Managing Tax Audits and Appeals

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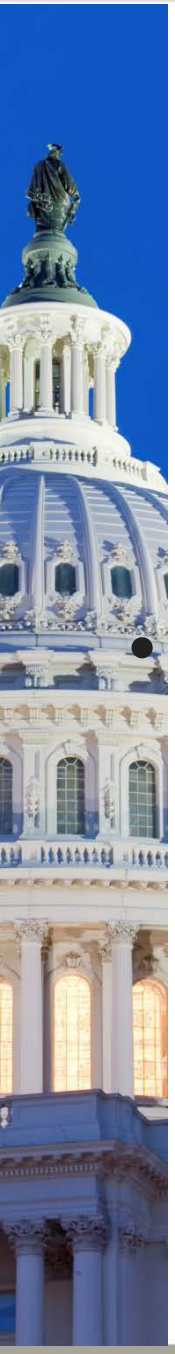
September 22, 2016



Introduction

- But in this world nothing can be said to be certain, except death and taxes.

(Benjamin Franklin 1789)

Agenda

- Introduction
- New LB&I Examination Process
- Privilege and Work Product
- SALT Audits
- Lunch (Legislative Update)
- Partnership Audits Changes
- ADR and Appeals
- Resolving Tax Accounting Issues
- Concluding Remarks

LB&I's New Issue-Focused Audit Paradigm

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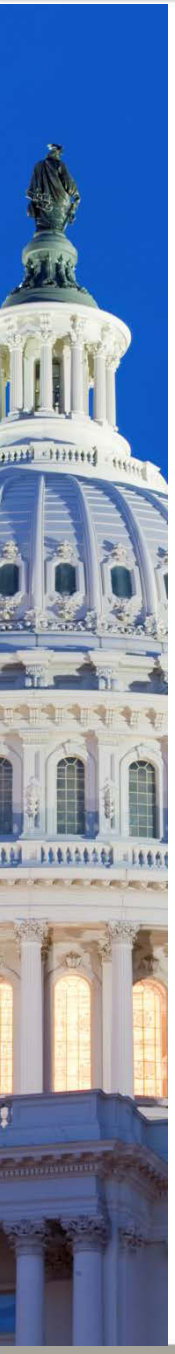
Current State of IRS: Doing Less with Less

- Over $1 billion in budget cuts since 2010
  - Small increase in 2016 ($250 million) allocated to customer service/telephone assistance/fraud detection/ cybersecurity
  - Training Cut From $172 million (2010) To $22 million (2013)
- Overall staffing down by 20%, from 94,700 to 76,500
  - Effectively a hiring freeze
  - Revenue Agents down 25% from almost 14,000 to 10,600
  - Appeals Officers down from 1,000 to 760 last year, back up to 1,000
  - Significant increases in executive/senior management retirements
  - 51% of executives and 41% of managers eligible to retire in 2016
  - 25% of overall workforce eligible to retire in 2015 (40% by 2019)
- Audit rate lowest since 2004: large business audits declined 22% since last year



IRS Large Business & International Examination Process

The only constant is change. Heraclitus (535-475 BC)

Concept of Operations (CONOPS) and the IRS "Future State"

- Began development in 2014 in response to IRS challenges
  - Significant budget reductions since 2010
  - Increased responsibilities: unfunded mandates of FATCA and ACA implementation
  - Technology concerns: identity theft, cyber attacks
- High level restructuring initiative across major divisions including LB&I and SB/SE
  - Guiding principles would change the way that the IRS operates
  - Goal was to increase efficiency in era of declining resources
- Became the cornerstone of the LB&I reorganization
  - Intended to fundamentally transform IRS interactions with taxpayers

Objectives of Reorganization

- Change the way LB&I is structured
  - One LB&I, practice areas, compliance areas
- Issue focus: select work based on compliance risk
  - Choose issues by employing data analytics and specialized staff
- Collaboration: seek ways to involve taxpayers in Exam process and create incentives for cooperation
- Develop better training and career paths and better tools and support
  - Knowledge management, deployment, mentors
- Define the compliance outcomes of all LB&I work

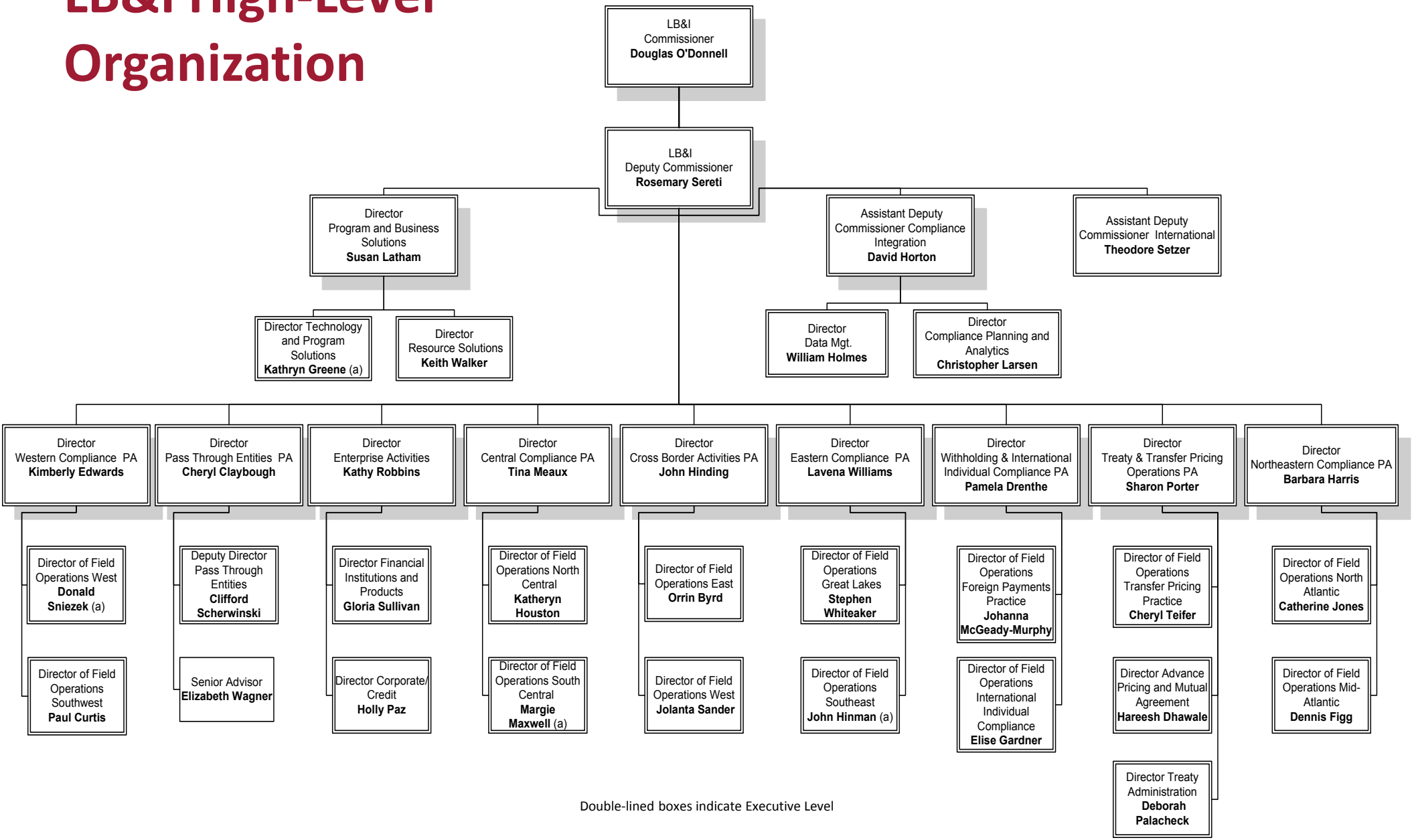
2016 LB&I Reorganization In Context

- CONOPS in development (2014)
- IDR Directive (March 2014)
- Centralized risk assessment pilot program (April 2014)
- Appeals judicial approach & culture (July 2014)
- LB&I reorganization announced (Sept 2015)
- IRS enterprise concept of operations (CONOPS) (March 2016)
- Pub. No. 5125 (February 2016)
- IRM updated (March 2016)
- New process for cases starting as of May 1, 2016; transition for cases in process May 1st

LB&I Reorganization Overview

- Changes to LB&I organization chart create "one LB&I"
  - Single Deputy Commissioner
    - International/Domestic Deputy Commissioners merge
  - Two Assistant Deputy Commissioners: International, Compliance Integration
  - Eliminate industry designations
  - Move to issue-based examinations
- 9 new practice areas:
  - A Practice Area is a group of employees organized together to focus on one or more areas of expertise
  - Each Practice Area will study compliance issues within their area of expertise and suggest campaigns to be included in the compliance plan

LB&I High-Level Organization

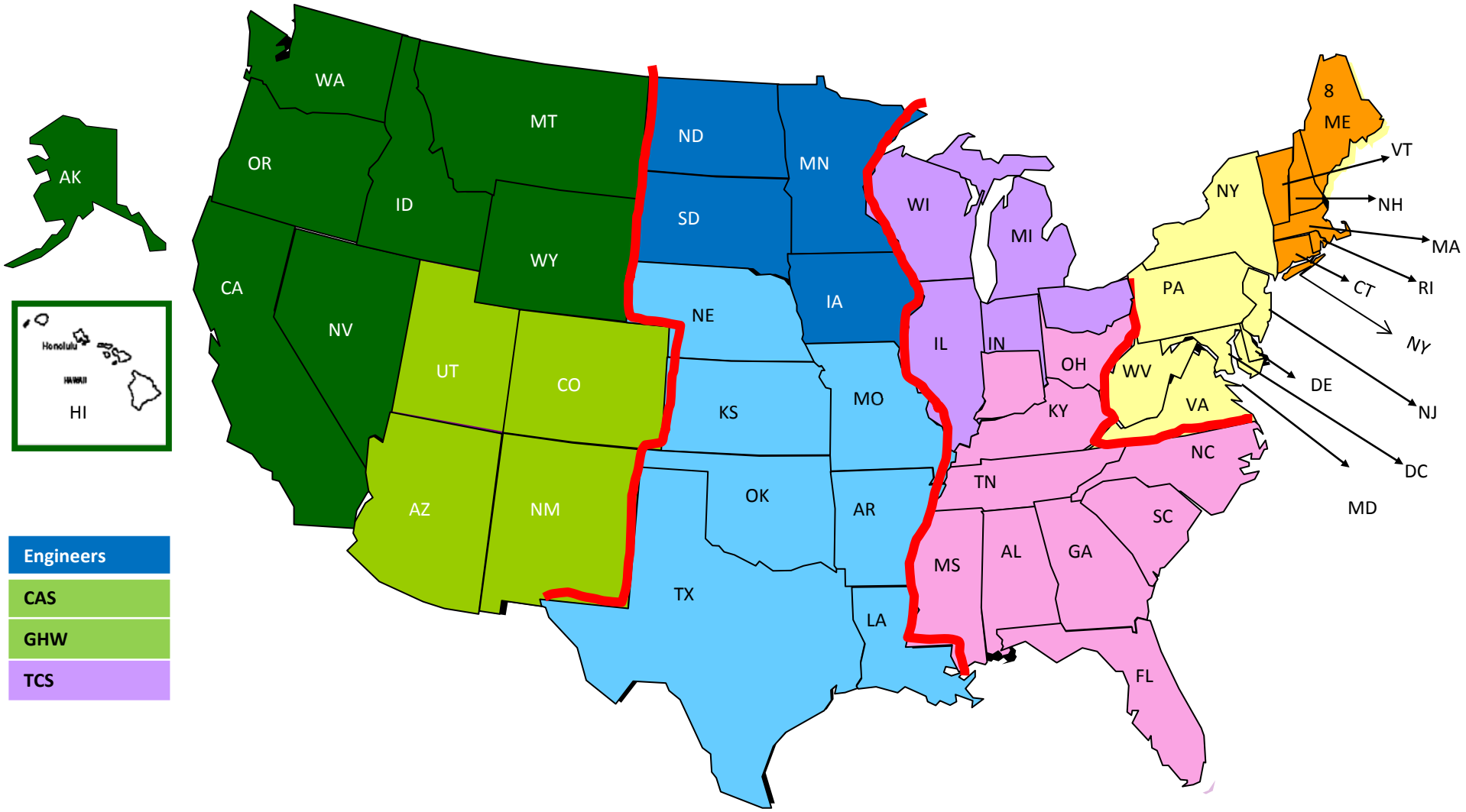


Double-lined boxes indicate Executive Level

Practice Areas

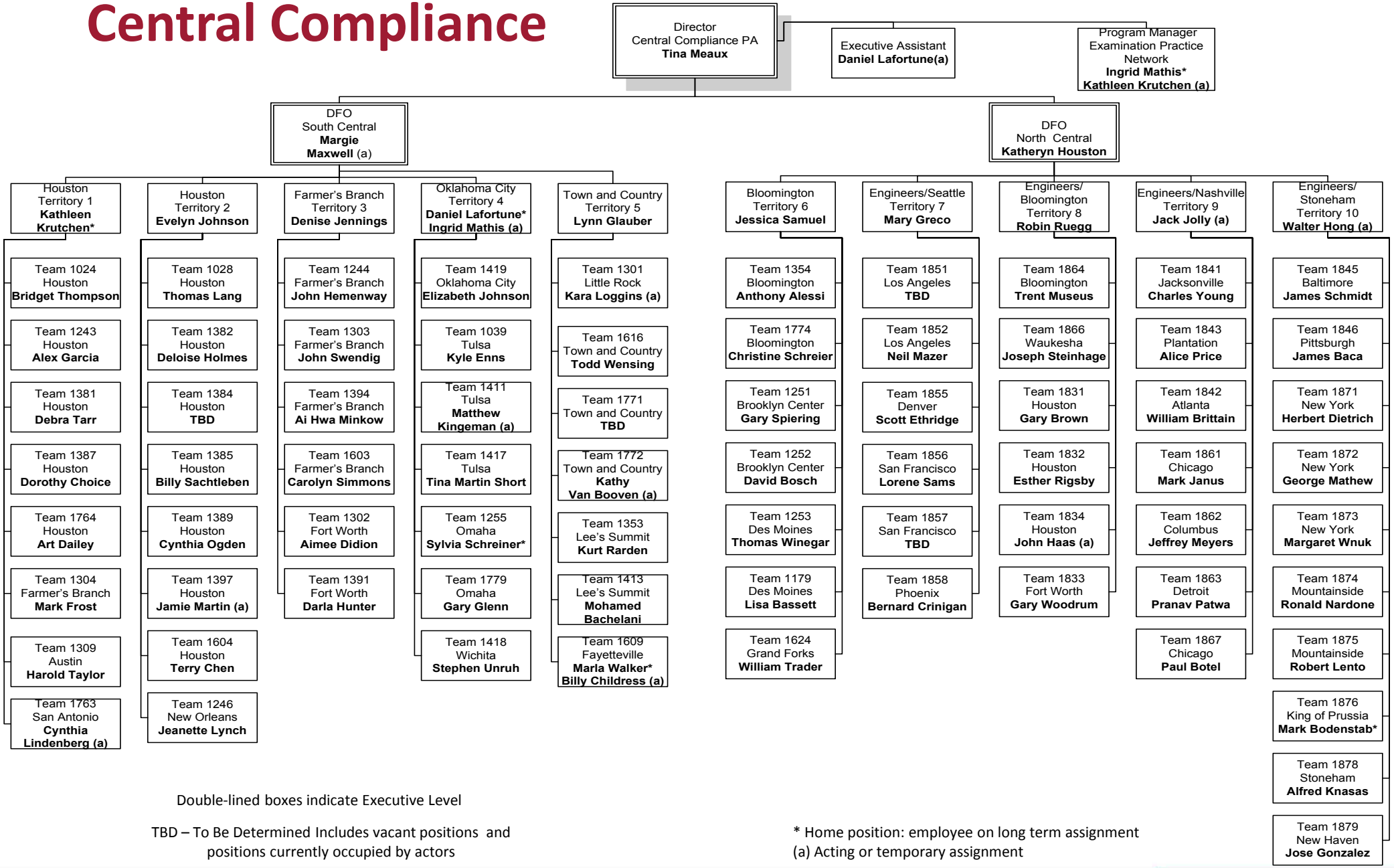
- 5 substantive practice areas:
  - Passthrough Entities
  - Enterprise Activities
  - Cross-Border Activities
  - Withholding & International Individual Compliance
  - Treaty and Transfer Pricing Operations
- 4 geographic practice areas:
  - Western (Oakland)
  - Central (Houston)
  - Eastern (Downers Grove)
  - Northeastern (New York)

Geographic Practice Area Map



West		Central		East		Northeast	
DFO-W	DFO-SW	DFO-SC	DFO-NC	DFO-GL	DFO-SE	DFO-NA	DFO-MA

Central Compliance



Double-lined boxes indicate Executive Level

TBD – To Be Determined Includes vacant positions and positions currently occupied by actors

* Home position: employee on long term assignment
(a) Acting or temporary assignment

Issue-Focused Exam Process: Identification of Issues

- Centralized risk model for case/issue selection
  - Greater use of predictive analytics
- Focus on streamlined audits with issue-focused approach
- Develop "campaigns" to alter taxpayer behavior
- Create tailored treatment streams to address areas of noncompliance
- Eliminate Coordinated Industry Case (CIC) Program
  - Audit Issues Rather Than Returns, But . . .
    - Largest Taxpayers Still Under Continuous Audit
    - Examiners May Still Identify Their Own Issues
  - Implications
    - Rev. Proc. 94-69 disclosures
    - Designated summonses
    - Delegation orders

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

Campaign Approach

- Identify areas of greatest non-compliance
- Deploy resources to those areas
- Transparent to taxpayers (eventually)
- Focus on mid-market companies
- Examples:
  - Inbound distributors and transfer pricing
  - Captive Insurance
  - Basket options
  - Section 199
  - R&E credit
- International practice units

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

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: The Examination

- 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 of IRS Team (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

Planning the Examination (IRM 4.46.3)

- Focuses on internal collaboration to effectively prepare for the opening conference with the taxpayer
- Emphasizes the importance of cooperation between the issue team and the taxpayer to assist in defining the scope and expectations of the examination
- Goal of the planning phase is for both parties to collaborate on completing an effective and efficient examination plan
- Describes three examination plan options
  - Issue-based examination plan
  - IC examination plan
  - CIC examination plan (this section was not updated, but most likely will be in the future as the CIC designation may be phased out as part of the LB&I reorganization)

Execution Phase (IRM 4.46.4)

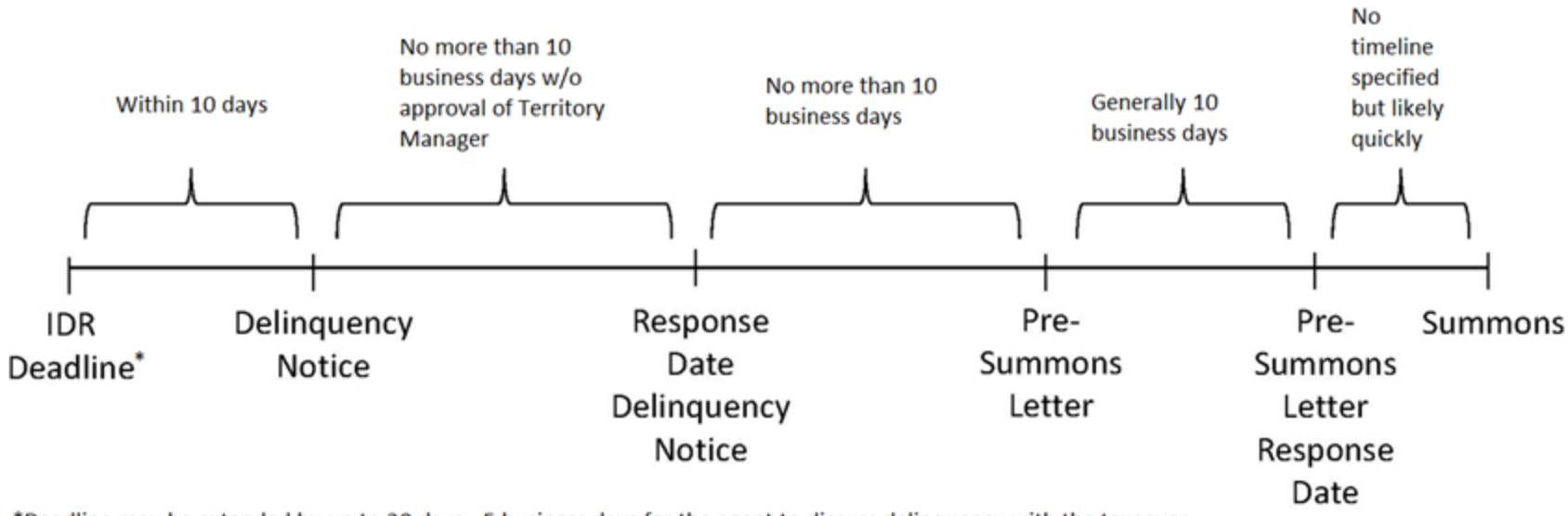
- Focuses on cooperation and transparency between the issue team and the taxpayer
- Information-gathering to be conducted by Information Document Request (IDR)
  - Exchange of information
  - Develop facts
- Mutually agree upon timelines

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

IDR Enforcement Process (IRM Exhibit 4.46.4-2)

- IDRs issued in compliance with IDR process subject to mandatory three-Step IDR enforcement process:
  - Delinquency Notice
  - Pre-Summons Letter
  - Summons



*Deadline may be extended by up to 20 days - 5 business days for the agent to discuss delinquency with the taxpayer and an extension of up to 15 business days for the taxpayer to resolve non-response or incompleteness

IDR Best Practices

- Respond to IDRs because of IRS summons power, use to guide responses
- Careful to provide only information requested
- Interpretations almost always necessary
  - Reducing burden is significant concern
  - Strategic decision whether to clarify in discussions with IRS
- Assert privileges and protect against waiver
- Keep log of receipt of IDR and date of response
- Maintain organized copies of all responses

IDR Best Practices

- Consider taxpayer presentations on significant issues prior to IDR issuance
  - May reduce the number of IDRs
- Develop agreements with Exam teams regarding IDR process
  - All IDRs in draft and discussed before issuance
  - Focus the IDRs on documents necessary and readily available
  - Due dates based on realistic discussions
- Push back on any IDRs that do not follow the IDR directive
  - Not focused (challenge “any and all” and kitchen-sink-type IDRs)
  - Not discussed with taxpayer prior to issuance
- Use management’s involvement in the IDR process to elevate noncompliant IDRs and other issues

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.

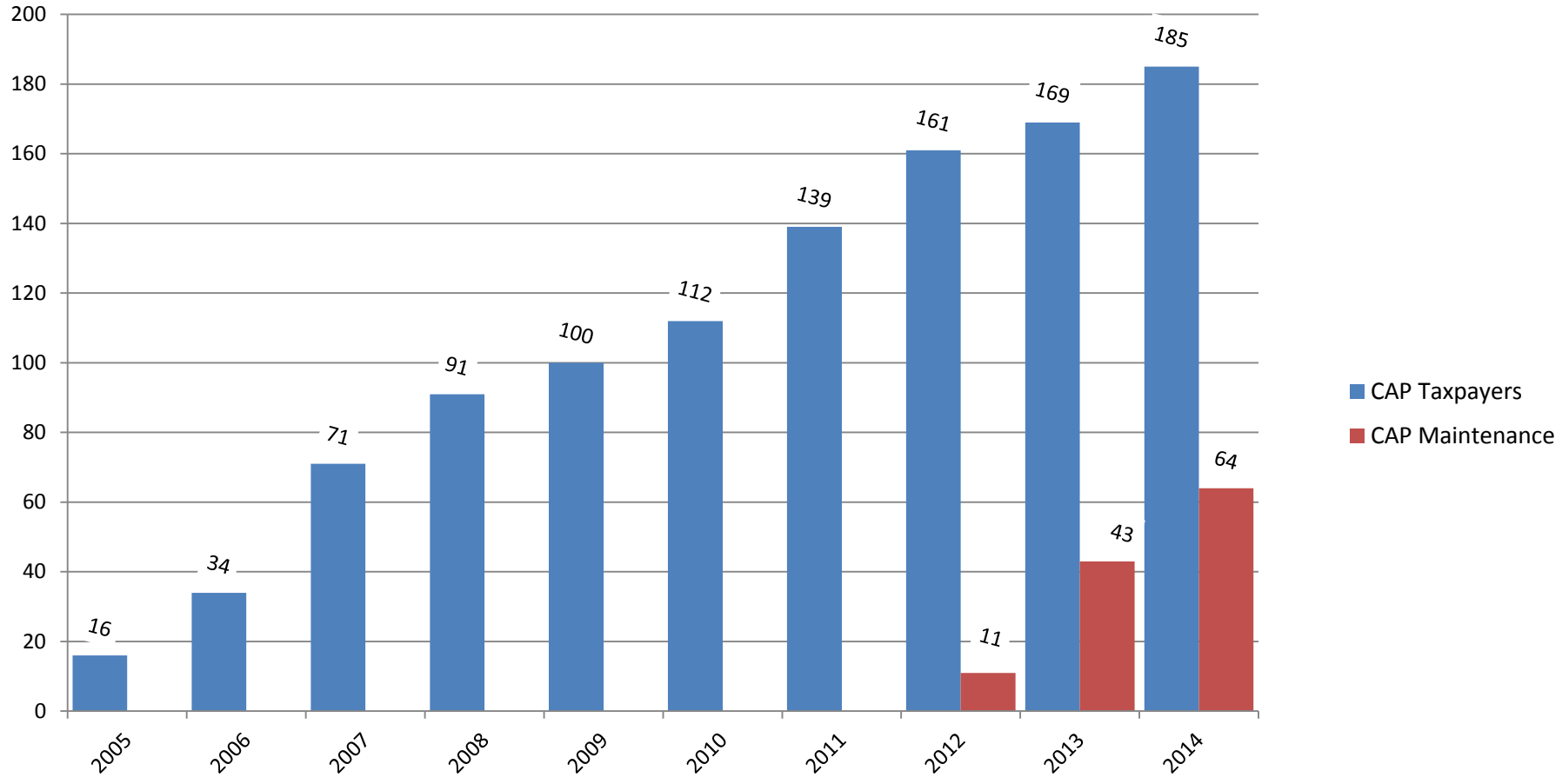
Claim for Refund Procedures (IRM 4.46.3)

- 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

Special Topics: CAP

- Compliance Assurance Process (CAP)
  - IRS and taxpayer work cooperatively and collaboratively to identify and resolve issues contemporaneously prior to filing tax return
  - Memorandum of Understanding establishes framework for audit
  - Phases:
    - Pre-CAP (closing years under examination)
    - CAP
    - Compliance Maintenance (less burdensome review)

Special Topics: CAP



Source: Corporate Tax Compliance: IRS Should Determine Whether its Streamlined Corporate Audit Process Is Meeting Its Goals (GAO-13-662, August 2013) (with 2013 update)

Special Topics: CAP

- Compliance Assurance Process (CAP)
  - Rosemary Sereti, others at LB&I evaluating CAP
  - LB&I has closed the CAP program to new entrants
  - Those currently in program may remain, for now
  - Discussion of creating CAP-like program that is less resource intensive

Special Topics: State Aid

- The European Commission has recently opened at least 7 **in-depth investigations on State aid tax issues**:
  - Two cases against Luxembourg (Fiat Finance and Trade; Amazon); in Fiat, the European Commission has issued a final decision that the arrangements constitute State aid; Fiat is on appeal to the EU General Court. The Amazon case is awaiting a final decision by the EC.
  - One case against Ireland (Apple); EC has issued a final decision that the arrangement constitute State aid; appeal expected.
  - One case against The Netherlands (Starbucks); the European Commission has issued a final decision that the arrangements constitute State aid; case on appeal to the EU General Court.
  - Two cases against Belgium and France regarding tax exemptions related to ports.
  - One case against Belgium for "excess profits" rulings; the EU has issued a final decision that the arrangements constitute State aid; case on appeal to the EU General Court

Special Topics: State Aid

- EU Competition law (non-tax) prohibits:
  - An advantage in any form whatsoever conferred on a selective basis by public authorities
  - That distorts or threatens to distort competition and has a negative effect on trade between EU Member States
  - General measures open to all enterprises are not covered by this prohibition and do not constitute state aid
- Rationale: prevent EU Member States from granting **distortive aid**, in any form

Special Topics: State Aid

- Key questions:
  - What is the baseline? Is it the tax law of the Member State or does EU law play a role?
  - Does it matter that other taxpayers could have gotten a similar ruling?
  - Does it matter that such rulings were "available" only to multinationals?

Special Topics: State Aid

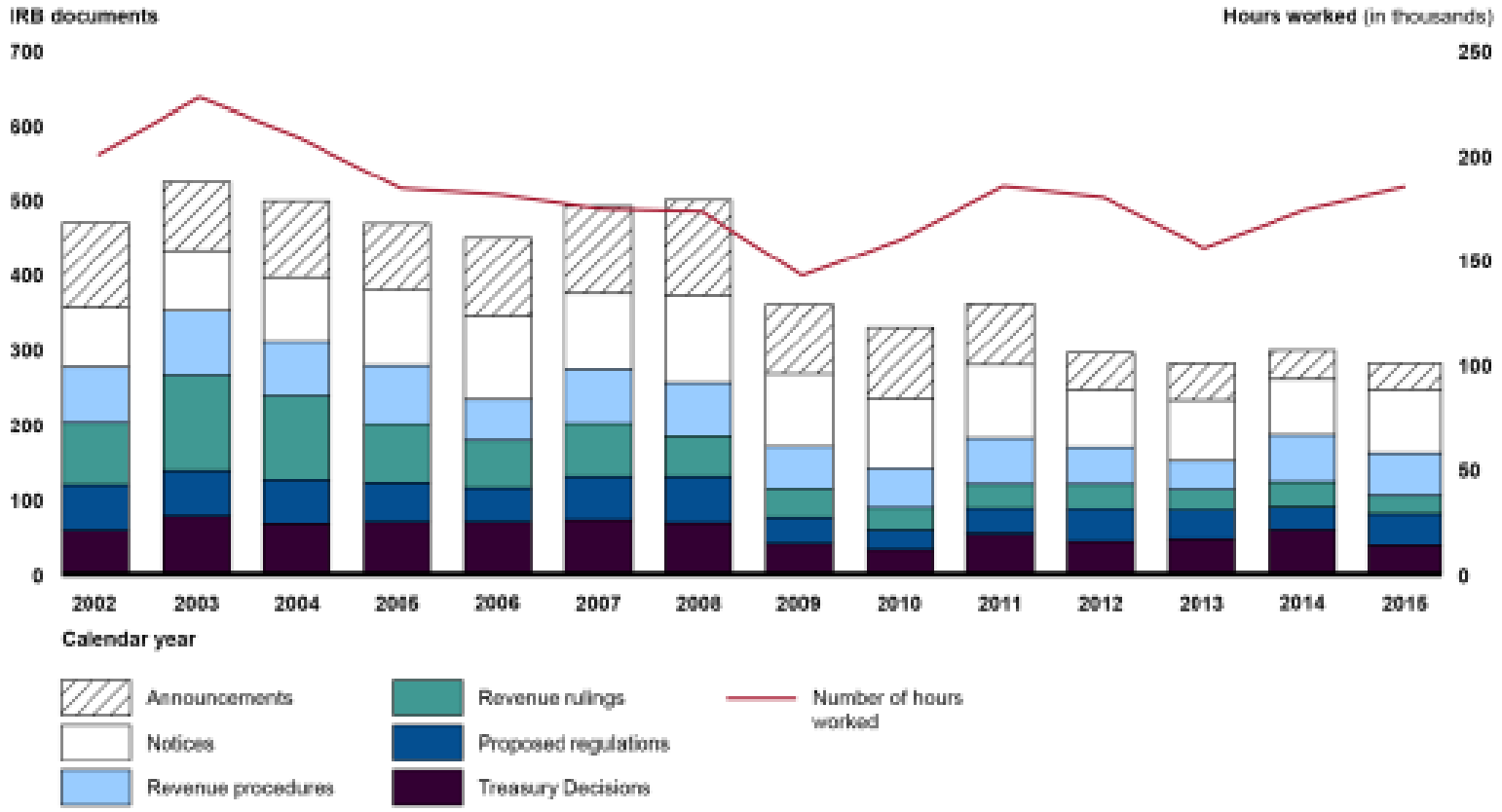
- Consequences if a tax ruling is state aid:
  - Member State must collect the back taxes
  - Look-back period is 10 years
  - If creditable in the United States, the real aggrieved party is the U.S. Treasury
  - Hence, Treasury's White Paper of Aug. 24, 2016

Special Topics: IRS Guidance

- Traditionally, new legislation was followed by temporary, and then final regulations
- Today, guidance process is slower
  - Resource constraints
  - APA challenges proliferating
  - Post-*Mayo*, IRS and Treasury taking more time to build file, explain decisions, respond to comments, and limit temporary regulations to "must-have settings"

Special Topics: 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

Special Topics: IRS Guidance

Hierarchy of IRS Guidance

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

Privilege and Work Product Developments

David J. Fischer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10:12
LAWYER PRAYERS.

Privilege 101

- Attorney-client privilege:
  - Communications between an attorney and client made and kept in confidence for the purpose of legal advice
- Section 7525 Tax Practitioner Privilege:
  - Relies on attorney-client privilege rules
- Work product doctrine:
  - Prepared in anticipation of litigation
  - Limited privilege, but often applies: IRS can obtain only on showing of need, inability to obtain elsewhere
  - Work product privilege claims raise spoliation issues

Attorney-Client Privilege

- Attorney-Client Privilege applies to:
  - A communication
  - Between an attorney and his or her client
  - Made and kept in confidence
  - For the purpose of seeking, obtaining or providing legal advice
- Applies to in-house counsel, but they face unique issues and challenges
- "Kept in confidence"
  - Intentional disclosure to persons without a "need to know" in connection with the legal advice could constitute subject matter waiver

Federally Authorized Tax Practitioner Privilege

- Codified at Section 7525
  - Modeled on Attorney-Client Privilege, but covers tax advice given by federally authorized tax practitioners
  - Can be waived just like Attorney-Client Privilege
- Applies to those "eligible to practice" before the IRS under Circular 230
  - Includes in-house tax advisors (*U.S. v. Eaton Cor*p., (N.D. Ohio 2012))
- Only applies to noncriminal matters involving IRS and DOJ
  - No protection against other Federal agencies (SEC, etc.), state tax authorities, or other parties in civil litigation
- Exception for written tax shelter promotional materials

Work Product Doctrine

- Materials prepared "in anticipation of litigation" are subject to qualified protection from disclosure
  - Opposing party can still obtain on showing of substantial need and inability to obtain information elsewhere
  - Documents disclosing attorney mental impressions typically not subject to this exception
- Work product protection applies regardless of who prepared materials (not limited to attorney)
- Work product generally provides robust protection; broadly applicable and less likely to have been waived
  - Materials can be shared provided that disclosure is not inconsistent with adversarial process

Spoliation

- Taxpayers are required to preserve evidence (including unfavorable evidence) for use in pending or reasonably foreseeable litigation
  - Sanctions increase with evidence of intent
    - Monetary sanctions for negligent spoliation
    - Adverse inference or exclusion of evidence for gross negligence
    - Dismissal of case for intentional
- Work product privilege requires anticipation of litigation
  - Institute document litigation hold if claim work product protection

Why Claim Privilege?

- Encourage full analysis of issues in confidence
- Avoid unfair disclosures
  - Audit / Appeals / Litigation strategy
  - "Roadmap" to analysis of issue at stake
  - Other issues not under examination
- Avoid "he said, she said" debates about preliminary discussions
  - Privileged documents often examine and assess contrary positions
- IRS often claims deliberative process or other privileges when "shoe is on the other foot"

Waiver

- Subject matter waiver is significant concern in delivering privileged documents
  - Difficult to predict full extent of waiver
- Waiver most litigated issue
  - Disclosure to attest firm or inclusion in tax accrual workpapers is almost certainly a waiver of attorney-client privilege or Federally authorized tax practitioner privilege (*Arthur Young, S. Ct. 1984)*
  - May not be waiver of work product protection

Circuits Split re Work Product Waiver

- *U.S. v. Adlman* (2nd Cir. 1998)
  - "Dual purpose:" prepared "because of" anticipation of litigation even if used for business decision
- *Schaeffler v. United States* (2d Cir. 2015)
  - Follows *Adlman* where disclosed to consortium of banks with "common interest"
- *U.S. v. Deloitte, LLP* (D.C. Cir. 2010)
  - Prepared "because of" litigation even if prepared for multiple purposes
  - Attest firm not adversary and required to keep confidential
- *U.S . v. Roxworthy* (6th Cir. 2006).
  - Because of litigation requires expectation of litigation to be reasonable
- *U.S. v. El Paso Co.* (5th Cir. 1982)
  - Litigation must be "primary" or "principal" purpose for work product to apply
- *U.S. v. Textron* (1st Cir. 2009) (*en banc*)
  - Not prepared "because of" anticipation of litigation, use for attest firm motivating factor

Work Product Waiver in the Tax Court

- Prior to 2015, Section 7543 required Tax Court to apply the Rules of Evidence as applied in the D.C. Circuit
- Protect Americans from Tax Hikes Act of 2015 (PATH Act) eliminated link to D.C. Circuit
  - Tax Court will apply Rules of Evidence applicable to Circuit to which the case would be appealed (*Golsen*, T.C. 1970)

Policy of Restraint

- Policy of Restraint set forth in I.R.M. § 40.10.20, and Announcement 2010-76 (UTP)
  - IRS not seek documents provided to auditor in connection with review of financial statements subject to attorney-client, tax practitioner, or work product unless:
    - Previously waived
    - Unusual circumstances
    - Engaged in one or more listed transactions
- Policy of Restraint applies to Exam, not litigation

Inadvertent / Accidental Disclosure

- Federal Rule of Evidence Rule 502 provides that inadvertent disclosure in federal or state proceeding to a federal office or agency does not operate as a waiver if
  - reasonable steps were taken to prevent disclosure and
  - the holder promptly takes reasonable steps to rectify the error, including (if applicable) following Federal Rule of Civil Procedure 26(b)(5)(B)
- Federal Rule of Civil Procedure 26(b)(5)(B) provides that
  - the party making the claim may notify any party that received the information of the claim and the basis for it
  - after being notified, a party must promptly return, sequester, or destroy the specified information and any copies it has
  - The matter may be presented to the court under seal for a determination of the claim

Implied Waiver

- Reliance on Advisor: Implied waiver may occurs when the taxpayer places advice at issue by claiming reliance on advice of outside advisor
- Reliance on Own Analysis: Implied waiver may result if taxpayer raises reasonable cause and good faith defense to accuracy related penalties, even if documents remain confidential and not claim reliance on advisor
- Reasonable cause/good faith defense puts into contention the subjective intent and state of mind of those who acted for petitioner and petitioner's good-faith efforts to comply with the tax law
  - *Ad Inv. 2000 Fund LLC v. Comm'r* (Tax Ct. 2014)
  - *Eaton Corp. and Subs.* (Tax Ct. Order 2015)
  - *In re: G-I Holdings, Inc*. (D. N.J. 2003)
- Policy of Restraint does not apply to implied waiver

Opinion Disclosure Practice

- IRS appears to penalty issues with purpose to obtain opinions
- Appeals will not consider new facts
  - Opinion, if not delivered to Exam, will be a new fact
  - Cannot withhold Opinion until reach Appeals
  - Generally, delivery with Protest viewed as part of Exam
- Requirement to deliver during Exam has led to different approaches to waiver
  - Non-Waiver Agreements
  - Quick Peek and Clawback Agreements

Non-Waiver Agreements

- Seek agreement with IRS that delivery of opinion does not constitute subject matter waiver
- Federal Rule Evidence 502 (adopted in 2008)
  - Permits non-waiver agreements to be binding
  - Provides binding only on parties unless incorporated in court order
  - Provides that intentional waiver applies to other documents with same subject matter if "ought in fairness be considered together"
- IRS policy against non-waiver agreements
  - CC 2009-023 (Aug. 3, 2009), IRS argues agreements not necessary
  - IRS claims subject matter waiver only if "intentional" and "misleading" (from Advisory Committee Notes), so claims non-waiver agreements not required
- Unclear if Rule 502 protects taxpayers
  - Does not apply to Federally Authorized Tax Practitioner privilege
  - How to determine "fairness" or "misleading" for subject matter waiver

Quick Peek

- Permit requesting party to take a "quick peek" at documents without sorting privileged / non-privileged
  - Shifts burden of review to requesting party
  - Often coupled with "clawback" procedure, permit to clawback inadvertent disclosures
- CC 2009 also states IRS policy against quick peek and clawback
- Current, highly-publicized, cases
  - *Guidant* (Tax Court) (quick peek for documents IRS claims covered by "deliberative process" privilege
  - *Microsoft Corp*. (W.D. Wash. Summons enforcement) (taxpayer privilege claims)
  - *Dynamo Holdings* (Tax Court) (taxpayer privilege claims(

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Tax Policy Update

Congress, the Election & Tax Policy in 2016-17

Jim Flood
Partner & Chair
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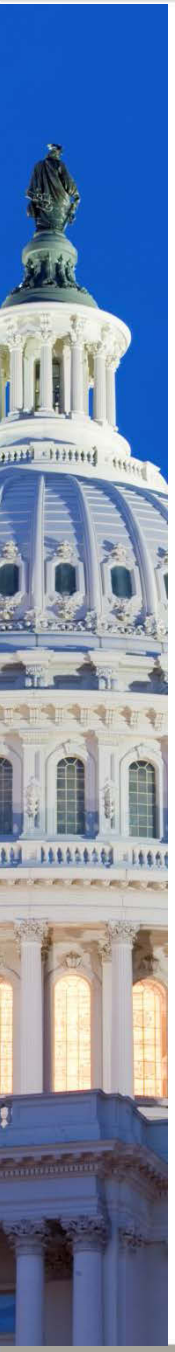
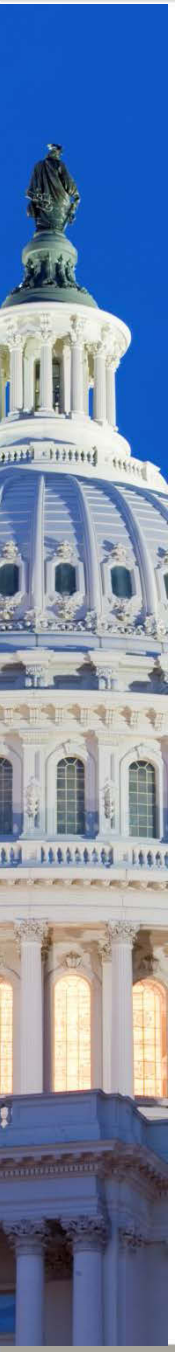
Washington, D.C.



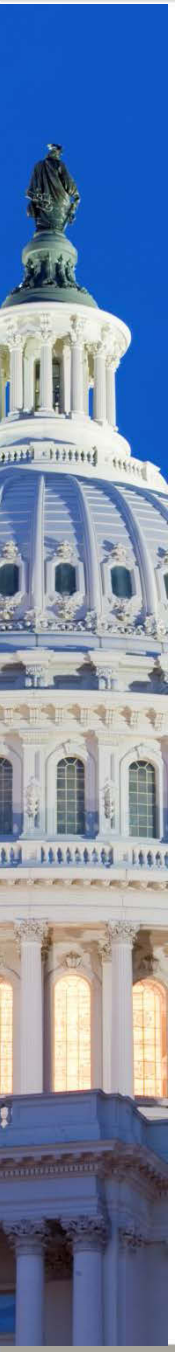
Agenda

- Introduction
- Key Congressional Players in Tax
- The 2016 Lame Duck Congress & Tax
- The Presidential Candidates on Tax
- The Presidential & Congressional Elections
- The 2017 Congress & Tax
- Conclusion



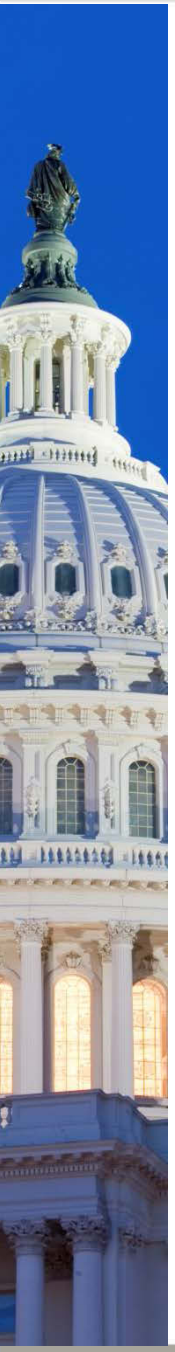
Jim Flood

- Chair, Government Affairs Group, C&M
- Former Counsel, Sen. Charles E. Schumer (D-NY)
- Former V.P., Government Affairs, Omnicare, Inc.
- Former U.S. Federal Prosecutor
- Attorney, Advocate & Analyst for Companies before Congress & Federal Agencies



A Summary of Current Congress

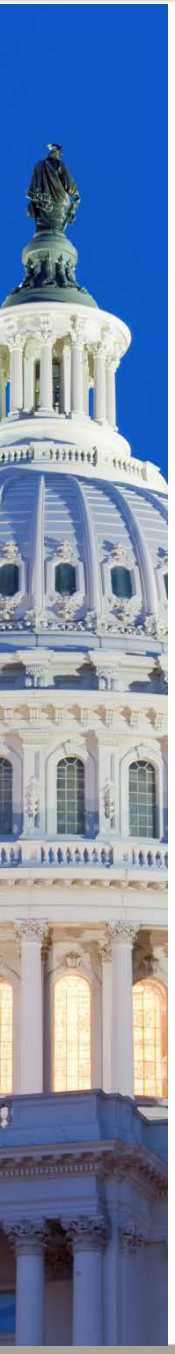
- U.S. House of Representatives
  - 435 House Members
  - 247 Republicans (**<u>218</u> to pass bill**)
  - 188 Democrats
  - Entire House Up for Re-election
  - Republican Hold House in 2017



A Summary of Current Congress

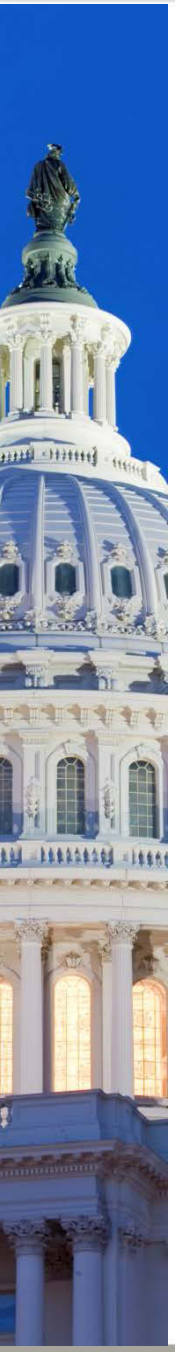
Tax Bill Legislative Process – Must Start in House

- Introduction of Bill & Assigned to House Ways & Means Committee
- Committee Votes Out Tax Bill
- Final Passage 1: “Suspension of Rules”
- Final Passage 2: Single Bill on Floor
- Final Passage 3: Pass as Amendment to Larger Bill Which Passes on Floor



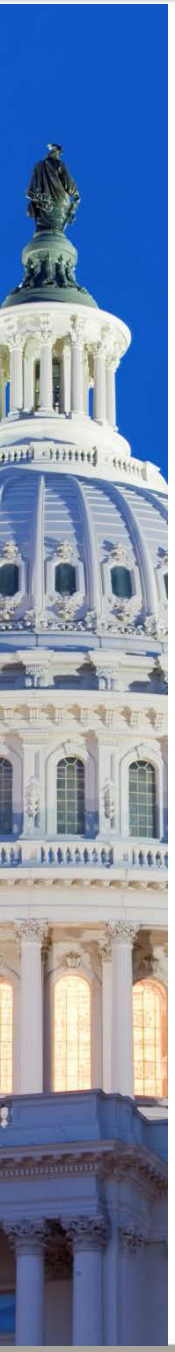
A Summary of the Current Congress

- The United States Senate composition:
  - 100 Senators
  - 54 Republicans
  - 46 Democrats
  - 34 Senators Up for Re-Election
    - **24 Republicans & 10 Democrats**
  - Which Party Will Run Senate in 17?



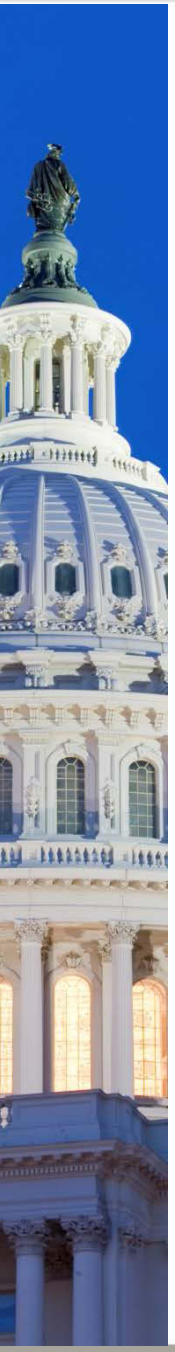
A Summary of Current Congress

- Tax Bill Legislative Process in Senate
  - The Senate Finance Committee receives House passed Tax Bill, Marks It Up & Passes It Out of Committee
  - Final Passage 1: “Unanimous Consent”
  - Final Passage 2: Single Bill on Floor
  - Final Passage 3: Amendment to a Larger Bill Which Passes on Floor



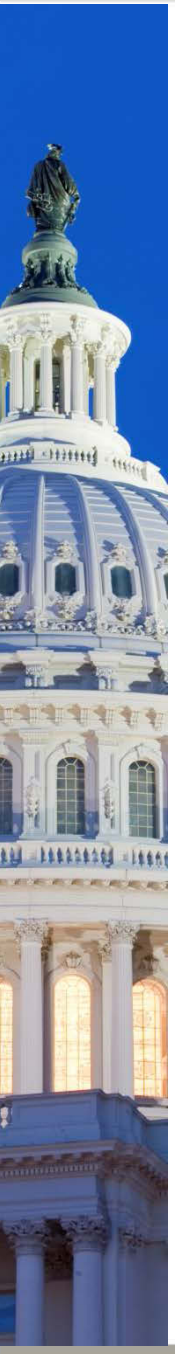
A Summary of Current Congress

- How a Tax Bill Ultimately Passes Congress
  - Option # 1 - Pass Identical Bill in both houses of Congress, OR
  - Option # 2 – Pass Different Bills in Both Houses of Congress
  - THEN a Conference Committee of Appointed Members From Both Houses Negotiates a Final Identical Bill Which Must Pass Both Houses of Congress



A Summary of Current Congress

- Key House Tax Bill Decision Makers
- (1) The House Ways & Means Committee
  - The Subcommittee on Tax Policy
- (2) The House Leadership
  - Speaker Paul Ryan (R-WI)
  - Minority Leader Nancy Pelosi (D-CA)
- (3) Both Must Support Tax Bill to Pass House

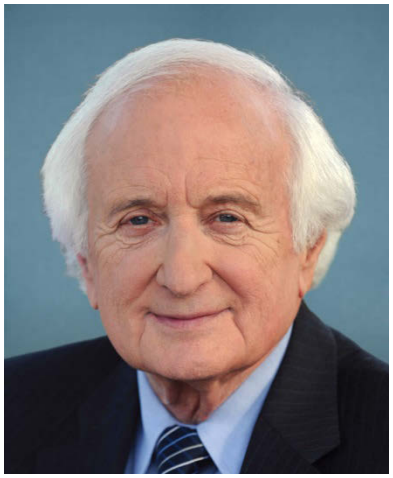


The House Ways & Means Committee

Full Committee

Kevin Brady (R-TX)
Chairman

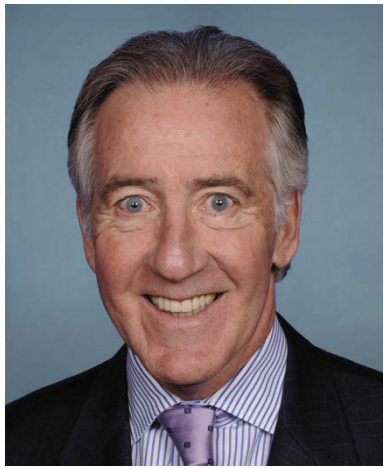
Sander Levin (D-MI)
Ranking Member

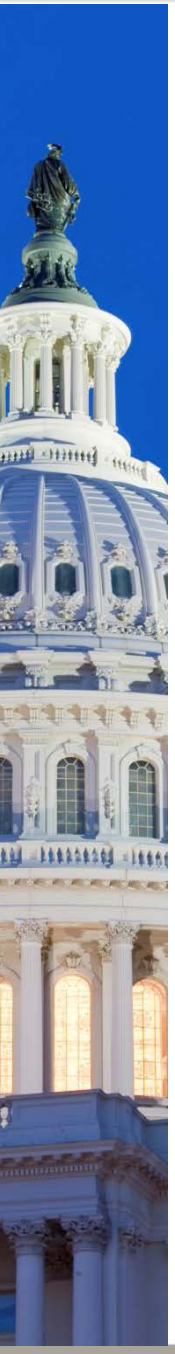


Subcommittee on Tax Policy

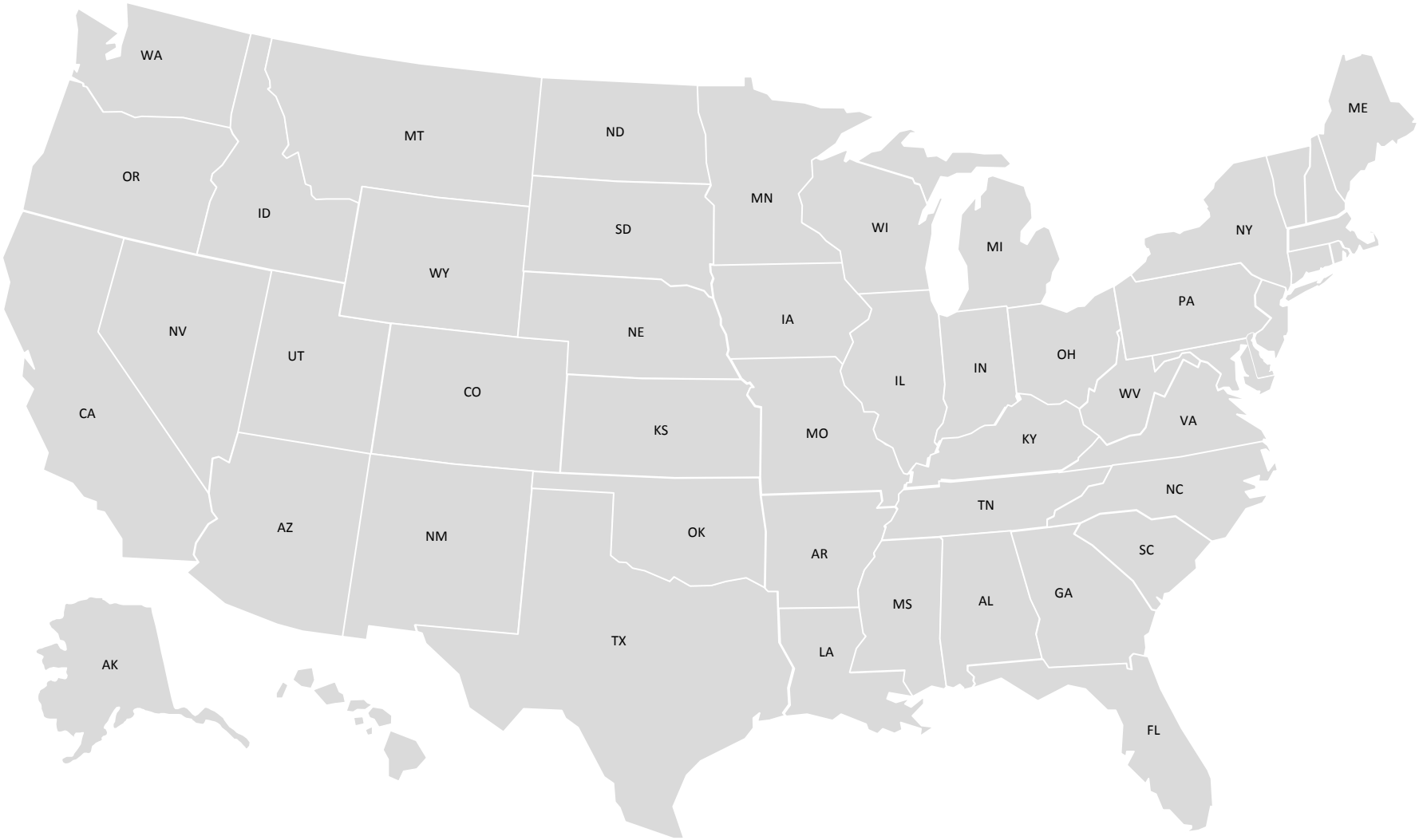
Charles Boustany (R-LA)
Chairman

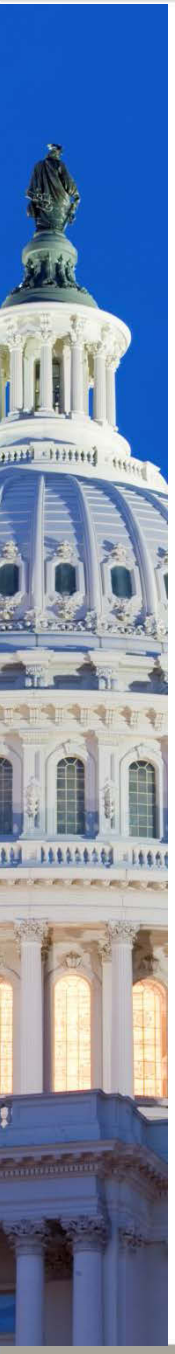
Richard Neal (D-MA)
Ranking Member





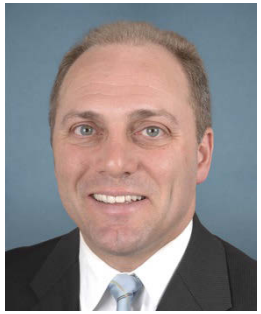
House Ways & Means Committee





House Leadership

Kevin McCarthy (R-CA)
Majority Leader



Steve Scalise (R-LA)
Majority Whip

Paul Ryan (R-WI)
Speaker of the House

Nancy Pelosi (D-CA)
Democratic Leader

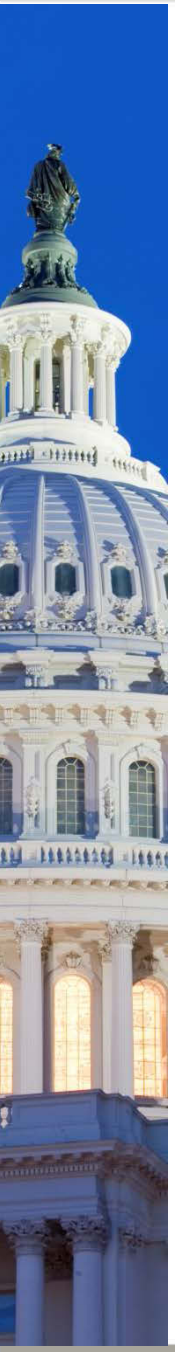
Steny Hoyer (D-MD)
Democratic Whip

Cathy McMorris-Rodgers (R-WA)
Conference Chairman

Luke Messer (R-IN)
Policy Committee Chairman

Jim Clyburn (D-SC)
Assistant Democratic Leader

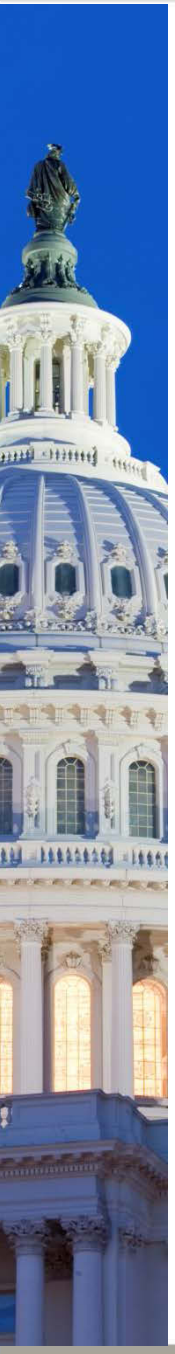
Xavier Becerra (D-CA)
Democratic Caucus



A Summary of Current Congress

- The Key Tax Decision Makers in the Senate
  - (1) The Senate Finance Committee
  - Subcommittee on Taxation and IRS Oversight

  - (2) The Senate Leadership
  - Majority Leader Mitch McConnell (R-KY)
  - Minority Leader Harry Reid (D-NV) through 2016
  - Minority Leader Chuck Schumer (D-NY) in 2017



The Senate Finance Committee

Full Committee

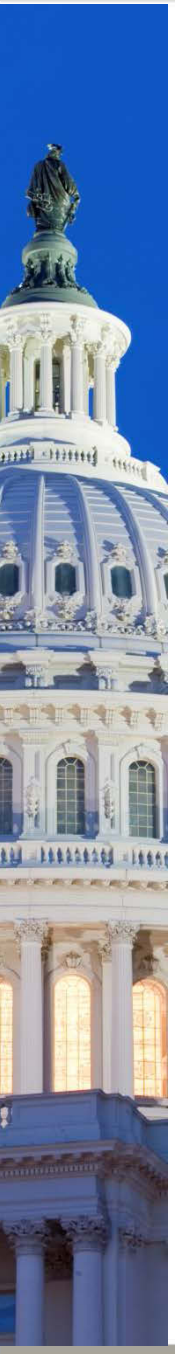
Orrin Hatch (R-UT)
Chairman

Ron Wyden (D-OR)
Ranking Member

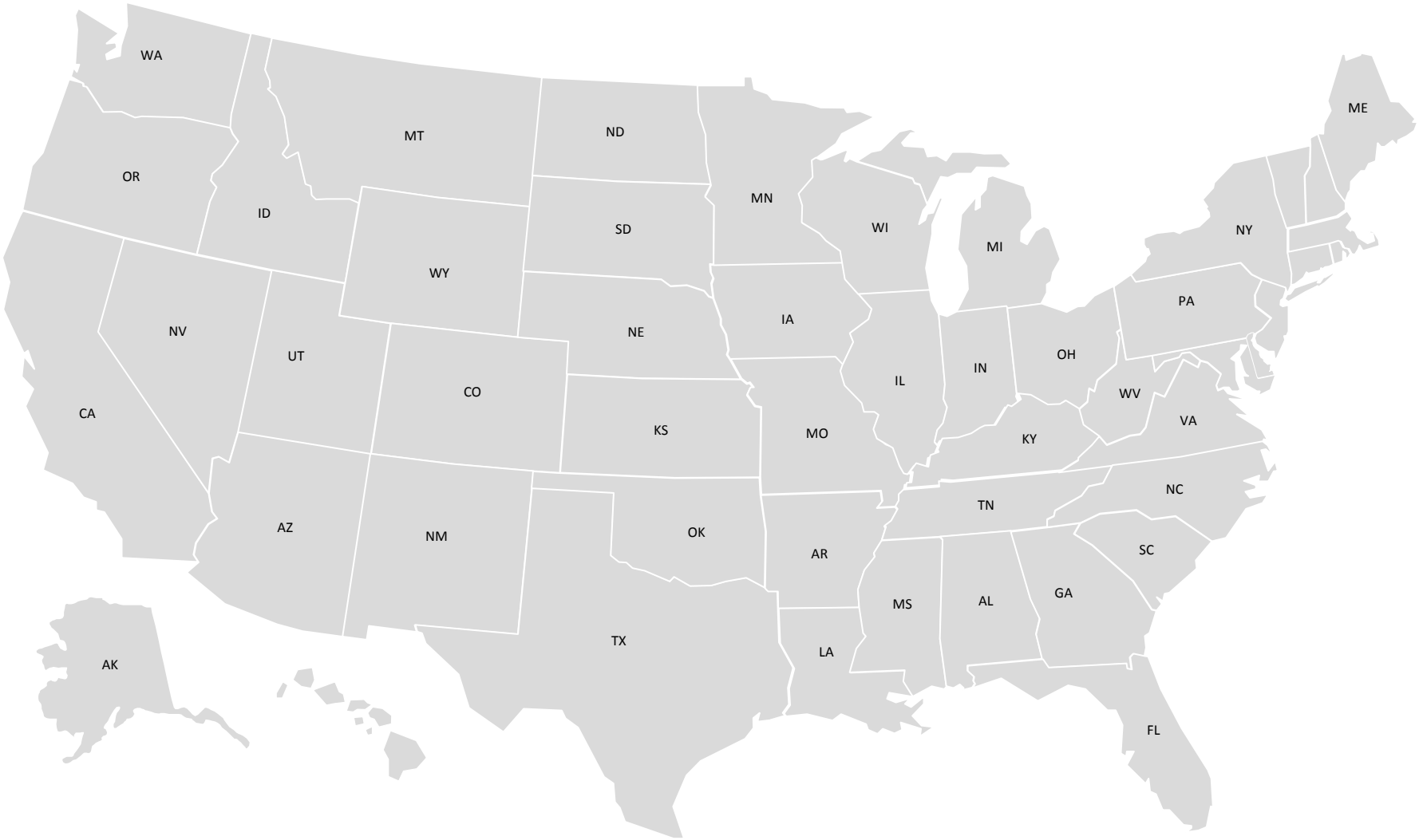
Subcommittee on Taxation and IRS Oversight

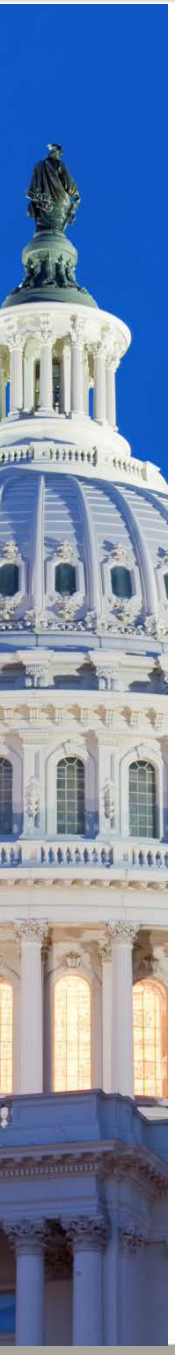
Mike Crapo (R-ID)
Chairman

Bob Casey (D-PA)
Ranking Member



Senate Finance Committee

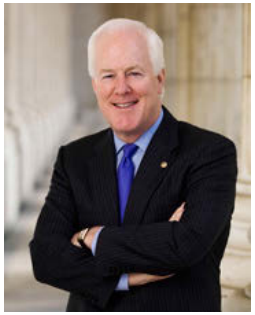




Senate Leadership

Mitch McConnell (R-KY)
Majority Leader

Harry Reid (D-NV)
Democratic Leader



John Cornyn (R-TX)
Majority Whip

John Thune (R-SD)
Conference Chair

Richard Durbin (D-IL)
Democratic Whip

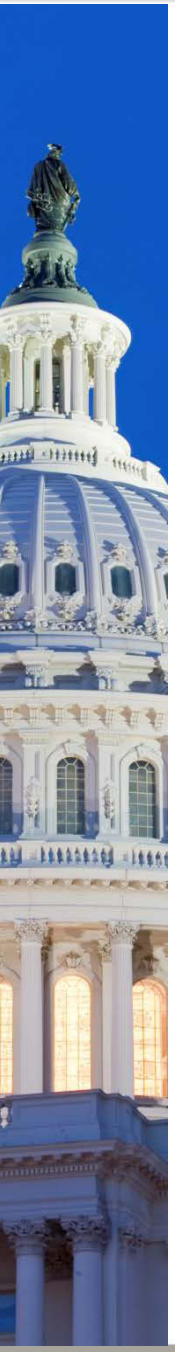
Harry Reid (D-NV)
Conference Chair

John Barrasso (R-WY)
Policy Committee Chair

Roy Blunt (R-MO)
Conference Vice Chair

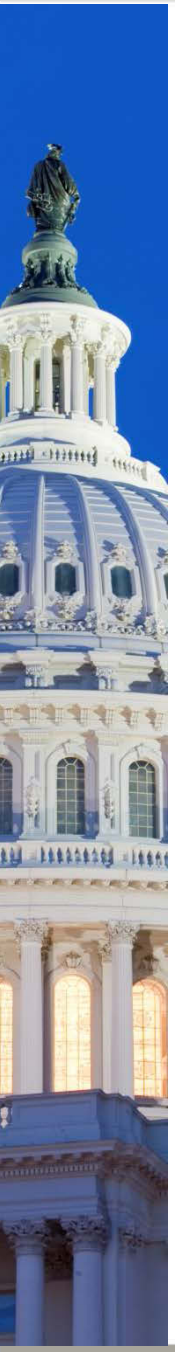
Chuck Schumer (D-NY)
Conf. Vice Chair & Policy Committee Chair

Patty Murray (D-WA)
Conference Secretary



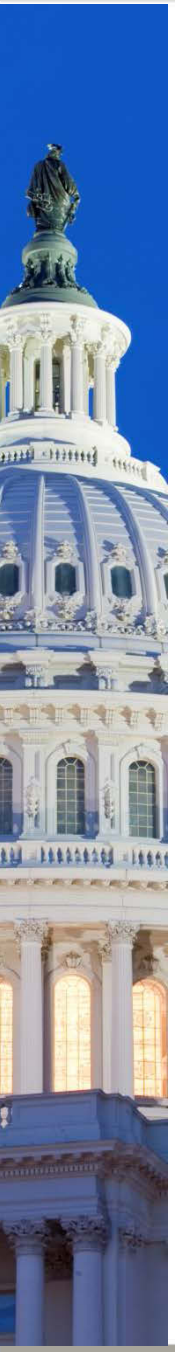
The Lame Duck Congress: Agenda

- Congress already has a full Lame Duck agenda, which leaves little room for debating comprehensive tax reform
- The issues which the Lame Duck Congress is expected to address after the November 8, 2016 election are:
  - The 21st Century Cures or Innovations Act
  - The Zika funding legislation
  - The National Defense Authorization Act (NDAA)
  - An Appropriations/Omnibus Bill
  - The Energy Bill
  - The FDA Cosmetics Bill
  - Tax Extenders?



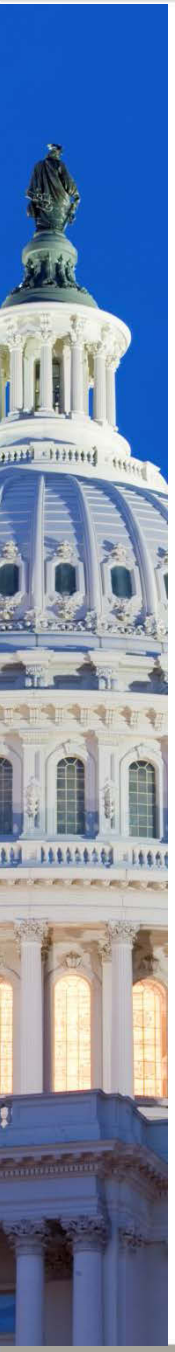
Tax Issues: 2016 Lame Duck Congress

- Tax Extenders – Normal Year End Decisions
- Last Year - 2015 Omnibus Bill – Congress Made One Third (22) of Tax Extenders Permanent
- These Now Permanent Tax Provisions Include Section 179 Expensing & Research Tax Credit
- Result – This Year – Less Extenders At Issue



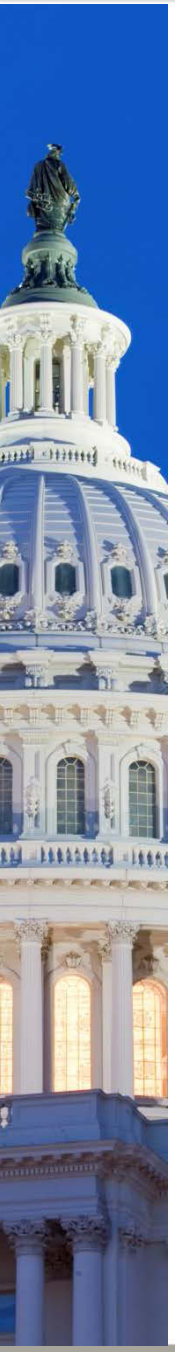
Tax Issues: 2016 Lame Duck Congress

- A tax extenders bill is possible & will be only tax bill
- Congress had considered attaching this bill to the FAA reauthorization earlier in 2016, but that effort fell apart
- BUT tax extenders is not guaranteed this year
- Some want to use it as leverage next year to pass comprehensive reform
  - Ways & Means Chair Kevin Brady (R-TX) has been ambivalent, though he complains that temporary extensions are bad policy
  - Finance Chair Senator Orrin Hatch (R-UT) supports a bill this year, as does Senators Wyden (D-OR), Grassley (R-IA), and others



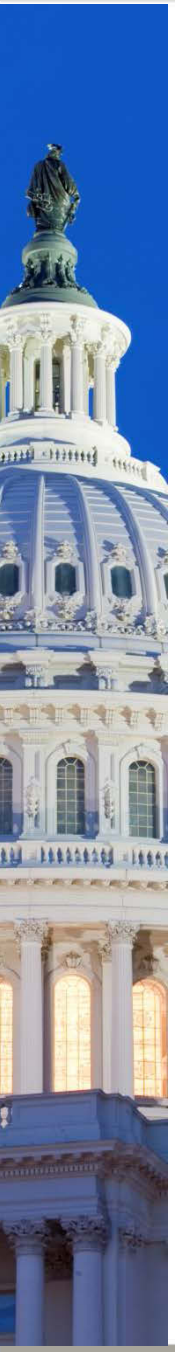
Tax Issues: 2016 Lame Duck Congress

- The Likely 2016 Tax Extenders bill
  - More than 30 tax breaks, valued over $17.7 billion, set to expire at end of this year (2016)
  - Half deal with renewable energy and energy conservation ($7.4 billion)
  - Two provisions deal with mortgages ($7.5 billion)
  - Other provisions affect rum producers, deductions for educational expenses, expensing rules for movie and theater productions, write-offs for NASCAR tracks, and depreciation for race horses



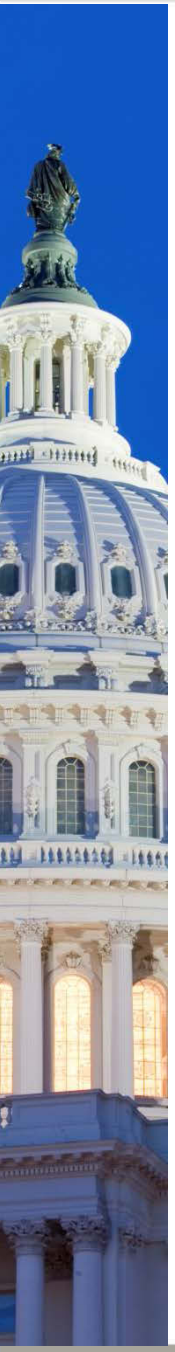
Tax Issues: 2016 Lame Duck Congress

- The Key 2016 Tax Extenders At Issue Are:
- (1) Renewable Energy Incentives – 16
- Most are tax credits - electric vehicles, biodiesel, residential energy equipment
- Total Cost in 2016 is $7.4B



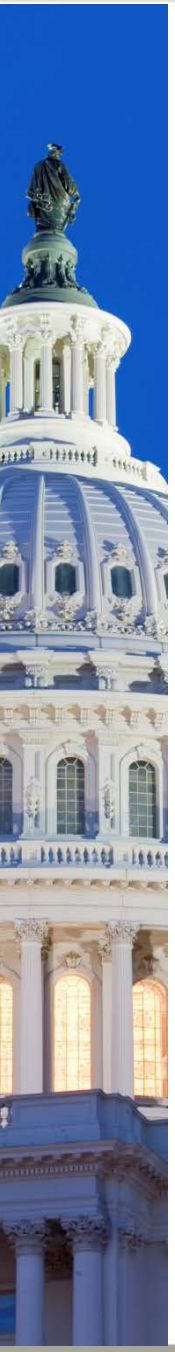
Tax Issues: 2016 Lame Duck Congress

- (2) Provisions for Homeowners
- The two largest provisions that are set to expire at the end of 2016 are both targeted at homeowners.
- One - exempts some homeowners from tax on amount they receive in mortgage loan forgiveness.
- Second - allows homeowners to count mortgage insurance premiums towards their mortgage interest deductions.
- Cost - Extending into 2016 costs $7.5 billion.



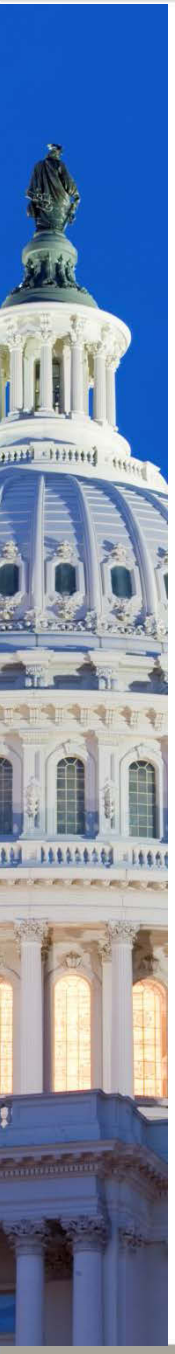
Tax Issues: 2016 Lame Duck Congress

- (3) Miscellaneous Provisions
- The remaining 18 provisions set to expire at end of 2016 are a mixture affecting various industries, including railroad companies, rum producers & race horses, film & television, & domestic production in Puerto Rico
- Several permit more favorable depreciation schedules which move towards full expensing
- Relatively minor compared to other two categories
- Cost - Extending into 2016 costs $2.8 billion.



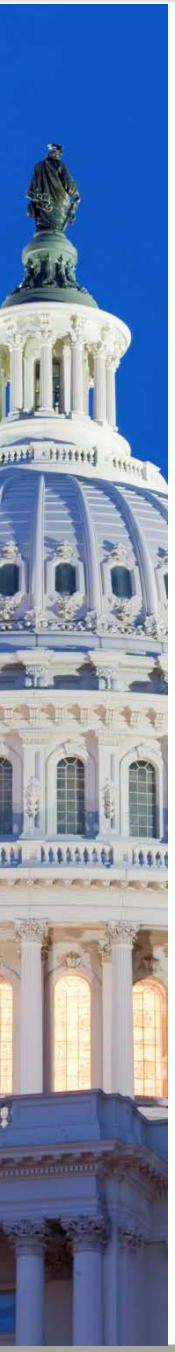
Tax Issues: 2016 Lame Duck Congress

- Will the Congress Pass Tax Extenders in 16?
- It depends on the election results.
- Likely No – if Trump wins the White House
- Strategic decision for Congressional Rs and Ds depends on whether to do tax extenders or wait for tax legislation in 2017



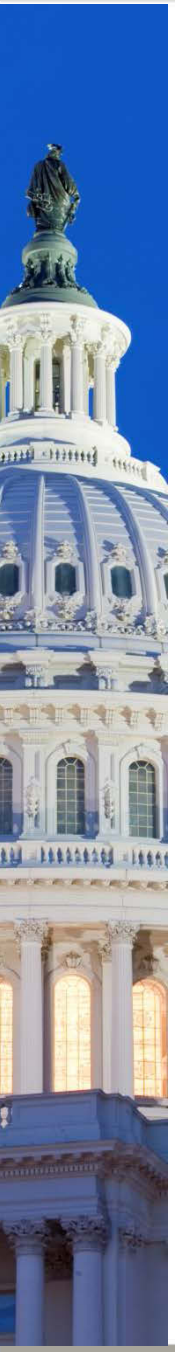
The 2017 Congress & Tax Reform

- Pressure for & interest in tax reform growing in Congress
- Bipartisan Consensus: Tax Reform Necessary for Growth
- Much Tax Reform Homework Done Last Few Years
- (1) The National Commission on Fiscal Responsibility & Reform (12/10)
- (2) The Tax Reform Act of 2014
- (3) Senate Finance Committee bipartisan tax reform working groups created in January 2015 & published report in July 2015



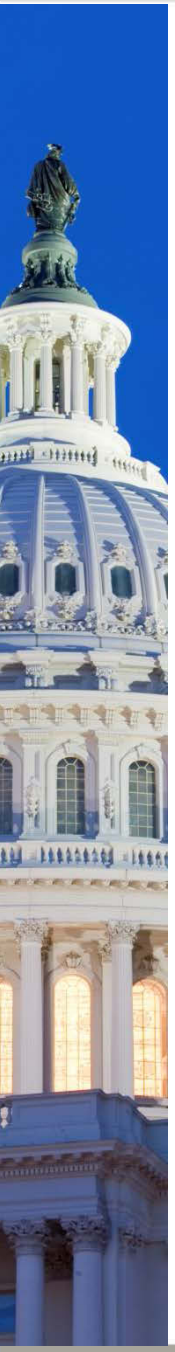
The Path to 2017: 2010 Report

- The National Commission on Fiscal Responsibility & Reform
- Presidential Commission Created by President Obama
- Co-chairs Alan Simpson & Erskine Bowles; “Simpson-Bowles”
- First met on 4/27/10 & report issued on 12/01/10.
- Supported by 60% of members – 11/18
- But did not reach 14 votes to get the report to Congress
- Supporters: JP Morgan Chase, Rep. Nancy Pelosi (D-CA)
- Opponents: Paul Krugman, Paul Ryan (R-WI), Grover Norquist



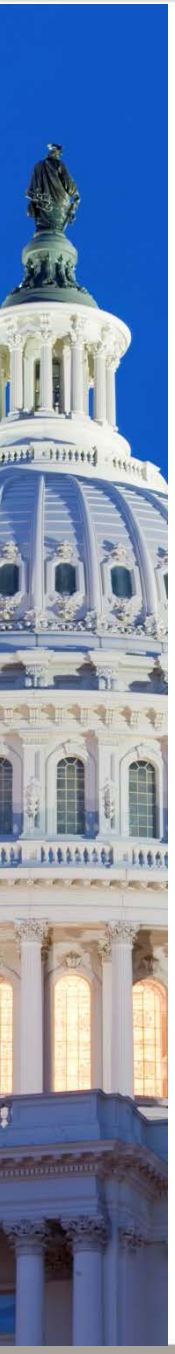
The Path to 2017: 2010 Report

- The Fiscal Commission Report on Tax Reform:
- (1) Lower Rates and Reduce Tax Expenditures
  - Individual rates to 23-29% & corporate rates to 23-29%
  - Territorial tax system for foreign earnings
- (2) Broaden Base
- (3) Simplify Code to ease tax prep, compliance
- (4) Maintain progressivity of tax code
- Savings used to pay for lower rates and deficit reduction



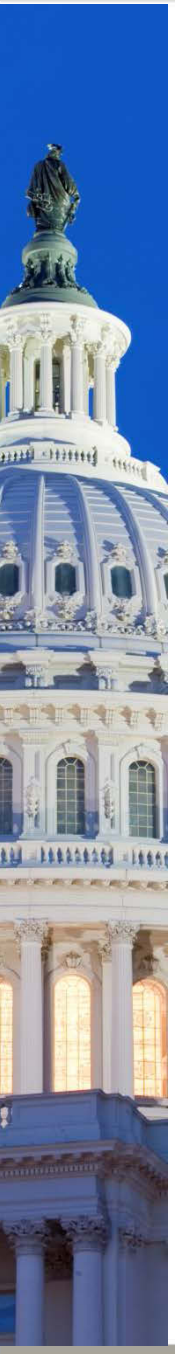
The Path to 2017: Tax Reform Act of 14

- Introduced by House W&M Chairman Dave Camp (R-MI) in 113th Congress (2013-2014)
- Comprehensive reform proposal
- Substantial reforms for individual, corporate, business taxes & changes to treatment of tax-exempt entities, tax administration & compliance, & excise taxes
- Not reintroduced in 114th Congress (2015-16)



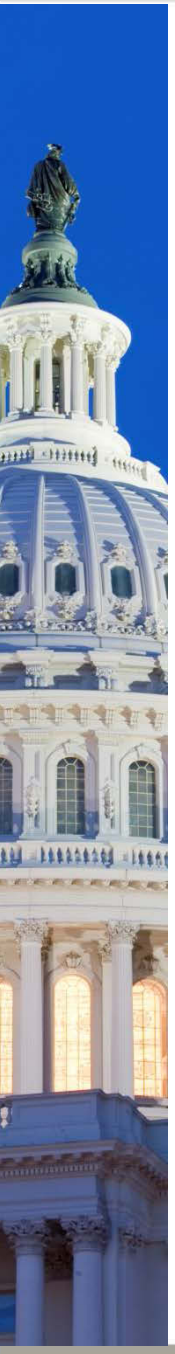
The Path to 2017: Tax Reform Act of 14

- Individual income tax changes – two brackets – 10% & 25% -
  - Plus a 10% tax on modified adjusted gross income for single filers making $400k+ and joint filers making $450k+, adjusted for inflation
  - Dividends and capital gains taxed as ordinary income, but 40% of capital gains and qualified dividends would be excluded
  - Increase of standard deduction, $11k for single filers, $22k for joint, and $5.5k for those with at least one child
  - Eliminates or reduces AMT, personal exemption, deduction for state and local taxes, mortgage interest deduction, earned income tax credit, charitable deduction, and education incentives
  - Changes treatment of 401(k) and Roth IRA savings



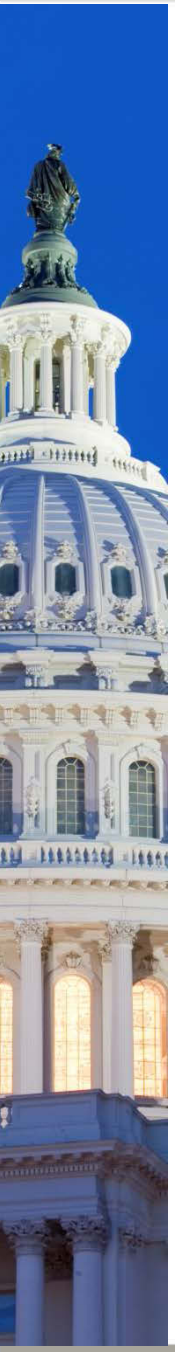
The Path to 2017: Tax Reform Act of 14

- Corporate and Business tax changes
  - All C corporations taxed at 25%
  - Other business income, including S corporations, partnerships, & sole proprietorships taxed through individual system
  - Eliminates or reduces corporate AMT, modified accelerated cost recovery system (MACRS), amortization of R&D & advertising expenses, net operating loss deduction (NOL), Sec. 199 domestic production activities deduction; LIFO inventory accounting



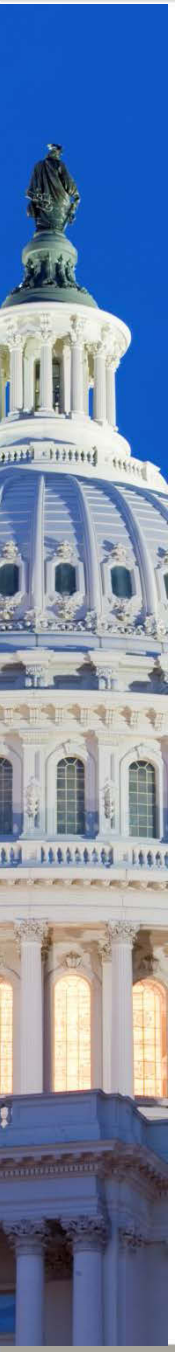
The Path to 2017: Tax Reform Act of 14

- Significant changes to treatment of foreign earnings
  - 95% exemption of foreign source income earned by foreign subsidiaries of US corporations
  - Modification of Subpart F, providing broad taxation at 15% of intangible income of foreign subsidiaries
  - "Thin capitalization" rules to restrict domestic interest deductions
  - Onetime 8.75% tax on previously untaxed earnings and profits (E&P) retained as cash and 3.5% tax on any remaining E&P
- Imposes excise tax on systemically important financial institutions



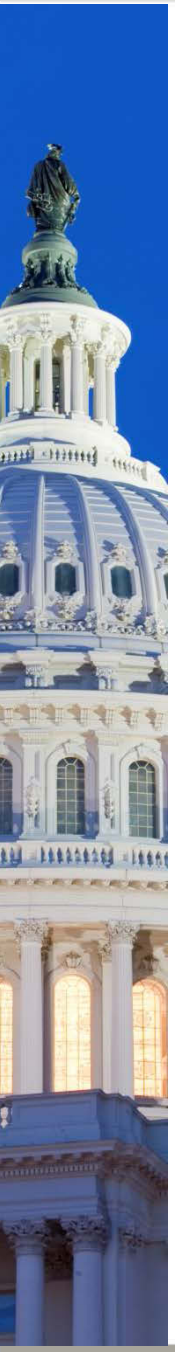
The Path to 2017: 114th Congress

- The 114th Congress has actively debated tax reform ideas
- The 114th Congress made permanent a number of temporary tax provisions in the Consolidated Appropriations Act for Fiscal Year 2016, passed in December 2015



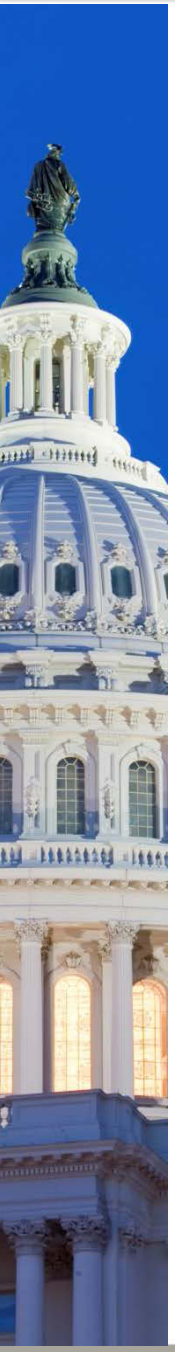
Major Tax Proposals in 114th Congress

- The Fair Tax Act of 2015 (HR 25/S 155)
- The Flat Tax Act of 2015 (HR 1040)
- The SMART Act – The Simplified, Manageable, & Responsible Tax (SMART) Act (HR 1824/S 929)
- The American Business Competitiveness Act (HR 4377)



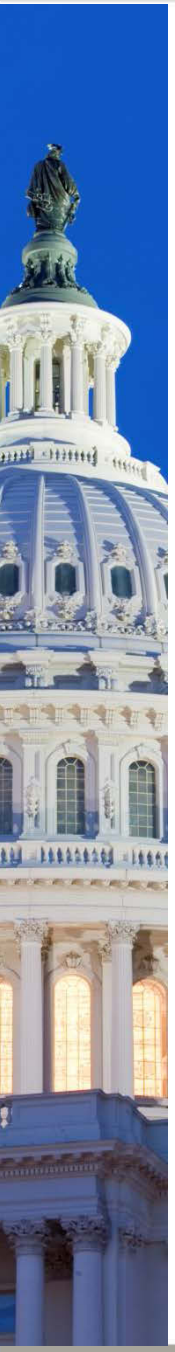
The Fair Tax Act of 2015 (HR 25/S 155)

- Repeals individual, corporate, payroll, self-employment, and estate and gift taxes
- Imposes new 23% federal retail sales tax
  - Tax-inclusive
- Provides a number of tax rebates
  - To those up to the federal poverty level
  - To account for any marriage penalty
  - To Social Security recipients
- Not levied on exports



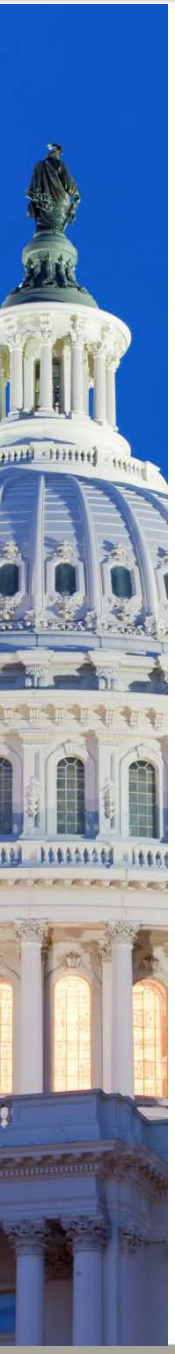
The Flat Tax Act (HR 1040)

- Requires individuals & businesses to make irrevocable election to be subject to new flat tax or stay in existing tax system
- Different systems for individual or person engaged in business activity or not
  - Engaged in business activity
    - Imposes 19% for first two years, 17% thereafter on the difference between gross revenue of the business and the sum of its purchases from other firms, wage payments, and pension contributions
    - Gov't employers and nonprofit orgs would pay flat tax on employee's fringe benefits, except retirement contributions, because they would be exempt from business tax



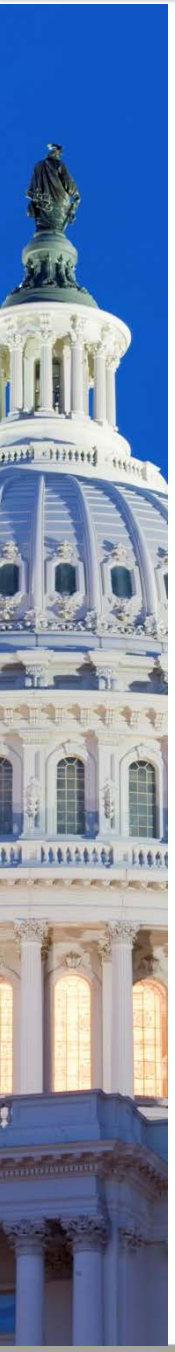
The Flat Tax Act (HR 1040)

  - Not engaged in business activity
    - Imposes 19% rate for first two years, then 17% thereafter
    - Provides several deductions that are based on filing status and number of dependents
- Repeals estate and gift taxes
- Requires any future increase of flat tax rate or reduction of standard deductions to pass Congress by three-fifths vote in both chambers



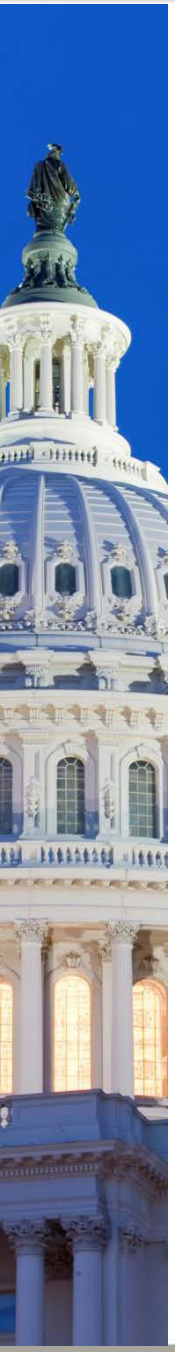
Simplified, Manageable, and Responsible Tax (SMART) Act (HR 1824/S 929)

- Replaces individual, corporate, and estate and gift taxes with flat tax
- Individual rate 17%
  - Not on Social Security income, repealing current tax on high income households
  - Provides several deductions that are based on filing status and number of dependents



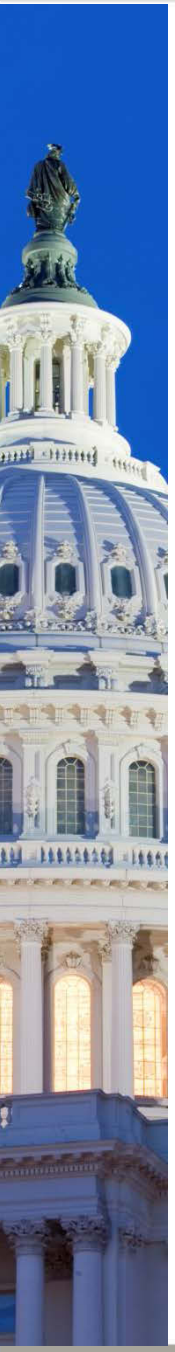
Simplified, Manageable, and Responsible Tax (SMART) Act (HR 1824/S 929)

- Business rate 17%
  - Between gross revenue and sum of purchases from other firms, wage payments, and pension contributions, if positive
  - Covers corporations, partnerships, and sole proprietorships
  - No deductions for fringe benefits
  - State and local taxes and payroll taxes not deductible
  - If deductions exceed gross revenue, excess can be carried to next year and increased by percent equal to 3-month Treasury security rate for last month of taxable year



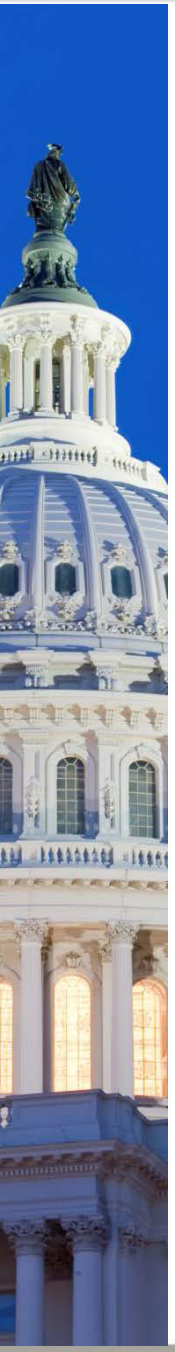
Simplified, Manageable, and Responsible Tax (SMART) Act (HR 1824/S 929)

- Requires Congress to pass by three-fifths vote in both chambers
  - Increase of federal income tax rate
  - Creation of new federal income tax rate
  - Reduction of standard deductions
  - Any exclusion, deduction, credit, or other benefit that would result in the reduction of federal revenue



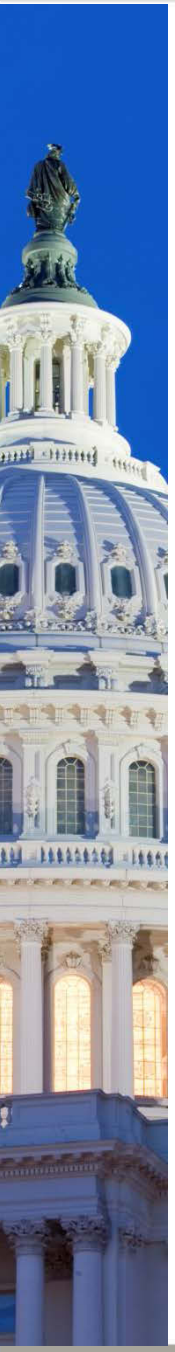
American Business Competitiveness Act (HR 4377)

- Replace corporate tax with cash flow tax on business income
- Top rate of 25% on income earned by corporate or non-corporate business
- Repeals most tax credits and deductions
- Repeals current depreciation system
- Business must expense capital purchases



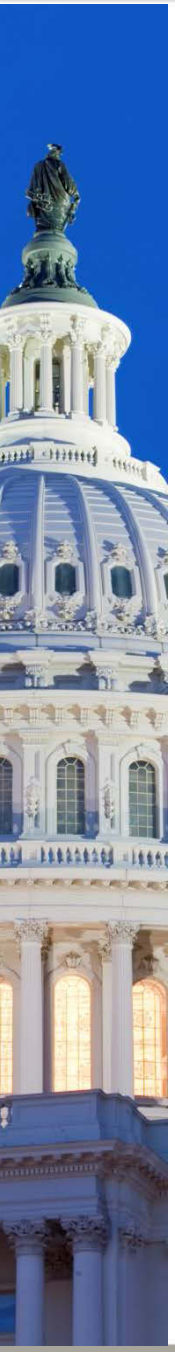
American Business Competitiveness Act (HR 4377)

- Interest no longer deductible
- Net operation losses carried back 5 years and forward indefinitely
- All businesses would be required to use cash method of accounting
- AMT for businesses would be repealed
- Establish a territorial system for overseas income



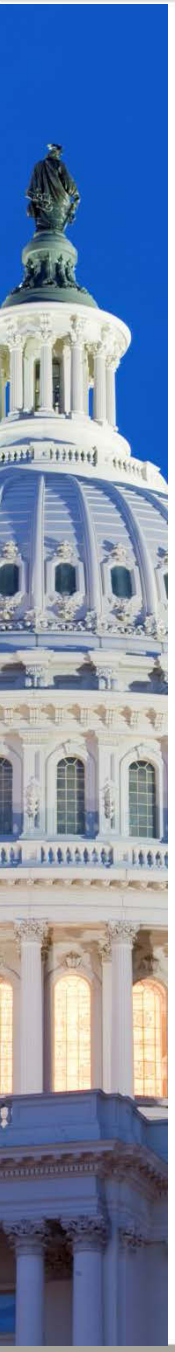
The Path to 2017: The 115th Congress

- There are two popular guiding principles for comprehensive reform
- (1) Generally maintain current system but at lower rates with broader base (Tax Reform Act of 2014)
- (2) Transform the tax system to rely on an alternative base, such as a consumption tax or a VAT or a federal retail sales tax or a flat tax



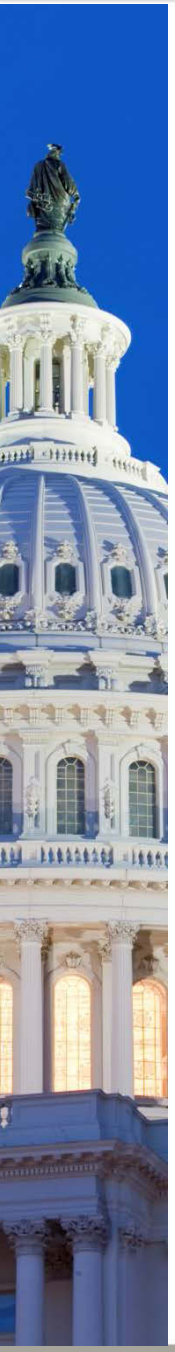
The Path to 2015: The 115th Congress

- Or Congress may focus on reforming particular aspects of the tax code or sectors of the economy
  - International tax
  - Corporate tax
  - Environmental tax (e.g., carbon tax)
  - Financial services (e.g., securities transactions tax)
- But a fundamental partisan disagreement remains – whether to make reforms revenue neutral
  - Republicans insist on it, while Democrats seek to increase revenue
- Reform proposals will be evaluated in terms of efficiency, equity, and simplicity



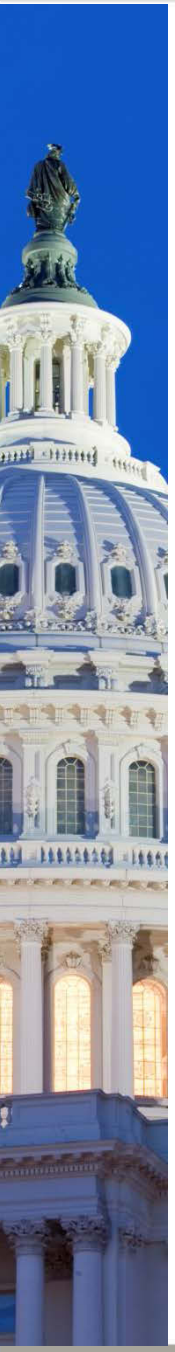
The Path to 2015: The 115th Congress

- The House Republicans and Paul Ryan in 2016 have proposed a "Better Way" Agenda with a Tax Reform Component
- The Tax Reform Pieces they propose would include:
- (1) Lowering rates
- (2) Cut seven brackets into three



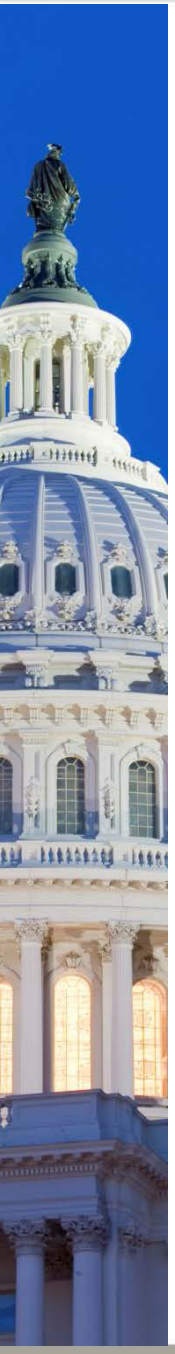
The Path to 2015: The 115th Congress

- (3) Eliminating special interest provisions
- (4) Incentives for savings and investment
- (5) Full and immediate expensing
- (6) Cutting corporate tax rate to 20%
- (7) No longer taxed at home and abroad
- (8) IRS Simplified into Three Units – (a) business taxation; (b) customer service; (c) IRS small claims tax court to resolve disputes quickly



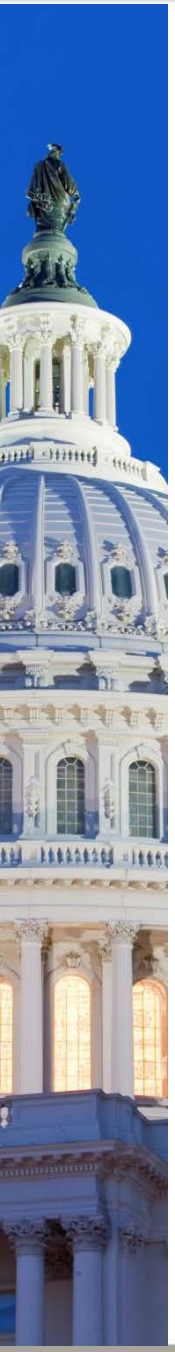
The Path to 2015: The 115th Congress

- What Will the Presidential Candidates Do – or More Correctly Ask Congress to Do - in Terms of Tax Reform If They Are Elected?
- Both Hillary Clinton & Donald Trump Have Put Out Detailed Tax Plans?
- Let's take a look…



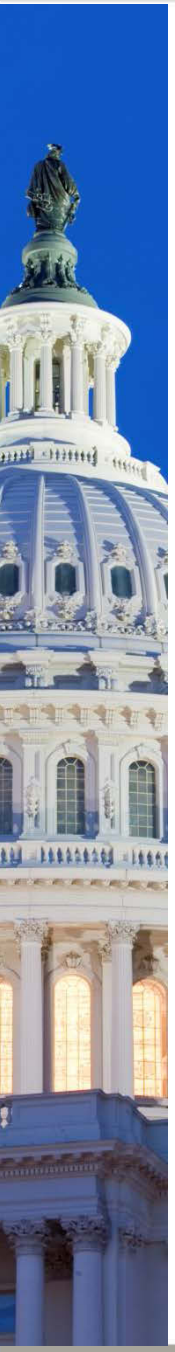
Hillary Clinton on Tax Reform

- Increase revenue by $498B over 10 years
- Individual taxes
  - "Buffet Rule," 30% on income over $1 million
  - 4% surcharge on income over $5 million
  - Limit tax value of specified deductions and exclusions to 28%
  - Raise medium-term capital gains (<6 years) to between 24% and 39.6%
  - Tax "carried interest" as ordinary income



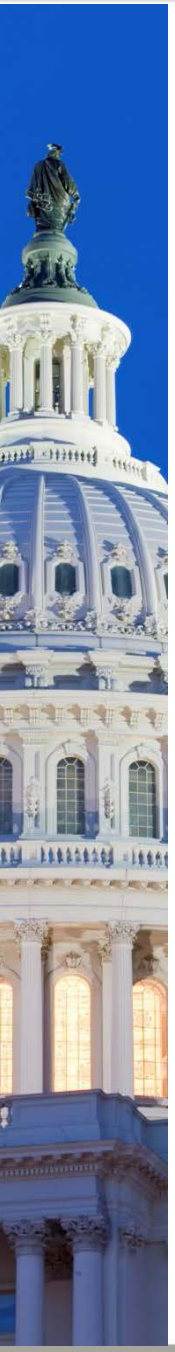
Hillary Clinton on Tax Reform

- Individual taxes
  - Increase top estate rate to 45%, lower exclusion threshold to $3.5 million ($7 million for married couples) and lifetime gift tax exemption of $1 million
  - Require derivative contracts to be marked-to-market annually, with results treated as ordinary income
  - Provide tax credits for caregiving for elderly family members and high out-of-pocket health care expenses



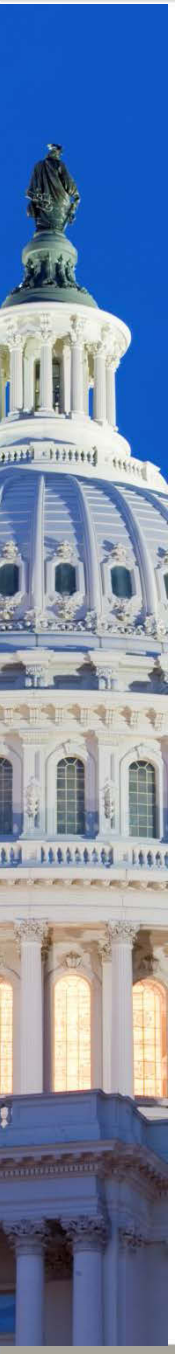
Hillary Clinton on Tax Reform

- Business taxes
  - Increase foreign ownership in inversion transaction from 20% to 50% of combined company shares
  - "Exit tax" on unrepatriated earnings
  - Limit interest deductions on US affiliates of multinational companies
  - Tax high-frequency trading
  - Eliminate tax incentives for fossil fuels
  - Provide tax credits for business that invest in community development
  - Reauthorize Building America Bonds



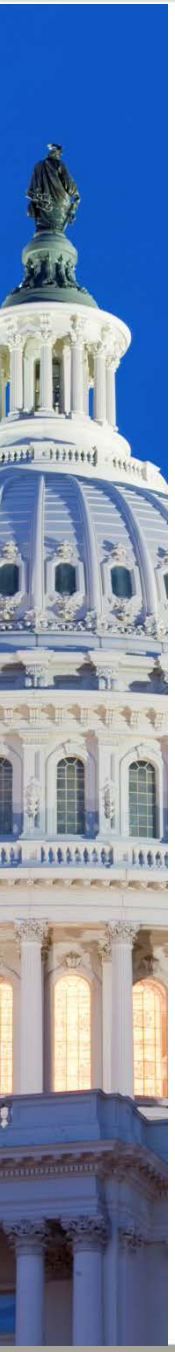
Donald Trump on Tax Reform

- Individual taxes
  - Three brackets: 10%, 20%, and 25%
  - Increase standard deduction to $25k for single filers, $50k for joint filers
  - Dividends and capital gains at 20%
  - Limit tax value of itemized deductions and exclusions for employer-provided health insurance and tax-exempt interest
  - Repeal AMT
  - Tax carried interest as ordinary income
  - Repeal federal estate and gift taxes



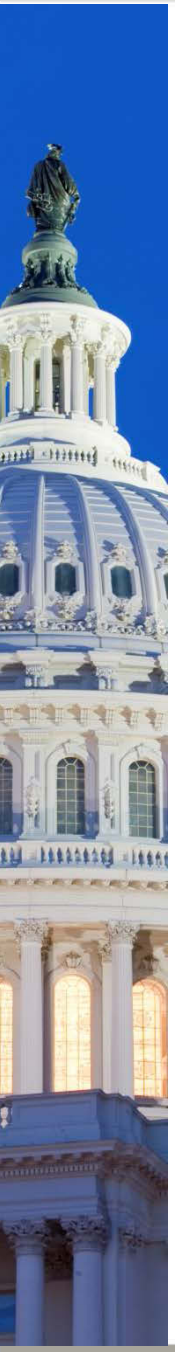
Donald Trump on Tax Reform

- Business taxes
  - Top corporate tax rate 15%
  - Limit top individual rate on pass-through businesses, such as partnerships, to no more than 15%
  - Repeal most tax breaks for businesses
  - Repeal corporate AMT
  - Impose up to 10% tax on deemed repatriation tax on accumulated profits of foreign subsidiaries of US companies
  - Tax profits of foreign subsidiaries of US companies as profits earned
  - Repeal ACA 3.8% tax on net investment income for high-income taxpayers ($200k single, $250k joint)



The Presidential Election

- The Only Way A Presidential Candidate's Tax Proposals Become Law Is If They Win the Presidential Election.
- Who is Going to Win the Presidential Election?
- Let's take a look at the current data …

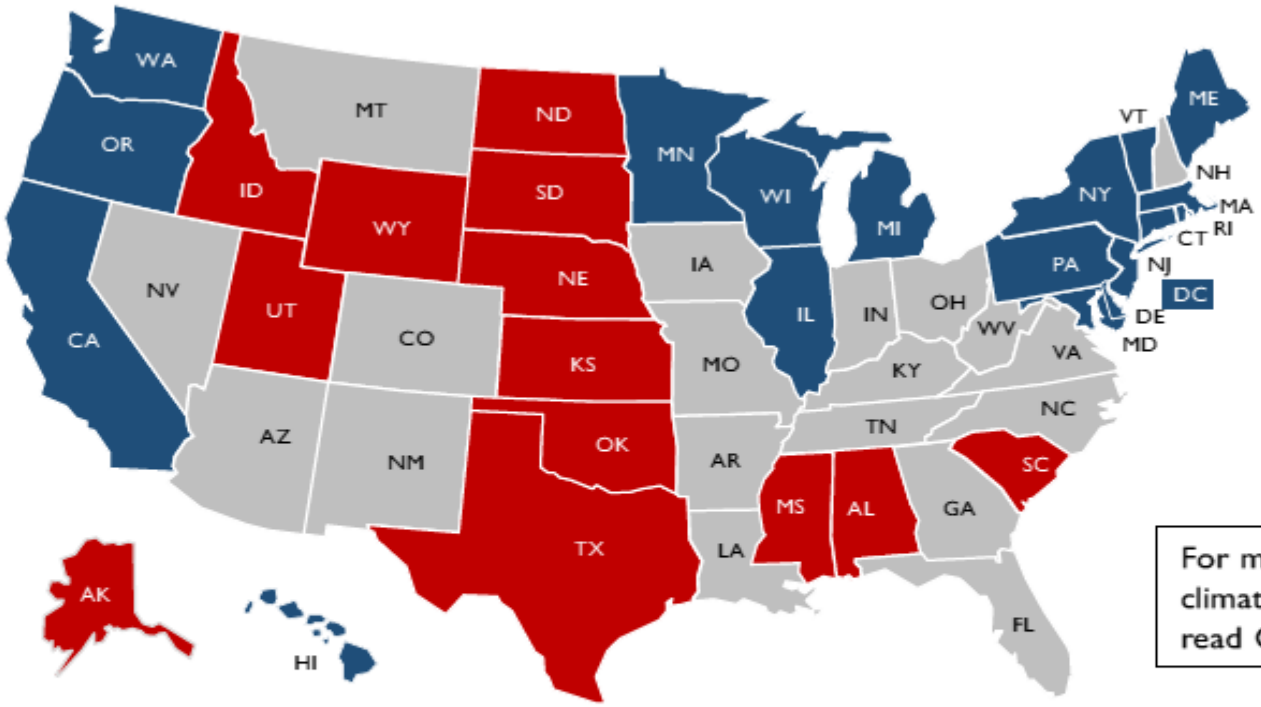


The Presidential Election

- Clinton had a good August as Trump campaign was plagued by a series of missteps, largely from the candidate himself.
- Trump, however, had a good September, with emails & pneumonia slowing HRC numbers.
- Race is still HRC's to lose, but is much tighter than it was on September 1.
- Trump path to victory very limited.

Based on Last Six Presidential Elections, Democrats May Hold a Slight Advantage Heading into 2016 General Election

States That Voted Consistently In The Past Six Presidential Elections



Voted Republican every election since 1992

Voted Democratic every election since 1992

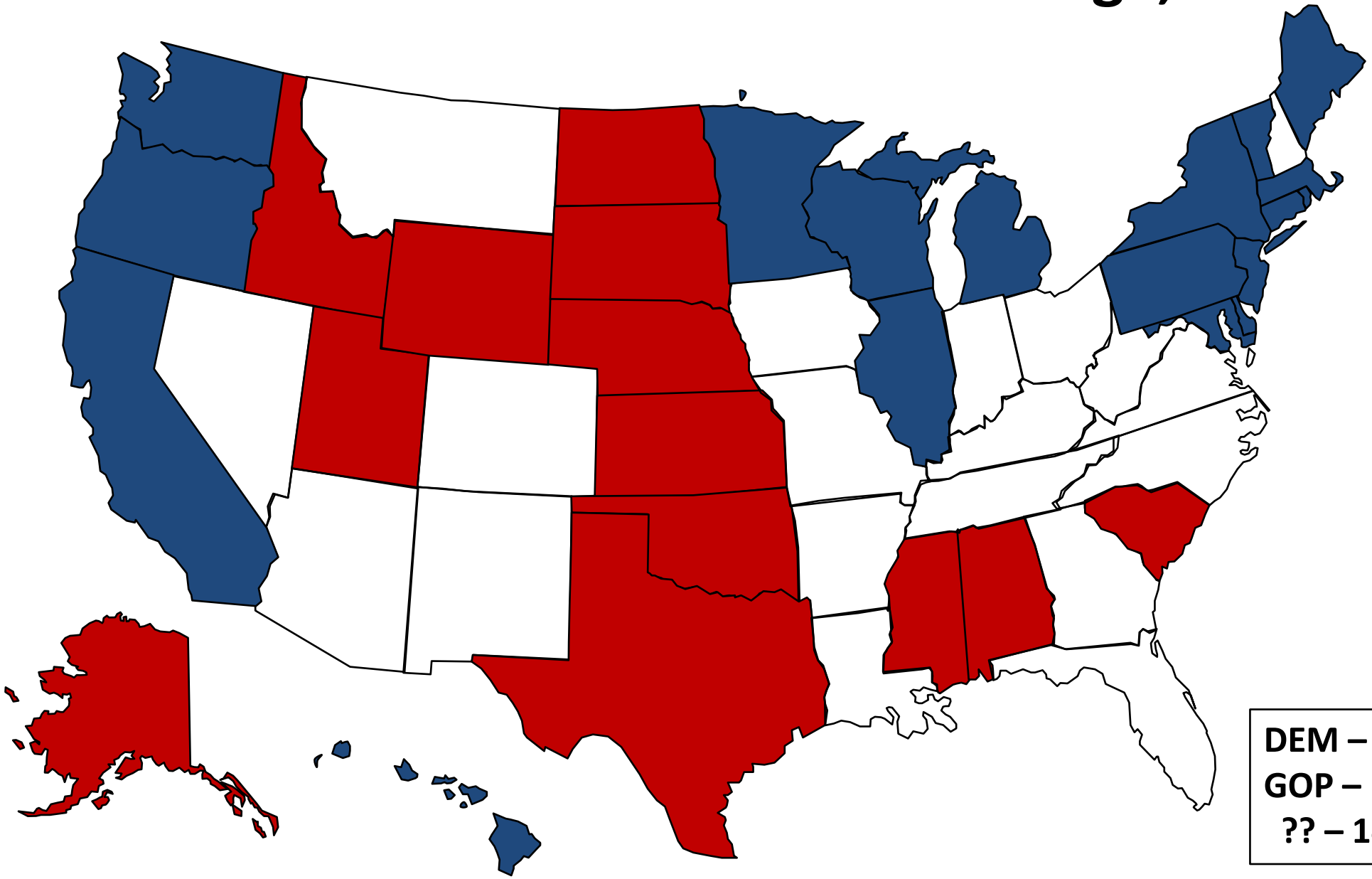
For more information on the political climate of the presidential primary, read Charlie Cook's analysis here

Analysis

- Democrats won 18 states plus the District of Columbia six times in a row, which in 2016 would earn 242 electoral votes, about 90 percent of the 270 electoral votes needed to win.
- In contrast, Republicans consistently carried 13 states over the last six elections, which in 2016 would earn the party 102 electoral votes, 38 percent of the 270 needed to win.
- The average state that voted Democratic in the past six elections delivers 13 electoral votes, while the average state that voted Republican in the past six elections delivers 8 electoral votes.

Sources: Archives.gov, "US Electoral College"; National Journal, Charlie Cook, "Is Clinton's Tide Shifting?"; Politifact.com, "18 States Have Voted Democratic in Six Consecutive Elections with 242 Electoral Votes, George Will Says"

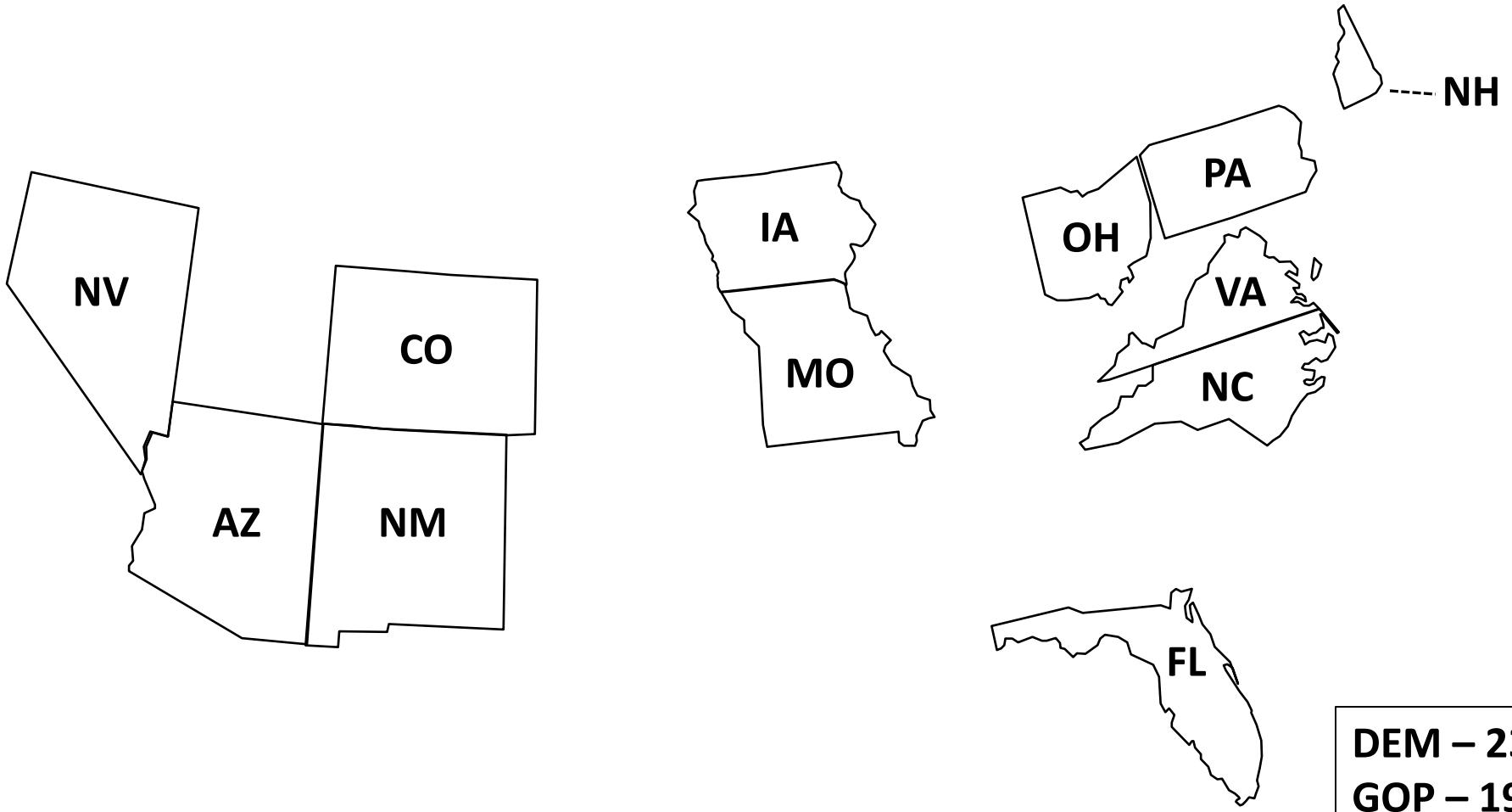
Dems Start With a 242-102 Advantage, but …



DEM – 222
GOP – 170
?? – 146

The First Tier of the 12 Swing States Are "Indicators"

Any Surprises in These May Point to a Larger Trend



DEM – 233
GOP – 191
?? – 99

The Presidential Race Will Be Decided in These 8 Swing States

Trump +4; HRC surprisingly weak here; LEAN GOP

Trump +2; Reversal from 9/1 when HRC led; LEAN GOP

HRC +6; down slightly but holding. LIKELY DEM

HRC +6; lead cut in half since 9/1; LIKELY DEM

NH

IA

PA

OH

HRC +5; Momentum from Kaine pick has run out; lead down by half since 9/1; LIKELY DEM

VA

NC

CO

HRC +1; down from +4 on 9/1; Must-win for GOP. LEAN DEM

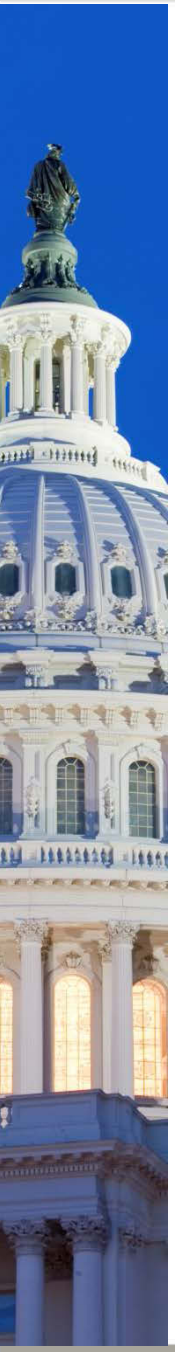
FL

HRC +3; down from +10 on 9/1; Must-win for Dems; LEAN DEM

Trump +1; 5-point swing since 9/1 when HRC led. LEAN GOP

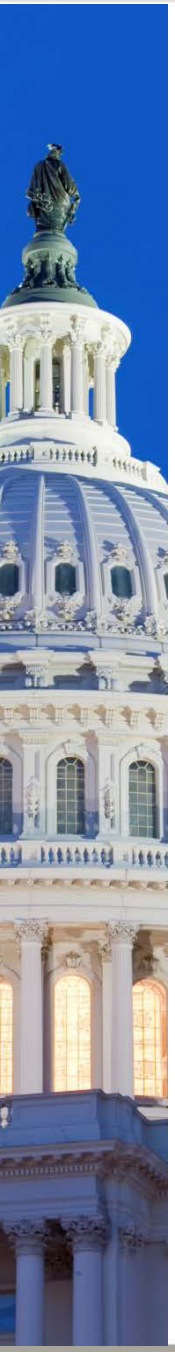
DEM – 294
GOP – 244

Source: Real Clear Politics (RCP)



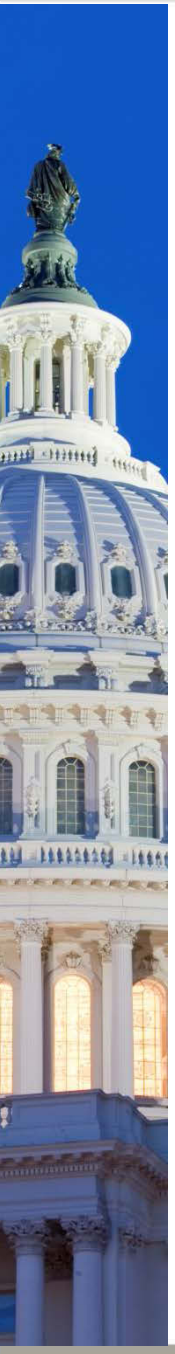
Presidential Election - Takeaways

- Even winning delegate-rich swing states of FL and OH, Trump still needs 26 EVs to hit 270.
- Priority #1: Take NC (15 EVs). If not, game over.
- After that, need another 11 EVs from the closest blue states:
  - PA (20); VA (13); CO (9); NV (6)
  - NH also close, but not enough EVs to matter (4)
- With seven weeks to Election Day, HRC still favored but must stop the bleeding. Trump must stay on message.



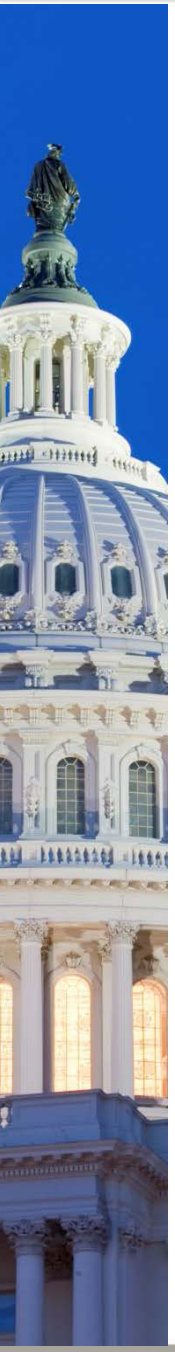
House Elections Update

- House — 247 Republicans
- House — 186 Democrats (not counting 2 vacancies)
- House — need 218 for majority
- Election — all 435 seats up for election
- Election — Dems need 30-seat gain for majority



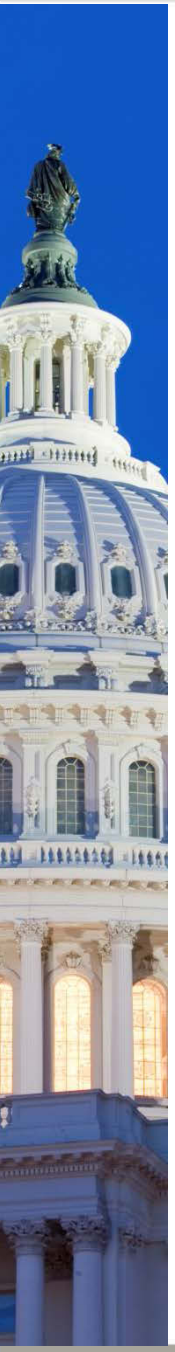
House Elections Update

- Current prediction — Republicans hold House, though with a smaller majority (circa 20 seats).
- House Will Likely Stay Republican through 2022
- Republicans actually control more state legislatures now than when the current Congressional map was drawn in 2012.
- If that advantage holds until 2022, the next round of Congressional redistricting will be just as favorable to Republicans, if not more.



Senate Elections Update

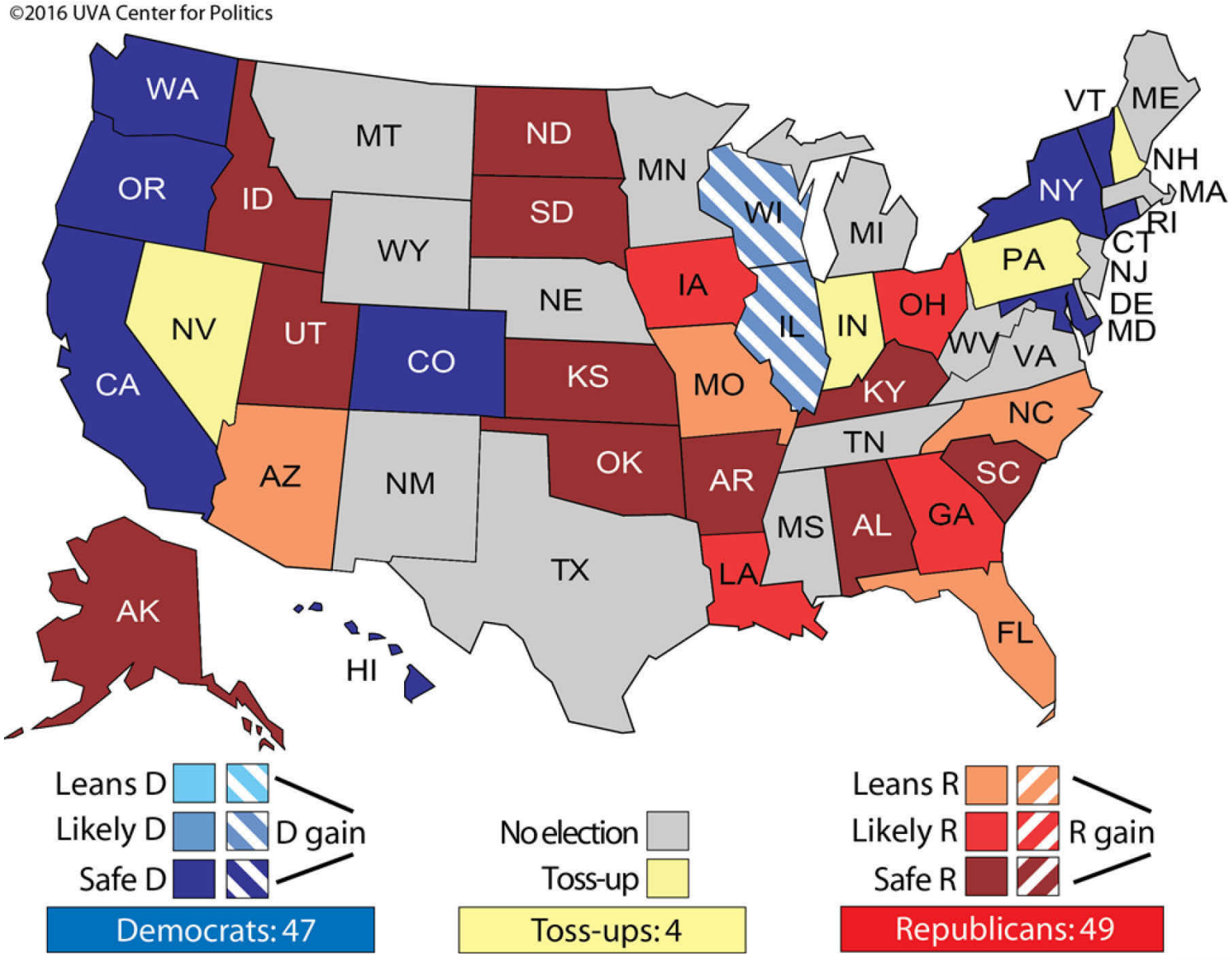
- Republican Senate Through 2016
- Senate — 100 Senators — 60 votes important
- Senate — 54 current Republican Senators
- Senate — 46 current Democratic Senators
- Need Republicans & Democrats to get to 60 votes to stop filibuster and to pass most bills



Senate Elections Update

- 2016 Senate election — Republicans overexposed; Majority could change
- Election — 24 Republican incumbents running
- Election — 10 Democrat incumbents running
- Dems — Need 4 or 5 seats to gain majority
- Current Sabato Senate prediction (8/4)
  - 49 R/47 D (8/1 forecast: 47 R/47 D)
  - 4 toss-up seats: NV, IN, PA, and NH
- If Republicans pick up NV, Dems have tougher path to majority
- Republican firewall: NH, OH, PA, and FL

Senate Elections Update



Senate Elections Update

Closer Look at the 4 Toss-Up Seats

GOP: 49

TOSS-UP: 1

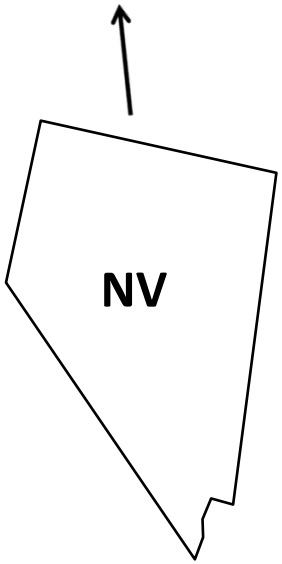
Dem: 48

All recent polls show slight Heck (R) lead; TOSS-UP

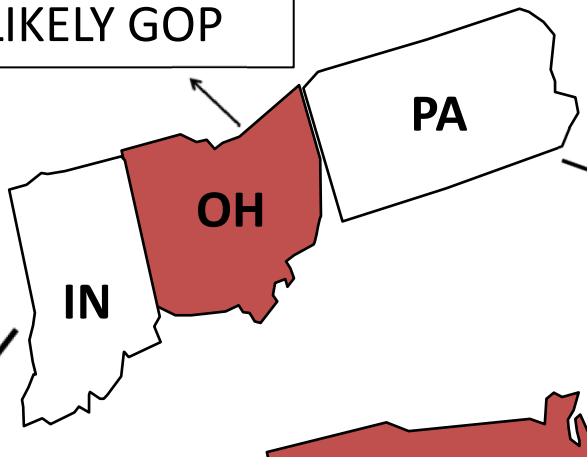
Portman (R) +10; Close to 50; Outside $ pulling out. LIKELY GOP

Slight Ayotte (R) lead; TOSS-UP

NH



NV



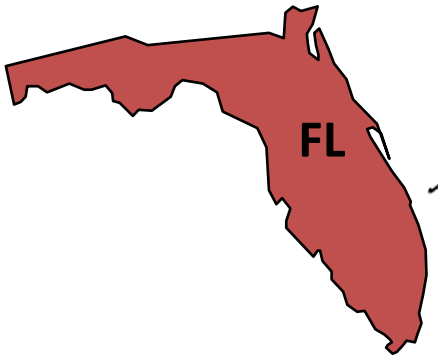
PA

OH

IN

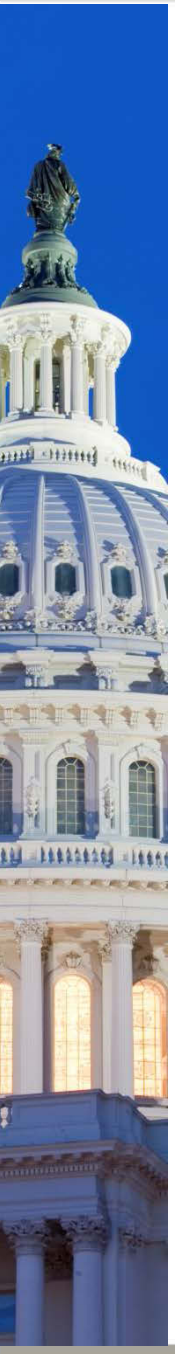
McGinty (D) +1; Race tightening; both in low 40s; LEAN DEM

Bayh (D) +7 but under 50; LEAN DEM



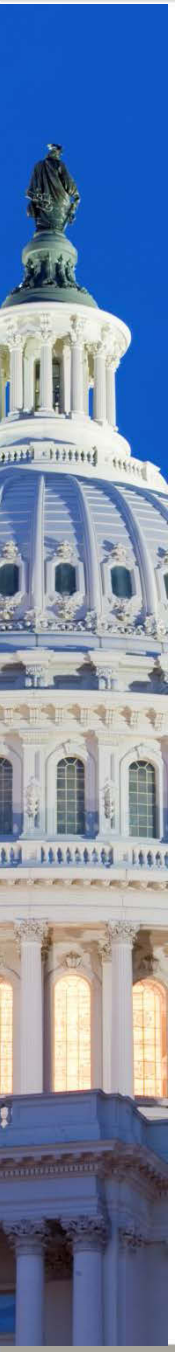
FL

Rubio (R) +6; Close to 50; DSCC delayed TV buy; Outside $ frozen; LIKELY GOP



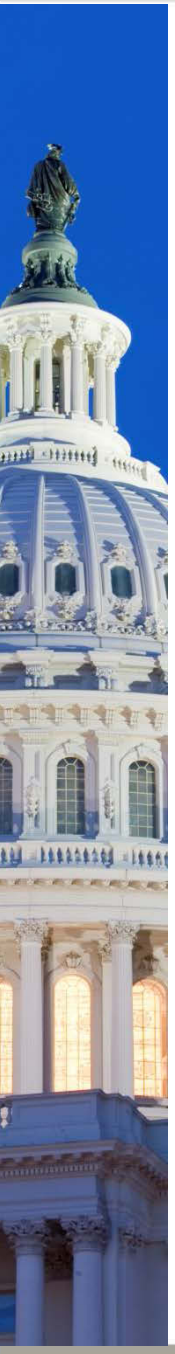
Senate Elections Update - Takeaways

- **Outcome Still Very Fluid** — The 4 remaining toss-up races are each still inside MoE.
- **All Politics Is Local** — Dems want to nationalize the election and tie GOP candidates to Trump. GOP wants local races.
- **Sense of HRC Inevitability May Hurt Dems** — Clinton's unfavorables could prompt voters to vote for a "check" on her power.
- **GOP Had a Good September** – Though control of Senate still close, GOP numbers improved in almost every state in September.
- **Races to Watch** – MO & NC (still GOP favored, but on the bubble)
- **Bold Prediction** — Whoever has the majority in 2017 will have fewer members than GOP currently has (54).
- **Looking Ahead** – Democrats overexposed in next election cycle (25 of 33 seats up for reelection in 2018).



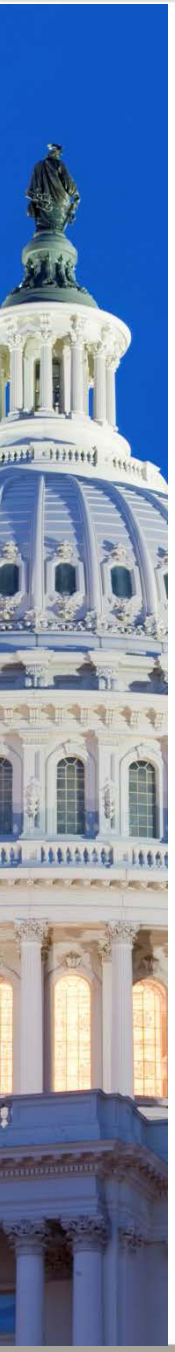
Take Aways

- The Next President Will Decide What Tax Reform Proposal to Send to Congress
- The Republican House of Representatives Will Stick To Its Proposal if HRC Wins WH
- Therefore, HRC Will Not Be Able to Jam a Tax Proposal Through Congress That Does Not Satisfy the House Republicans
- Only Bipartisan Ideas Will Pass



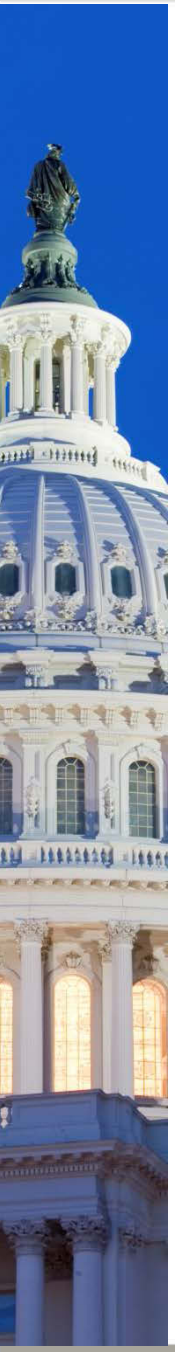
Take Aways

- Bipartisan Tax Ideas Include:
- (1) Lower rates for lower incomes
- (2) Closing tax loopholes
- (2) Broadening the tax base
- (3) Taxing “carried interest” as ordinary income
- (4) Punish U.S. Companies for Inversion & Earning Income Overseas



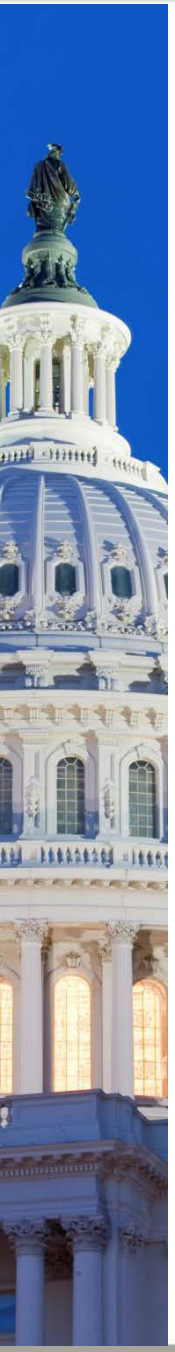
Take Aways

- If Trump Becomes President & Republicans Hold House & Democrats Take Senate, There Still May Be Broad Tax Reform
- The Republican House of Representatives Will Work with a President Trump
- But Trump Will Have to Compromise With the Senate Because No Party Will Have 60 Votes to Defeat a Filibuster
- Senator Schumer Will Reach Across the Aisle



Conclusion

- There is Momentum Continuing to Build in Congress for Tax Reform
- There is Bipartisan Consensus that Tax Reform is Key to New Economic Growth
- The Parties Disagree on the Details
- But There Will Be a Push To Do Comprehensive Tax Reform in 2017 in the United States Congress



Thank You

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Managing Tax Audits and Appeals – Transfer Pricing

Crowell & Moring LLP Tax Seminar
September 22, 2016
Marina Del Rey, California

Peyton Robinson, Team Leader
APMA Program

Erwin Walker, Territory Manager
Western Compliance Practice Area

IRS Large Business & International

AGENDA

- LB&I Reorganization and Impact
- Campaign Process
- Virtual Library – Practice Units
- LB&I Examination Process
- APA & CA Procedures
- APMA in Appeals and Other ADR Processes

Future State Initiative

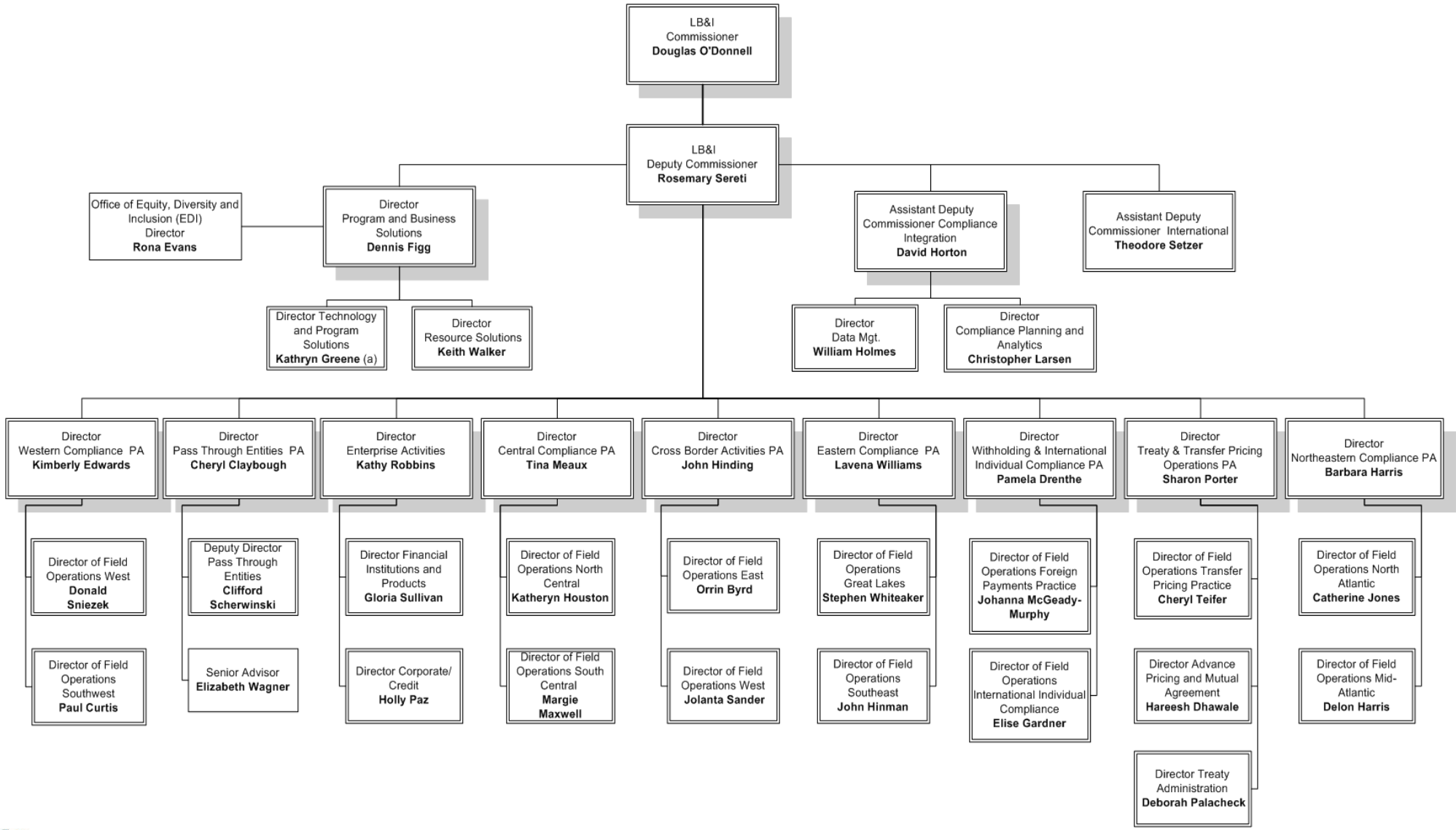
LB&I Future State Reorganization

- LB&I Future State Initiative
  - https://www.irs.gov/uac/newsroom/irs-future-state
  - IRS effort to improve and modernize taxpayer service in an efficient and effective manner
  - Initial changes implemented in February 2016
- Practice Areas – Overall LB&I organization
- Practice Networks – knowledge sharing
- Campaigns – improve taxpayer compliance

LB&I Practice Areas

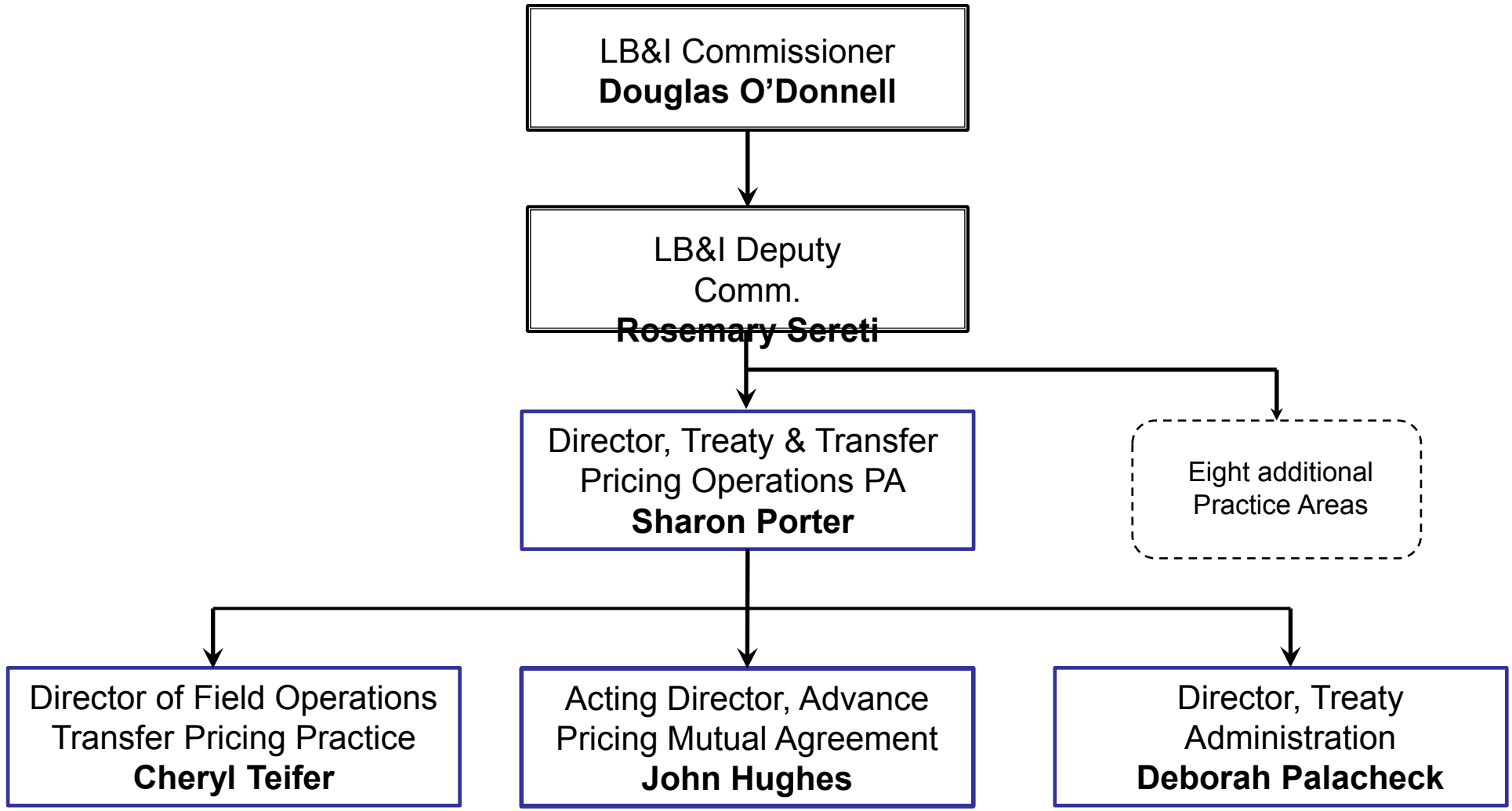
- LB&I is now organized into Practice Areas
  - Headquarters and Support
    - Assistant Deputy Commissioner, Compliance Integration
    - Assistant Deputy Commissioner, International
    - Program and Business Solutions
  - Practice Areas
    1) Cross Border Activities Practice Area
    2) Enterprise Activity Practice Area
    3) Pass Through Entities Practice Area
    4) **Treaty and Transfer Pricing Operations Practice Area**
    5) Withholding and International Individual Compliance Practice Area
    6) Central Compliance Practice Area
    7) Eastern Compliance Practice Area
    8) Northeastern Compliance Practice Area
    9) **Western Compliance Practice Area**

LB&I Practice Areas



LB&I org chart as of July 1, 2016

LB&I - TTPO Organizational Chart



Update of LB&I Restructuring

- Why Restructure LB&I
  - Greater efficiencies in line with budget challenges
  - More agility to design compliance strategies and evaluate intended compliance outcomes
  - Principles of Restructure
    - Flexible, well-trained workforce
    - Better return selection
    - Tailored treatments
    - Integrated feedback loop
  - Centralized approach to assessing compliance risk
  - Move away from CIC or “continuous” exam paradigm to issue focus

LB&I Campaigns

- A campaign is an LB&I plan focused on the right "strategic" issues using the right resources and the right combination of treatment streams to achieve the intended compliance outcomes
  - Strategic approach to address particular types of noncompliance

LB&I Campaigns (cont.)

- LB&I will use campaigns to identify, prioritize, and allocate resources to compliance issues
  - In the future, LB&I workload selection will be centrally selected, prioritized, and risk assessed based on campaigns and defined compliance goals
- If the Practice Area director and Compliance Integration Council approve a campaign proposal, then a campaign owner will be assigned, resources will be allocated to it, treatment streams will be determined, and a campaign monitoring schedule will be used

Practice Networks

- The Service's initiative includes a large knowledge sharing component
  - Managed within Practice Areas
  - Conduct network calls for issue discussions, data sharing
  - Communicate best practices and facilitate networking among those working similar issues
  - Virtual Library (in-development)
    - Example TTPO Practice Networks
      - Income shifting inbound and outbound PNs
      - Economics PN
      - Treaties PN
  - Transaction based approach to training
  - Released both internally and externally
    - Focus on issues and strategies

Update of LB&I Restructuring

- What LB&I restructure means for you
  - Little change in the short term
  - Shift to centralized return / issue selection and campaign structures will be long term effort
  - CIC designation and procedures under discussion
  - CAP Process under review to align with LB&I future state objectives
  - Issue teams and campaign teams will drive exams in the future
  - Other treatment streams

LB&I Examination Process (LEP)

- **Effective May 1, 2016**
- **New - LB&I Examination Process (LEP) publication 5125**
  - Replaces Pub 4837 commonly referred to as Quality Examination Process (QEP).
  - Sets clear expectations for LB&I examiners, taxpayers, and representatives.
  - Encourages taxpayers and/or representatives to work transparently with examiners to provide an overview of business activities, operational structure, accounting systems and a global tax organizational chart.
  - Examiners are expected to work collaboratively and transparently with taxpayers to fully understand their business and openly share any issues identified for examination.
  - Establishes expectations for working collaboratively to develop audit steps, timelines and providing appropriate personnel to actively assist in the development of the issue(s) identified.

LB&I Examination Process (LEP) (cont.)

- **New - Claim for Refunds Requirements**
  - Requires adherence to Treas. Regs.301.6402-2 and 301.6402-3.
  - Defines a 30 day period from the opening conference for the acceptance of informal claims.
  - Allows for early identification of issues and resource needs in the exam planning stage.

- **New - Acknowledgement of Facts (AOF) –** impact on cases going to appeals

LB&I Examination Process (LEP) (cont.)

New - Issue Driven Examination Process

- Focuses the right resources on selected issues.
- Encourages collaboration within issue teams where every examiner and their managers are equally responsible and accountable for the examination.
- Leverages knowledge transfer among technicians.
- Establishes a case timeline as determined by the most complex issues.
- Provides examiners an optional issue-driven risk analysis form (13744-I). See IRM 4.46.3.8.5
- Encourages a dialog around issue exit strategies as a part of issue resolution.

Update of LB&I Restructuring

- What restructure means for Treaty & Transfer Pricing Operation (TTPO):
  - TPP & APMA has expanded and will remain under the Director. Treaty Administration (TAIT,EOI) will become part of the new organization
  - TTPO will be a Subject Matter Practice Area, responsible for transfer pricing strategies; case selection; strategic litigation; transfer of knowledge and skills
  - Income Shifting and Economic Practice Networks are embed in TPP
  - TTPO will identify, lead & participate in campaigns

Update of LB&I Restructuring (cont.)

- Treaty and Transfer Pricing Operations Practice Area formed out of TPP, APMA, and Treaty Administration (comprising TAIT and EOI)
  - **APMA** primarily handles transfer pricing (Article 9) and allocation (Article 7) issues and Advance Pricing Agreements
  - **TAIT** primarily handles everything other than Article 5 (PEs)
    - TAIT = Treaty Assistance and Interpretation Team
  - **APMA and TAIT** jointly work on PE (Article 5) issues

What is APMA?

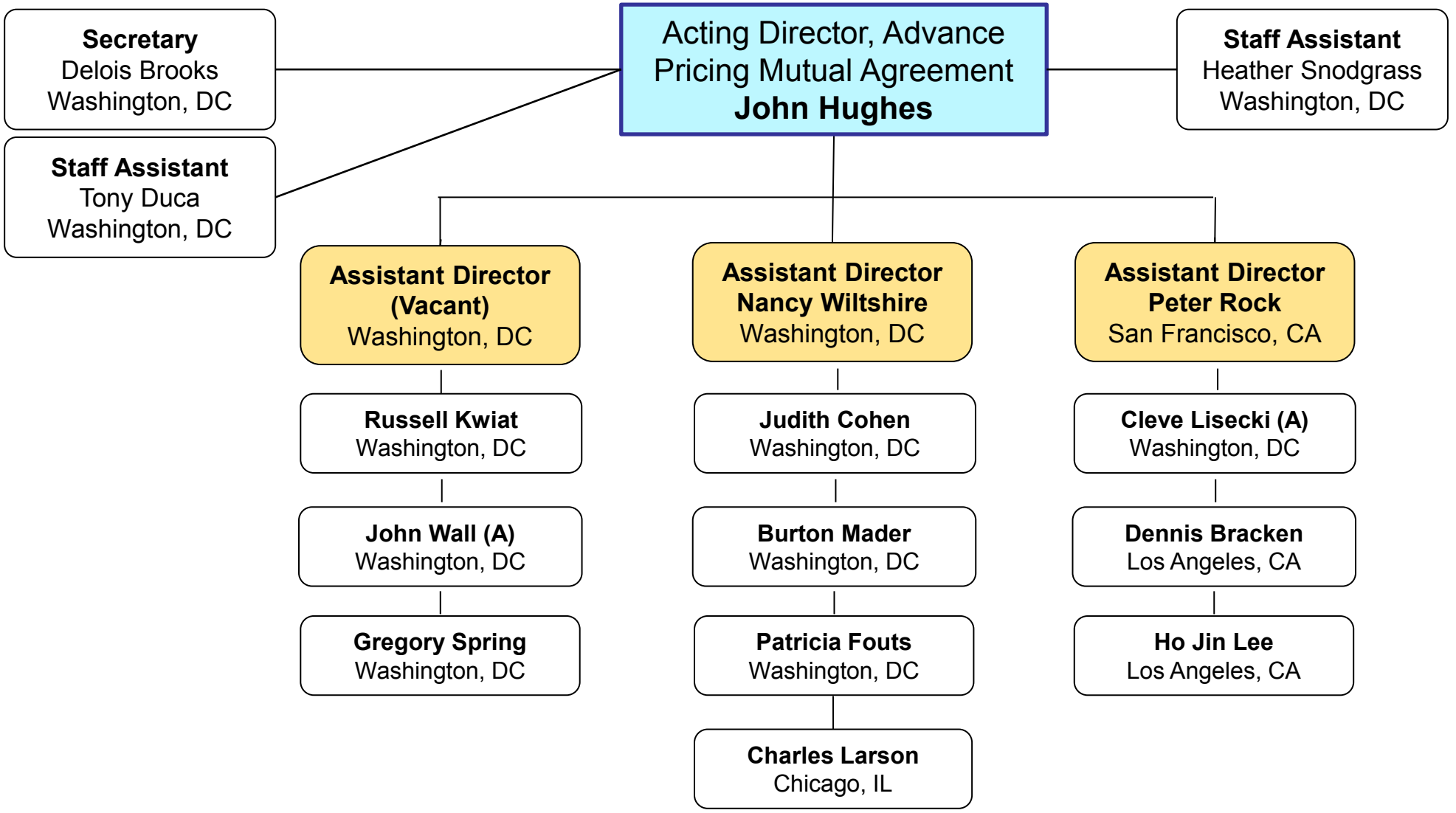
APMA and Future State

- APMA's primary functions are centered around double tax (or MAP) cases and APAs
  - These core functions have not changed under the Future State initiative
  - Instead making relatively small modifications to improve taxpayer service, to be more efficient, and to make effective use of technology and other resources

APMA Organization

- APMA staffing is presently 62 Team Leaders, 20 Economists, 10 Senior Managers, 2 Assistant Directors, and 1 Director
- Team leaders and their managers are generally assigned to cases involving specific countries
  - See -- https://www.irs.gov/businesses/corporations/apma-contacts
  - However, expertise and experience are taken into account
- Economists are typically assigned to cases within their groups
  - May assist with Exam cases from time to time
- APMA has offices in 7 cities: Washington, DC, New York City, Chicago, San Francisco, San Jose, Los Angeles, and Laguna Niguel

APMA Organization Chart



APMA in ADR

- The IRS has numerous Alternative Dispute Resolution procedures that may resolve a transfer pricing dispute, including APAs and Competent Authority
  - Fast track settlement, delegation order 4-24, AIR Program, Appeals as well as its mediation or arbitration, & others
- APMA Processes
  - Mutual Agreement Procedure (MAP or double tax resolutions)
  - APAs – bilateral / multilateral and unilateral APAs
  - Simultaneous Appeals Competent Authority (SAP)
  - Accelerated Competent Authority (ACAP)
  - Arbitration

Current APA and CA Procedures

- Current Revenue Procedures
  - Rev. Proc. 2015-40 (Competent authority)
  - Rev. Proc. 2015-41 (APAs)
- Broad Themes
  - "Broad access to the U.S. competent authority", coupled with expectation of taxpayer responsibility to all stakeholders before and during the CA and APA processes
  - Clarity of procedural choices (and consequences) in order to allow taxpayers to decide which route they wish to pursue to address taxation not in accordance with the applicable treaty
  - Integration of CA and APA processes as complementary programs of tax and treaty administration

Focus on APAs: Why an APA?

- Uncertainty pervades in current international transfer pricing environment
- Taxpayers interested because the focus is on the transfer pricing, and they are involved in the discussion in a much more active way than a typical audit
- Taxpayers obtain certainty that their TPM will be accepted, which generally means the TPM application will avoid double tax
- The IRS benefits with an effective use of resources, obtains knowledge of taxpayers' businesses and transfer pricing practices in what is intended to be a cooperative environment

How Does an APA Work?

- General chronological process from IRS perspective (see Rev. Proc. 2015-41, Section 3, et seq.):
  1) APA request is filed (prefiling requirements met, complete submission filed, and fee paid)
  2) Due Diligence process (APMA team formed, questions, responses, meetings, etc.)
  3) APMA and taxpayer (and treaty partner) discuss results of analysis
  4) Bilateral APA: Negotiations with other government(s), mutual agreement reached, bilateral case closed
  5) Unilateral APA: Negotiation and agreement reached with taxpayer
  6) US domestic agreement executed between the IRS and taxpayer

The APA Process & Concerns

- The IRS has a preference for bilateral and multilateral APAs vs unilateral agreements
  - A unilateral APA may limit the taxpayer and the IRS from resolving a transfer pricing dispute with another country despite coverage in the APA
  - Bilateral / multilateral APAs generally bring all of the stakeholders into the discussion and make for a more complete resolution
- APA processing time varies
  - Many factors can influence the time involved, including decisions by taxpayers – completeness of request, responsiveness to questions, data availability, etc.
  - APMA continuously seeking improvements in its own handling of APA process to increase efficiency

APA Process & Concerns (cont.)

- When do APAs tend to work the best?
  - Field exam team involvement and status
  - Nature of the issues
  - Clarity of transactions and reliability of data
  - Financial impact of the transactions
  - Other governments involved
  - Internal taxpayer support for the process
- Changing facts and circumstances may make an APA inappropriate (e.g., mergers)

Competent Authority and MAP

- Intended to resolve “taxation not in accordance with” the treaty under the MAP article (e.g., in the US-Japan treaty it is Article 25)
- 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 possibly apply depending on the specific treaty involved

Tax Treaty Protective Claims

- Rev. Proc. 2015-40, Section 11.01
  - Most tax treaties allow for the MAP to resolve an issue despite any time limits or other procedural limitations (i.e., statutes of limitation)
  - A few 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 protective claim allows for the notification of a potential issue to be made to USCA and thereby comply with the treaty requirement for the MAP
  - Statutes of limitation are still critical

Coordination with Appeals

- Rev. Proc. 2015-40, Section 6, sets forth general principles regarding coordination between Appeals and U.S. competent authority. It also sets forth the only options for presenting a U.S.-initiated adjustment to both U.S. competent authority and to Appeals:
  1) Simultaneous Appeals Procedure ("SAP") review,
  2) Severing CA issues, and
  3) Presenting issues to Appeals after competent authority process is unsuccessful
  - *Taxpayers wishing to contest a U.S.-initiated adjustment are advised to understand these coordination rules*
- Section 6.04(2): SAP review
  - Part of U.S. competent authority's unilateral review of a competent authority request
  - Appeals works jointly with U.S. competent authority and taxpayer
  - Decisions over requests for SAP review, conduct of SAP review, and takeaways from SAP review lie solely with U.S. competent authority
- Section 6.04(3): Severing CA issues
  - Taxpayer may pursue Appeals and then sever competent authority issue within 60 days of opening conference
  - Taxpayer will not have access to competent authority if issue is not severed before 60 days

Accelerated Competent Authority (ACAP)

- A taxpayer may have a proposed adjustment related to past years for which it intends to request that USCA resolve 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

BEPS and the Future

Questions?

Partnership Audits

Crowell & Moring, LLP

Gregory Armstrong, Senior Technician Reviewer, Office of Chief Counsel (Procedure & Administration)

Jennifer Ray, Partner, Crowell & Moring, LLP

September 29, 2016

Partnership Taxation

- Partnership is not subject to income tax
- "Partnership items" are passed through to partners
- Partners report the partnership items and are taxed accordingly

Partnership Audits

- TEFRA (1982)
  - Partnership items determined at the partnership level
  - Additional tax assessed to the partners
- ELP (1997)
  - Partnership level audit
  - Additional tax generally assessed to partners, but through election could be assessed at partnership level
- BBA (2015)
  - Partnership level audit
  - Additional tax may be assessed at partnership level or pushed out to partners
- Partner level audit
  - If no other regime applies

TEFRA: applicability

- Applies to all partnerships except "small partnerships"
  - A small partnership has ten or fewer partners who are individuals (other than nonresident aliens), C corporations, or estates of deceased partners
  - Single member LLC is disqualifying partner for this purpose
  - Most corporate joint ventures are small partnerships
- Small partnerships can elect into TEFRA
- In 2013, 72% of partnerships identified as not subject to TEFRA

TEFRA: stages of audit

- IRS issues Notice of Beginning of Partnership Audit ("NBAP")
- When the examination is complete, IRS sends 60-day letter to TMP, informing TMP of the right to go to Appeals
- If no settlement at Appeals, Final Partnership Administrative Adjustment ("FPAA") is sent toTMP and Notice Partners
- TMP may bring suit within 90 days after FPAA is issued
- A Notice Partner may bring suit in the following 60 days if the TMP does not
- FPAA is final 150 days after it is issued, if suit is not brought, or when court's decision becomes final and period to appeal has expired
- IRS makes adjustments at the partner level and begins deficiency proceedings for certain affected items

TEFRA: stages of audit

- "Partnership items" are determined at partnership level
- Penalties and additions to tax determined at partnership level and assessed directly against partners
  - Partner-level defense must be raised in a separate refund action
- "Affected items" are adjusted at the partner level

TEFRA: tax matters partner

- Partnership designates "Tax Matters Partner"
  - Must be partner
  - Represents the partnership
  - Can extend SOL, file for refund, settle with IRS, etc.

TEFRA: notice partners

- Other partners with a one-percent or greater interest (or any partner if fewer than 100 partners) are “Notice Partners”
  - Entitled to receive notice of proceedings
  - Can bring action if TMP does not
  - Participate in any proceeding brought by TMP
  - TMP generally cannot bind Notice Partner to settlement

TEFRA: contractual restrictions on TMP

- Partnership agreements generally provide for significant restrictions on TMP
  - Requirement to keep members informed about proceedings and discussions with tax authorities
  - TMP can't take material actions without the consent of [other members]/[the board]
    - E.g., extend SOL, settle audits, file suit
  - TMP can't bind another member without the consent of that member

TEFRA: statute of limitations

- Minimum statute of limitations of three years
  - Generally three years after partnership return is filed or, if greater, the normal section 6501 three-year statute of limitations for a partner
  - Usual extensions for significant understatements of gross income, fraud, and no return
  - If a partner (including an indirect partner) is not identified on a partnership return, the SOL is extended for a year after the partner is identified

Bipartisan Budget Act of 2015 ("BBA")

- IRS could not effectively audit large and multi-tiered partnerships because of complexity of allocating adjustments to partners
- The Electing Large Partnership (ELP) rules provided an alternative but were rarely elected
- Prior proposals
- TEFRA and ELP Rules repealed and replaced
- Congress estimates new rules will raise $9.3 billion

BBA: effective date

- Effective for partnership years beginning after 2017
- May elect in for partnership years beginning after November 2, 2015
  - Proposed and temporary regulations

Which regime applies in 2016 and 2017?

	Partnership tax year beginning between 11/3/2015 and 12/31/17	Partnership tax year beginning after 12/31/17
TEFRA "small partnership" (10 or fewer partners of a certain type)	Neither, unless (1) elect into TEFRA or (2) elect into BBA	BBA unless eligible to and properly elect out
BBA "small partnership" (100 or fewer partners of a certain type)	TEFRA unless elect into BBA	BBA unless eligible to and properly elect out
All other partnerships	TEFRA unless elect into BBA	BBA

- Assuming ELP rules do not apply.

BBA: election out

- Partnership may elect out by noting election on its return
  - Must have 100 or fewer partners, and
  - No partner that is itself a partnership or trust
  - S corporations may be partners but each S corporation shareholder is counted against 100-partner limit
  - Single member LLC?
  - Election made for each taxable year

BBA: election out

- Is election out a good idea?
  - Potential whipsaw issues (allocable share of profit or loss, whether a person is a partner)
  - Partner may not have records supporting items on K-1
  - Statute of limitations may not be open for all partners, resulting in inconsistent adjustments
  - Unclear what election out means for a partnership that is an upper-tier partner in another partnership and receives an adjustment from that partnership

BBA: 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”

BBA: stages of audit

- IRS issues a notice of administrative proceeding to the partnership or partnership representative
- If applicable, IRS calculates "imputed underpayment" and mails notice of proposed partnership adjustment (NOPPA)
- Partnership has 270 days to submit information to reduce imputed underpayment
- IRS issues notice of final partnership adjustment (FPA)
- Partnership has 45 days after issuance of FPA to determine whether to make "push out" election
- Partnership has 90 days after issuance of FPA to file a petition in court

BBA: applicability

- Under TEFRA, partnership items are determined at partnership level.
- Separate partner proceedings are necessary for affected items and partner items.
- Same result under BBA?

BBA: 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")

BBA: 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
  - Audit adjustment in 2020 with respect to 2018 return results in tax owed on partnership's 2020 return
- Interest and penalties assessed at partnership level

BBA: imputed underpayment

- IRS and Treasury to provide rules allowing for modification of imputed underpayment 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
- Broad authority to provide additional modifications
- Information must be provided to IRS (or amended returns must be filed) within 270 days after NOPPA

BBA: imputed underpayment

- 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.

BBA: imputed underpayment

- Imputed underpayment is not deductible
- Each partner's outside basis in its partnership interest reduced by its share of the imputed underpayment.
  - How do you determine a partner's share?
  - Presumably each partner's outside basis is also increased by its share of the underlying income.
    - In previous example, each partner's outside basis is reduced by $175,000 (its share of the imputed underpayment) but increased by $500,000 (to correct for the depreciation deductions erroneously taken)
    - Presumably the partnership's basis in the asset should be increased by $1 million.

BBA: imputed underpayment

- Imputed underpayment reduced to the extent partners file amended returns for reviewed year and pay associated tax.
- If A and B both file amended returns for 2018, omit the excess depreciation deductions, and pay the tax due, the imputed underpayment is reduced to zero.
  - What if A has an NOL carryforward in 2018 that was otherwise carried to 2019 but can now be used in 2018? Does A have to file an amended 2019 return in order to reduce imputed underpayment?
- If only A files an amended return, partnership still has imputed underpayment of $175,000.
  - How to ensure A does not bear the cost?
- How does this work for tiered partnerships?

BBA: imputed underpayment

- What if, in 2019, A had sold its partnership interest to C?
- Does the partnership agreement obligate A to bear its share of the cost of the imputed underpayment?
- 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?
    - If so, is A's outside basis in its partnership interest at the time of sale increased by $500,000?
    - 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?
  - Or does A's payment to the partnership cause the partnership to have taxable income?

BBA: misallocation of income

- Example:
  - In 2018, partnership AB has income of $1 million, which the partnership allocates 100% to A. In 2020, the IRS determines that the partnership should have allocated the income 50% to A and 50% to B. Both A and B are corporations.
- Imputed underpayment is $175,000 unless both partners file amended returns for 2018.

BBA: push out election

- Even if partnership has not elected out, it 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
  - Tax due includes the increase in what the tax would have been in the reviewed year, taking into account the adjustment, plus any increase in tax in intervening years resulting from adjustment to tax attributes
  - Partnership must make election within 45 days of receiving the FPA
    - What if there is a settlement pre-FPA?
  - Partners have no right to administrative or judicial review

BBA: push out election

- Example:
  - In 2018, partnership AB understated income by $1 million, which should have been allocated 50% to A and 50% to B. In 2019, A sold its partnership interest. In 2020, the IRS audits the partnership and adjusts 2018 income. The partnership elects to push out the adjustment.
- A has additional tax due in 2020 based on a hypothetical inclusion of income in 2018.
- Income inclusion should have increased A's basis, resulting in less gain on sale, but how does A claim this benefit?

BBA: push out election

- What if a partner is itself a partnership?
  - Does the upper-tier partnership have to pay the tax due, or push it out to its own partners, or is it elective?
  - Does the answer change if the upper-tier partnership had elected out of the BBA rules?
  - If the upper-tier partnership has to pay the tax due, what rate applies? Can it reduce the rate by showing that its partners are tax-exempt entities or corporations?

BBA: push out election

- Interest determined at partner level, and is short-term rate plus 5%.
- Penalties and additions to tax determined at partnership level, but imposed on reviewed year partners.
- How to determine a partner's share of penalties?
- To what extent can partner-level defenses be raised?

BBA: imputed underpayment vs. push out election

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

BBA: 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.
- Before the effective date, need to revise the partnership agreement

Considerations for LLC agreement

- Will the partnership elect out?
- Will the partnership elect in early?

Considerations for LLC agreement

- Partnership representative
  - Who will it be?
  - How much power will it have?
    - Only the representative receives notice from IRS and has sole power to act (extend SOL, file suit, or settle case).
    - 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 contrary to the agreement?
  - Indemnification for liability for actions taken?

Considerations for LLC agreement

- Rights of other partners during proceedings
  - Notification
  - Participation
  - Consent
- 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?

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
- If audit adjustment results in tax benefit to buyer, seller may want to be paid

Purchasing a partnership interest

- If partnership ceases to exist prior to assessment, the historic partners are liable for underpayment under regulations to be drafted
- If 100% of the partnership interests are purchased, a partnership is treated as ceasing to exist for this purpose

Fast Track and IRS Appeals Developments

David J. Fischer

Neville Jiang

"Now let's talk about that loophole you've claimed!"

"Mission" of IRS Exam

- Identify the applicable law, correctly interpret its meaning in light of congressional intent, and, in a fair and impartial manner, correctly apply the law based on the facts and circumstances of the case IRM § 4.10.7.1(1).
- May resolve disputed issues of fact, but bound by IRS positions in Treasury Regulations, rulings, and acquiescence or non-acquiescence in court cases
- Not supposed to consider the hazards of litigation in settling cases

Alternatives on Conclusion of Exam

Once receive a Notice of Proposed Adjustments:

- Request Fast Track
- Request 30-Day Letter and proceed to IRS Appeals
- Request Competent Authority assistance
- Request Notice of Deficiency and Proceed to Litigation
  - Tax Court without payment
  - Pay tax, claim refund, and file suit for refund in Federal District Court or Court of Federal Claims
- Concede the issue

Fast Track Settlement (Rev. Proc. 2003-40)

- Mediation (by Appeals officer acting as mediator) between taxpayer and Exam
  - Provides settlement authority to Exam, including "hazard" settlements
- Designed for resolution within 120 days
  - Taxpayer and IRS must have decision-maker present
- Either party may request on receipt of Notice of Proposed Adjustments (NOPA)
  - IRM directs Exam to suggest
  - Both parties must agree

Fast Track Settlement

- Can withdraw at any time
- Can still go to IRS Appeals (or litigation)
  - Post-Appeals Mediation not permitted
- Timing: After NOPA and before 30-day letter
- Taxpayer presents position in Fast Track Memorandum

IRS Appeals

- Designed as "independent" settlement forum
- "Mission" of IRS Appeals: To settle cases

  To resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer, and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service

  – Consider "hazards of litigation"
  – Do not consider costs of litigation (no nuisance settlements)

IRS Appeals

- Taxpayer may select by submitting formal written "Protest"
  - Exam team will review and prepare written "rebuttal" to Protest
  - Pre-submission conference with IRS exam and IRS Appeals
- Appeals conference follows pre-submission conference (usually same day)
  - Normal procedure is to exclude Exam (ex parte rules apply)

Post-Appeals Mediation

- Rev. Proc. 2009-44; Rev. Proc. 2014-63
- Non-binding mediation process following unsuccessful efforts at Appeals settlement
  - Designed to be used where limited issues remain unresolved
- Available to all LB&I taxpayers
  - Unavailable if Fast Track used at Exam
- Appeals Officer as mediator, taxpayer may use non-IRS co-mediator at taxpayer expense

Fast Track

- Requires IRS approval
- No "hot" interest
- Fast?
  - Single meeting
  - Lower administrative costs
- Decision maker: IRS Exam
- *Ex parte* not applicable
- Two bites: Fast Track Settlement + Appeals

Appeals

- No IRS approval required
- Hot interest
- Less Fast
  - Multiple meetings
  - Higher administrative costs
- Decision maker: Appeals
- *Ex parte* rules apply
- Two bites: Appeals + Post-Appeals Mediation

Fast Track

- May submit new facts
- Educate Exam about legal arguments, may respond
- Exam may raise new issues

Appeals

- No New Facts
- Exam locked-in and no new legal arguments
- Not raise new issues

Fast Track / Post Appeals Mediation

Program	2012	2013
Fast Track Settlement – SB/SE	64	165
Fast Track Settlement – LB&I	124	105
Fast Track Settlement – TE/GE	6	11

Program	2012	2013
Post-Appeals Mediation (non-collection)	71	88
Post-Appeals Mediation (OIC/TFRP)	23	11

IRS Appeals Trends

- Appeals Judicial Approach and Culture Project
  - Policy not to consider new facts impacting Exam strategy
- Centralization of decision-making at Appeals
  - Issue Specialists are controlling more cases
- *Ex parte* rules eroding
  - Rapid Appeals Process
  - Involve exam in the Appeals presentation

Appeals Judicial Approach and Culture Project (AJAC)

- Two major themes:
  - Appeals will not consider **new facts** not presented to Exam
  - Appeals will not raise **new issues** not considered by Exam
    - See IRM 8.6.1.6 (New Issues and Reopening Old Issues); Appeals Policy Statements 8-2 and 8-3 (IRM 1.2.17)

New Issues at Appeals

- Appeals will not raise new issues not considered by Exam
- Appeals will not reopen previously agreed issues
- Taxpayer can raise new issues or new theories
  - Appeals can consider (without developing new facts)
  - Appeals to request review and comment from Exam
  - 210 days required on statute of limitations to consult Exam

New Facts at Appeals

- Appeals will not engage in fact-finding
  - Appeals will not consider new facts not presented to Exam
  - Factual issues that are not properly developed are returned to Exam (with view of hazards)
  - Appeals expected to announce procedures for new facts in Docketed cases shortly (Fall 2016)
- New information or evidence means
  - Not shared with Exam
  - In view of Appeals Office, merits additional analysis or investigative action
  - New information provided after NOPA or with Protest may extend Exam (possible additional IDRs)

Acknowledgment of Facts (AOF)

- 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
- AOF IDR aimed at ensuring that Appeals is not considering new facts
  - Taxpayers should ensure that all relevant evidence is presented to Exam before the case is closed

Impact of AJAC on Exam Strategy

- No new issues places premium on allowing Exam to present case without comment from taxpayer
  - Unintended result
- No new facts requires taxpayer to present all facts as part of examination process
  - Protest is end of Exam, so should present facts in Protest
  - If need expert, must present opinion to Exam before Appeals

Impact of AJAC Fast Track v Appeals

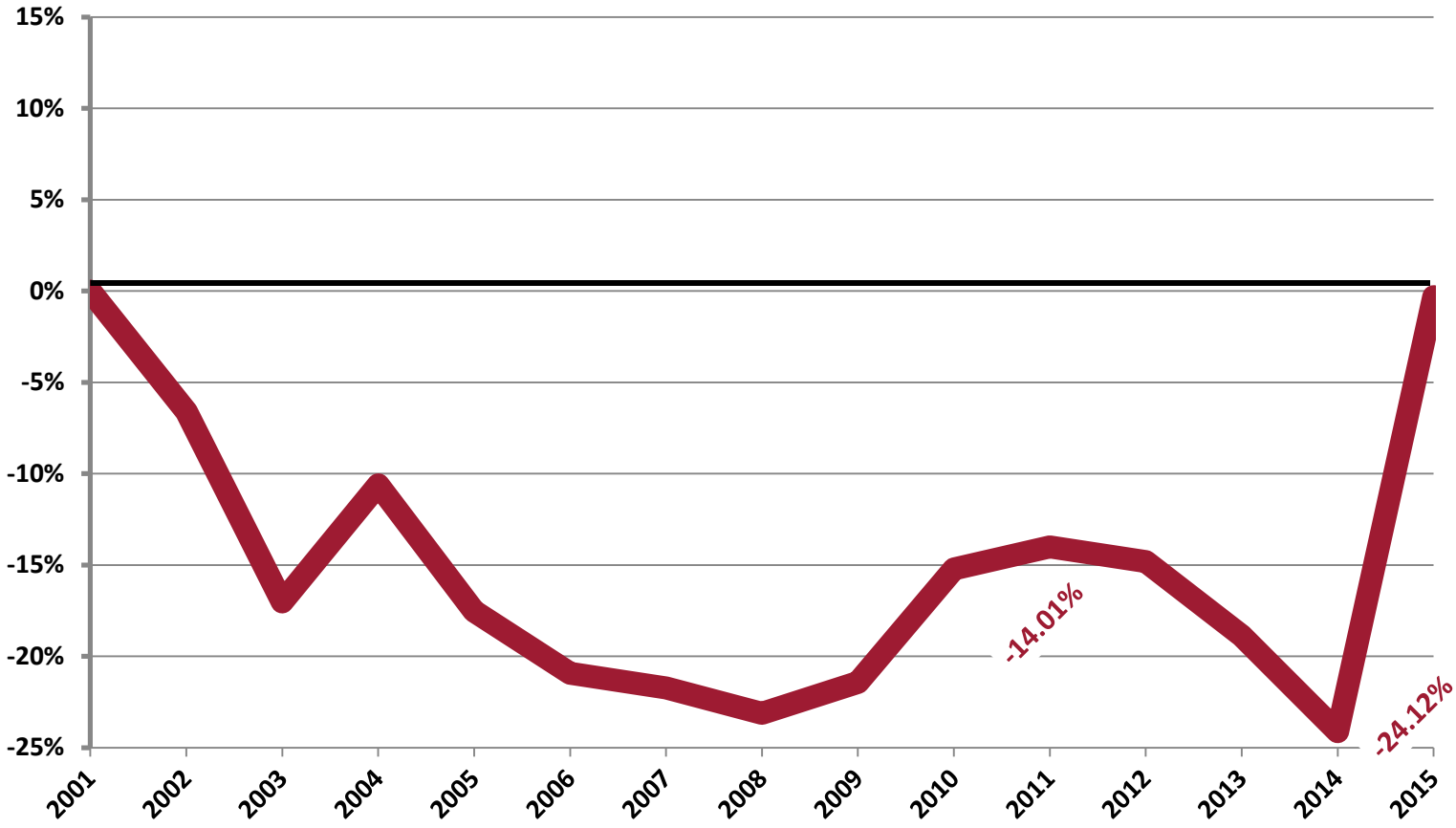
- If facts undeveloped, Fast Track permits presentation of facts before Appeals
- If law undeveloped, Fast Track will disclose legal position to Exam and permit response
  - No new legal issues can be big advantage

Centralization of Decision Making

- Appeals reducing or eliminating Appeals Team Case Leaders (ATCL)
  - ATCL's have independent settlement authority
  - Other Appeals Officers require supervisor approval
- Appeals issue focus results in Appeals Technical Specialists on issue-by-issue basis
  - Appeals claims increases consistency
  - Our experience is that interfering with settlement

Appeals Officers

Changes in Workforce 2001-2015



Appeals Officers

999 in 2001
758 in 2014
996 in 2015

Source: IRS Data Book Table 30.

Impact of Centralization on Fast Track v Appeals

- Who is decision-maker at Fast Track for issue that is part of campaign?
- Rise of Technical Specialists leads to less favorable results at Appeals
- Unclear, but Appeals advantage appears to be eroding

Prohibition on *Ex parte* Communications

- Adopted as required by the Restructuring and Reform Act of 1998 (with the Taxpayer Bill of Rights) to assure Appeals independence
- Appeals may not communicate with IRS personnel in other functions (i.e. Exam) without the taxpayer (or representative) being provided the opportunity to participate in the communication
- Appeals may discuss case with Exam in presence of taxpayer
  - Rev. Proc. 2012-18, *superceding* Rev. Proc. 2000-43; IRM § 8.1.10

Rapid Appeals Process (IRM 8.26.11)

- Appeals program similar to Fast Track Settlement, but Appeals, rather than Exam in FTS, has settlement authority
- Mediation (by Appeals officer acting as mediator) between taxpayer and Exam
- Exam remains part of Appeals process, ex parte waived

Exam Participation in Appeals

- Appeals Officers may request to extend Pre-Submission conference, include Exam in discussion of case for extended period
  - Technically not Rapid Appeals Process
  - Can request that Exam be excluded
- Difficult for taxpayer to object

Impact on Fast Track v Appeals

- Erosion of *Ex Parte* rules eliminates some of the advantage of Appeals
  - Still changing decision-maker
- Fast Track and Appeals become more similar
- Ultimate impact still to be determined

Teleconference Developments

- Appeals is attempting to encourage teleconferences and may restrict face-to-face meetings
- New IRM provisions provide default rule will be teleconference or video conference IRM § 8.6.1
- Taxpayers may request in person conference, Appeals team manager must agree
  - Complex, fact intensive cases, or will numerous participants will receive in person conferences

IRS Appeals Organization

- IRS Appeals currently working on reorganization
- Appeals currently organized geographically, and with specialty operations separated
- New organization to divide between Exam and Collections functions
- Announcement expected Fall 2016

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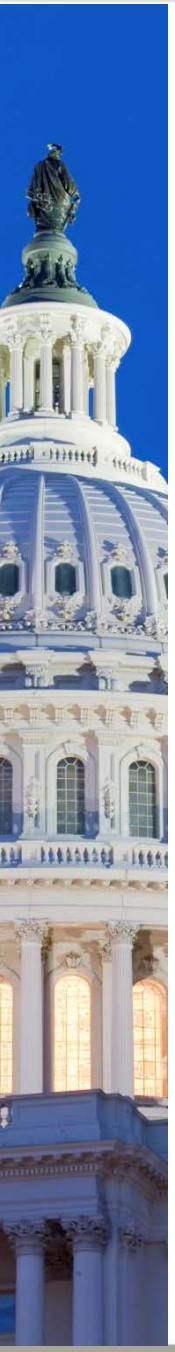
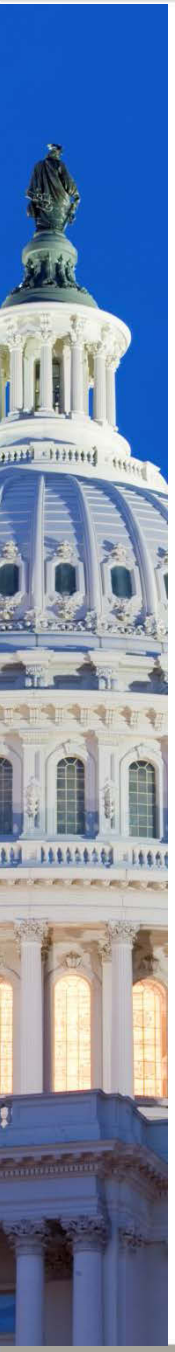
Tax Accounting Controversies & Developments

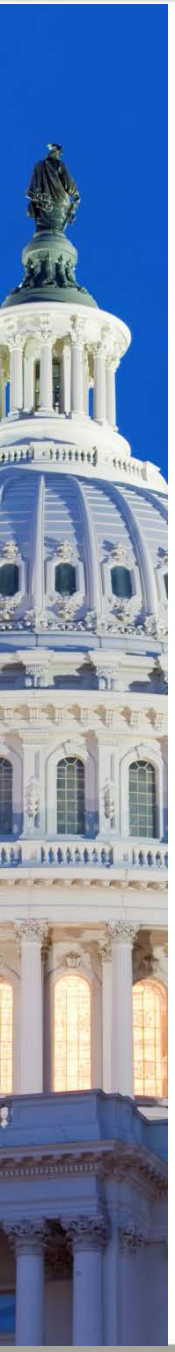


Resolving Accounting Method Issues



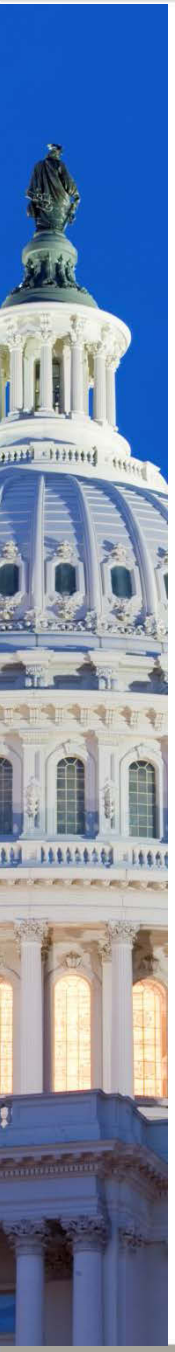
General Background

- A taxpayer adopts an impermissible method by using it on two consecutively filed returns.
- After adopting a method (either permissible or impermissible) the taxpayer must use the method for all items arising during the year, and from year to year.
- A taxpayer must obtain the consent of the Commissioner to change a method.



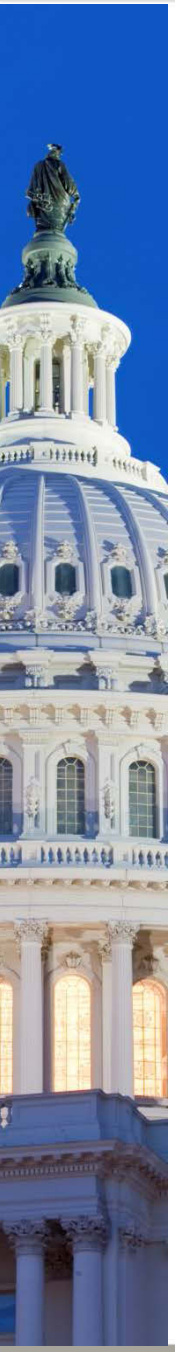
General Background

- Accounting methods determine when a taxpayer takes into account and item of income or deduction.
- A taxpayer may:
  - Adopt any permissible overall method on its first return; and
  - Any special method the first time it accounts for the item.



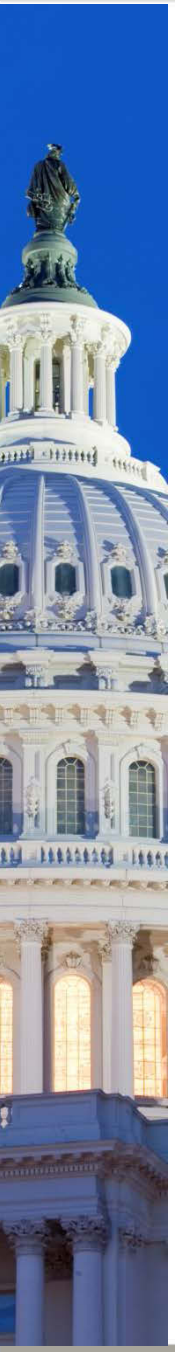
General Background

- What constitutes a change in method is not always clear, and it is the subject of frequent controversy.



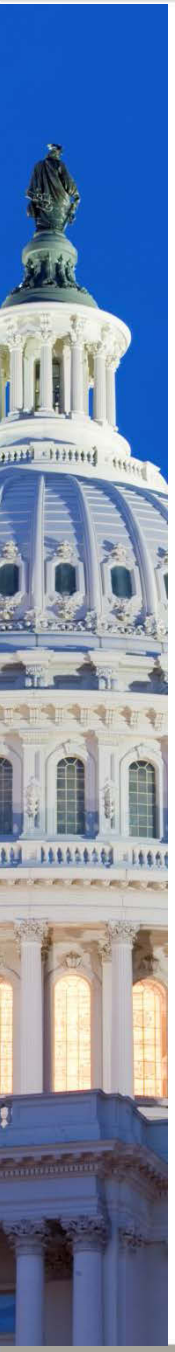
Changes Imposed by Exam

- Exam has the authority to change a taxpayer's method if—
  - Improper method
  - the taxpayer has not regularly used a method, or
  - the taxpayer's method does not clearly reflect its income.
- Exam cannot change a taxpayer from a permissible method to a method Exam believes "more clearly reflects" the taxpayer's income.



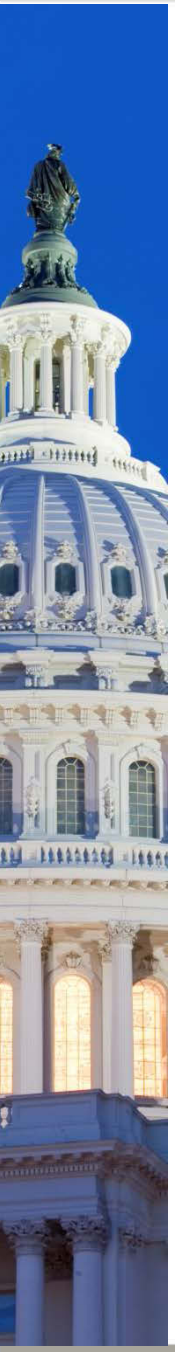
Changes Imposed by Exam

- Where Exam has authority to change a taxpayer's method, however, Exam can change the taxpayer to any method that it believes clearly reflects income.
  - Courts give great deference to the determination of the new method, and have even allowed Exam to change a taxpayer to a method that otherwise would be impermissible.



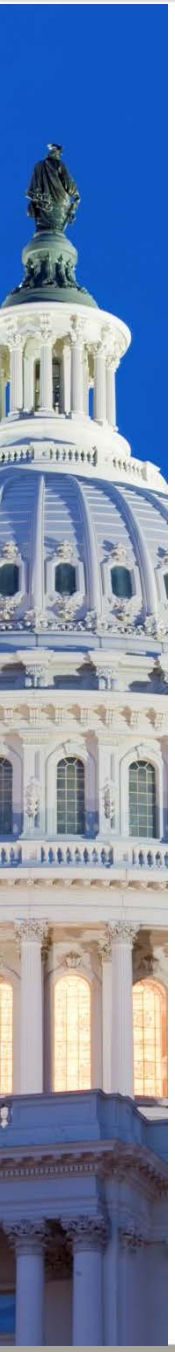
Changes Imposed by Exam

- Exam must notify the taxpayer in writing that it is changing the taxpayer's method.
  - In a closing agreement, if one is executed.
- Content of notice:
  - A statement that the issue is being treated as an accounting method change or a clearly labeled section 481(a) adjustment; and
  - A description of the new method.



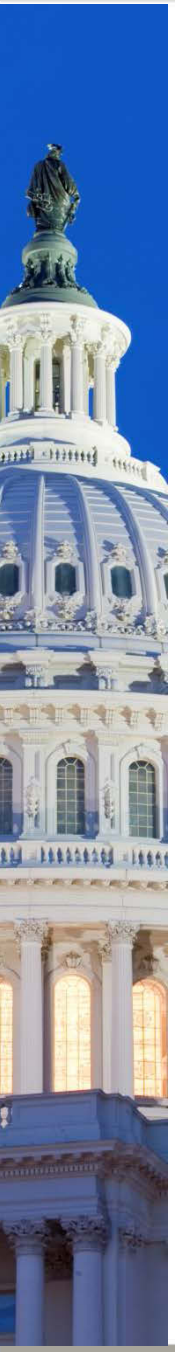
Changes Imposed by Exam

- If Exam does not provide the required notice, there is no change in method.
  - The taxpayer is required to continue to use its original method.
  - Exam and the taxpayer must treat all items in a manner to prevent duplications and omissions.



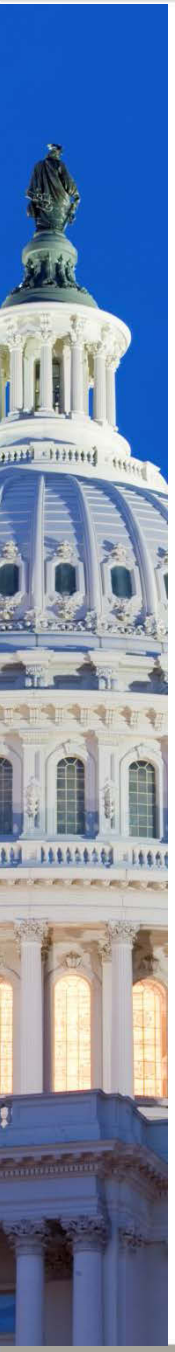
Changes Imposed by Exam

- If Exam determines the taxpayer is using an impermissible method, Exam may propose an adjustment with respect to the method only by changing the taxpayer's method.
  - Exam must change the taxpayer to a permissible method, not a method contrived to reflect hazards of litigation.



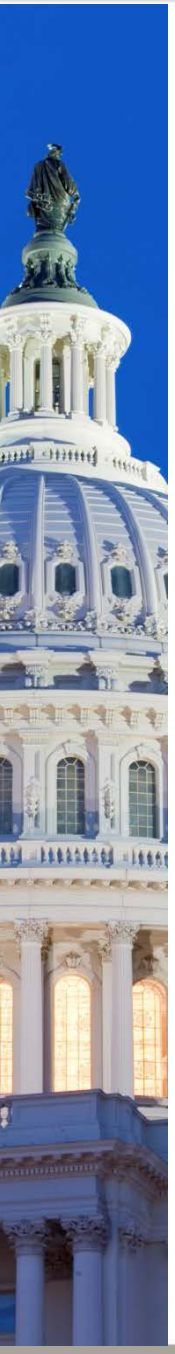
Changes Imposed by Exam

- Generally, Exam must make the change in the earliest year under examination (or, if later, the earliest year the method is impermissible).
  - Limited exception if the records are insufficient to allow a computation of the §481(a) adjustment and Exam cannot reasonably estimate it.



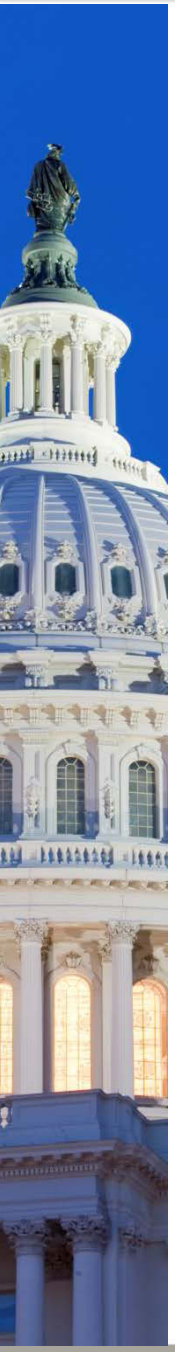
Changes Imposed by Exam

- Exam must compute a §481(a) adjustment, and cannot use a "cut-off" to reflect the hazards of litigation.
- Must include the entire amount of the §481(a) adjustment in the year of change.



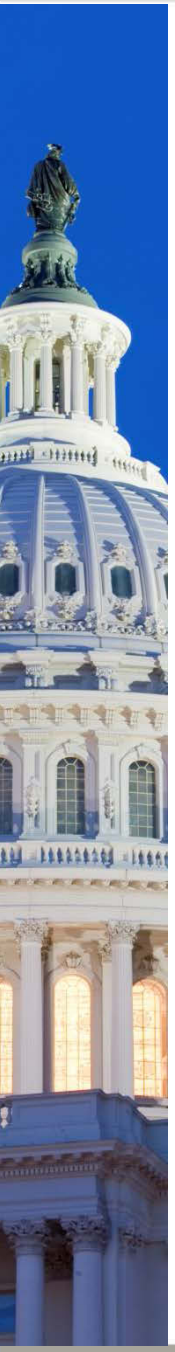
Resolution at Appeals

- Because of their mission to "resolve controversies without litigation," Appeals has greater flexibility than Exam.
- Appeals may resolve an accounting method issue using any means appropriate under the circumstances to reflect the hazards of litigation.



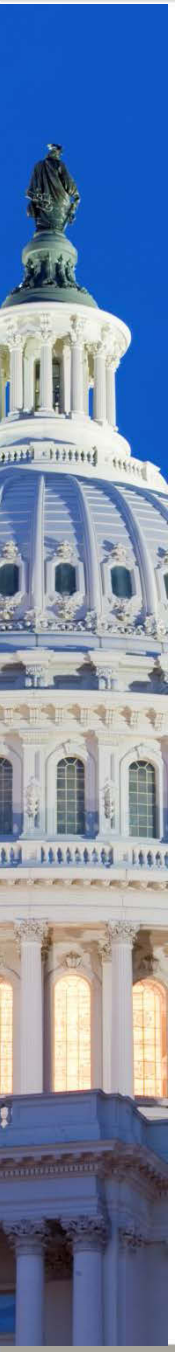
Resolution at Appeals

- Three examples of how Appeals can resolve accounting method issues:
  - Accounting Method Change;
  - Alternative-Timing Resolution;
  - Time-Value-Of-Money Resolution.



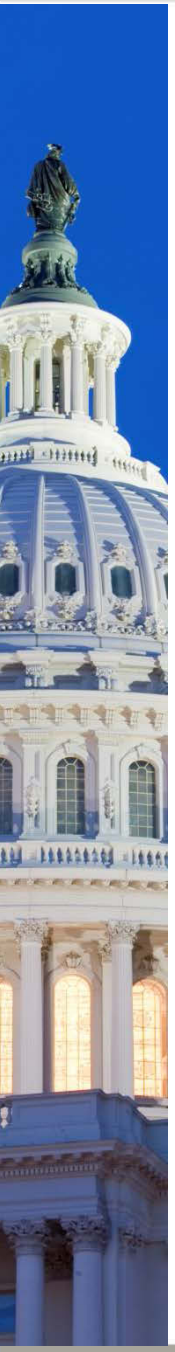
Resolution at Appeals

- Appeals can change a taxpayer to any permissible method, but unlike Exam, Appeals has flexibility with the terms and conditions.
- Appeals can:
  - Defer the year of change;
  - Use a “cut-off” method;
  - Compromise the amount of the §481(a) adjustment;
  - Spread the §481(a) adjustment over an extended period.



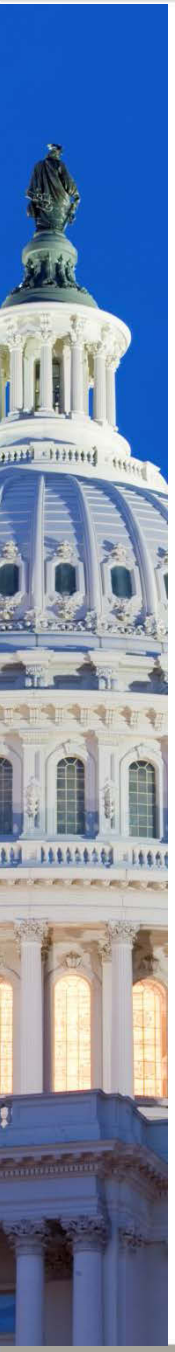
Resolution at Appeals

- Under an Alternative-Timing Resolution, the taxpayer treats certain items arising during the year before Appeals (or prior to and during) differently than under its method, but otherwise continues to use its method.
  - For example, the taxpayer may agree to capitalize certain costs incurred during the year before Appeals, but otherwise continue to deduct such costs.



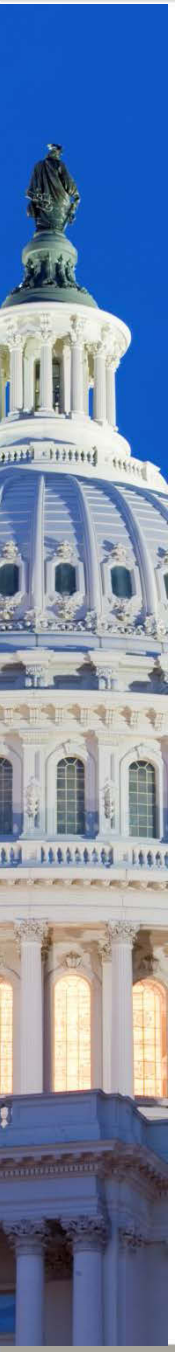
Resolution at Appeals

- Under a Time-Value-Of-Money Resolution, the taxpayer pays a "specified amount" that approximates the benefit the taxpayer receives under its method compared to the method proposed by Exam, reduced to reflect hazards of litigation.
- The taxpayer continues to use its method.



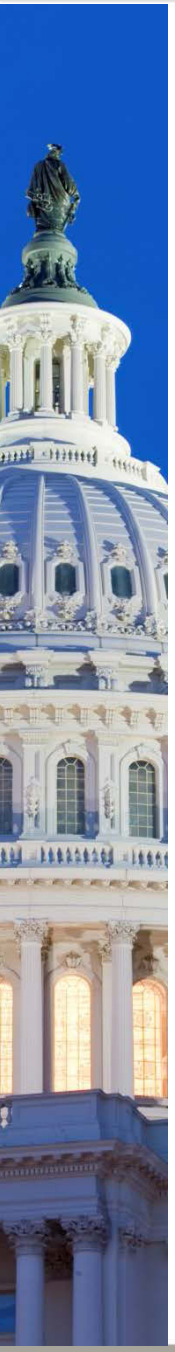
Resolution at Appeals

- For example, the benefit a taxpayer receives from deducting a cost currently rather than amortizing it over some number of years can be quantified and then reduced by some percentage to reflect the hazards of litigation.

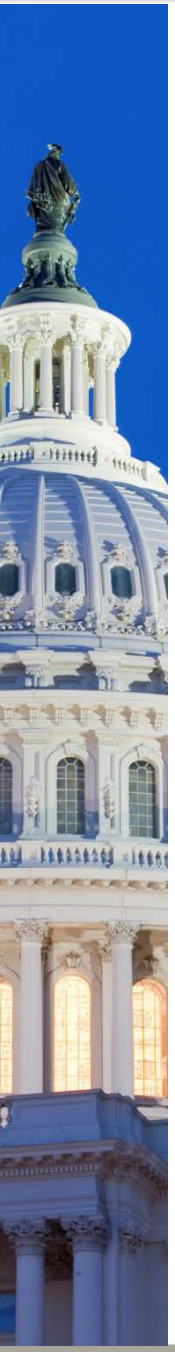


Resolution at Appeals

- If Appeals resolves the accounting method issue other than by changing the taxpayer's method, Appeals must enter into a closing agreement with the taxpayer.

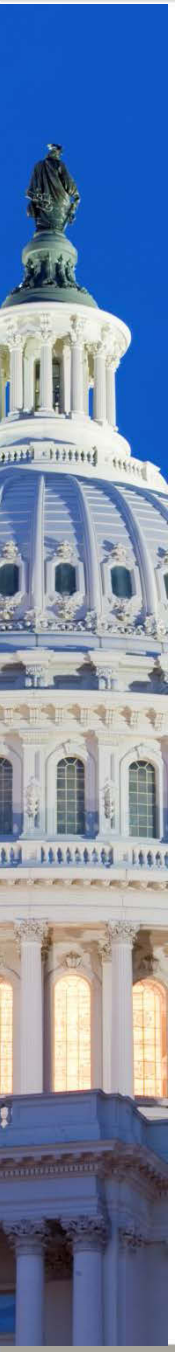


Section 199 – Domestic Production Activities Deduction

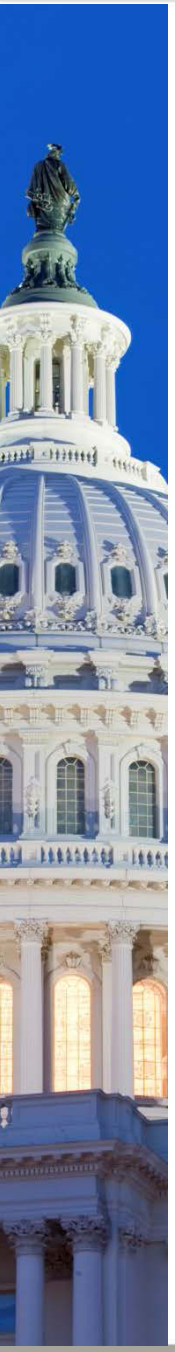


Overview

- Section 199 is an incentive provision relating to certain domestic manufacturing and production activities
- The deduction provides a permanent tax benefit (federal and states), increases cash flow and enhances shareholder value
- The deduction currently equal to 9% (or 6% for certain oil and gas) of the lesser of:
  - The qualified production activities income (QPAI)
  - Taxable income (determined without regard to Section 199)
- Section 199 limits the deduction to 50% of DPGR-related W-2 wages

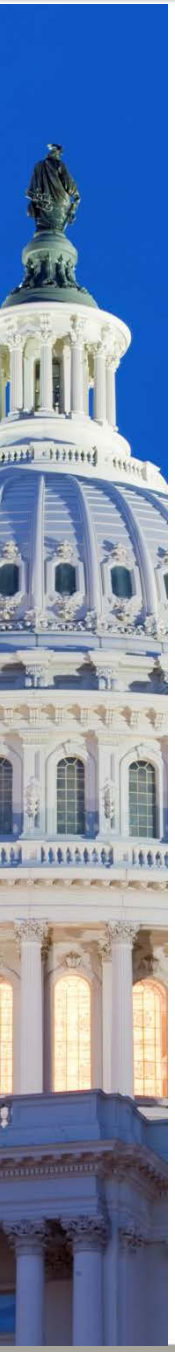


"... and then you smile and say... all together now... 'that's not deductible'."



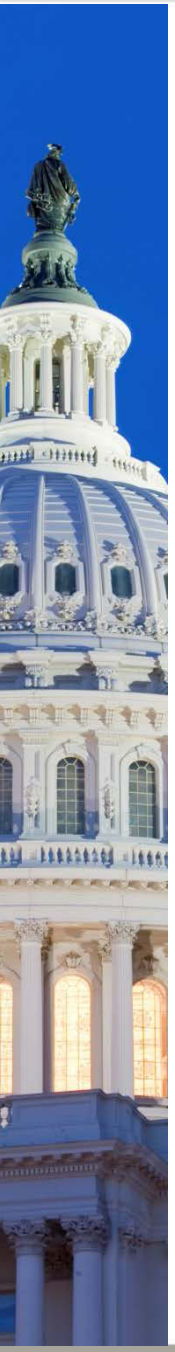
Section 199 Controversy

- Contract manufactures – benefits and burdens test
- Manufacture, Production, Grow, or Extract (MPGE) Activities
- Exam/Appeals



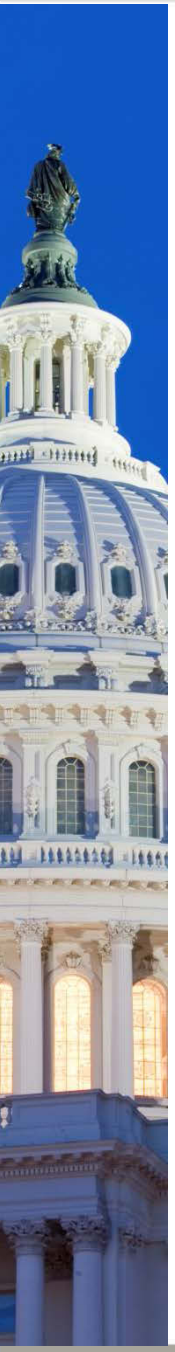
Section 199 Benefits and Burdens

- Under final regulations, taxpayer with "benefits and burdens of ownership" over the qualifying MPGE activity may claim the section 199 deduction
  - facts and circumstances test
- Only the taxpayer with benefits and burdens is entitled to the deduction



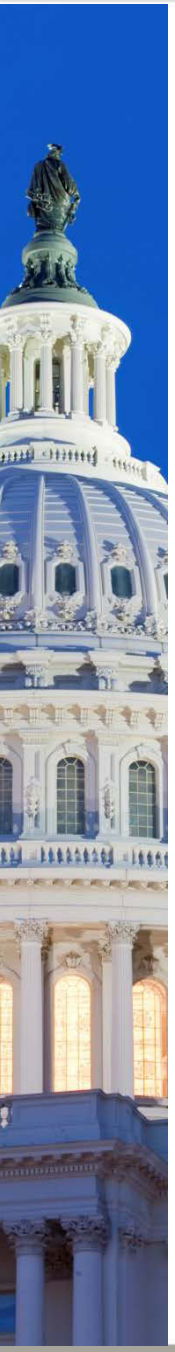
Section 199 Benefits and Burdens

- *ADVO, Inc. v. Commissioner*, 141 T.C. 298 (2013).
- *Limited Brands* – TC Petition filed August 2010 & settled
- *Hibu Group (USA), Inc. (f/k/a Yellow Book Inc.) v. Commissioner* (Tax Court)
- *Bare Escentuals* – TC Petition filed December 2015
- *AT&T Advertising, L.P., YP Advertising & Publishing, LLC v. United States* (Court of Federal Claims)



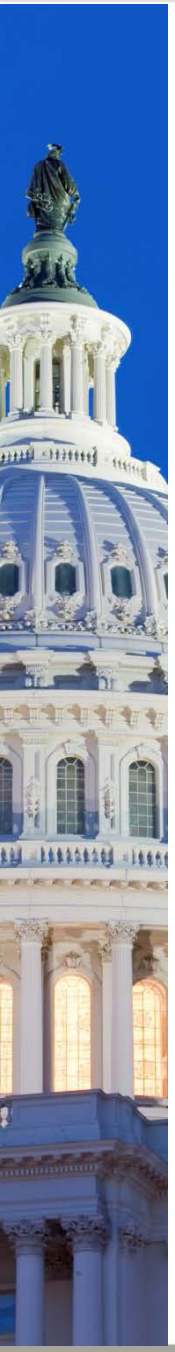
Section 199 Benefits and Burdens

- ADVO nine factor analysis:
  - Which party has legal title
  - How do the parties treat the transaction
  - Which party has equity interest
  - Whether there is a present obligation to deliver a deed
  - Who has the right of possession and control
  - Who pays property taxes after the transaction
  - Who has risk of loss or damage
  - Who has profit from the sale of the property
  - Whether the taxpayer actively and extensively participated in the management and operations of production



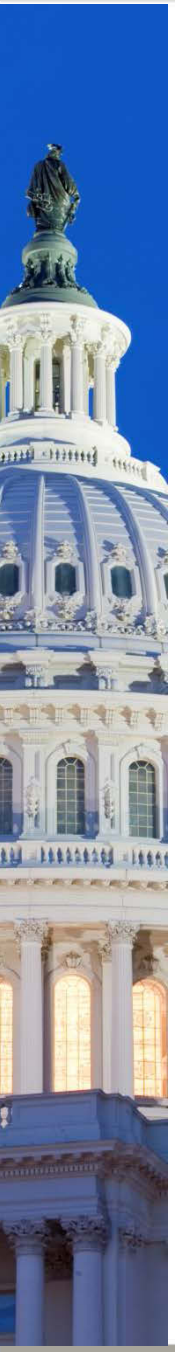
Section 199 Benefits and Burdens

- Proposed regulations remove the benefits and burdens rule, instead awarding the 199 deduction to the entity actually performing the qualifying MPGE activity



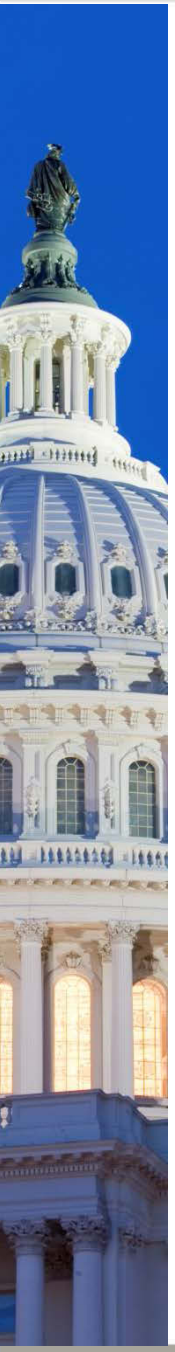
Section 199 Benefits and Burdens

- Potential revision to §199(d)(10) — relating to contract manufacturing.
- New Section 199(d)(10) to provide that in contract manufacturing situations, any party to the arrangement that makes a substantial contribution through the activities of its U.S. employees to the manufacture of qualifying production property shall be entitled to claim the deduction



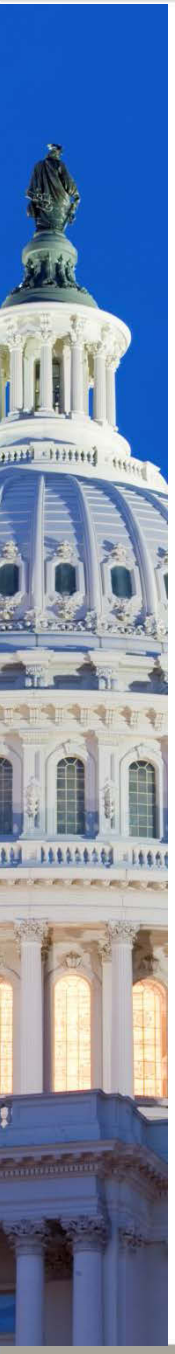
Section 199 Non-qualifying MPGE

- Activities relating to packaging, repackaging, labeling or minor assembly of QPP does not qualify as MPGE when performed on a standalone basis
- *Precision Dose, Inc. v. United States* (Dist. Ct. Ill., 2015).
  - Taxpayer's activities constituted MPGE rather than packaging, repackaging, labeling, minor assembly
    - Based on *Dean* (gift baskets)
    - *See also* CCA 201246030 (blister packs)



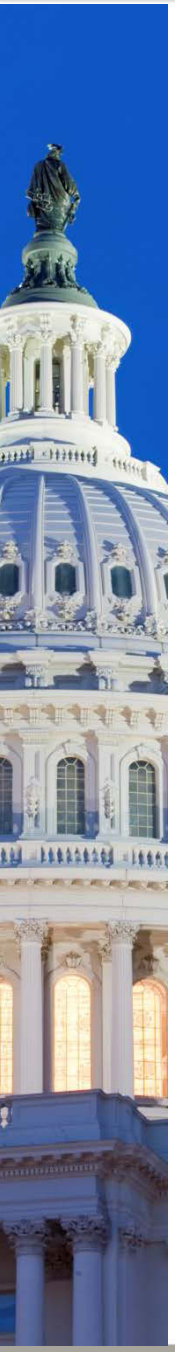
Section 199 non-qualifying MPGE

- Proposed Regulations add as non-qualifying:
  - Testing activities (without other related MPGE activities)
  - Gift baskets example – Direct challenge to *Dean*
- Proposed regulation: Definition criteria
  - whether an activity is a single process that does not transform an article into a materially different QPP; and
  - whether an end user reasonably could engage in the same assembly activity of the taxpayer



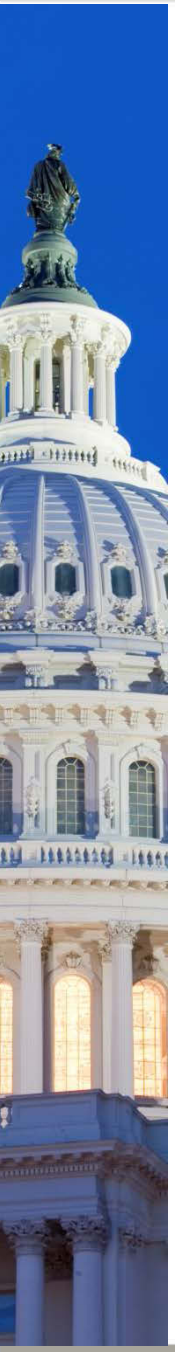
Section 199 non-qualifying MPGE

- 2015 LB&I Directive (LB&I-04-0315-001) taking the position that MPGE also excludes:
  - Cutting blank keys to a customer's specification
  - Mixing base paint and a paint coloring agent
  - Applying garnishment to cake that is not baked where sold
  - Applying gas to agricultural products to slow or expedite fruit ripening
  - Storing agricultural products in a controlled environment to extend shelf life
  - Maintaining plants and seedlings



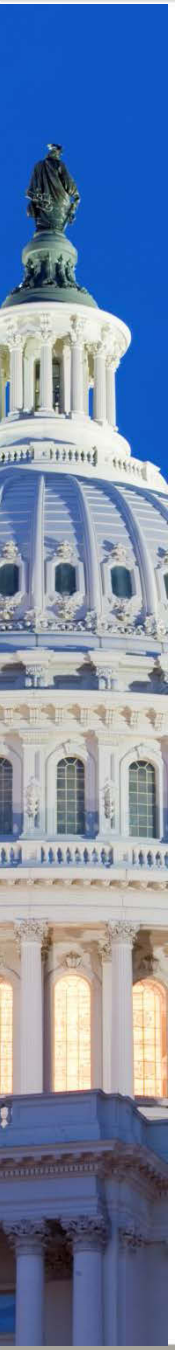
Section 199 Proposed Regulations Other Changes

- Construction Rules
  - Limitation on qualifying general contractor activities
  - Modification of "substantial renovation" to align with tangible property regulations
- Oil & Gas
  - Special definition of oil-related QPAI
- Long-Term Contract Method
  - Rules for allocable contract costs under the percentage of completion method or the completed contract method
- Allocation of COGS between DPGR and non-DPGR

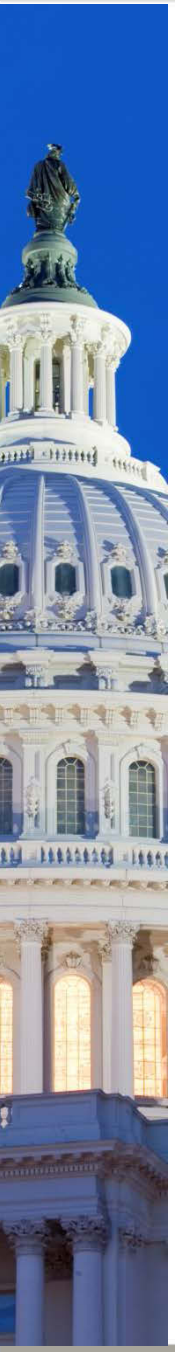


Section 199 Proposed Regulations Other Changes

- Qualified Film
  - W-2 wages and qualified film – Definitions revised
  - Clarify impact of distribution method, attribution rules for pass-through entities, determining DPGR from promotional films and safe harbor for live or delayed television programs
- Hedging Transactions
- Agricultural and horticultural cooperatives



Tangible Property and Repair Regulations



Tangible property and repair regulations

- History
- Application
- Safe Harbors
- Controversy?