are also provided

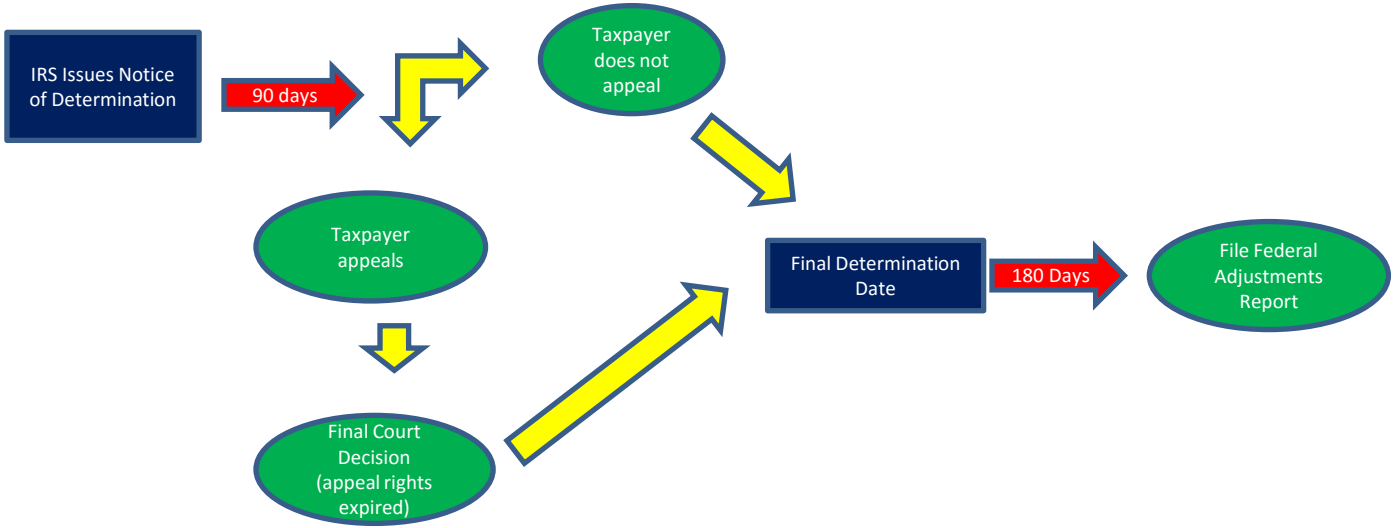
How It's Accomplished: General Reporting Process

- **Reporting Adjustments to Federal Taxable Income – General Rule**
- **<u>Except in the case of a Partnership subject to a Partnership Level Audit</u>**
  - Taxpayer shall notify the State agency of adjustments to its federal taxable income within **180 days** of the Final Determination Date or amended federal return
  - Includes an optional *de minimis* ($250) provision to notify State of change without filing Federal Adjustments Report

Note: *De minimis* provisions will <u>not</u> apply to partnerships subject to a partnership level audit or their partners

Flow Chart Following Reporting Federal Audit Adjustment

(***This is <u>not</u> for Partnerships subject to Partnership Level Audit***)



How It's Accomplished: Partnership Definitions

Partnership Definitions:

Imputed Underpayment—The total under-paid tax based on each partner's state tax rate and their apportioned share of the partnership's under-reported income

Partnership Adjustment Tracking Report—Form prescribed by the State that conforms with the IRS form to identify all of a partnership's partners and their allocable share of any federal audit adjustments

Partnership Level Audit–BBA audit (IRC Section 6221(b))

Resident Partner—An individual, estate of a deceased individual, or trust that was a partner and a resident of the State for income tax purposes

State Partnership Representative—Federal partnership representative or the person designated to be the partnership's representative for state tax purposes

How It's Accomplished: Reporting Federal Partnership Level Audits

- If a Federal Partnership Level Audit results in an **Imputed Underpayment** to State, the partnership shall within 60 days of the Partnership's Final Determination Date must:
  - File a Federal Adjustments Report with the State to notify the State of the partnership's taxable income apportioned to State

  AND
  - Make an election as to whether the partnership or its partners will pay the tax:

    Option 1: Partnership pays the tax (entity level tax)

    Option 2: Partners pay the tax (partnership issues "state" K-1 forms)

    Option 3: Hybrid approach, partnership pays the tax on behalf of all non-resident partners but resident partners pay their own tax
  - Election is irrevocable unless the State, in its discretion, otherwise allows

How It's Accomplished: Composite/Withholding Return Partners

- Most States have composite return filing requirement for certain partners that elect not to file separate tax returns to a State to report their income from a partnership or non-resident partners not agreeing to be subject to the State's tax on its apportioned income from the partnership
- The Proposed Model includes provisions to require composite return filers on an original return (or an amended return) to have the tax paid by the partnership
  - *i.e.*, there is no election for composite return filers to receive a K-1 from the partnership to directly report and pay the tax

How It's Accomplished: Reporting Federal Partnership Level Audits

Option 1 – Partnership Pays the Tax

Within 180 days of Final Determination Date, the partnership shall:

- File a schedule indicating each partner's apportioned share of under-reported state taxable income with the State, and
- Calculate and pay the additional state tax owed by the partnership

Calculation of partnership's tax:

- Tax-exempt or nontaxable partners - zero percent tax rate
- Individual partners, S corporations, trusts, estates of deceased partners, disregarded entities that are not owned by a C corporation, or entities treated as partnerships for state tax purposes - highest state individual income tax rate, and
- C corporations, disregarded entities owned by C corporations, and Unrelated Business Taxable Income of tax-exempt or nontaxable partners - highest state corporate income tax rate

How It's Accomplished: Reporting Federal Partnership Level Audits

Option 2 – Partners Pays the Tax

- Within 90 days of Final Determination Date, the partnership shall:
  - Mail amended K-1s to each partner, and
  - File a schedule with State indicating each partner's share of under-or over-reported state taxable income
- Within 180 days of Final Determination Date, partners shall file a Federal Adjustments Report and pay any additional tax due

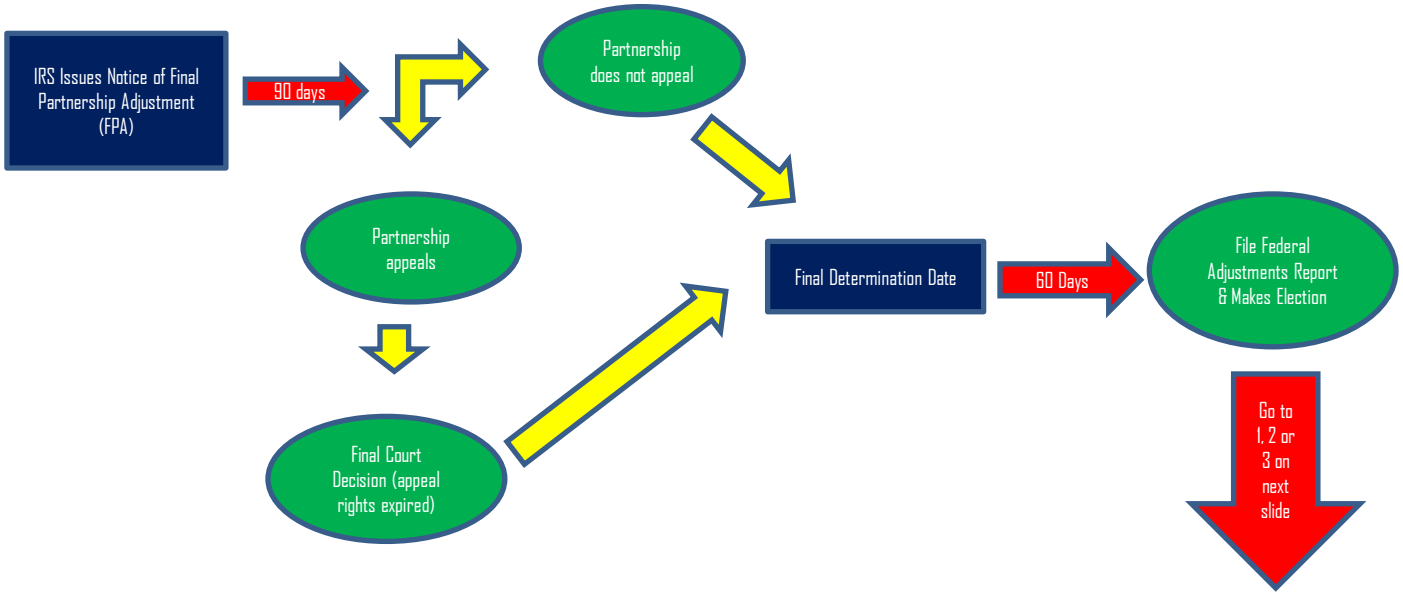
How It's Accomplished: Reporting Federal Partnership Level Audits

Option 3 – Hybrid Method

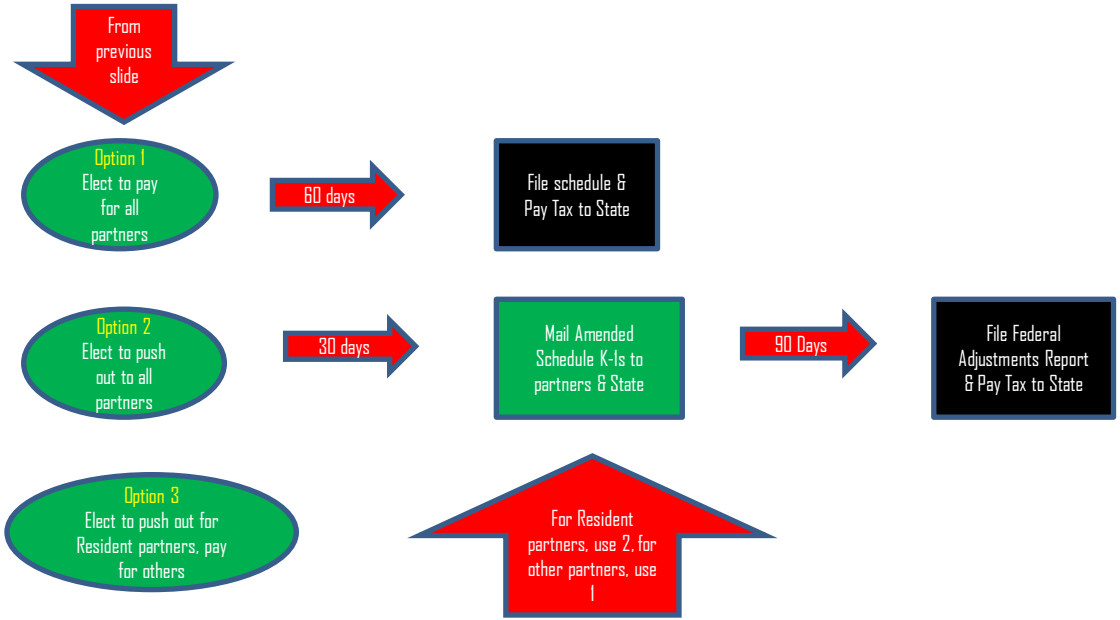
- Within 90 days of Final Determination Date, the partnership shall:
  - Mail amended K-1s to each resident partner, and
  - File a schedule with State indicating each partner's share of under-or over-reported state taxable income
- Within 180 days of Final Determination Date, the partnership shall:
  - File a schedule with State indicating each non-resident partner's apportioned share of under-reported state taxable income with State, and
  - Calculate and pay the additional state tax owed by the non-resident partner
- Within 180 days of Final Determination Date, Resident Partners shall file a Federal Adjustments Report with State and pay any additional tax due

Flow Chart following Federal Partnership Audit Adjustment

– Slide 1



Flow Chart following Federal Partnership Audit Adjustment – Slide 2



How It's Accomplished: Reporting Federal Partnership Level Audits

- Federal Partnership Representative acts on behalf of the partnership unless the Federal Partnership Representative delegates such authority to another person
- Model Requires partners to pay if:
  - The federal audit does not result in an Imputed Underpayment to the State; or
  - The partnership has dissolved or becomes insolvent
- The States' tax agencies can promulgate regulations to address special allocations among or between the partners that are affected by a BBA audit

How It's Accomplished: Tiered Partnerships Filing Requirements

- Tiered Partnerships are required to comply with special provisions that conforms to IRC provisions for such partnerships
- Have partnerships with different fiscal year ends – still must file all returns by the extended federal due date of the audited partnership's return of the year the IRS completes the Final Determination Date
  - Eliminates huge time lag that could exist if there was not a set date for all tiers to have to remit the additional tax to a State

How It's Accomplished: Tiered Partnerships Filing Requirements

Example:

- ABC Partnership's 2018 Form 1065, filed in March 2019, is audited by IRS
  - In January 2020, IRS begins an audit of ABC Partnership
  - On August 2, 2021, IRS completes audit of ABC Partnership (issues Notice of Final Partnership Adjustment), which results in an Imputed Underpayment at the federal level (with corresponding Imputed Underpayment at State X)
  - ABC Partnership does not appeal the Imputed Underpayment at the federal level
- Final Determination Date is 90 days after appeal right is exhausted – October 31, 2021
- ABC Partnership elects Option 2 (K-1 reports sent to partners) within 60 days of the Final Determination Date (Dec. 30, 2021)
- Partners that are partnerships, through all tiers, must have the tax paid to State X by Sept. 15, 2022
  - This is the extended due date of ABC Partnership's federal tax return

Other Misc. Model Provisions: Assessments

Assessments of Additional State Tax, Interest, and Penalties Arising from an Adjustments to Federal Taxable Income

- An assessment must be issued within the later of one year or the expiration of the general limitations period where a taxpayer timely files a Federal Adjustment Report
- Otherwise the following statutes apply:
  - The expiration of the general limitations period
  - One year following the date the Federal Adjustments Report was filed
  - One year following the date on which the IRS, another State, or an organization representing and/or conducting audits for two or more States' tax agencies, notified the State, in writing or by electronic means, of the federal adjustment
  - Six years following the Final Determination Date absent fraud

Other Misc. Model Provisions: Estimated Payments

- Allows taxpayers to make an estimated payments to a State during a pending IRS audit, where a taxpayer has not yet obtained a final determination
  - State obtains tax faster
  - Stops the running of interest to the taxpayer
  - Does not require filing of any type of pro-forma amended return for a taxpayer to make an estimated payment
  - Some work may be needed with some of the Integrated Tax System Providers used by the States

Other Misc. Model Provisions

Model Statute:

- Clarifies the period in which a taxpayer may file a claim for refund and that a taxpayer's Federal Adjustment Report will serve as a claim for refund
- Provides that state adjustments shall be limited to the adjustments made by the IRS, unless a taxpayer and state taxing agency otherwise agree in writing
- Allows taxpayers and the state agency to agree in writing to an extend the statute beyond periods otherwise provided
- Specifies that the States should provide a clear effective date when the changes apply

MULTISTATE TAX COMMISSION
Maximizing the synergies of multi-state tax cooperation

To: MTC Uniformity Committee

From: Sheldon H. Laskin, Counsel

Date: March 3, 2017

Subject: Joint Request from COST, TEI, the ABA SALT Committee, and the AICPA State Tax Working Group to Update the MTC's Model Uniform Statute for Reporting Adjustments to Federal Taxable Income

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The purpose of this memo is to provide the Committee with a comparison of the provisions of the State Tax Working Group's proposed Model Uniform Statute for Reporting Adjustments to Federal Taxable Income (hereafter, "Working Group Model") with the provisions of the Commission's Model Uniform Statute for Reporting Federal Tax Adjustments. Both models are attached.

The Working Group Model is generally consistent with the Commission's model, with the following significant differences.

1. Definition of Final Determination

The Working Group Model provides a considerably more detailed definition of the term "final determination" than does the Commission's model.

The Commission model defines "final determination" as:

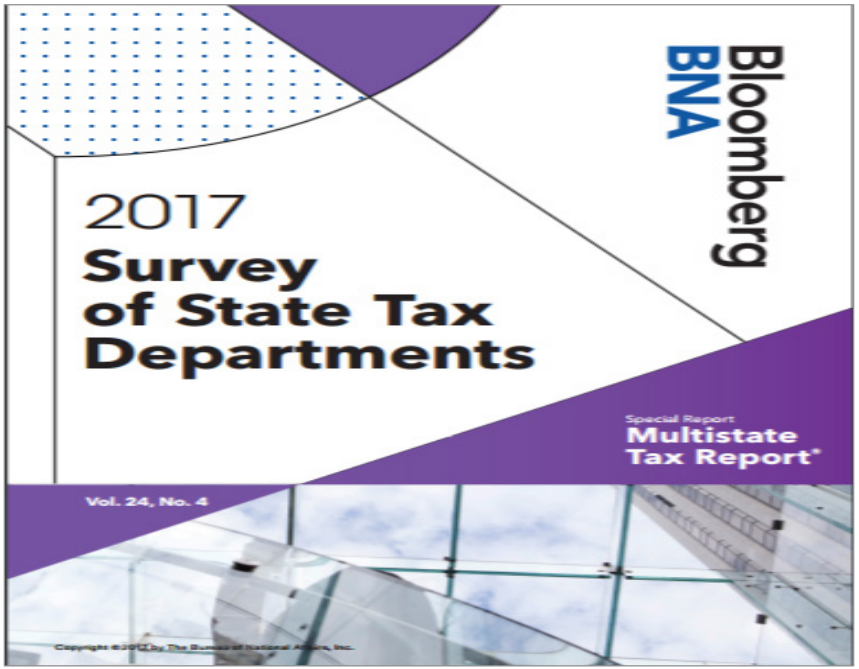
(a) the allowance of a refund or credit under Section 6407 of the Internal Revenue Code of 1986; or
(b) the official act of assessment under Section 6203 of the Internal Revenue Code of 1986, except assessments that result from the following shall not be considered final determinations:
1. tax under a partial agreement,
2. tax in jeopardy, and
3. advance payments; or
(c) a final denial of a refund claim where a state refund claim has been filed or any other final action by the Internal Revenue Service that increases or decreases the state tax

Next Steps

Next Steps: We need your help!

- Interested Parties are seeking comments and would like to hear from your agency
  - Please feel free to distribute this within your State's tax agency and other interested parties such as your State's CPA association
  - Participate in discussion of Model on MTC partnership working group calls
- Work in 2018 and beyond toward broader state adoption of model to provide for great uniformity among the States
  - Greater uniformity will result in increased compliance, which will ensure States get taxes owed more quickly and with greater accuracy

State Tax Survey – Reporting Fed. Changes

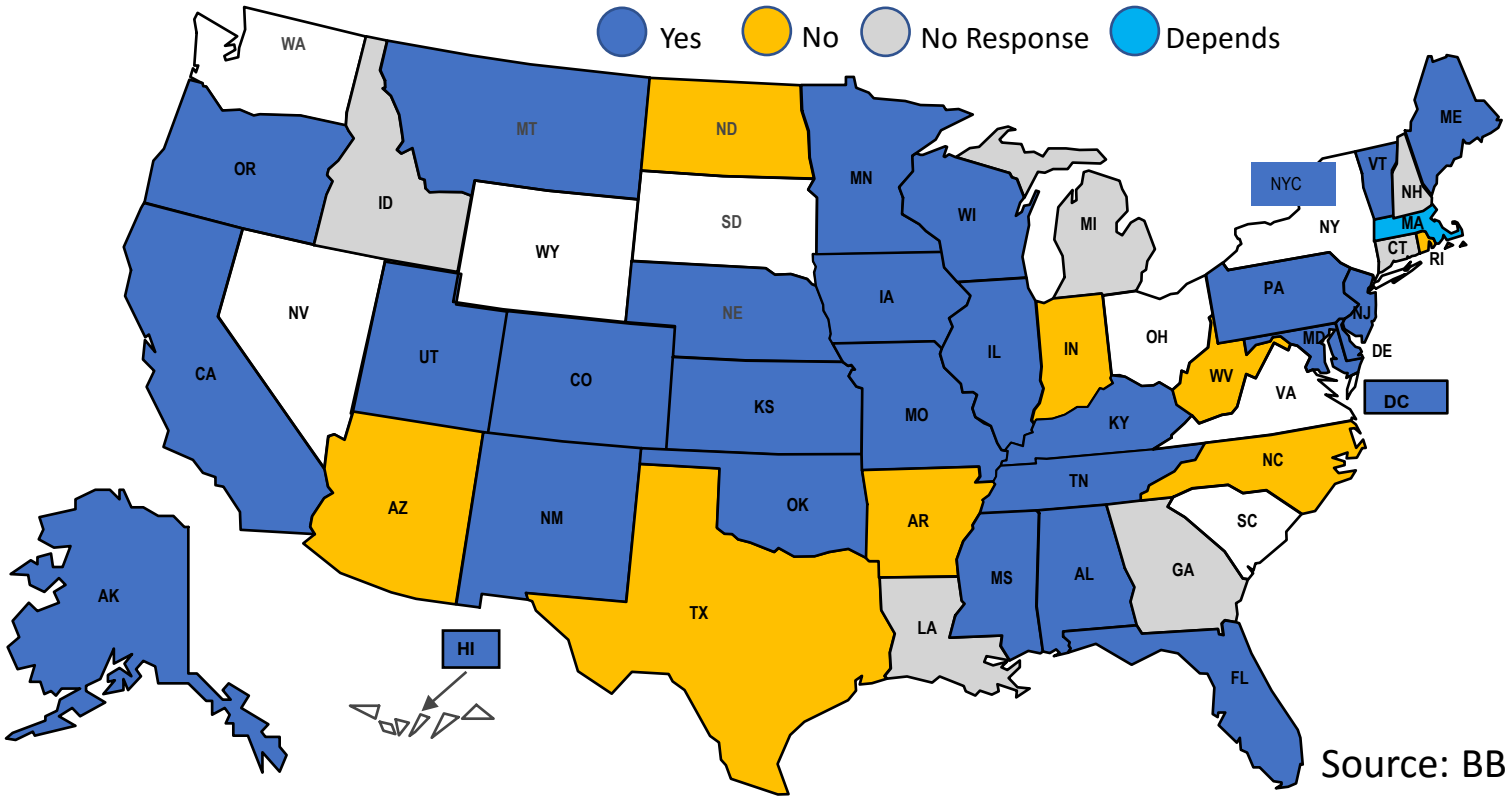


State Tax Survey – Reporting Fed. Changes

Reporting Federal Changes: IRS Audit Reportable Adjustments After Your State's Normal Statute of Limitations Expires

State[1]	Signing IRS Form 870 for one audit when other issues still under review[2]	Partial settlement of federal tax issues reported/ paid to IRS[3]	Form 4549-A[4]	Form 886-A[5]	Final federal tax changes[6]	Answer changes if refund of federal taxable income[7]	Written guidance re: final federal tax change[8]
Alabama	Yes	Yes	No	No	Yes	No	No
Alaska	Yes	Yes	Yes	No	Yes	No	Yes[9]
Arizona	No	No	No	No	Yes	No	Yes[10]
Arkansas	Yes	No	Yes	Yes	Yes	No	No
California	Yes[11]	Yes[12]	Yes[13]	Yes[14]	Yes[15]	Depends[16]	Yes[17]
Colorado	Yes	Yes	Yes	Yes	Yes	**No**	**Yes**
Connecticut	No Response[18]	No Response[19]	No Response[20]	No Response[21]	No Response[22]	No	No
Delaware	**No**	**Yes**	**Yes**	**Yes**	**Yes**	**No**	**No**
District of Columbia[23]	Yes	Yes	Yes	Yes	Yes	Yes	No

States That Require Filing/Payment Based on Partial Settlement



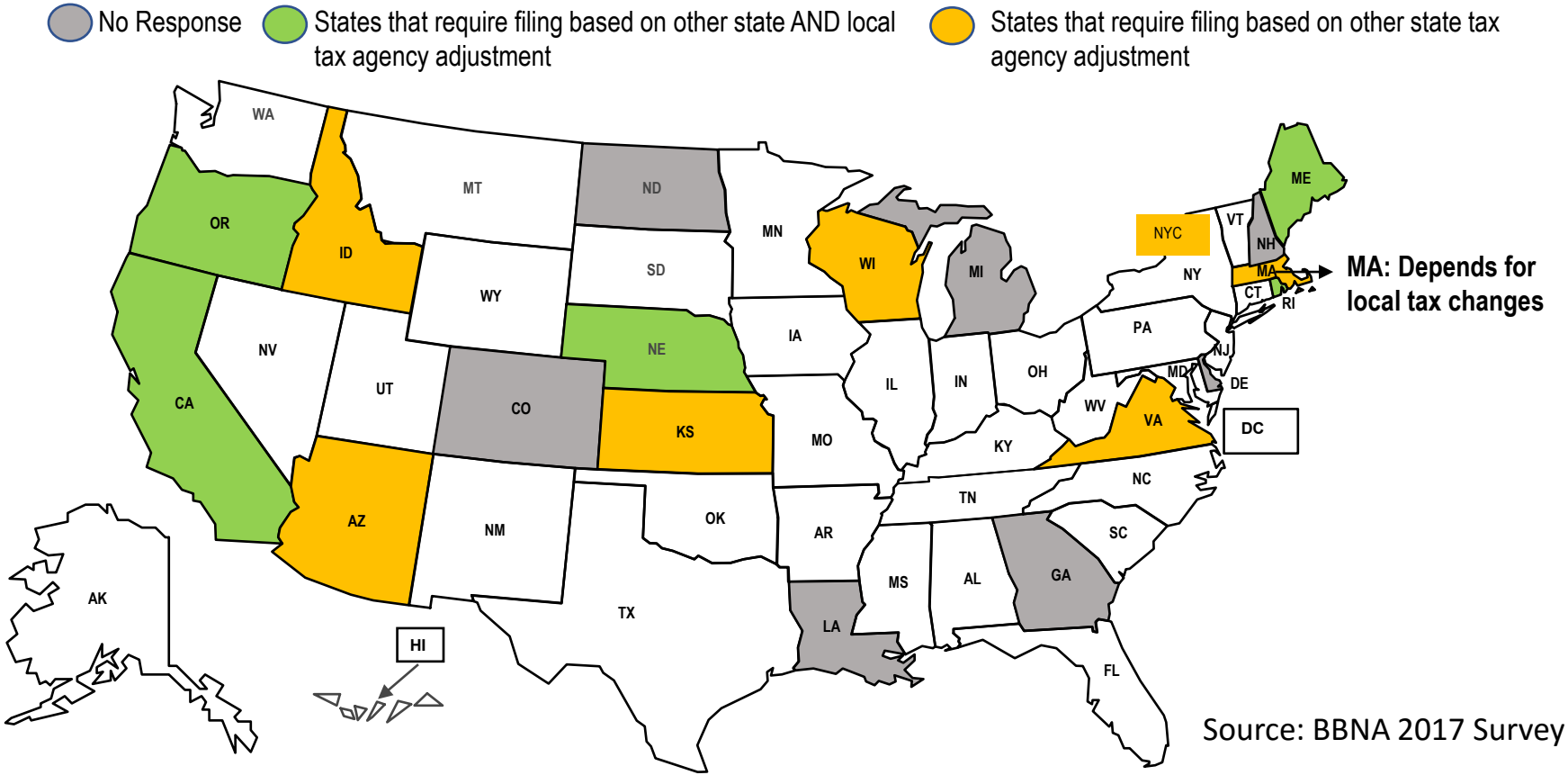
Source: BBNA 2017 Survey

State Tax Survey – Reporting Fed. Changes

Reporting Federal Changes: Other Reportable Adjustments After Your State's Normal Statute of Limitations Expires

State[1]	Other state tax changes[2]	Other local tax changes[3]	Changes to financial statements[4]	Changes by foreign governments[5]	Federal change with no impact on tax liability in state[6]
Alabama	No	No	No	No	Yes[7]
Alaska	No	No	No	No	Yes[8]
Arizona	Yes[9]	No	No	Yes[10]	No
Arkansas	No	No	No	No	No
California	Yes	Yes	No	Yes	Depends[11]
Colorado	No Response	No Response	No Response	No Response	No Response
Connecticut	No	No	No	No	No
Delaware[12]	**No Response**	**No Response**	**No Response**	**No Response**	**Yes**
District of Columbia	No	No	No	No	No
Florida	**No**	**No**	**No**	**No**	Yes
Georgia	No Response	No Response	No Response	No Response	No Response
Hawaii	No	No	No	No	No
Idaho	Yes[13]	No	No	No	Yes
Illinois	No	No	No	No	No
Indiana	No	No	No	No	Yes
Iowa[14]	No	No	No	No	No
Kansas	Yes	No	No	No	No

States That Require Filing Based on Other State and Local Tax Agency Adjustment



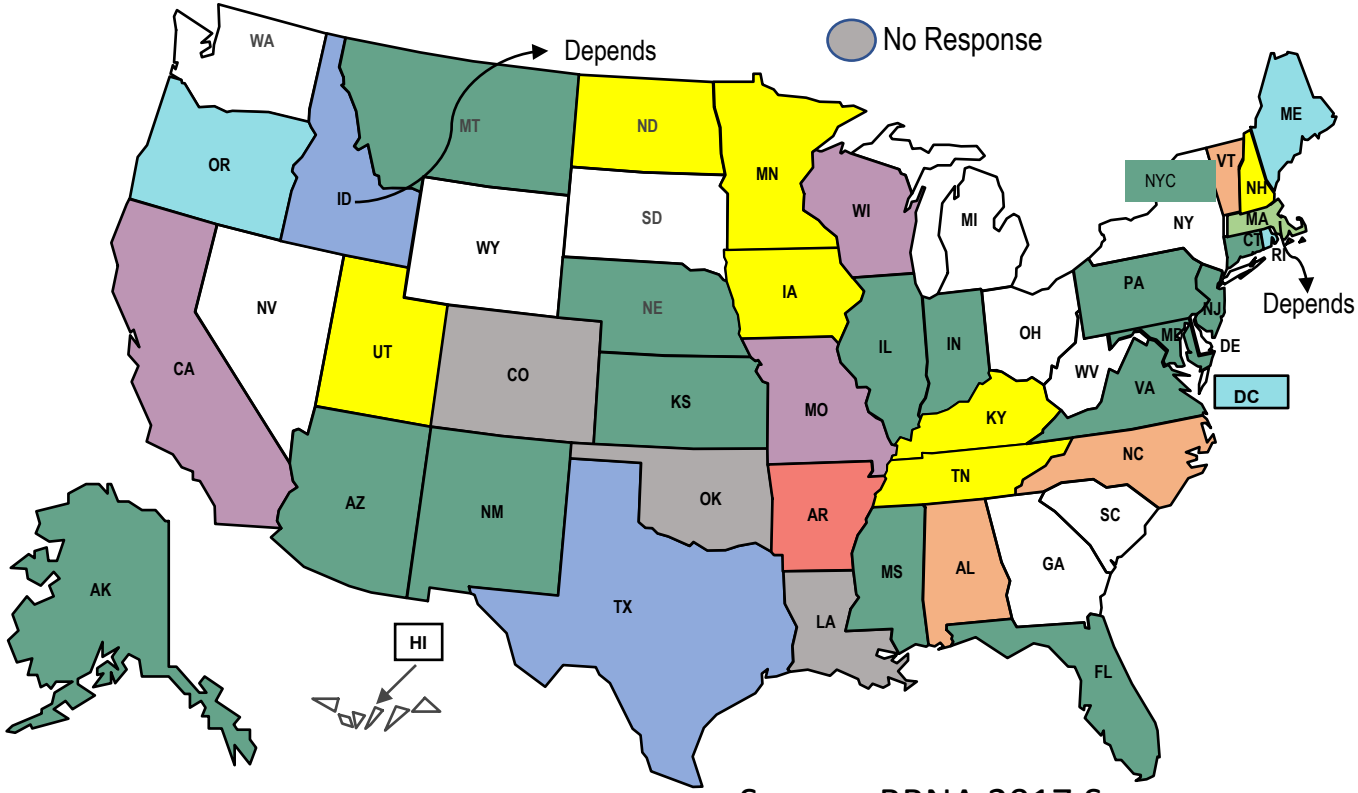
Source: BBNA 2017 Survey

State Tax Survey – Reporting Fed. Changes

Reporting Federal Changes: Adequate Notice of Reportable Adjustment

State[1]	Only when taxpayer actually files amended return[2]	Taxpayer files some type of notice in writing[3]	Imputed to tax agency when IRS or another jurisdiction provides information to agency[4]
Alabama	Yes	No	Yes[5]
Alaska	Yes	No Response[6]	No Response[7]
Arizona	Yes	No	No
Arkansas	No	No	Yes
California[8]	No	Yes	Yes
Colorado	No Response	No Response	No Response
Connecticut	Yes	No	No
Delaware	**No Response**	**No Response**	**No Response**
District of Columbia	Yes	Yes	Yes
Florida[9]	Yes	No	No
Georgia	No Response	No Response	No Response
Hawaii	No[10]	No	No[11]
Idaho	Depends[12]	Depends[13]	No
Illinois	Yes	No	No
Indiana	Yes	No	No
Iowa[14]	No	Yes	No
Kansas	Yes	No	No

States That Require Return and Those That Allow Writing or Imputed



Source: BBNA 2017 Survey

Adequate notice of a reportable adjustment is only made when a taxpayer **actually files** an amended return

Adequate notice of a reportable adjustment may be made when a taxpayer files some type of **notice in writing** to the agency

Adequate notice of a reportable adjustment is only made when a taxpayer **files an amended return** and may be made when a taxpayer **files notice in writing** to the agency

Adequate notice of a reportable adjustment **is imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Adequate notice of a reportable adjustment may be made when a **taxpayer files notice in writing and is imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Adequate notice of a reportable adjustment is only made when a **taxpayer actually files an amended return and is imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

Adequate notice of a reportable adjustment is only made when a taxpayer **files an amended return** and may be made when a taxpayer **files notice in writing** to the agency and **is imputed to the tax agency** from the day the IRS or another jurisdiction provides information to the agency

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Questions?

Thank You For Attending

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