



Managing Tax Audits and Appeals

Crowell & Moring, LLP

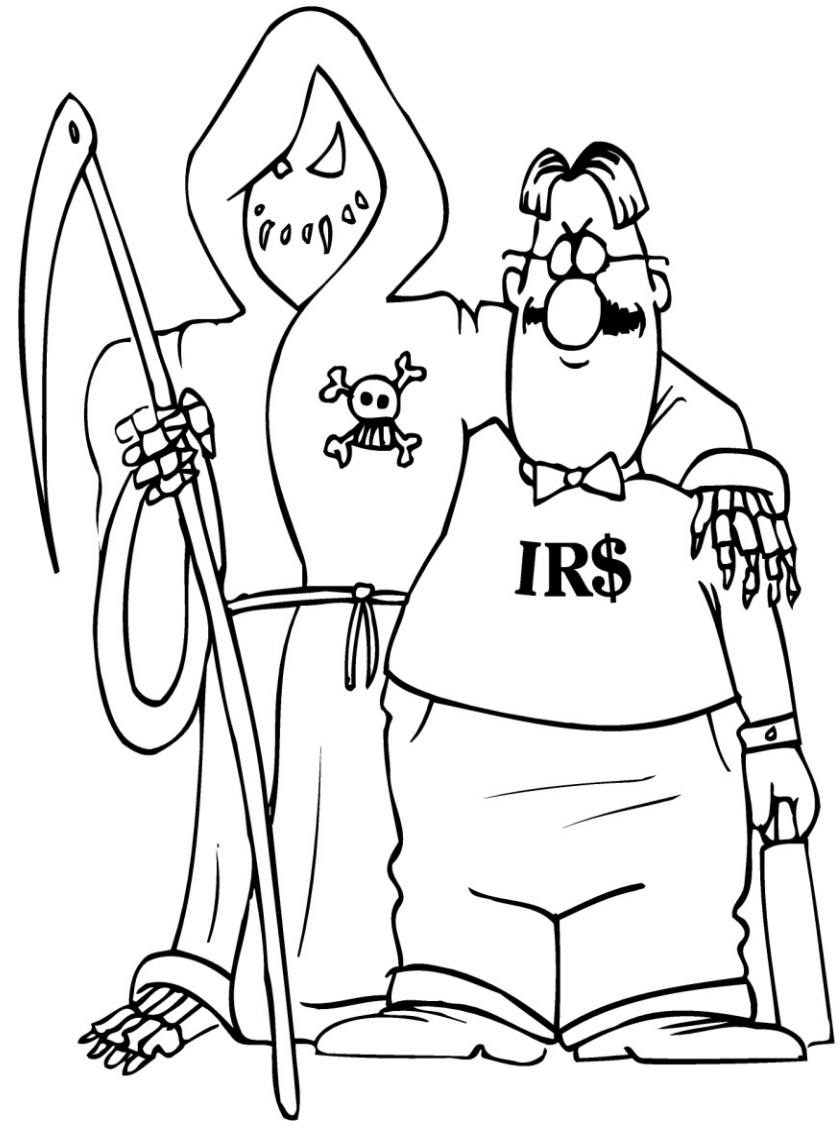
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Washington, DC
September 29-30, 2016

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

Crowell & Moring, LLP

David Blair

Washington, DC

September 29-30, 2016

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



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

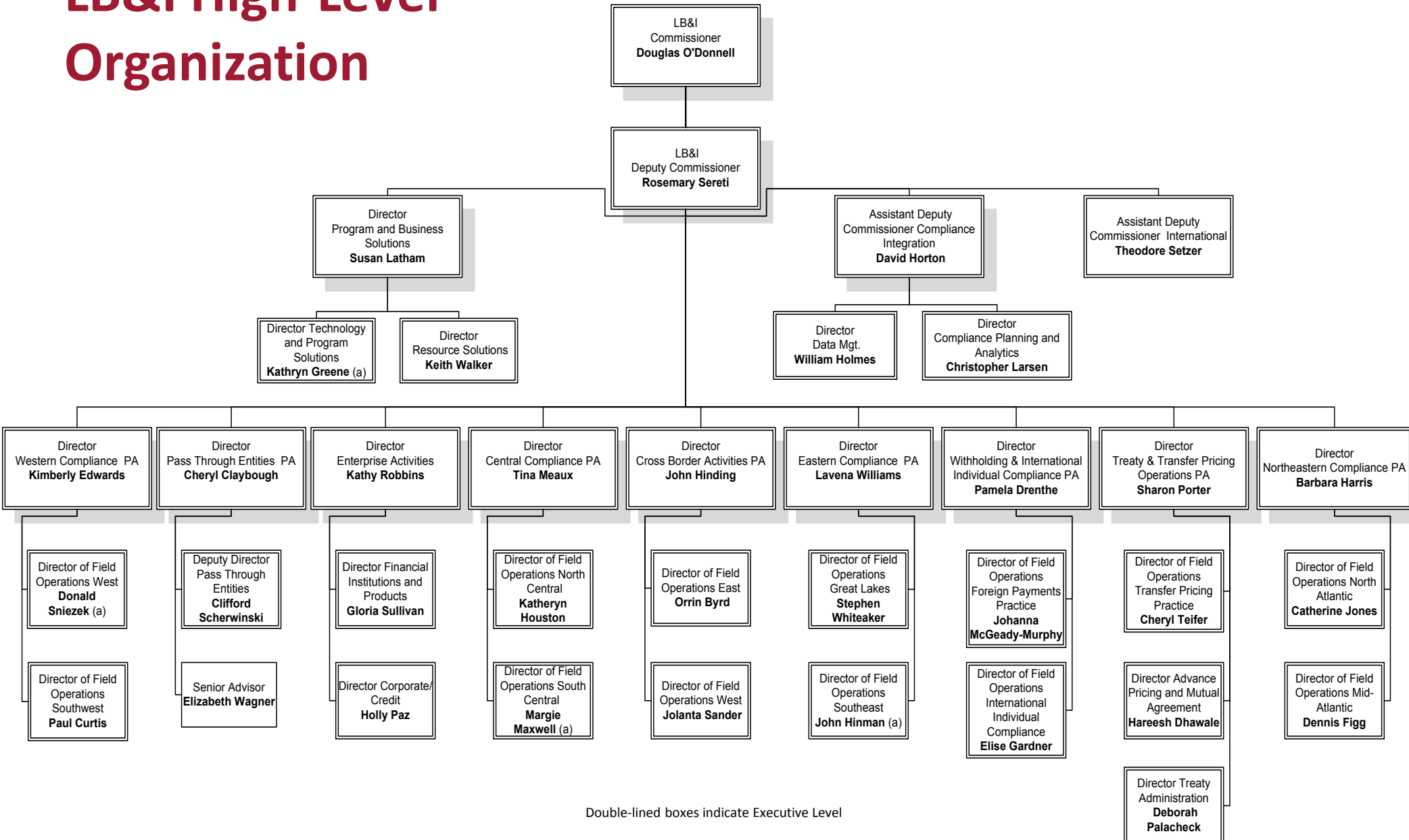
2016 LB&I Reorganization In Context

- 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

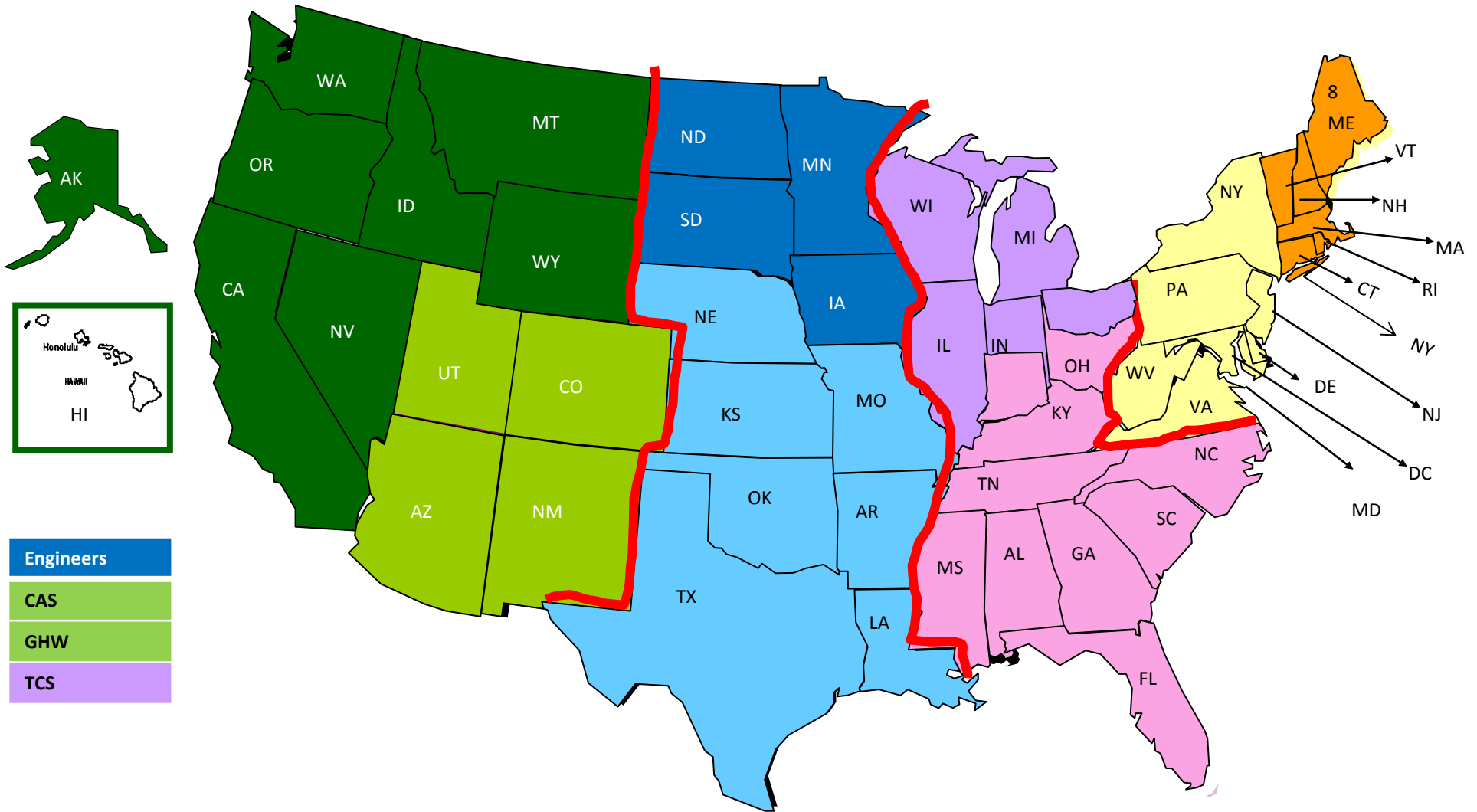
LB&I High-Level Organization



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)

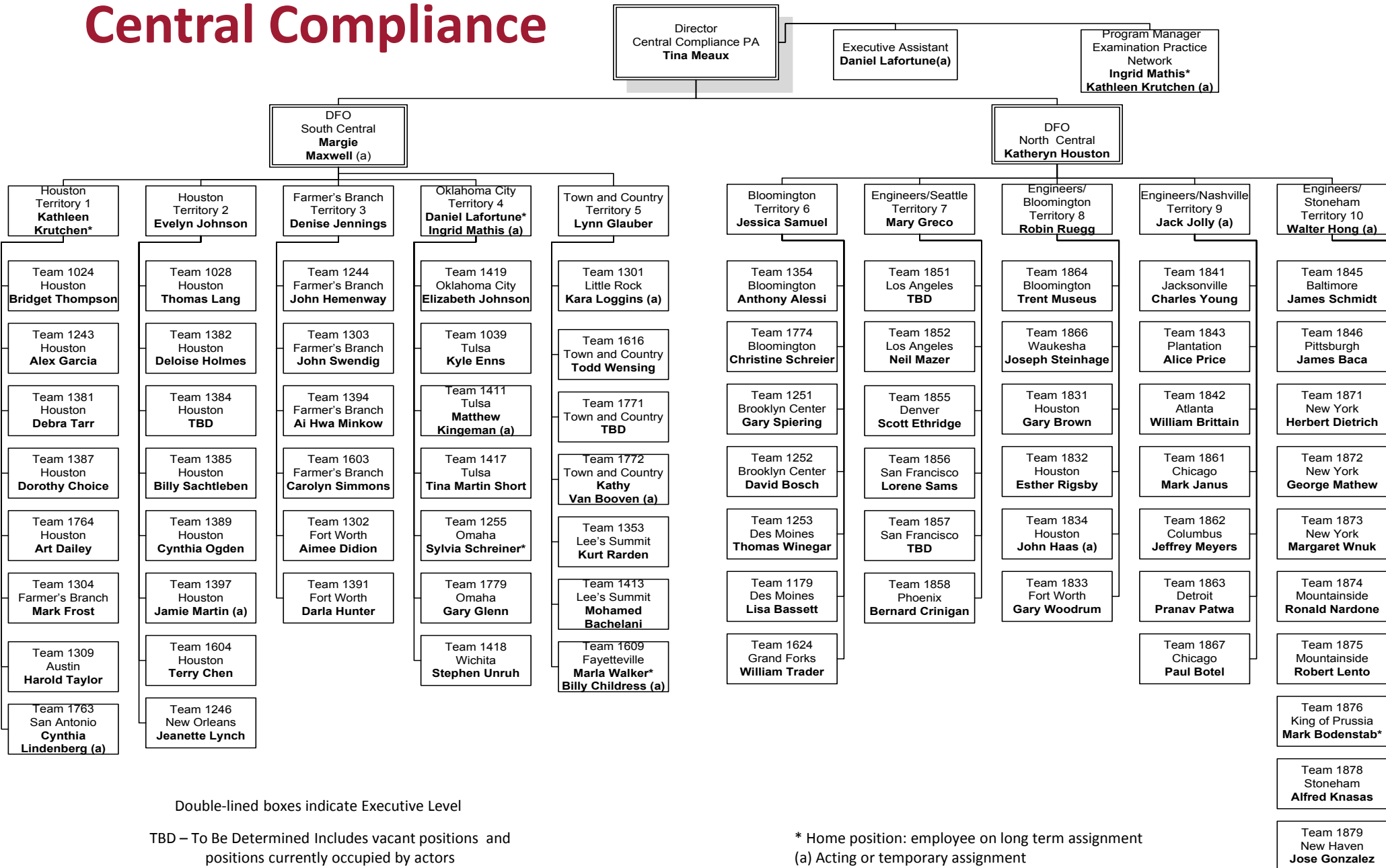
Geographic Practice Area Map



Engineers
CAS
GHW
TCS

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)

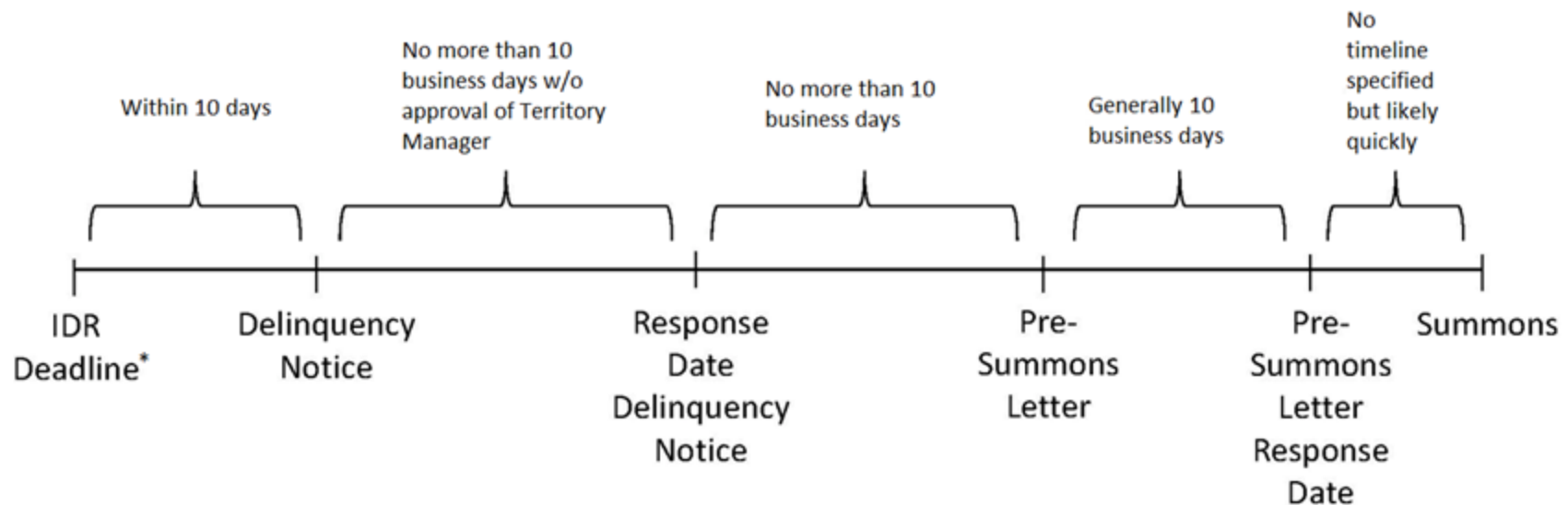
- Focuses on cooperation and transparency between the issue team and the taxpayer
- Information-gathering to be conducted by Information Document Request (IDR)
 - Exchange of information
 - Develop facts
- Mutually agree upon timelines

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: <i>(Name of Taxpayer and Company Division or Branch)</i>		Subject				
		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%;">SAIN number</td> <td style="width: 50%;">Submitted to:</td> </tr> <tr> <td colspan="2">Dates of Previous Requests <i>(mmdyyyy)</i></td> </tr> </table>	SAIN number	Submitted to:	Dates of Previous Requests <i>(mmdyyyy)</i>	
SAIN number	Submitted to:					
Dates of Previous Requests <i>(mmdyyyy)</i>						

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.

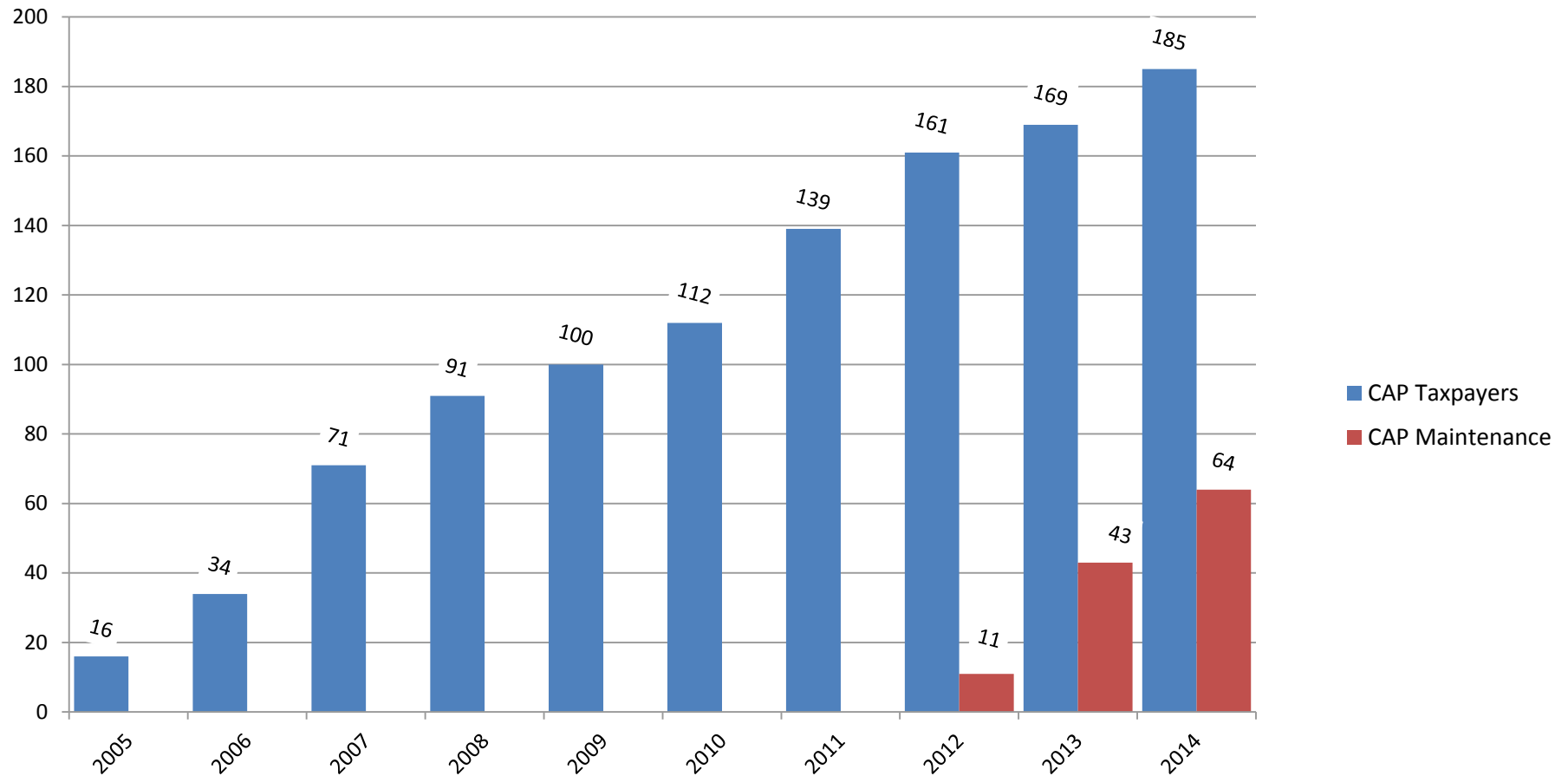
Claim for Refund Procedures (IRM 4.46.3)

- 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

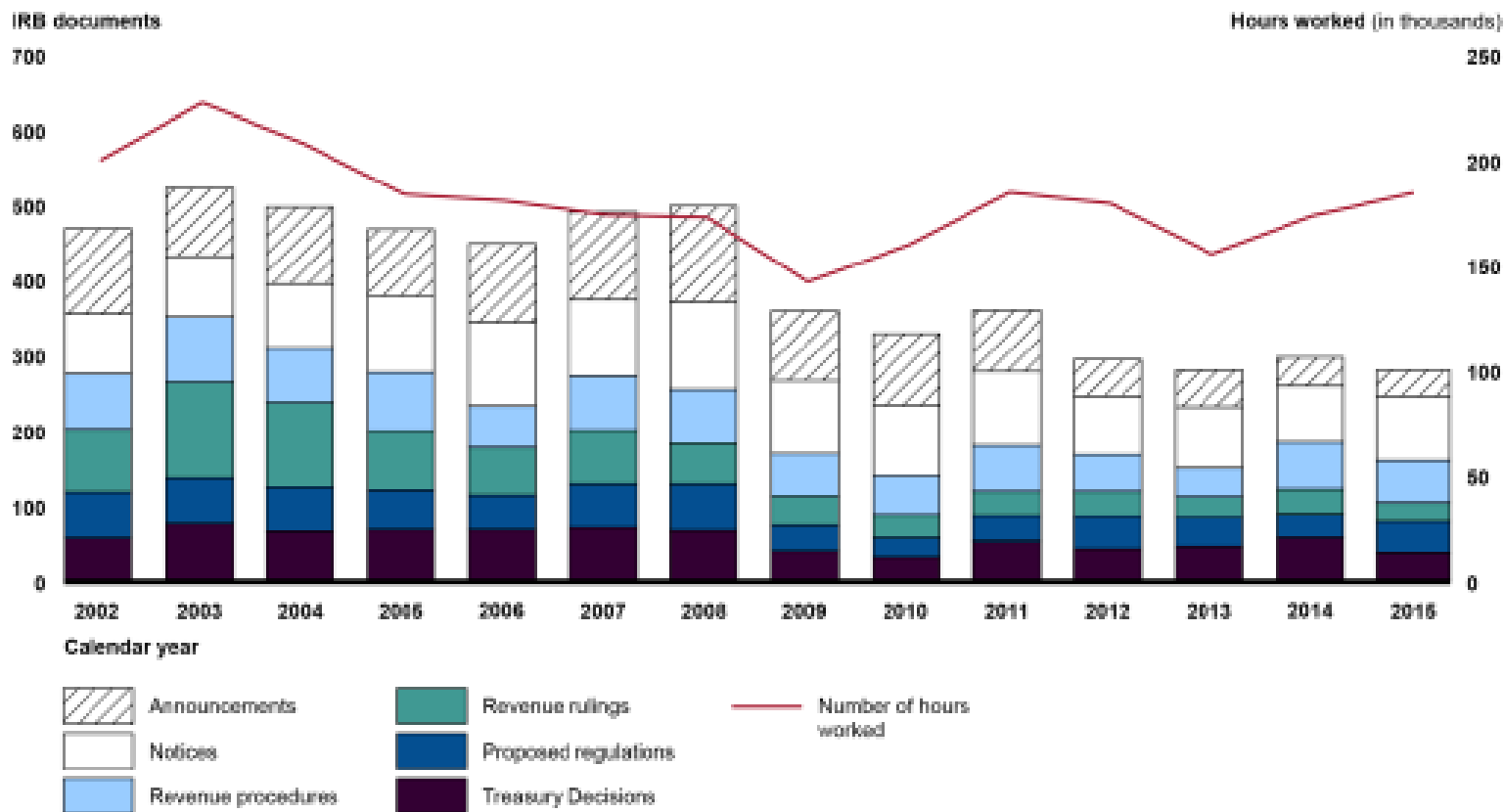
- Consequences if a tax ruling is state aid:
 - Member State must collect the back taxes
 - Look-back period is 10 years
 - If creditable in the United States, the real aggrieved party is the U.S. Treasury
 - Hence, Treasury's White Paper of Aug. 24, 2016

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

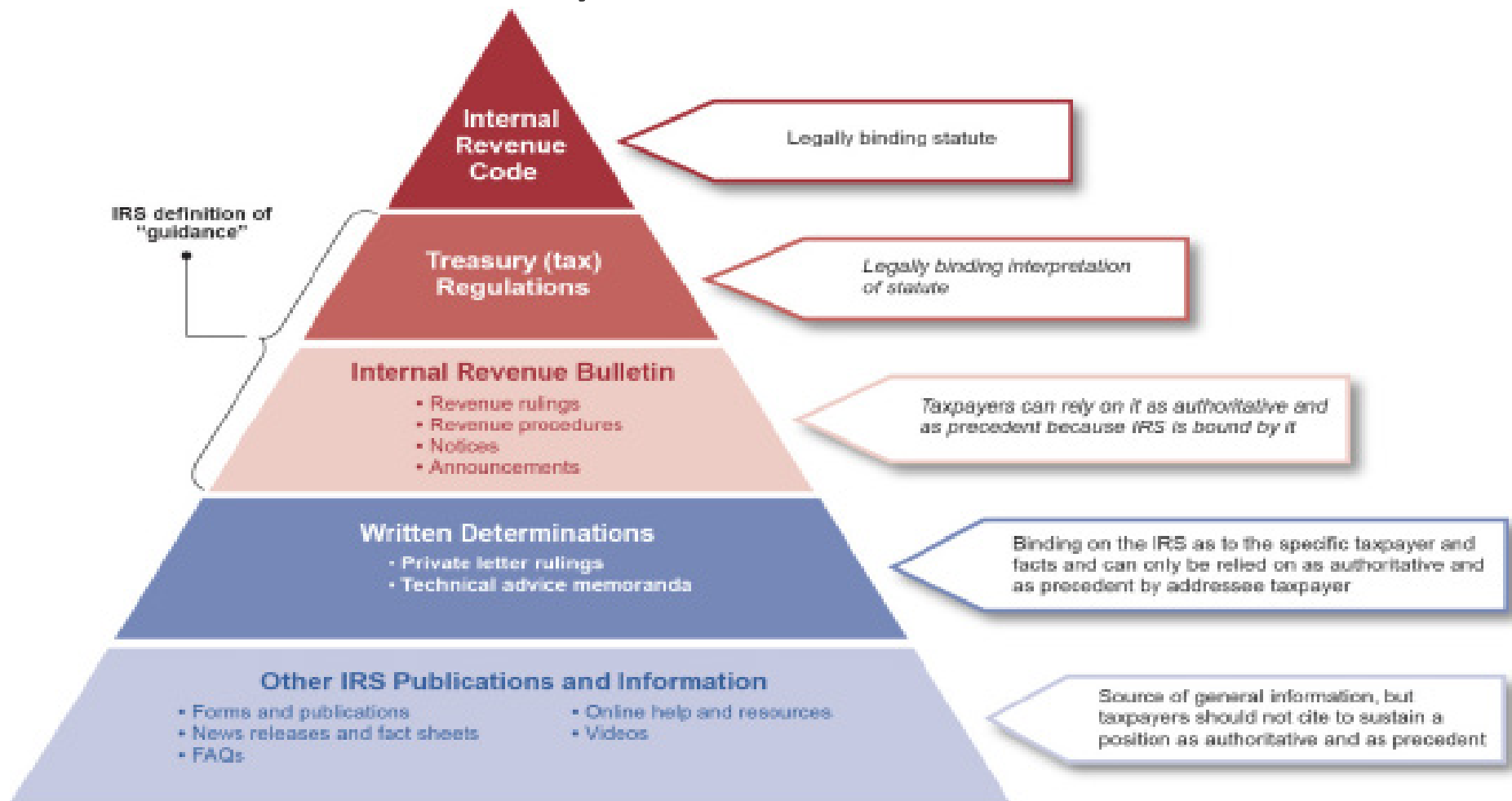
Guidance Documents in the Internal Revenue Bulletin and IRS Chief Counsel Hours Worked on Guidance



Source: GAO analysis of Internal Revenue Bulletin (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

Managing Tax Audits and Appeals – Transfer Pricing

Crowell & Moring LLP Tax Seminar
September 29, 2016
Washington, D.C.

John C. C. Hughes, Acting Director
APMA Program

John Wall, Acting Senior Manager
APMA Program



**Large Business
& International**

AGENDA

- ❖ LB&I Reorganization and Impact
- ❖ Campaign Process
- ❖ Virtual Library – Practice Units
- ❖ LB&I Examination Process
- ❖ Advance Pricing Agreement (APA) & Competent Authority (CA) Procedures
- ❖ APMA in Appeals and Other ADR Processes

LB&I Reorganization

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

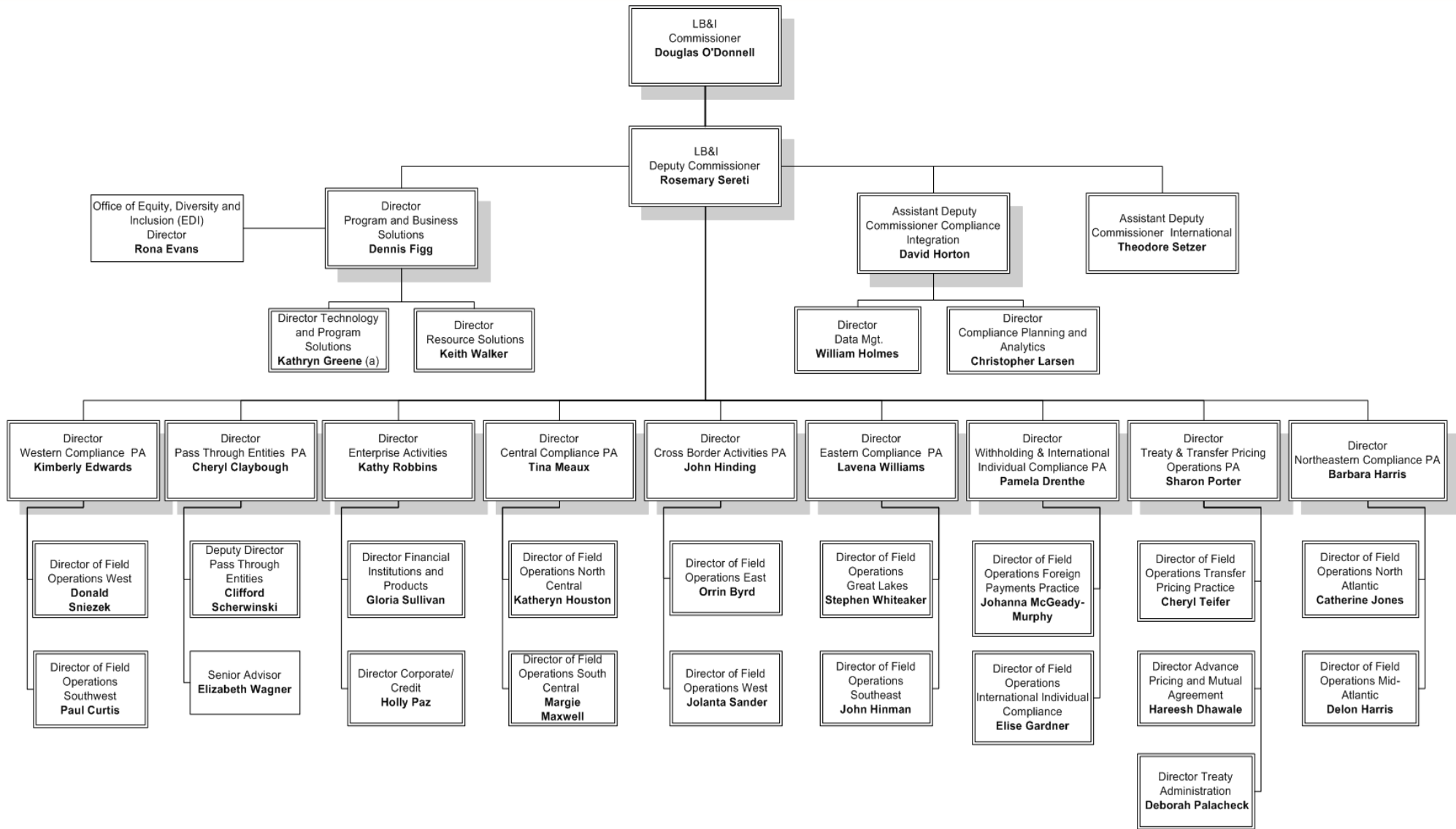
■ Headquarters and Support

- Assistant Deputy Commissioner, Compliance Integration
- Assistant Deputy Commissioner, International
- Program and Business Solutions

■ Practice Areas

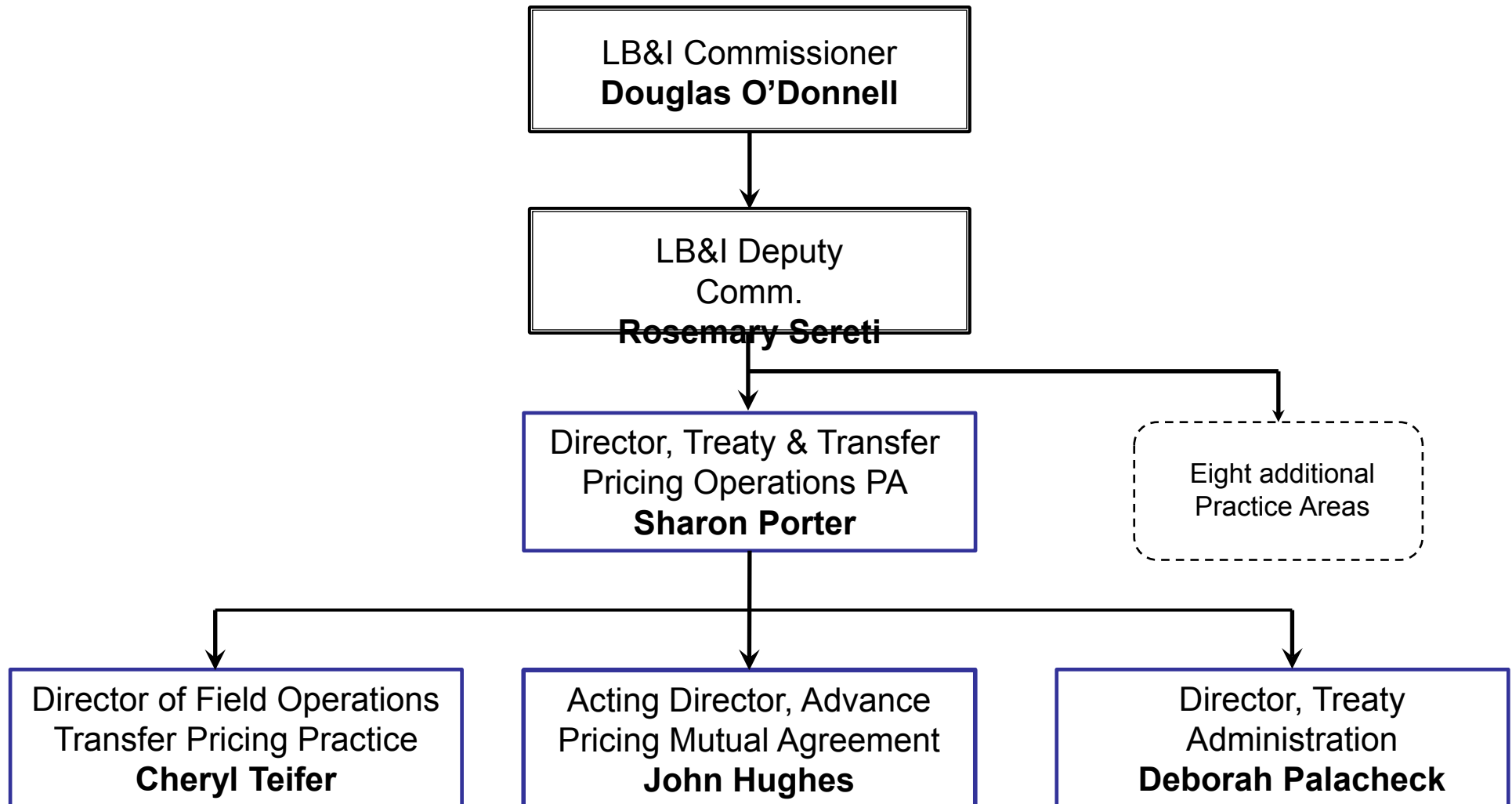
- 1) Cross Border Activities Practice Area
- 2) Enterprise Activity Practice Area
- 3) Pass Through Entities Practice Area
- 4) **Treaty and Transfer Pricing Operations Practice Area**
- 5) Withholding and International Individual Compliance Practice Area
- 6) Central Compliance Practice Area
- 7) Eastern 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

Advance Pricing Mutual Agreement

What is APMA?

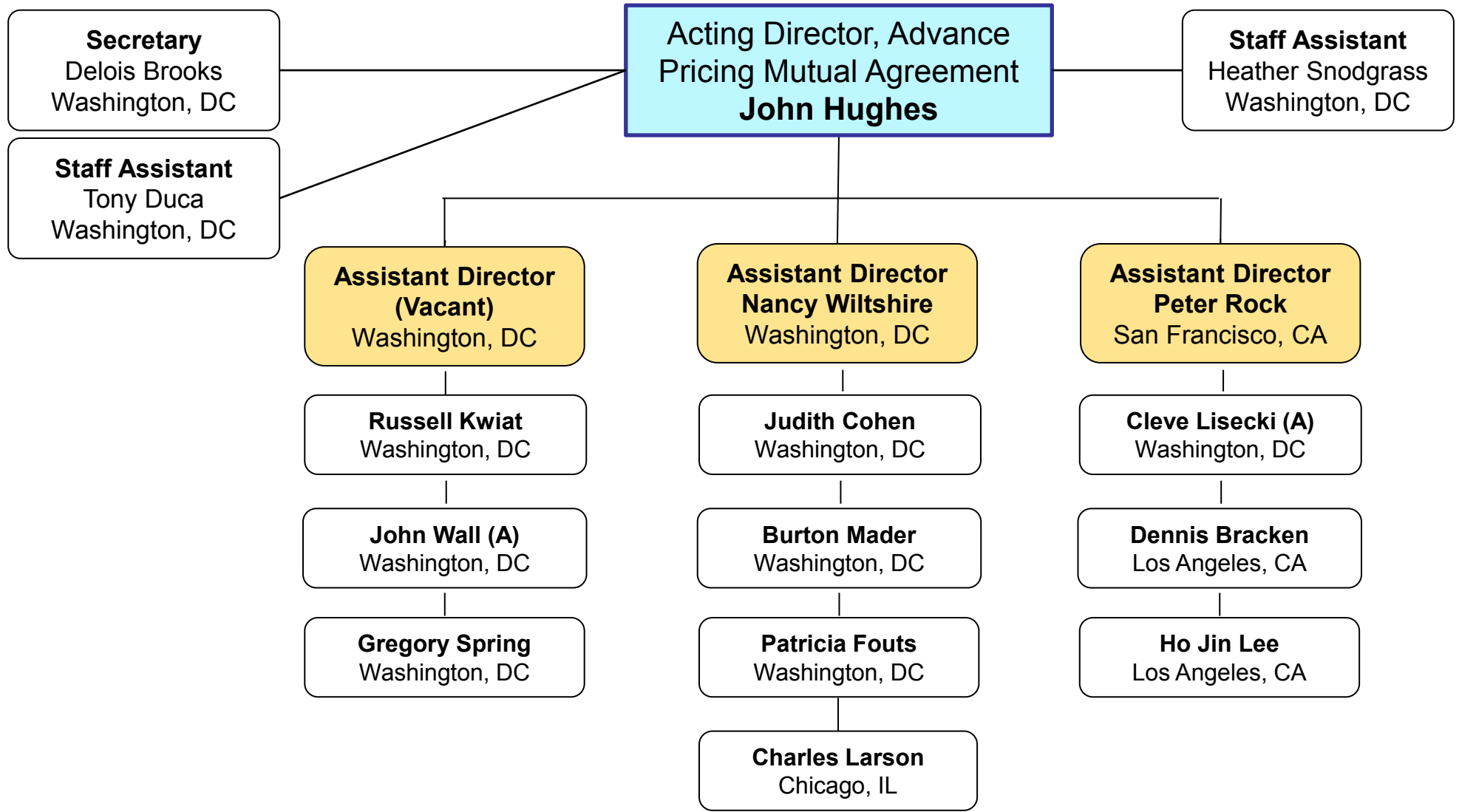
APMA and Future State

- ❖ 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 Procedure (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 transfer pricing method (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 the U.S. CA 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

General Interest

BEPS and the Future

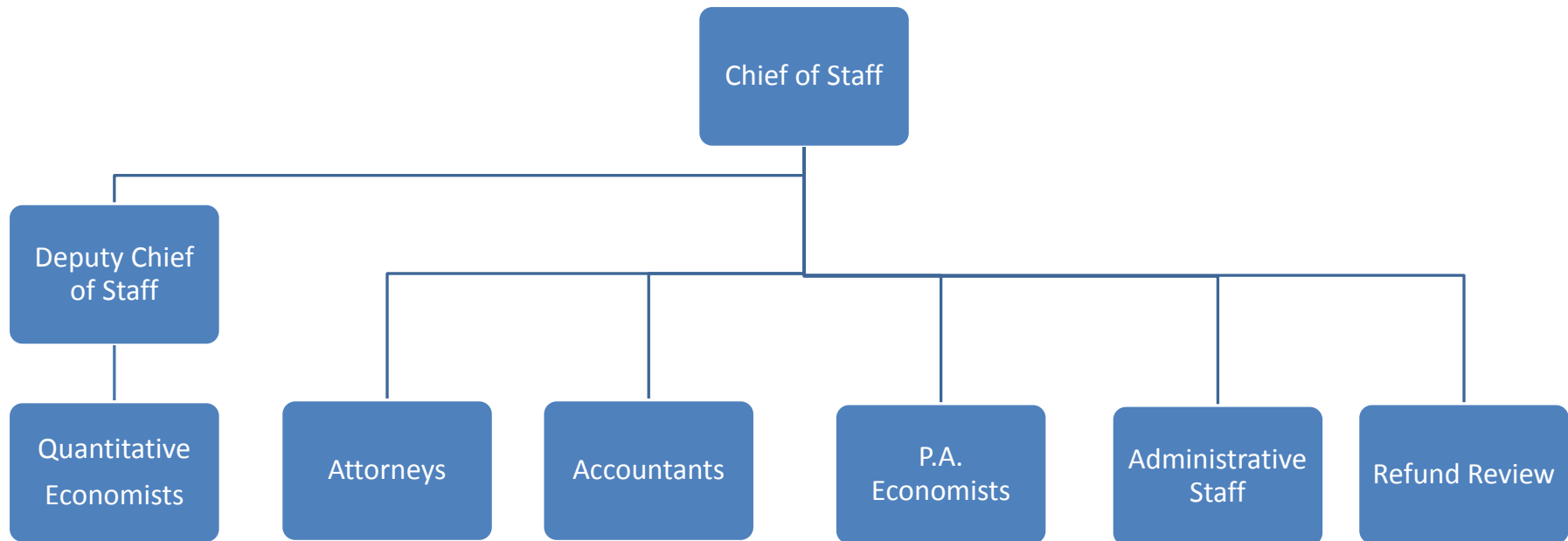
Questions?

OVERVIEW OF THE JOINT COMMITTEE STAFF IN THE TAX LEGISLATIVE PROCESS



September 29, 2016

Joint Committee Staff



Refund Review

- ❑ Review any refund of \$2 million or larger
 - \$5 million if t/p is a C corporation
- ❑ General Oversight
 - Consistency across taxpayers and time
 - Identify issues that may require legislative action
- ❑ Greater than 85 percent of cases closed within 45 days

Attorneys, Accountants, Policy-Analyst Economists

- ❑ All hired on a non-partisan basis
- ❑ Attorneys come with at least 5 years tax experience
 - Most from private sector
 - A few from IRS
- ❑ Accountants (CPAs)
 - 10+ years private sector experience
 - Large public accounting firms
- ❑ Median experience with Joint Committee, 11 years

Attorneys, Accountants, Policy-Analyst Economists

- Help Members and committee staff in developing proposals
 - Refine design
 - Offer alternatives
 - Issue spot
 - Assist in drafting legislative language
- Prepare background materials for committee hearings
- Prepare committee markup documents
- Draft committee reports

Quantitative Economists

- ❑ All hired on a non-partisan basis
- ❑ All, except one, have Ph.D.s
- ❑ Median experience with Joint Committee, 10 years

Quantitative Economists

- Gather data, construct economic models
 - Both conventional modeling and macroeconomic modeling
- Prepare revenue estimates
 - More than 1,000 requests received per Congress
- Prepare distributional analysis
- Prepare other quantitative economic analysis
 - Example: Report business income by entity type

What is a JCT Revenue Estimate?

- ❑ A JCT revenue estimate compares *predicted* Federal revenues under the proposal with predicted revenues under present law
 - Predicted future revenues under proposed new law (**proposal revenues**)
 - Less predicted future revenues under present law (**baseline revenues**)
 - Equals the revenue estimate
- ❑ A year by year comparison is provided over the 10-year “budget window”
- ❑ The distinction between current revenues and baseline revenues is important
 - JCT estimates are comparisons with predictions of future revenues under present law, **not** current revenue levels
- ❑ The receipts under a new proposal in a future year may be higher than at present, but *still lower than the forecasted present law receipts in that year*
 - JCT would estimate such a proposal as losing revenue (less revenue than the baseline)

JCT Tax Models

- ❑ JCT tax models simulate future taxpayer behavior under the baseline and under the proposal
- ❑ JCT uses many different models
 - An individual tax model to forecast revenues from the individual income tax and from employment taxes
 - A corporate model for the corporate income tax
 - An estate and gift model for changes to inheritance and gift taxes
 - Many different excise tax models
 - And many smaller tax, credit, or exclusion specific models
- ❑ Each model incorporates relevant taxpayer behavior, such as:
 - Changes in the timing of transactions and income recognition
 - Changes between business sectors and among legal entities
 - Changes in the types and timing of consumption and investment
 - Tax planning and tax avoidance (or evasion) strategies

JCT Tax Models

Individual Tax Model

- ❑ JCT's Individual Tax Model is a representation of all 168 million U.S. tax filing units (actual and potential)
 - All categories of taxpayers
 - For each of the 10 years in the budget window
 - Taking into account projected economic, demographic and social trends
- ❑ The Individual Tax Model uses a detailed representative sample of 332,000 actual 2013 income tax returns filed by U.S. taxpayers
 - Uses Current Population Survey and other data to impute information not reported on tax returns
 - Uses information returns (W2's, 1099-INTS, etc.) to impute information about tax filing units that did not file tax returns in 2013
 - JCT staff extrapolate the data by adjusting the weights and income items to match CBO's 10-year economic forecast

JCT Tax Models

Corporate Income Tax Model

- JCT's Corporate Income Tax Model is based on 10 consecutive years of tax returns filed by U.S. corporations
- Approximately 100,000 observations per year
 - Both C and S corporations
 - All large corporations
 - Sample of smaller corporations (<\$50 million in assets)

Taxpayer Behavior in JCT Tax Models

- ❑ Every JCT revenue estimate is a “dynamic” estimate, estimates reflect taxpayers’ predicted reactions to a new law
- ❑ JCT economists adjust each model to reflect the anticipated changes in supply or demand in response to proposed new tax rules
- ❑ Predicting behavioral responses requires original research as well as JCT economists’ knowledge of the relevant economics literature
- ❑ Consistent with economic theory, JCT tax models assume that taxpayers will largely behave rationally, while taking into account other behaviors as implicated by data and recent research
- ❑ JCT lawyers help the economists to better understand the law and taxpayer planning or avoidance strategies

Behavior in Conventional Revenue Estimates

- Based on information from economics and legal literature and from original research, a revenue estimate reflects a range of behavioral responses, such as:
 - Changes in the time of transactions and income recognition
 - Realization of capital gains in response to changes in gains tax rates
 - Issuance of corporate dividends in response to changes in dividend tax rates
 - Acceleration of bonuses in anticipation of an individual income tax increase
 - Changes between business sectors or the legal form of doing business
 - Organizing as a partnership in response to rising corporate rates or falling individual rates
 - Shifts in investment from more heavily taxed sectors to more lightly taxed sectors

Behavior in Conventional Revenue Estimates (cont'd)

- Changes in types of portfolio investments
 - Shifts from bonds to stocks in response to dividend or capital gains changes
 - Shifts from taxable to tax-favored savings vehicles
- Changes in the amount, types, and timing of consumption
 - Reduced consumption of items that experience an excise tax increase
 - Increased consumption of goods that are tax-favored, such as employer-sponsored health insurance and mortgage interest
- Tax planning and tax avoidance strategies
 - Use of foreign tax credits and income allocation rules
 - Reliance on performance-based compensation in response to 162(m) corporate deduction limitation
 - Structuring of compensation to obtain capital gains rather than ordinary income tax rates

Example: Cost Recovery

- ❑ A machine cost \$100
- ❑ The machine helps t/p generate \$100 of revenue per year for 5 years
- ❑ Straight line cost recovery of machine over 5 years

Example: Cost Recovery Baseline Receipts

Baseline Receipts

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	100	100	100	100	100
Depreciation	20	20	20	20	20
Taxable Income	80	80	80	80	80
Tax Liability (@35%)	28	28	28	28	28

Example: Cost Recovery

Policy Change: Expensing

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	100	100	100	100	100
Expensing	100	0	0	0	0
Taxable Income	0	100	100	100	100
Tax Liability (@35%)	0	35	35	35	35

Example: Cost Recovery

Estimate If Expensing for Only One Year

- ❑ Ignoring many microeconomic behaviors
- ❑ This is one step of the process

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Baseline revenues	28	28	28	28	28	
Revenues Policy Change	0	35	35	35	35	
Reported Estimate	-28	+7	+7	+7	+7	0

Example: Cost Recovery

Estimate: Permanent Expensing

- An identical machine is placed in service each year as part of baseline investment
- Ignoring many microeconomic behaviors
- This is one step of the process

Example: Cost Recovery

Estimate: Permanent Expensing

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Year 1 machine	-28	+7	+7	+7	+7	0
Year 2 machine	–	-28	+7	+7	+7	-7
Year 3 machine	–	–	-28	+7	+7	-14
Year 4 machine	–	–	–	-28	+7	-21
Year 5 machine	–	–	–		-28	-28
Total	-28	-21	-14	-7	0	-70

Limits of the Conventional Estimate

- ❑ A conventional JCT estimate incorporates behavioral responses in projecting tax revenues, but assumes that these tax and behavioral changes do not change the size of the US economy, as measured by the Gross National Product (“GNP”)
- ❑ The fixed GNP Constraint results in the following types of assumptions
 - Total labor supply, employment and investment do not change, so that
 - A surtax on labor income will not cause taxpayers to retire early or work less, but a wage credit in certain industries will result in a shift of employment into the favored industry;
 - A tax credit for certain types or investment of production will result in shifts in investment to the tax favored activity, but the overall level off investment stays the same

JCT MACROECONOMIC MODELS

MACROECONOMIC EQUILIBRIUM GROWTH MODEL (MEG)

OVERLAPPING GENERATIONS MODEL (OLG)

DYNAMIC STOCHASTIC GENERAL EQUILIBRIUM MODEL (DSGE)

Macroeconomic Equilibrium Growth Model (MEG)

- ❑ In the MEG model, prices adjust so that demand equals supply in the long run, but not necessarily in the short run
- ❑ MEG models household consumption according to the life-cycle consumption patterns
- ❑ Labor supply responses to changes in after-tax wages (elasticities) are separately modeled for four different groups
 - High-income primary earners
 - High-income secondary earners
 - Low-income primary earners; and
 - Low-income secondary earners
- ❑ Household saving and consumption respond to the after-tax return to saving and after-tax income. We refer to this response as the marginal propensity to consume (“MPC”)
- ❑ Business production and housing production are modeled separately. Business investment responds to changes in the user cost of capital (the after-tax return on investment in the tax sectors)
- ❑ MEG is an open economy model; cross border capital flows and changes in net exports affect domestic economy outcomes
- ❑ Individuals are myopic. They do not anticipate changes in the economy or government policy

Overlapping Generations Model (OLG)

- ❑ Unlike the MEG model, the OLG model assumes that prices adjust to any changes in economic conditions (such as a change in fiscal policy) so that supply equals demand in both the short and long run
- ❑ Economic decisions are modeled separately for each of 55 adult-age cohorts
- ❑ OLG model has separate production sectors for business and housing
- ❑ Key parameters (as in MEG) include
 - ❑ Responsiveness of labor supply to changes in the after-tax wage rate
 - ❑ Responsiveness of saving and consumption to the after-tax return to saving and after-tax income
 - ❑ Responsiveness of investment to the user cost of capital
- ❑ OLG is a perfect foresight model
 - ❑ Responsiveness of individuals to expected future changes in after-tax rates of return are important
 - ❑ The model cannot allow the Federal government debt to grow faster than GDP for an indeterminate period

Dynamic Stochastic General Equilibrium (DSGE)

- ❑ In the DSGE model, as in the OLG model, supply equals demand in the short and long run, so there is always full employment
 - But the model includes sticky prices and adjustment costs, which causes output to be more sensitive to demand
- ❑ Unlike the MEG and OLG models, the DSGE model accounts for uncertainty - agents look at all possible states of the future economy
 - For example, an increase in volatility of future asset returns will change the investment decisions of agents in a typical DSGE model
 - When policy variables are given stochastic or random components the DSGE model will give us implications that OLG and MEG will not
- ❑ Economic decisions are modeled separately for savers and non-savers;
 - Non-savers do not own capital, have no access to credit markets, and have lower incomes
- ❑ Key behavioral parameters similar to those in the MEG and OLG models
- ❑ As in the OLG model, the DSGE model cannot allow the Federal government debt to grow faster than GDP for an indeterminate period
- ❑ The DSGE model is currently a closed economy that does not model international capital flows

Unclaimed Property: Delaware Department of State VDA Program

Presented by:

Alison J. Iavarone

Unclaimed Property VDA Administrator
Delaware Department of State

Wednesday, September 29, 2016



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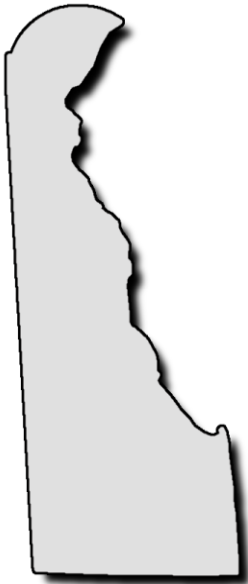
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Agenda

- Relevant DOS VDA Legislation
- Logistics of DOS VDA Program
- DOS VDA Resources
- Benefits of DOS VDA Program
- Who in your organization may address Unclaimed Property?
- Could your organization have a problem?
- Financial Statements and Unclaimed Property
- Why Delaware?
- UP Updates
- Is Unclaimed Property Owed to Me?

Relevant DOS VDA Legislation



Legislation

146th General Assembly (2012)



Senate Bill 258

- Authorizes Secretary of State to resolve claims via a voluntary disclosure agreement (VDA).
- Holders not currently reporting or under reporting and not currently excluded from participation (e.g., currently under audit or VDA with DOF) are eligible to enroll in the DOS UP VDA.
- The “look-back” period covered by such VDAs is reduced.

Legislation

146th General Assembly (2012)



Senate Bill 258 (cont'd)

- 1996 if enrolled by June 30, 2013 and complete or enter payment plan by June 30, 2014.
- 1993 if enrolled after June 30, 2013 and complete or enter payment plan by June 30, 2015.
- SOS no authority to accept holders into VDA after June 30, 2014.
- The Act sunsets on July 1, 2015.
- Codified 12 Del. C. § 1177.

Legislation

147th General Assembly (2013)



House Bill 2

- Holders that elected into a DOS VDA prior to June 30, 2013 now have until June 30, 2015 to finalize VDA or enter into a payment plan with the State.
- Clarified that a holder may enter into the new voluntary disclosure program with respect to any related property that was not included in an earlier voluntary self-disclosure.
- Clarified State Escheator's duties with respect to protecting confidential information.

Legislation

147th General Assembly (2014)



Senate Bill 215

- Prohibits use of “commissions” to pay outside auditors.
- Requires rebidding of audit contracts every 3 years.

Senate Bill 228

- Protects confidentiality of financial information obtained during examination, settlements and voluntary self-disclosure agreements.
- Reduces failure to file penalty from 5% per month to the lesser of 5% per month or \$100 per day (max penalty reduced from 50% of amounts required to \$5,000.)
- Eliminates assessment of interest on outstanding unpaid amounts.
- Extended the period that holder may submit letter of intent to participate in unclaimed property voluntary self-disclosure agreement from June 30, 2014 to September 30, 2014.
- Extends the sunset of the DOS VDA by one year to July 1, 2015 to July 1, 2016.

Legislation

148th General Assembly (2015)



Senate Bill 11

- Limits total audits assigned to outside firms to 50%.
- Limits employment by Department of Finance employees.
- Revises administrative and procedural guidelines.



Legislation

148th General Assembly (2015)



Senate Bill 141

Extension of SOS VDA program

- Removes expiration of VDA program administered by Secretary of State which was set to expire on June 20, 2016.



Legislation

148th General Assembly (2015)



Senate Bill 141 (Cont'd)

Limitation for new audit examinations:

- Holder has been notified in writing by the Secretary of State, expressing that an holder may enter unclaimed property voluntary disclosure agreements.
- If a holder does not join VDA program within 60 days of invite, holder will be referred to State Escheator for audit examination.
- Note, it will be the decision of the State Escheator as to who will eventually be audited.

Limitation of look-back period

- Audits initiated between July 1, 2015 and December 31, 2016 have a look back period to January 1, 1991.
- After January 2017, any audits initiated will have a look back period of 22 years.

Reinstatement of interest assessment

- On March 1, 2016 and after, interest would be levied at 5% per month on outstanding unpaid amounts/late-filled unclaimed property reported or remitted.

Thank you for your participation in the Delaware Secretary of State's Voluntary Disclosure Agreement (VDA) program. As you know, our VDA program was put in place to respond to concerns about Delaware's ongoing audit program, and to encourage more companies to come into compliance with their legal responsibilities as they relate to abandoned property. Companies that have completed the VDA program have told me the process is rigorous but fair. This is evidenced by the more than 800 companies that have enrolled in the VDA program, and the more than 400 VDAs settled to date.

In light of the memorandum opinion issued on June 28, 2016 in the case of *Temple-Inland, Inc. v. Cook*, and the subsequent settlement and voluntary dismissal of the case, I thought it was important to address some of the questions current VDA enrollees have asked regarding the impact of the Court's opinion on the VDA program.

The Court's ruling in *Temple-Inland* is limited to the specific facts and circumstances of the unclaimed property audit at issue in the case. The decision was critical of several specific executive actions taken by the State Escheator during the course of that audit that, in combination, the Court deemed to be procedurally unfair. The actions taken by the State Escheator in the *Temple-Inland* audit bear little, if any, resemblance to the administration of the VDA program. We designed the VDA program with procedural safeguards in place to ensure that companies that voluntarily step forward and enroll will be treated fairly.

Still, while the Court's decision does not have any direct impact on how we administer the VDA program, I do not want to ignore the seriousness of some of the issues raised by the Court. The VDA program is, after all, a voluntary compliance program, and we want to continue to encourage companies to comply.

The key question my team has encountered since the opinion was issued is whether the Court's decision will change how Delaware estimates unclaimed property in the VDA.

As outlined in our Implementing Guidelines, we expect holders to "reasonably estimate" liabilities for periods in which the holder's records are unavailable or insufficient to prepare a report of presumed past due unclaimed property liability. There is no estimation involved for non-Delaware domiciled entities, and all estimated unclaimed property for the period for which a holder determines it does not have available records would be reportable to the holder's state of incorporation or formation.

This rule is a bright line between what is owed to Delaware and what is owed to any other state to ensure that a holder does not pay twice for the same unclaimed property. Most if not all states estimate past due unclaimed property liability for holders domiciled in their state the same way as Delaware. Unclaimed property paid to another state during the estimated period will not be assessed twice. When entering into a VDA settlement agreement, a holder is provided a release and the state agrees to indemnify the holder for all future claims by another state on the estimated unclaimed property that was reported. As a result, there is no risk of paying twice based on how the VDA analysis is conducted in combination with the settlement and release agreement entered into by the holder.

We continue to believe that our VDA program's approach to estimation is the best business practice for all involved. In our discussions with holders, this bright line rule benefits holders as compared to the alternative of performing potentially 50 separate estimations based off of 50 different state standards and then entering into 50 different VDAs or audits to come into legal compliance.

Other parts of the opinion raise concerns that I know have been voiced previously by holders and holder advocates. Over the past several years, the State has adopted several amendments to its unclaimed property statute in order to address these concerns. Besides creating the Secretary of State VDA program in 2012, Delaware shortened the look-back period for audits, and issued draft regulations regarding how unclaimed property audits would be conducted. Last year, Delaware amended the law so that no new unclaimed property audits would be conducted without a company first being offered the opportunity to enter into a VDA.

When the Delaware General Assembly returns in January, my office and the Department of Finance will propose additional common sense changes to Delaware's unclaimed property law. This would include a further reduction in the VDA look-back period that is in accord with most states' look-back periods, as well as addressing some of the issues specifically raised by the Court in the *Temple-Inland* opinion, namely a record retention provision for unclaimed property reports tied to the current statute of limitations, and possibly a negative reporting requirement.

While some of these changes cannot be made until our legislature reconvenes in January 2017, the look-back period can be addressed now, meaning that VDAs from this point forward will be settled based on a look-back period of 10 years plus dormancy from the date a holder enrolled.

In conclusion, I believe the VDA program continues to be the same procedurally fair and business-friendly program that we set out to create together in 2012 – offering enrollees the opportunity to voluntarily "catch-up" on past due unclaimed property obligations, get into a regular cycle of compliance, and significantly reduce their liability, all at the same time. I hope you agree and urge you to contact me or my team if you have any questions or concerns.

Sincerely,

Jeffrey W. Bullock
Secretary of State



Message from Secretary Bullock

- VDA program is designed to treat companies fairly.
- The State has adopted amendments over the years to address concerns raised by holders and will continue to propose changes when legislature reconvenes in January 2017.
- VDAs from this point forward will be settled based on a look-back period of 10 years plus dormancy from the date a holder enrolled.
- VDA program will continue to be the same procedurally fair and business-friendly program as it was set out in 2012.

Logistics of DOS VDA Program

- Holder invited into VDA Program or alternatively any organization can voluntarily enroll.
- Holder signs Form VDA-1 Notice and Intent.
- DOS Vendor reaches out to Holder with introductory email and provides forms to be completed by the Holder.
- Holder reviews its records to determine what is to be included in the scope of the VDA and completes forms addressed above.
- Holder will perform a detailed review of the available records for each in-scope property type and prepare a written narrative of the analysis performed.
- Holder will provide a final report, along with source documentation, to the Vendor for review.
- Management Representation letter – availability of records.
- Follow up between DOS Vendor and Holder.
- The State and Holder will execute Form VDA-2 regarding the agreed-upon amount and the State will generate a “demand letter” to the Holder for payment.
- Post VDA Compliance.

DOS VDA Resources

- www.delawareVDA.com
- Implementing Guidelines
- Questionnaire
- Sample Workplan
- Holder Advocate List



Benefits of DOS VDA Program

- Audit Protection
- Avoid interest and penalties
- Reduced lookback period
- Holder managing process



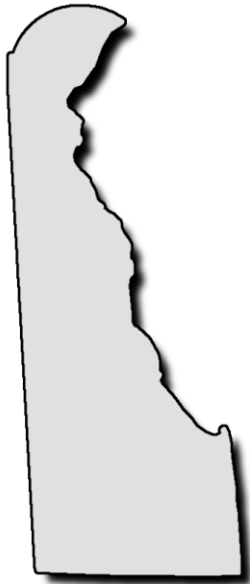
Who in your organization may address Unclaimed Property?

- CEO
- CFO / Controller
- Legal Counsel
- Chief Compliance Officer
- Treasurer
- Tax
- Internal audit
- Audit Committees

Could your organization have a problem?

- Inconsistent UP filings
- Not filing all property types - mainly just some uncashed payroll checks and lots of negative reports
- No UP policies and procedures/no centralized process
- No subject matter expert
- Dispute between ownership of the UP function (Tax vs. Accounting)
- AR group doesn't know what to do with aged credits- they were never "looped" into the process
- Misinformation about reporting requirements

Financial Statements and Unclaimed Property



Financial Statements and Unclaimed Property

Undisclosed Unclaimed Property Liabilities

- Impact Balance Sheet and Income Statement
- Could cause a restatement



Financial Statements and Unclaimed Property

ASC 450-20 (f/k/a FAS 5) – Accounting for Loss Contingencies

An estimated loss (once it's met the definition of a contingent loss) is required to be "**accrued**" only if available information indicates that:

- (1) it is probable a liability has been incurred at the reporting date, and
- (2) the amount of the loss can be reasonably estimated.

May be required to "**disclose**" in the financial statements the nature and estimate, range, or reason it cannot be estimated to make financials not misleading.

May be required to disclose in unrecognized loss contingencies as referenced in ASC 450-20-50-2A

Financial Statements and Unclaimed Property

Accounting Restatements

- ASC 250 - requires a company to account for ***correction*** of a material error in previous periods as a prior period restatement.

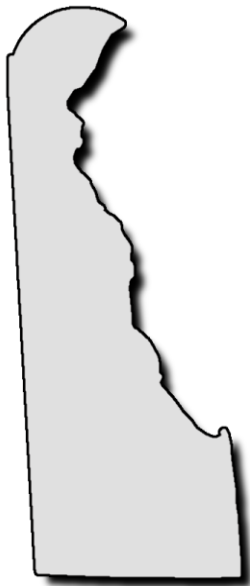


Financial Statements and Unclaimed Property

- Sarbanes Oxley
 - Section 302 - CFO/CEO - Corporate Responsibility for Financial Reports
 - Section 404 - CFO/CEO - Management Assessment of Internal Controls



Why Delaware?



Why Delaware?

- The State's aim is to provide both managers and investors with laws optimal for engaging in ethical and profitable business. A number of factors have led to Delaware's dominance in business formation:
 1. **Statute**: stable, annually reviewed to include mandatory requirements to protect investors but otherwise provides flexibility to conduct business.
 2. **Courts**: corporate law cases are tried exclusively by professional, nonpartisan judges, not juries.
 3. **Case Law**: history of issuing well reasoned written opinions - provides detailed, substantive guidance to corporations and its advisors.
 4. **Legal Tradition**: in addition to judiciary, Delaware has many lawyers who specialize in the State's business matters and continually review its statutes and advise to stay relevant.
 5. **Delaware Secretary of State**: the Division of Corporations offers efficient, quality service to its registered agents and can handle nearly any situation to meet their needs.

Why Delaware: Statistics

- More than 1,181,000 legal entities are incorporated in Delaware.
- 66% of all Fortune 500 companies are incorporated in Delaware.
- 86% of U.S. based IPOs in 2015 chose Delaware as its corporate home.



Why Delaware: Statistics

- IT systems house 116 years of corporate records data, processing over \$16 billion in revenue.
- In September 2015, the Division upgraded its system:
 - Expanded flexibility and functionality for staff and customers;
 - Made data more searchable.
- Revenue collections grew by 11% in 2015, topping \$1 billion for the first time.
- In 2014, Delaware became the first State to provide corporations with clear statutory mechanisms to rectify defective corporate acts.

UP Updates

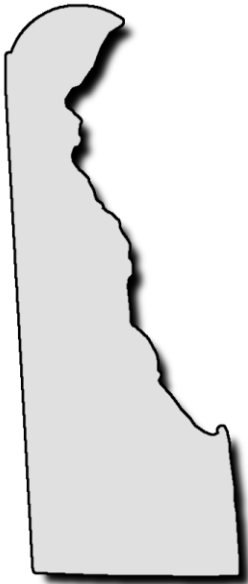
- Escheat Handbook
 - Online Naupa Submission
 - Check frequently for updates
- New claims administrator



Is Unclaimed Property Owed to Me?

<https://www.missingmoney.com/>

<https://delaware.findyourunclaimedproperty.com/>



Questions



Presenter's Contact Information

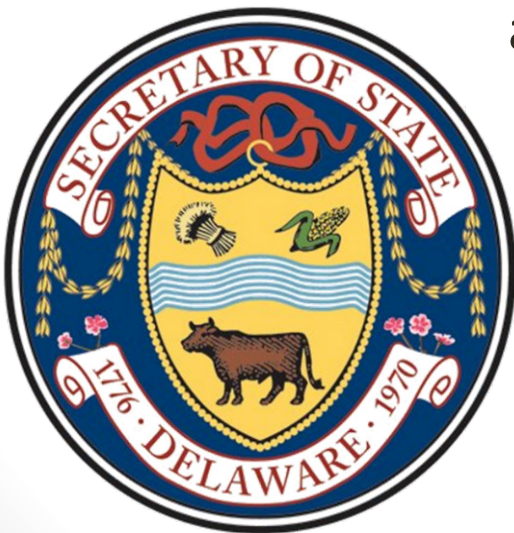
Alison J. Iavarone

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Multistate Tax Commission's Transfer Pricing Initiative

Marshall Stranburg
Deputy Executive Director
Multistate Tax Commission

MTC SITAS PROJECT

Issue

- Pricing of transactions between related entities
- Whatever called
 - Transfer pricing
 - Related party transactions
 - Intercompany transactions

MTC SITAS PROJECT

Why do taxing authorities care?

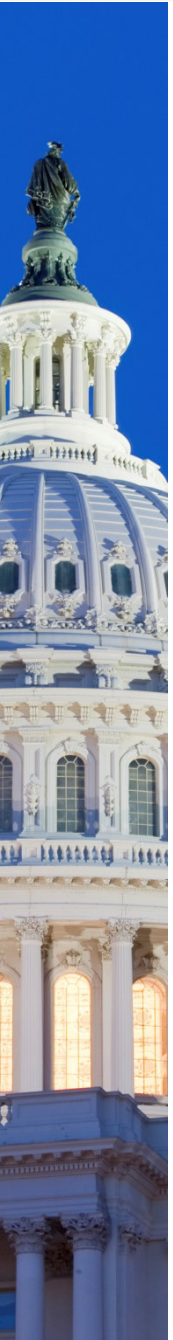
- Clearly and accurately reflect income
- Prevent evasion of taxes



MTC SITAS PROJECT

Transactions

- Loans/Financing
- Tangible Property (sales, leases/rentals)
- Intangible property (sales, leases/licenses)
- Services
- Cost sharing arrangements
- Factoring of accounts receivables/Cash pooling





MTC SITAS PROJECT

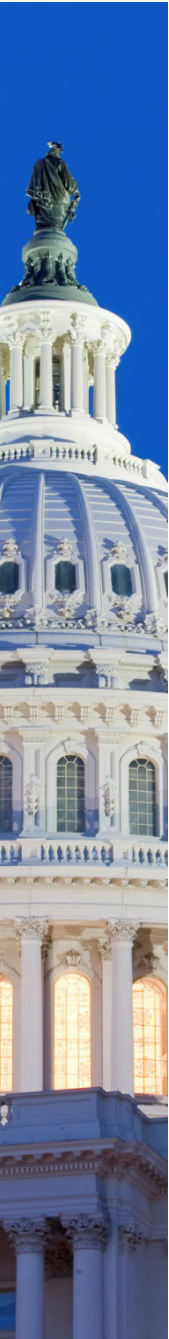
How states have responded

- Nexus
- Add back provisions
- Combination
- Consolidation
- Apportionment factor adjustment
- Tax Haven legislation
- Reverse transaction
- Adjust transaction

MTC SITAS PROJECT

Arm's Length Standard

- Results of transaction are consistent with results reached if transaction was between unrelated parties
- Use comparables as not usually find identical transactions



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Method to Determine Arm's Length Price

- Find best method, under facts and circumstances, that produces the most reliable measure of an arm's length result
- No method favored over another
- May vary depending upon type of transaction



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Methods: Transactions and Profits

☐ Transactions (CUT)

- Uncontrolled price: price paid/charged in a comparable uncontrolled transaction
- Resale price; gross profit margin realized in a comparable uncontrolled transaction
- Cost plus: gross profit markup



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Methods: Transactions and Profits

Profits (CPM)

- Comparable profits: profits made by other uncontrolled taxpayer engaged in similar business activities
- Profit split: compare relative economic contributions that parties make to success of a venture and divide return on basis of relative value of contributions

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Practical Considerations

Evaluation

– Technical

- Written agreement/study/report
- Timely
- Match facts of transaction
- Performance (payments, accounting entries)
- Obvious errors or omissions
- Other concerns



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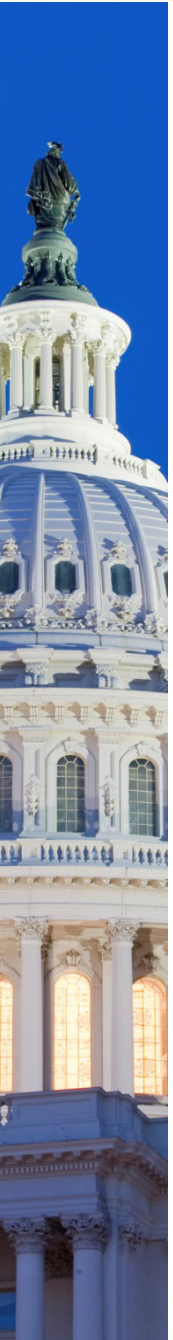
Practical Considerations

Evaluation

– Economic

- Methodology
- Comparables
- Pricing point selected
- Other factors

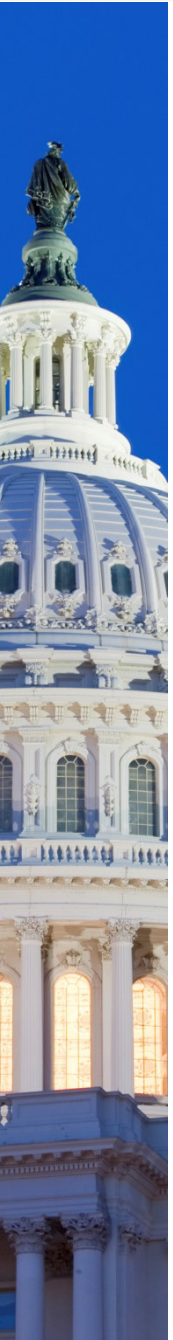
Business Purpose



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Advisory Group

- Nine states (Alabama, District of Columbia, Florida, Georgia, Hawaii, Iowa, Kentucky, New Jersey, North Carolina)
- Meetings held throughout 2014 into early 2015
- Developed Project Design





MTC SITAS PROJECT

Project Design

- Set forth proposed plan for the development and initial operation of service
- Proposed project design sought to:
 - Provide technical and economic expertise to states
 - Enhance the ability to utilize this expertise
 - Facilitate consistency of treatment and results
- Suggested a proposed budget and funding proposal
- Approved by MTC Executive Committee May 2015

MTC SITAS PROJECT

ALAS Committee Formed

- Five member states
 - Alabama
 - Iowa
 - New Jersey
 - North Carolina
 - Pennsylvania
- Initial meeting held April 16, 2016
- Joe Garrett (Alabama) elected Committee Chair
- Subsequent meetings held in May, June, and August

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Initial Committee Focus

- Training, information sharing, case discussion
- Set aside Project Design, for now



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Name Change

- Approved at August meeting
- State Intercompany Transactions Advisory Service (SITAS) Committee



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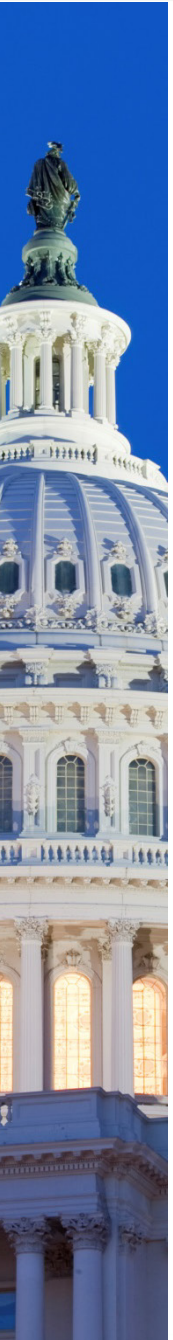
Agreement

- Participation Commitment and Exchange of Information
- Required before attending October meeting
- Reflects importance, care, and concern when dealing with taxpayer information

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October Meeting

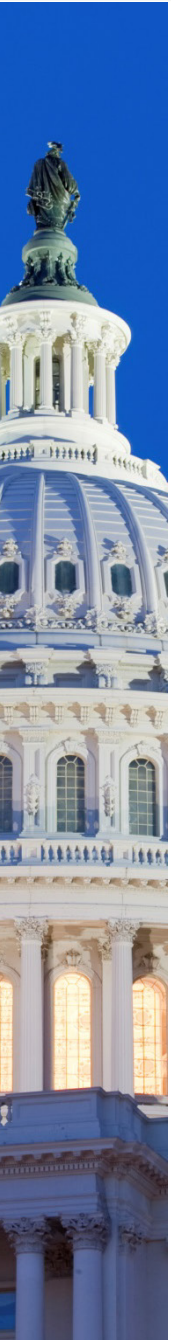
- Informational and training session
- Case discussion



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To Be Determined

- Future training
- Use of experts
- State participation – more states needed to fully launch?
- Funding



MTC SITAS PROJECT

What's Next?

- Continued state interest in area?
- Varied approaches among separate entity, consolidation, or combination?
- Information sharing with IRS? Other jurisdictions?
- Development of advance pricing agreements?

FEDERAL TAX POLICY 2016

Rick Grafmeyer
Capitol Tax Partners©
September 29, 2016

2015/16 -- Year in Review

- PATH Act (\$622 billion)
 - Permanent extenders (R&D, AFE, 15-year depreciation, etc.)
 - 5-year extenders (CFC look-thru; NMTC, bonus depreciation (phased down), etc.)
 - 2-year extenders (30 left to expire at end of 2016)
 - Four alt. energy extenders left off final bill
 - ACA delays (Cadillac tax, medical device tax, HI excise tax)
 - Improved baseline for tax reform?
- Highway bill (\$305 billion)
- 2016 tax reform developments
 - Obama budget proposals
 - EU efforts
 - Members' attention on international tax
 - Admin. Efforts on Sec. 385
 - Corporate integration – Hatch
 - Prior proposals remain relevant? (Camp (2014), Baucus (2013), Obama framework (2012))

Remaining key dates for 2016

- September 30 – End of Fiscal Year and House and Senate adjourn for election
- November 8 – Election Day
- November 14-18 -- New leadership elections; Lame duck discussions
- November 28 - December 9 – Lame duck session, but could be extended until December 16, which is likely adjournment *sine die*
- December 31– Thirty extenders expire.
- Chairman Hatch intends to release corporate integration proposal after election

House Tax Reform Blueprint

- Speaker Ryan set up six task forces with a mission “to be bold, to do what is necessary to get America back on track.”
- Five policy goals: Lower tax rates for families, small businesses, and corporations; eliminate special-interest carve-outs; reduce complexity in the tax code; reduce the double taxation of savings and investment; reduce the tax bias against headquartering businesses and locating jobs in America.
- Big issue - - border adjustments (no deduction for imports). How to allocate expenses to imports? Impact on certain industries.
 - Two sentences in over 100 page Blueprint, but impact of over \$1 trillion over ten years.
- Staff working on drafting statutory lang.
- **“How we run in 2016, how we lay this foundation is critical to how we finish this effort [in 2017].”**



Senate Finance Committee



- Hatch: corporate integration – dividends paid deduction
 - “Best solution to inversions”
 - Companies are mobile; shareholders aren’t
 - Viewed (by Hatch staff) as addressing flaws in corporate tax system
 - Effective rate cut for dividend paying companies
 - Effective exemption for foreign earnings paid out as dividends
 - Tax business income once; align treatment of debt and equity
 - Nonrefundable withholding tax on both interest and dividends?
 - JCT analysis pending
 - Adjunct to any tax reform effort?
- Wyden discussion drafts
 - Depreciation pooling
 - Financial products

Impediments to Tax Reform Remain

- Winners and losers/Sacred cows
 - Did Ryan solve this by adding headroom in Path Act?
- No agreed framework
 - Except possibly International
 - Reaction to all proposed tax reforms have been mixed
- Treatment of pass-throughs
- Haven't engaged the electorate
 - Perception on the Left that many corporations pay no tax or will use savings to enrich executives
 - Right wants to abolish the IRS - - Why?



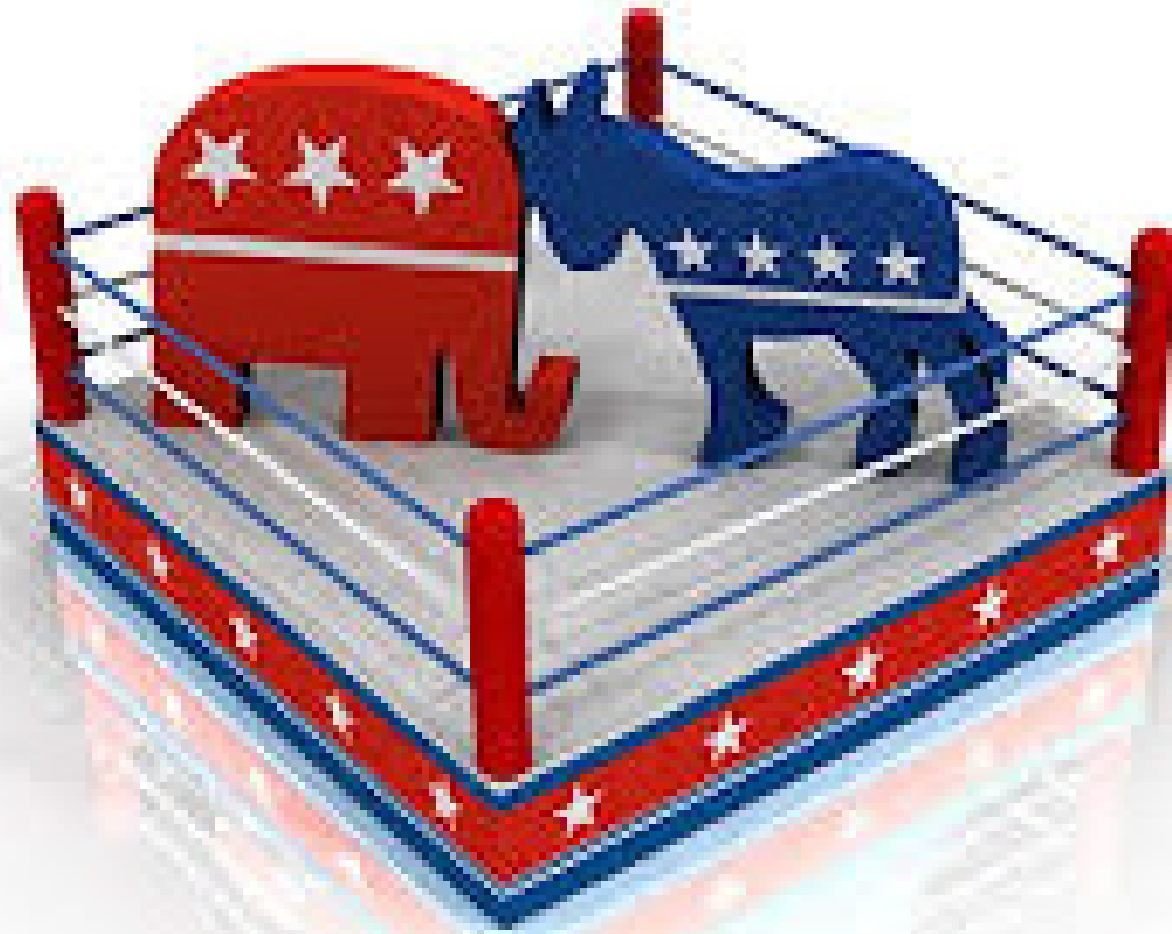


- Key for taxes is four alt. energy extenders
- Member miscellaneous bills in House and Senate
- Other 30 Extenders (alt. energy, mort. insur., tuition ded., and empowerment Zs)
- Offsets - - if any, will focus on compliance issues
 - IRS access for Customs, incr. filing penalties for pension filings,
 - repeal 708(b)(1)(B) tech. pship term., hardship W/D broadened

Presidential tax plans

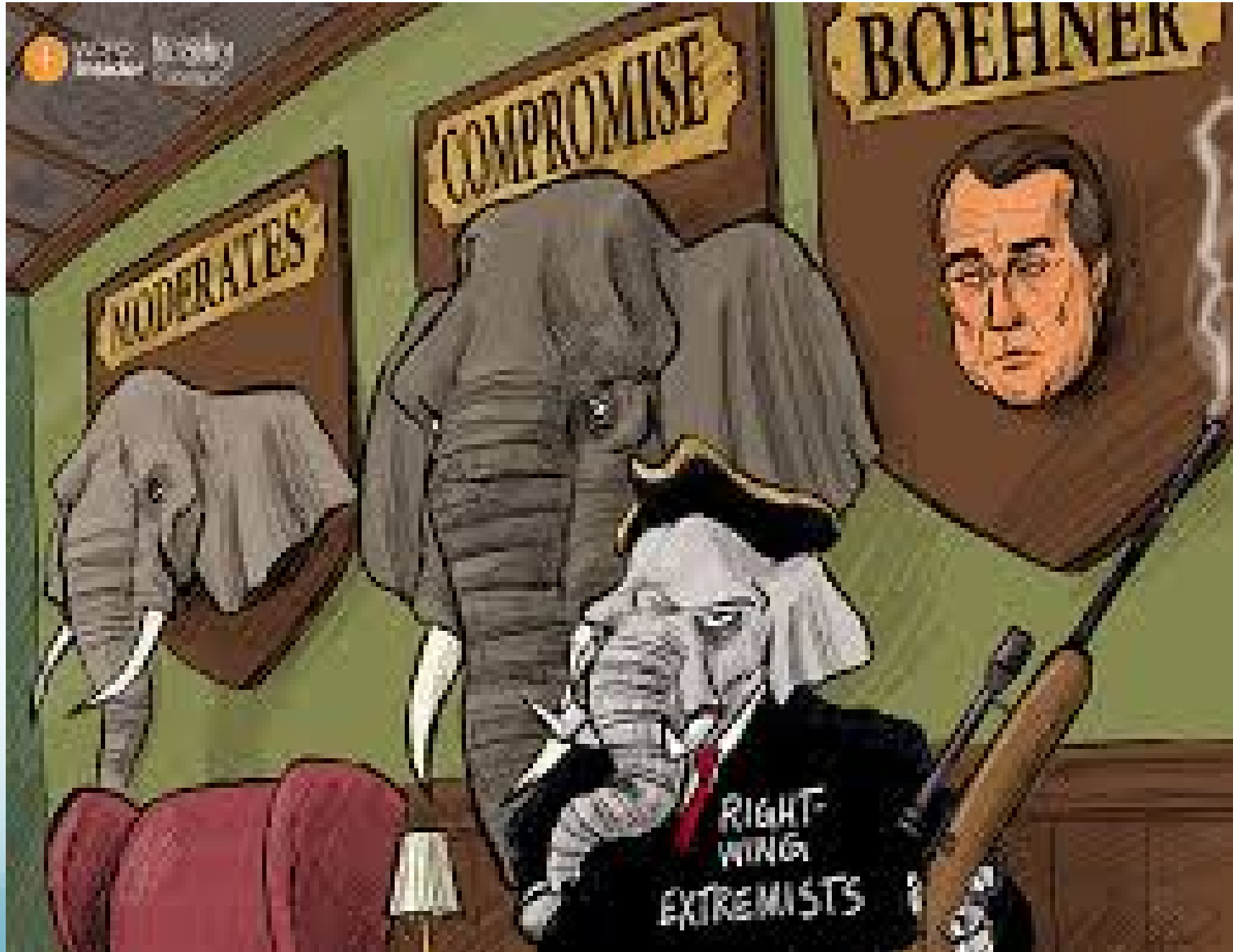
- Basically non-existent
- Tax policy not an HUGE issue
- Likely will not know until after elections what each candidate's real tax plans are.

Senate: Narrow Margins



EVERY VOTE WILL MATTER

House Has Its Own Issues





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 to TMP 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 \$350,000 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