Developments at LB&I

David B. Blair
Carina Federico

- State of LB&I
- Issue Focused Exams
- IRS Campaigns
- Data Analytics
- Changes to CAP
- Draft NOPAs and AOF IDR
- IRS Guidance Process
Current State of IRS

Figure 1: Total Tax Revenue by Type of Tax

Source: TIGTA analysis of the IRS Data Book.

Current State of IRS

Figure 12: Percentage Change in the Number of Field Examiners and Examinations Since FY 2013

Source: IRS Data Book and Table 37 Examination Program Monitoring.
Current State of LB&I

Figure 19: LB&I Division Percentage Change in Tax Returns Examined and Recommended Additional Tax Since FY 2013

Source: TIGTA analysis of IRS Examination data.

Current State of LB&I

Figure 20: LB&I Division Corporate Examinations by Size of Taxpayers’ Total Assets

Source: TIGTA analysis of IRS Examination data.
Current State of LB&I

Figure 21: LB&I Division Recommended Additional Tax for Corporate Examinations by Size of Taxpayers' Assets (in Thousands)

<table>
<thead>
<tr>
<th>Corporate Assets</th>
<th>FY 2013</th>
<th>FY 2014</th>
<th>FY 2015</th>
<th>FY 2016</th>
<th>FY 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10 Million &lt; $100 Million</td>
<td>362,168</td>
<td>1,087,237</td>
<td>366,125</td>
<td>282,580</td>
<td>211,039</td>
</tr>
<tr>
<td>$100 Million &lt; $500 Million</td>
<td>497,743</td>
<td>646,679</td>
<td>364,095</td>
<td>370,263</td>
<td>181,555</td>
</tr>
<tr>
<td>$500 Million &lt; $1 Billion</td>
<td>231,440</td>
<td>624,492</td>
<td>366,724</td>
<td>145,025</td>
<td>319,695</td>
</tr>
<tr>
<td>$1 Billion and Over</td>
<td>14,384,935</td>
<td>13,872,664</td>
<td>7,924,995</td>
<td>12,374,230</td>
<td>15,623,427</td>
</tr>
<tr>
<td>Total</td>
<td>15,476,286</td>
<td>16,249,072</td>
<td>8,961,939</td>
<td>13,172,098</td>
<td>16,335,716</td>
</tr>
</tbody>
</table>

Source: TIGTA analysis of IRS Examination data.

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
Issue-Focused Exam Process

- Issue Team to take responsibility
- Collaboration with taxpayer emphasized
- Resolve issues at earliest appropriate point
  - Exam to seek taxpayer agreement on facts before NOPA
  - Exam Team required to consider Fast Track Settlement
- Rules of engagement
  - Prior system relied on domestic chain, which failed to resolve problems on international issues
  - New “principles of collaboration” allow moving up substantive, geographic chains,
  - May not be one decision maker for all audit issues. Accountability is diffused

Roles and Responsibilities (IRM 4.46.1)

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

- Where to Find Campaigns:

- Campaign Example: Repatriation
  
  Practice Area = Cross Border Activities; Lead Executive = John Hinding

  "LB&I is aware of different repatriation structures being used for purposes of tax free repatriation of funds into the U.S. in the mid-market population. It has also been determined that many of the taxpayers do not properly report repatriations as taxable events on their filed returns. The goal of this campaign is to simultaneously improve issue selection filters while conducting examinations on identified, high risk repatriation issues and thereby increase taxpayer compliance."

How IRS Develops Campaigns

- Campaign Development Portal
  - LB&I employees submit a recommendation for a campaign
  - LB&I evaluates proposals and designs campaigns using tailored treatment streams and integrated feedback loops
- Data analytics to support identification and evaluation of potential campaign issues
- Consider potential treatment streams
- Decide what resources to deploy
- Identify training, mentoring, networking, and tools needed
Tax Gap Study: Corporate Compliance Issues

<table>
<thead>
<tr>
<th>Table 4: Common Examination Issues Identified for Large and Small Corporations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issue</strong></td>
</tr>
<tr>
<td>---------------------</td>
</tr>
<tr>
<td>Large corporations</td>
</tr>
<tr>
<td>Transfer pricing</td>
</tr>
<tr>
<td>Domestic production deduction</td>
</tr>
<tr>
<td>Subpart F issues</td>
</tr>
<tr>
<td>Business expense deductions</td>
</tr>
<tr>
<td>Foreign tax credits</td>
</tr>
<tr>
<td>Credits for research activities</td>
</tr>
<tr>
<td>Repatriation issues</td>
</tr>
<tr>
<td>Inbound financing</td>
</tr>
<tr>
<td>Withholding taxes for international transactions</td>
</tr>
<tr>
<td>Proper taxable year deduction</td>
</tr>
</tbody>
</table>


Pending IRS Compliance Studies

IRS plans to release its next tax gap estimate in 2019 to cover tax years 2011 to 2013. IRS is also undertaking several additional studies that may offer data IRS can use to improve the tax gap estimate, including these examples:

- **Taxpayers’ tipping behavior**: IRS is surveying taxpayers to help estimate total tip income and tipping rates by industry/occupation and by major method of payment (e.g., credit card, debit card, and cash).
- **Limited studies on C corporations and other midsize corporations**: IRS studied compliance of C corporations with assets less than $250,000 and with a balance sheet, and corporations with assets of $10 to $50 million for tax year 2010. These studies plan to identify potential areas of noncompliance.
- **Partnership misreporting pilot**: In 2016, IRS initiated this study to measure reporting compliance for certain partnerships, as well as to estimate tax misreported at the taxable partner level as a result of partnership misreporting. This study was initiated in response to a recommendation from a prior report.¹¹
- **NRP employment tax estimates**: As previously mentioned, IRS is determining how it will use the NRP employment tax study it concluded in 2017 to improve the tax gap estimates.

Role of Subject Matter Experts

- Issue Practice Groups (IPGs), International Practice Networks (IPNs)
  - Facilitated knowledge management, collaboration
  - Developed practice units on various issues
- Practice units (PUs) are available
  - 18 new PUs in 2018 so far – not all international
- LB&I Directives also published
  - 7 new LB&I Directives for 2018, so far

Data Analytics
The IRS’s Use of Big Data and Artificial Intelligence
What is Big Data?

“Big Data” is extremely large data sets that may be analyzed computationally to reveal patterns, trends, and associations, especially relating to human behavior and interactions. The IRS collects big data from many sources, including:

- Social media (i.e., Facebook, Twitter, Instagram)
- Credit reports
- City and state records (i.e., deeds and registries)
- Credit and debit card processors, eBay, and PayPal
- Marketing Data
- Prior tax returns and information returns
- Data collected from third parties (i.e., Coinbase summons, offshore John Doe summonses, subpoenaed financial records)
- Other government agencies (i.e., Census Bureau, Social Security Administration)
- Proprietary databases owned by the IRS

IRS Seeks Assistance from Artificial Intelligence

The IRS must do more with fewer resources and is attempting to use data analytics to supplement, replace, and increase the efficiency of current enforcement efforts.

- Data mining allows for the analysis of large data sets.
- Artificial intelligence uses computer systems to perform tasks that normally require human intelligence, such as visual perception, speech recognition, decision-making, and language translation.
- Machine learning, a type of artificial intelligence, is based on the idea that systems can learn from data, identify patterns, and make decisions with minimal human intervention.
- The IRS is looking to enhance its artificial intelligence capabilities.
  - In June 2018, the IRS issued a Request for Information seeking input from the industry regarding artificial intelligence, machine learning, cognitive computing and data analytics techniques, algorithms, and capabilities that have application to cybersecurity areas at the IRS.
The IRS’s Use of Big Data

Currently, the IRS focuses most of its data mining efforts on predictive analysis, which forecasts attributes or behaviors.

• The IRS uses data analytics to:
  • Identify potential noncompliant taxpayers
  • Build histories of taxpayers through continuous monitoring of financial and personal behavior
  • Detect identity theft and fraud

Data Analytics Tools Currently Used by the IRS


• These divisions used the following data analytics tools: Investigative Data Examination Application (IDEA) and Lead Case Analytics (LCA)
  • IDEA and LCA search and analyze large sets of data through a single access point. They help identify patterns of illegal activities.
  • Programs do not enable IRS with to determine indicators of terrorist or criminal activity. Rather, they allow IRS Agents and Analysts to perform inquiries based on their investigative experience.

• Return Review Program (RRP)
  • RRP uncovers patterns in data associated with fraud using machine learning algorithms and scores returns to determine likelihood that return is fraudulent.

*Department of Treasury, "2017 Annual Privacy, Data Mining, and Section 803 Reports," available at https://www.treasury.gov/privacy/annual-reports/Documents/Annual_Privacy_Data_Mining_Report_and_Section_803%20Report%20FINAL_2.pdf
Data Analytics Tools Currently Used by the IRS

- FinCEN
  - FinCEN uses algorithms to identify transactions associated with specific types of financial crimes and to examine filing patterns across financial sectors.
  - FinCEN Query provides analysts with the capability to search for specific entity names and term combinations across FinCEN records.
  - FinCEN “Advanced Analytics” system is comprised of tools with capabilities including statistics, social network, and geospatial analysis, data modelling and visualization, and text analytics.
- Compliance Data Warehouse (CDW)
  - CDW is used to identify relationships of corporate flow-through entities, entity fabrication and pyramiding, and preparer interactions.

Data Analytics Tools of the Future

- The IRS may use speech recognition software to translate foreign documents into English, particularly documents received from international sister agencies.
- The IRS is exploring the use of chatbots and virtual assistants to answer taxpayer questions when taxpayers call the IRS.
Risks Posed by the Use of Data Analytics

- Difficult to challenge, correct collected data
- Privacy concerns
- Data breach risk
- Increase in government power and potential for misuse
- Lack of transparency

Changes to CAP
Changes to CAP

• Compliance Assurance Process
  • Like Pre-filing agreement, provides certainty
  • Very Popular – Expanded from 17 (2005) to 169 taxpayers (today)
  • Resource intensive for IRS; few metrics to measure success
• CAP Maintenance
  • IRS Froze program in 2016

• Recently announced changes IR-2018-174 (Aug. 27, 2018)
  • Program continues for current CAP taxpayers
  • Applications due October 1, 2018
  • Preliminary list of issues, including transfer pricing, research credits

Changes to CAP

• Recently announced changes IR-2018-174 (Aug. 27, 2018) (cont’d)

  • CAP Team and taxpayer develop issues list for review
  • IRS seeking to better allocate resources:
    • Issues lists to direct IRS resources; Not all issues reviewed
    • 90-Day goal for issue resolution
    • Some transfer pricing issues sent to APA program
    • Tighter timelines for taxpayer representation letter and post-file review
    • Unagreed issues sent to Appeals sooner (Fast Track?)
  • In future, taxpayers may need to provide certification of tax controls framework
  • CAP Maintenance to be modified; may skip review some years for low-risk taxpayers
  • In future, IRS may use “issue-based resolutions” in CAP cases
Acknowledgement of Facts IDR

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 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 IDR

The purpose of the IDR is to ensure that all relevant facts, whether favorable to the taxpayer or IRS, are being considered before the Notice of Proposed Adjustment (NPA) is issued.

IRS Guidance Process

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.
Current State of IRS Guidance Process

- New IRS Process for IRS Regulations
  - Trump Administration’s Executive Orders
  - OIRA Review
- Additional IRS budget for guidance under TCJA 2017
- Ninth Circuit’s Two-Step in *Altera*
- Sub-Regulatory Guidance likely to increase

IRS Guidance

Hierarchy of IRS Guidance

- Source: GAO analysis of IRS documents | GAO-16-178
Background Controls on Agency Rulemaking

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

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

(b) General notice of proposed rule making shall be published in the Federal Register, . . . . The notice shall include—
(1) a statement of the time, place, and nature of public rule making proceedings;
(2) reference to the legal authority under which the rule is proposed; and
(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice or hearing is required by statute, this subsection does not apply—
(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or
(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

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

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except— (1) a substantive rule which grants or recognizes an exemption or relieves a restriction;
(2) interpretative rules and statements of policy; or
(3) as otherwise provided by the agency for good cause found and published with the rule.
(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

APA Notice and Comment Requirements

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

State Farm – Reasoned Decision-Making

- Reasoned decision-making requires:
  - Basis in facts
  - Rational connection between choice made and facts found
  - Response to significant comments
  - Regulation consistent with evidence before Treasury
Courts Are Applying APA To Tax Cases

- **Mayo** (S. Ct. 2011): Treasury Regulations subject to APA, entitled to Chevron deference
- **Home Concrete** (S. Ct. 2012): Rejects regulation under Chevron Step 1 because statute (§6501(e)), as interpreted in prior S. Ct. case, left no gap for agency to fill
- **Dominion Resources** (Fed. Cir. 2012): Invalidates interest capitalization regulation under Chevron Step 2 and reasoned decision-making requirement of State Farm

Courts Are Applying APA To Tax Cases

- **Altera** (T.C. 2015), reversed, (9th Cir. July 24, 2018), opinion withdrawn, (9th Cir. Aug. 7, 2018):
  - Tax Court – Cost sharing regulation on stock options invalid under the APA; failed to follow “reasoned decision making” standard of *State Farm*.
  - Ninth Circuit (opinion withdrawn)
    - Cost sharing regulation did not violate APA’s reasoned decision-making standard
    - Comparability analysis not required after 1986 commensurate with income amendment to §482
    - What will new Ninth Circuit panel decide?
- **Chamber of Commerce** (W.D. TX Sept. 29 2017), appeal dismissed, (5th Cir. July 26, 2018):
  - Temporary serial acquisition rule in anti-inversion regulation was invalid; IRS failed to follow APA’s notice and comment procedures
  - Chamber had standing to challenge regulation because one of its members, Allergen, was injured
  - Anti-Injunction Act did not bar suit
  - Treasury issued final regulations in July, and DOJ dismissed Fifth Circuit appeal as moot
Executive Order 12866 (Sept. 30, 1993)

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

Prior IRS Positions on APA, Exec. Order 12866

- APA notice and comment requirements inapplicable to most IRS Regulations because:
  - Typically not “legislative,” but “interpretive”
  - But still have “force and effect of law”
- Executive Order 12866 typically inapplicable to IRS Regulations because
  - Not “significant regulatory action”
  - Taxes do not count towards $100 m. impact test
  - Code, not Regulations, impose taxes
Trump Executive Order 13771 (Jan. 30, 2017)

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

Trump Executive Order 13789 (April 21, 2017)

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

- Regulatory actions under Title 26 are subject to OIRA review, if likely to result in a rule that may:
  - create serious inconsistency or otherwise interfere with action of another agency;
  - Raise novel legal or policy issues, such as rule of conduct backed by assessable penalty; or
  - Have annual non-revenue effect on the economy of $100 million or more.
- Treasury must submit to OIRA: draft of the proposed regulation; detailed description of the need for the regulation and how the regulation meets that need; assessment of potential cost/benefit; and explanation of how regulation is consistent with statute, promotes President’s priorities, and avoids unduly interfering with state, local, or tribal government functions.
- Where economic impact exceeds $100 million, Treasury must also must include quantitative analysis of costs/benefits of regulation and any alternatives considered by the IRS.
- OIRA has 45 days to conduct review; Regulations implementing Tax Cuts and Jobs Act can have accelerated 10-day review.

Congressional Review Act

- Congressional Review Act (CRA) – No final rule can become effective until IRS submits a report containing certain information to the House of Representatives, the Senate, and the Comptroller General of the GAO.
- CRA covers an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency.
- A Revenue Ruling, Revenue Procedure, Notice, or Announcement may fall under CRA, in which case the IRS must make the CRA submission to the House, Senate, and GAO (President is also copied).
- IRS submission includes:
  - CRA submission form
  - Concise summary of the rule
  - Unsigned copy of the final version of the rule
  - For the GAO, if the rule is a major rule, a copy of the cost benefit analysis
Upshot on Guidance Process

• IRS has been pushing out informal guidance on the Tax Cuts and Jobs Act
• IRS often addresses issues through informal guidance:
  – Notices, campaigns, press releases, FAQs, publications, forms/instructions, web site, IRM
• Over-reliance on informal guidance leads to problems:
  – “Zombie Notices”
  – Sudden unexplained changes to IRM, FAQs, forms/instructions, web site
  – Positions taken in informal guidance like campaigns, practice units positions may cause Exam and even Appeals to claim “my hands are tied”
• On the other hand,
  • The IRS is bound by the positions taken in Revenue Rulings and Revenue Procedures
  • Chief Counsel attorneys must follow legal positions established by IRB publications in Tax Court and defense letters sent to DOJ
  • Notices and Announcements are authority for purposes of avoiding accuracy related penalties.

Questions?

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Agenda

- IRS International Organization
- Tax Cuts & Jobs Act: Early Issues
- Case Developments
- New Transfer Pricing Audit Guidelines
- iCAP
- International discovery
U.S. International Tax

U.S. Treasury Department
Deputy Assistant Secretary (International Tax Affairs)
LG Chip Harter

IRS Office of Chief Counsel
Chief Counsel, IRS
William M. Paul (Acting)

IRS Large Business & International
LB&I Commissioner
Douglas O’Donnell

Associate Chief Counsel (International)
Marjorie Rollinson

Director, Treaty & Transfer Pricing Operations
Jennifer Best

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Tom West

Deputy Associate Chief Counsel (International)
Daniel M. McCall

Director of Field Operations
Transfer Pricing Practice
John Hinman

Deputy International Tax Counsel
Brian Jenn

LB&I Deputy Division Counsel (International)
Kathryn Patterson (Acting)

Tax Cuts and Jobs Act of 2017

Early possible Exam Issues

• Repatriation on Transition to Participation Exemption System (Section 965)
  – Frequently Asked Questions / Proposed Regulations (August 8, 2018)
  – IRS Campaign: “alert potentially impacted taxpayers about new filing and payment obligations”
  – Rev. Proc. 2018-17, limit CFC elections of November 30 tax years
• Foreign Derived Intangibles Income deduction / Global Intangibles Low-Taxed Income inclusion
  – GILTI Proposed Regulations (September 13, 2018)
  – Lack of guidance on Foreign Tax Credit issues
• Base Erosion and Anti-Avoidance Tax
  – COGS (payments for goods) are not base-erosion; are software payments COG or royalties? embedded royalties? sales commissions v resales?
Tax Cuts and Jobs Act of 2017

Early possible Exam Issues

• Withholding on Transfers of Partnership Interests
  – Notice 2018-08, “PTP” Notice, publicly traded partnerships excepted
  – Notice 2018-29, use FIRPTA procedures to withhold
• Gain on Sale of Partnership interest
  • Overruled Grecian Magnesite

Does Tax Reform Conflict with Treaties?

• Savings clause: can tax domestic residents as if Treaty does not exist
• Non-discrimination: not impose taxes on foreign entities more burdensome tax than on domestic entities
  • Savings clause not applicable to non-discrimination
• Do BEAT, GILTI, FDII violate non-discrimination?
• Treaty override
  – Last in time (no new U.S. treaties ratified since 2010)
  – Specifically provide that override
• Potential for challenge prior to tax being applied (US Chamber of Commerce)
Transfer Pricing Examination Process (TPEP)

- Publication 5300, June 29, 2018, updated August 2018
  - Replaces Transfer Pricing Audit Roadmap, follows Publication 5125, LB&I Examination Process
  - Similar Phases: Planning, Execution, Resolution
- Incorporates review of Country by Country Report in Planning
- Working hypothesis in planning phase, with caution that need to review
- Request Transfer Pricing Documentation in Execution Phase
  - Mandatory Transfer Pricing Documentation IDR no longer mandatory (Jan. 12, 2018 Memorandum)
  - Applies if Transfer Pricing Operations or Cross-Border Activities assigned, or instructed in Campaign
- Ratio analysis as part of Execution
- Incorporates Acknowledgment of Facts

Transfer Pricing: Selection of Methods

- In LB&I cases, Treaty and Transfer Pricing Review Panel (in Transfer Pricing Operations) to review decisions by Exam to change transfer pricing method from method used by taxpayer
  - Consists of TPPO Director, or APMA Director, a Senior Advisor, and the income-shifting practice network manager
- Conditions
  - Taxpayer timely provides Transfer Pricing Documentation
  - Includes best method analysis
  - Applies specified method
- Standard: facts and circumstances - reliability
  - Consider whether adjustments to Taxpayer method can be made to make it more reliable
- Degree of Taxpayer participation unclear

(Directive LB&I 04-0118-002)
**ICAP**

**International Compliance Assurance Programme**

- Joint review of transfer pricing risks by several jurisdictions cooperatively
- Pilot program launched in January, 2018: US / Canada lead
  - Arises out of APA, BEPS, CAP, CbC
  - Participation by 8 OECD countries: Australia, Canada, Italy, Japan, the Netherlands, Spain, the UK, the US
  - Transfer pricing documentation, country-by-country reports
  - Kickoff meeting, share information with all countries
  - Participating countries each assess risks
  - Each country prepares “CAP outcome letter”
- Assessment of “high risk” will result in examination in country
- Concern: is this the first step to global formulary apportionment? Safe harbor?

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**Altera**

**Arm’s Length Standard Concerns under Ninth Circuit reversal, now withdrawn**

- Commensurate with income means can allocate under Section 482 without regard to comparable transactions or arm’s length methods
- Acceptable for Treasury to ignore evidence of arm’s length transactions when issuing Regulations under Section 482
- Reminiscent of Xilinx, issued and withdrawn after uproar re Treaty obligations requiring arm’s length standard
Illinois Tool Works *(T.C. Memo 2018-121)*

**Repatriation Strategy Upheld**

- Loan from lower tier CFC to upper tier was *bona fide* debt
- Debt / equity factor analysis: intent to repay, control, dividend history, presence of indicia of debt (form), treatment in corporate records, ability to pay/size of advance, record of repayment, use of funds, “thinness”
  - Found heavily favor debt treatment
- Avoidance of Subpart F:
  - Leave to Congress to “repair shortfall”
  - Fix had been proposed, not adopted

![](chart.png)

Medtronic *(8th Circuit Reversing and Remanding to Tax Court)*

**“The Jig Is Up” (anonymous)**

- Medtronic develops and sells medical devices (Cardiac), manufactured by Puerto Rico subsidiary
- Taxpayer and Tax Court adopted comparable uncontrolled transactions (CUT) based on settlement of lawsuit with Pacesetter
- Eighth Circuit:
  - Tax Court factual findings insufficient to evaluate use of CUT (remand)
  - Hostility toward CUT
    - Settlement circumstances; not “ordinary course”
    - Comparability of contractual terms (Cross license)
    - Presence and coverage of other intangibles
    - Risk/product liability expense
- Prediction of result on remand?
Coca-Cola (Tax Court)

- Coke's transfer pricing was based on a 1996 Closing Agreement, resolving prior years
  - 10% routine return, 50/50 profit split
- Coke had relied on Closing Agreement from 1987 through 2004, accepted by the IRS
- $3 billion Transfer pricing case for 2007-2009, trial completed (Judge Lauber)
- Coke won summary judgment re Foreign Tax Credits for Mexican taxes
  - Compulsory payment requires “reasonable determination” and “exhaustion of remedies”
  - Not need to wait until Tax Court litigation over
  - Coke sought Competent Authority assistance and was denied by IRS
  - Adjustments and deficiency claim if Mexican taxes end up less

Questions?

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Competent Authority and Advance Pricing Agreements
Current Practice Developments and Trends, Lifecycle of an APA

Charles Larson
Advisor, APMA

Agenda

- Overview of APMA
- Lifecycle of APA and MAP Cases
- Trends
Advance Pricing and Mutual Agreement (APMA)

IRS Practice Area Responsible for Transfer Pricing

LB&I Commissioner
Douglas O’Donnell

LB&I Deputy Commissioner
Nikole Flax

Director, Treaty & Transfer Pricing Operations
Jennifer Best

Director of Field Operations
Transfer Pricing Practice
John Hinman

Director, Advance Pricing Mutual Agreement
John Hughes

Director, Treaty Administration
Deborah Palacheck

Eight additional Practice Areas

IRS Treaty and Transfer Pricing Operations

• Transfer Pricing Practice
  – IRS examination, campaigns
• Treaty Assistance and Interpretation Team (TAIT)
  – Competent Authority matters other than double taxation
• Advance Pricing and Mutual Agreement (APMA)
  – Competent authority in business profits and associated enterprises double taxation cases (Article 9 transfer pricing and Article 7 allocation)
  – Advance Pricing Agreement program
APA and MAP Procedures

See Revenue Procedure 2015-41 (APA); Revenue Procedure 2015-40 (MAP)

- Taxpayers may request Advance Pricing Agreement under which IRS and taxpayer agree to transfer pricing method that will be accepted for the application year and in the future
  - Unilateral, Bi-lateral, Multi-lateral
- Taxpayers may request competent authority assistance to obtain relief from double taxation with respect to tax adjustments
- Cooperative process, both parties have an interest in establishing an accurate and workable transfer pricing method
- Conservation of resources for both parties in long run

Lifecycle of APA and MAP Cases

* Assumes bilateral APA
Pre-Filing Conference / File APA or MAP Request

- Pre-filing / Pre-submission conference
  - Mandatory
  - Anonymity Possible
- File request per Revenue Procedures
- User Fee (increases)

The APMA Organization

Director, Advance Pricing Mutual Agreement
John Hughes

Assistant Director
John Wall
Washington, DC

Assistant Director
Greg Spring (A)
Washington, DC

Assistant Director
Dennis Bracken (A)
Los Angeles, CA

Manager
Sue Papiewski (A)
Washington, DC

Manager
Russell Kwiat (A)
Washington, DC

Manager
Spencer Stowe
Los Angeles, CA

Manager
Mona Cairncross (A)
Washington, DC

Manager
Judith Cohen
Washington, DC

Manager
Robert Liu
Los Angeles, CA
APA Team

- Team members and roles
  - Assistant Director and Advisor(s)
  - Team Manager
  - Team Leader
  - Economist
  - Specialists (cross border activities, transfer pricing office, international examiners, issue specialists)

- Reorganization
  - Goals
  - Effect on ongoing matters

Acknowledgment / Treaty Partner Notification

- APA or MAP Submission reviewed for completeness
- Taxpayer notified of acceptance
- Treaty partner notified of request
Due Diligence

- Meetings with taxpayer
- Due diligence follow-up questions
- How to get the most out of the APA or MAP process:
  - Responsiveness
  - Effective Communication
  - Understanding the Process
- Common difficulties

Position Process

- APMA will prepare position paper to share with Treaty partner
- Arm’s Length Standard
  - OECD’s revised 2017 Transfer Pricing Guidelines
- Common Concerns and Solutions:
  - Hard to Value Intangibles
  - Application of Profit Split Method
  - Assumption versus Control of Risk
Treaty Partner Negotiation and Resolution

- Dialog with Treaty partner
  - Good working relationships
  - Common issues
  - Reference sets
- Resolution procedures
- New APA Template
  - Standardized definitions
  - Option-based approach
  - Goal: Increase efficiency and enhance consistency
- Exchange of APAs with other countries
  - Concern over disclosure / leaks

### APMA Statistics

**Table 7: Months to Complete New and Renewal APAs Executed in 2017**

<table>
<thead>
<tr>
<th></th>
<th>Unilateral</th>
<th>Bilateral</th>
<th>Unilateral &amp; Bilateral</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Average</td>
<td>Median</td>
<td>Average</td>
</tr>
<tr>
<td>New</td>
<td>40.4</td>
<td>34.8</td>
<td>46.9</td>
</tr>
<tr>
<td>Renewal</td>
<td>28.7</td>
<td>27.2</td>
<td>37.5</td>
</tr>
<tr>
<td>New &amp; Renewal</td>
<td>32.6</td>
<td>31.0</td>
<td>41.5</td>
</tr>
</tbody>
</table>

**Table 2: Executed and Pending APAs § 521(b)(2)(C)(ii-vi)**

<table>
<thead>
<tr>
<th></th>
<th>Unilateral</th>
<th>Bilateral</th>
<th>Multilateral</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Executed 1991-2016</td>
<td>560</td>
<td>1,023</td>
<td>14</td>
<td>1,597</td>
</tr>
<tr>
<td>Total Executed in 2017</td>
<td>30</td>
<td>85</td>
<td>1</td>
<td>116</td>
</tr>
<tr>
<td>Total Executed 1991-2017</td>
<td>590</td>
<td>1,108</td>
<td>15</td>
<td>1,713</td>
</tr>
<tr>
<td>Total Pending as of 12/31/2017</td>
<td>57</td>
<td>321</td>
<td>8</td>
<td>386</td>
</tr>
<tr>
<td>Renewals Executed in 2017</td>
<td>22</td>
<td>48</td>
<td>0</td>
<td>70</td>
</tr>
<tr>
<td>Renewals Pending</td>
<td>29</td>
<td>133</td>
<td>2</td>
<td>164</td>
</tr>
</tbody>
</table>
Trends: By Country 2017

Trends: By Industry, Relationship, and Type
APA Value Proposition

• Best way to address double taxation
• Best way to avoid double tax disputes
• Common issues

Arbitration

• Mandatory arbitration in Treaties
  – Canada, France, Belgium, Germany
• “Baseball” arbitration
• Effect on negotiations / resolution
Competent Authority Statistics

- BEPS Action Item 14: MAP resolution within an average time frame of 24 months

<table>
<thead>
<tr>
<th>Year</th>
<th>U.S. Initiated Adjustments</th>
<th>Foreign Initiated Adjustments</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>28.2</td>
<td>27.8</td>
<td>27.9</td>
</tr>
<tr>
<td>2012</td>
<td>23.1</td>
<td>26.6</td>
<td>26.0</td>
</tr>
<tr>
<td>2013</td>
<td>23.8</td>
<td>26.9</td>
<td>26.1</td>
</tr>
<tr>
<td>2014</td>
<td>15.0</td>
<td>25.3</td>
<td>21.4</td>
</tr>
<tr>
<td>2015</td>
<td>27.7</td>
<td>32.7</td>
<td>32.1</td>
</tr>
</tbody>
</table>

- BEPS Peer Review report for 2016 reports 31.61 months to completion
Running with Scissors and Other Prohibited, Bad and Silly Tax Practices to Avoid in the ERISA-World

David McFarlane and Samuel Krause
September 27, 2018

Agenda

• PLEASE Don’t Do This (or That)...
  – Ugh...
  – Latest & “Greatest” Benefit Plans

• ERISA Penalties
  – Jail Time
  – Fines
  – Fiduciary Liability
  – Significant Litigation Risks

• 9 Months Later - IRC Changes to Executive Compensation/Employee Benefits
  – Section 162(m) – Executive Compensation
  – New Section 83(i) - Tax Deferral Election for Equity Grants
  – Tax Exempt Entities - Excise Tax on Excessive Compensation
  – Fringe Benefits
PLEASE Don’t Do This (or That)...

PLEASE Don’t....

• Ugh...
  – Murder to collect under benefit plan (State Slayer Statues v. ERISA)
  – $31,402 embezzlement 401(k) (4.5 years jail/$4.3 million fine)
  – Pension Fiduciary – steering $2.4 billion to investment firms for concert tickets, drugs, prostitutes, $17,000 watch, travel (2 years jail)
  – Plan interpretation of drunk snow mobile death – was it a “motor vehicle”?
  – FedEx misclassifying independent contractors – $13 million for lost benefits
  – Forgot to mention a retirement change? $290 million ($95 million attorneys fees)
  – Dragging your feet in providing copy of plan? $74,000 penalty
  – Forced Arbitration under ERISA? Nope
  – Suing Company/Board Directors/Committee Members (or have removed)
  – Failure to fund self-funded health plan (new areas of ERISA health plan suits)
PLEASE Don’t....

- The Latest & “Greatest” Benefits Ideas
  - Student loan repayments - considered 401(k) contribution for match
  - “Paw-ternity” – pet leave
  - Stem cell storage
  - Medical debt coverage
  - Breast milk shipping
  - Genetic testing (medical and genealogical)
  - College tuition
  - Sleep programs
  - “Alexa...what is my retirement account balance?”
  - Zombie walking (wellness dollars)
  - Universal Savings Accounts

ERISA Penalties
## ERISA Penalties

<table>
<thead>
<tr>
<th>ERISA Penalty</th>
<th>Description of ERISA Violation</th>
<th>2018 Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>ERISA §411</td>
<td>Persons convicted/imprisoned for certain offences may not serve as fiduciary/consultant or in any decision-making capacity for 13 years</td>
<td>$10,000 and/or jail up to 5 years</td>
</tr>
<tr>
<td>ERISA §502(c)(2)</td>
<td>Failure or refusal to file annual report (Form 5500) (Failure of a multiemployer plan to certify endangered or critical status under ERISA § 305(b)(3)(C))</td>
<td>Up to $2,140 per day</td>
</tr>
<tr>
<td>ERISA §511</td>
<td>Coercive Interference – use of force, fraud, violence or threat of same to restrain, intimidate or attempt to interfere with or prevent exercise of any right under a plan</td>
<td>Up to $100,000 fine and/or 10 years jail</td>
</tr>
</tbody>
</table>

## ERISA Penalties

<table>
<thead>
<tr>
<th>ERISA Penalty</th>
<th>Description of ERISA Violation</th>
<th>2018 Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>ERISA §501</td>
<td>Violating ERISA’s reporting and disclosure requirements</td>
<td>Up to $100,000 fine and/or 10 years jail</td>
</tr>
<tr>
<td>ERISA §519</td>
<td>False statements or representations in sale or marketing of MEWAs</td>
<td>Up to 10 years jail and/or Title 18 fine (federal sentencing guidelines)</td>
</tr>
<tr>
<td>ERISA §502(c)(5)</td>
<td>Failure to file Form M-1 (MEWA)</td>
<td>Up to $1,558 per day</td>
</tr>
<tr>
<td>ERISA §502(c)(6)</td>
<td>Failure to furnish information requested by DOL under ERISA 104(a)(6)</td>
<td>Up to $1,527 per request</td>
</tr>
</tbody>
</table>
## ERISA Penalties

<table>
<thead>
<tr>
<th>ERISA Penalty</th>
<th>Description of ERISA Violation</th>
<th>2018 Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>ERISA § 715</td>
<td>Failure to provide Summary of Benefits Coverage</td>
<td>Up to $1,128 per failure</td>
</tr>
<tr>
<td>ERISA § 502(c)(4)</td>
<td>Failure to furnish certain multiemployer plan financial information upon request by plan participant, beneficiary or representative</td>
<td>Up to $1,659 per day</td>
</tr>
<tr>
<td>ERISA § 502(c)(4)</td>
<td>Failure to notify participants under ERISA §10(j) of certain benefit restrictions and/or limits under IRC §436</td>
<td>Up to $1,659 per day</td>
</tr>
<tr>
<td>ERISA § 502(c)(10)(c)(ii)</td>
<td>GINA violations – minimum penalty for non de minimis violations that are not corrected prior to notice from DOL</td>
<td>$17,084 minimum</td>
</tr>
<tr>
<td>ERISA § 502(c)(10)(D)(iii)</td>
<td>Cap on unintentional failures to meet generic information requirements</td>
<td>$569,468 maximum</td>
</tr>
<tr>
<td>ERISA § 502(c)(5)</td>
<td>Distribution prohibited by ERISA §206(e)</td>
<td>Up to $16,169 per distribution</td>
</tr>
</tbody>
</table>
## ERISA Penalties

<table>
<thead>
<tr>
<th>ERISA Penalty</th>
<th>Description of ERISA Violation</th>
<th>2018 Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiduciary Breaches</td>
<td>Breach of fiduciary duty under ERISA is a personal liability of individual fiduciaries</td>
<td>Unlimited (personal assets at risk)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>D&amp;O coverage?</td>
</tr>
<tr>
<td>Other Bad Acts</td>
<td>Title 18 of U.S. Criminal Code</td>
<td>Up to 5 years jail and/or fine (determined under federal sentencing guidelines)</td>
</tr>
<tr>
<td></td>
<td>• Theft/embezzlement benefit plan (§664)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• False statement/concealment in ERISA documents (§1027)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Solicitation to influence benefit plan (§1954)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Conspiracy? Mail Fraud? Wire Fraud? False Claims, State Laws?</td>
<td></td>
</tr>
</tbody>
</table>

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### 9 Months Later – IRC Changes to Executive Compensation/Employee Benefits

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Tax Code Changes

Update - Section 162(m) Deduction Limits

• Tax Cuts and Jobs Act eliminated 25 year exception to Section 162(m) allowing deduction of qualified performance-based compensation and commissions, including non-discounted stock options and stock appreciation rights.

• Publicly held corporations - no deduction for compensation paid to covered employees in excess of $1 million. Narrow transition rule if performance-based compensation over $1 million if paid under written contract in effect 11/2/17 (if not materially modified).

• Includes private companies that issue publicly traded securities & file ‘34 Act reports

• IRS Guidance: Notice 2018-68

---

Tax Code Changes

Update - Tax Deferral Election for Qualified Equity Grants

• New § 83(i) allows certain individuals to defer income (that previously would be recognized upon exercise/vesting) for five years, or earlier upon any of the following events:

  – Stock becomes transferable (including to the employer)
  – Employee becomes an excluded employee
  – Stock becomes readily tradeable on established market
  – Employee revokes the deferral election
Tax Code Changes

Update - Tax Deferral Election for Qualified Equity Grants

- For privately held companies with at least 80% of employees in U.S.
- Must have an equity plan providing for stock options or RSUs
- Who are eligible employees? Those customarily employed at least 30 hours per week, excluding:
  - 1% owner (any time during 10 preceding calendar years)
  - Current or former CEO/CFO (or a spouse, child, grandchild, or parent)
  - Four highest compensated officers for taxable year in which option is exercised/RSU vests (or any of 10 preceding taxable years)

- IRS Guidance?

Tax Code Changes

Update - Excise Tax on Excessive Compensation Paid by Exempt Organizations

- Tax on excessive executive compensation and severance benefits paid by tax-exempt organizations for taxable years after December 31, 2017.
- Exempt organizations are subject to 21% excise tax on any compensation paid to covered employees in excess of $1 million.
- Covered employees can include former employees still being compensated.

- IRS Guidance
Tax Code Changes

Update - Fringe Benefits

• Moving expenses not deductible by employer or employee. Reimbursement included in employee’s income (certain military exceptions)
• No employer deduction for transportation/commute benefits
• Employer deductions limited:
  – No deduction for transportation or moving benefits
  – 50% deduction for on-premises employee eating facilities
  – Deduction for providing meals to employees will be eliminated in 2026

• IRS Guidance: See Publication 15-B “Employer’s Tax Guide to Fringe Benefits”

Questions?

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Washington Update
September 2018
Rick Grafmeyer
Capitol Tax Partners, LLP

Update on Congress / Treasury / IRS - - Implementing Tax Reform

- FAA bill at end of Sept.? Tax vehicle?
- Omnibus spending bill
- Lame duck bill in December
  - Technicals - bill in late Fall?
  - Extenders
  - Fixes to glitches
  - IRS reforms / retirement savings modifications
  - Tax Reform 2.0
- JCT Bluebook - - late 2018
- Tax bill early 2019?
Update on Congress / Treasury / IRS - - Implementing Tax Reform (cont.)

- IRS Commissioner
- Guidance schedule and issues
  - OMB review
  - Effective dates

Questions?
Recent Developments in Partnership Audits

Charles C. Hwang
Teresa Abney
September 27, 2018

Centralized Partnership Audits
Overview
Centralized partnership audit regime

**Basic rule**

- Assessment and collection of tax is done at partnership level
- Partnership is liable for resulting tax
- Effective for tax years starting after December 31, 2017; partnerships can elect in for tax years starting after November 2, 2015
- Certain partnerships can elect-out

---

Centralized partnership audit regime

**Key terms**

- Reviewed year
- Audit year
- Imputed underpayment
- Partnership representative
Centralized partnership audit regime

Stages of BBA audit

- Notice of Administrative Proceeding
- Notice of Proposed Partnership Adjustment (NOPPA)
- Submit modification information (270 days)
- Final Partnership Adjustment (FPA)
- "Push out" election (45 days)
- Petition in court (90 days)

What is missing?
Centralized partnership audit regime

Three ways to pay resulting tax – AS ORIGINALLY ENACTED

- Partnership pays the imputed underpayment
- Review year partners file amended returns for the reviewed year
- Partnership elects to push out to reviewed year partners

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

<table>
<thead>
<tr>
<th>Who pays?</th>
<th>Imputed Underpayment</th>
<th>Amended Return</th>
<th>Push Out Election</th>
</tr>
</thead>
<tbody>
<tr>
<td>A, B, and D</td>
<td>A, B, and C</td>
<td>A, B, and C</td>
<td>A, B, and C</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>On which return?</th>
<th>2020</th>
<th>2018</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate</td>
<td>General underpayment rate</td>
<td>General underpayment rate</td>
<td>General underpayment rate PLUS 2%</td>
</tr>
</tbody>
</table>

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Centralized partnership audit regime

Open questions

- BBA left unanswered many questions, including:
  - Is the scope of the BBA narrower than TEFRA?
  - Can tiered-partnerships make the push-out election?
- In 2016, bipartisan technical corrections were proposed but they did not pass
- Congress directed IRS to issue regulations in several important areas

BBA Developments

2018 Developments

Technical Corrections
- Scope of the regime
- Push-out election
- Pull-in procedure

IRS Regulations
- Final regulations on Partnership Representative
- Final regulations on opting out of BBA regime
- Final regulations on early opting into BBA regime
- Proposed regulations reflecting changes technical corrections
Technical Corrections
Consolidated Appropriations Act of 2018

2018 Technical Corrections

Scope

- TEFRA = partnership items, affected items, computational items
- BBA as enacted = income, gain, loss, deductions or credits of the partnership
- Technical Corrections = partnership-related item
  - Partnership-related items = any item or amount with respect to the partnership that is relevant in determining the income tax liability of any person, without regard to whether the item or amount appears on the partnership’s return and including an imputed underpayment and an item or amount relating to any transaction with, basis in, or liability of, the partnership
- But there are still open questions
2018 Technical Corrections

Push-out election: increases and decreases

- BBA as enacted: push-out adjustment includes only increases to partner’s income
- Technical corrections: push-out adjustment includes increases and decreases to partner’s income

---

2018 Technical Corrections

Decrease adjustment example

XYZ’s 2018 tax return is audited; IRS makes an adjustment in 2020; A was a partner in 2018 but sold his interest in 2019 for $500,000. His outside basis was $300,000 so A reported $200,000 of gain on the sale.

XYZ pushes the adjustment out to reviewed year partners; A’s share is $100,000. XYZ issues a Schedule K-1 to A reporting $100,000 of income.

Because A has an additional $100,000 of income from the partnership, his outside basis increases to $400,000 and he should have had only $100,000 gain on the sale of his XYZ partnership interest. Under the technical corrections, A can decrease the gain he reported on the sale.
2018 Technical Corrections

Push-out election: multi-tiered partnerships

Partnership makes push-out election
Partner sends K-1s to partners
UTP files “partnership adjustment tracking report”
UTP pays imputed tax
UTP pushes out to its partners
UTP’s partners pay or push out

2018 Technical Corrections

Multi-tiered partnerships example

In 2020, XYZ’s 2018 partnership tax return is audited and the IRS increases the partnership’s income by $1 million. In 2018, XYZ had three equal partners: A, B, and C. C is partnership with three partners during 2018: M (individual), N (individual), and O (partnership). O is partnership with three partners during 2018: R (individual), S (individual), and T (individual). XYZ is a calendar year taxpayer.

All push outs must be made by September 15, 2021

Red partners report the adjustment and pay the resulting tax
2018 Technical Corrections

Pull-in procedure

- A new way to pay the imputed tax
- Reviewed-year partners pay tax on their portion of the adjustments but do not need to file a return

Example

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

<table>
<thead>
<tr>
<th></th>
<th>Amended return</th>
<th>Imputed underpayment</th>
<th>Push out election</th>
<th>Pull-in procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who pays?</td>
<td>A, B, and C</td>
<td>A, B, and D</td>
<td>A, B, and C</td>
<td>A, B, and C</td>
</tr>
<tr>
<td>On which return?</td>
<td>2018</td>
<td>2020</td>
<td>2020</td>
<td>None (payment remitted with IRS form)</td>
</tr>
<tr>
<td>Interest rate</td>
<td>General underpayment rate</td>
<td>General underpayment rate</td>
<td>General underpayment rate PLUS 2%</td>
<td>General underpayment rate</td>
</tr>
</tbody>
</table>
New Regulations

Final Partnership Representative regulations

• Eligibility to serve as Partnership Representative
  • Substantial presence
  • Designated Individual
• Designating or changing a Partnership Representative or Designated Individual
• IRS designation of Partnership Representative
• Authority of Partnership Representative

Form 8979

Partnership Representative Revocation, Designation, and Resignation Form

Go to www.irs.gov/Form8979 for instructions and the latest information.
New Regulations

Partnership Representative example

On its 2018 return, XYZ designates PR1 as its partnership representative. On its 2021 return, XYZ designates PR2 as its partnership representative. In 2022, IRS mails XYZ a Notice of Administrative Proceeding with respect to XYZ’s 2018 tax return.

Who is the partnership representative for the 2018 return?

PR1
On its 2018 return, XYZ designates PR1 as its partnership representative. In 2020, XYZ and PR1 have a falling out. XYZ does not want PR1 as its partnership representative.

What can XYZ do?

Wait. XYZ cannot revoke the PR1’s designation until the IRS issues notice of selection for examination or Notice of Administrative Proceeding.
On its 2018 return, XYZ designates PR1 as its partnership representative. XYZ’s 2018 return is selected for audit in 2020. In 2021, XYZ has three partners: A, B, and C. A is the majority partner. B is a general partner. A and C are limited partners.

On January 1, 2021, A signs and mails a form revoking PR1 as the partnership representative and designating PR2.

On January 15, 2021, B signs and mails a form revoking PR2 as the partnership representative and designating PR3.

On February 27, 2021, C signs and mails a form revoking PR3 as the partnership representative and designating PR1.

Who is the partnership representative?

Whomever the IRS picks.
New Regulations

Partnership Representative example

On its 2018 return, XYZ designates PR1 as its partnership representative. XYZ’s partnership agreement says PR1 cannot extend the period of limitations without the consent of partners A and B.

The period of limitations for making adjustments is March 15, 2022. The IRS asks to extend the period of limitations to March 15, 2023. A and B tell PR1 not to agree to the extension, but he does. PR1 signs the extension.

Is the extension valid?

Yes.
New Regulations

Partnership Representative example

On its 2018 return, XYZ designates PR1 as its partnership representative. XYZ’s partnership agreement says PR1 cannot extend the period of limitations without the consent of partners A and B.

The period of limitations for making adjustments is March 15, 2022. The IRS asks to extend the period of limitations to March 15, 2023. A and B tell PR1 not to agree to the extension, but he does. PR1 signs the extension and then resigns as a partnership representative.

Is the extension valid?

Yes.
**New Regulations**

**Other final regulations**

- Opting in for tax years before 2018
- Opting out of BBA regime

**New Regulations**

**Re-proposed regulations**

- Scope of regime
- Partner’s return must be consistent with partnership items
- Imputed underpayment, modification, and adjustments that do no result in imputed underpayment
- Election for alternative payment of the imputed underpayment
- Administrative adjustment receipts
- Notices of Proceedings and Adjustments
- Assessment, collection, and payment of imputed underpayments
- Interest and penalties related to imputed underpayments
- Judicial review of partnership adjustments
- Period of limitation on making adjustment
Questions?

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South Dakota v. Wayfair, Inc.

Charles Hwang  
September 27, 2018
Which sellers may a State compel to collect sales taxes?

• distinction between sales taxes (collected from seller) and use taxes (collected from buyer)
• inefficient to collect from buyers, who tend to be numerous, with each buyer owing a small amount of use tax
• exceptions for high value items, such as art

Four key US Supreme Court cases

• National Bellas Hess (1967)
• Quill (1992) (Justice Stevens wrote the majority opinion)
• Netscape’s first press release: 10/13/1994
• Direct Marketing Ass’n (2015) (in a separate concurrence, Justice Kennedy suggested that Quill should be revisited)
• Wayfair (2018) (Justice Kennedy wrote the majority opinion)
South Dakota statute at issue in Wayfair

- has a safe harbor for small sellers
- is not retroactive

Wayfair opinion

- “Each year, the physical presence rule becomes further removed from economic reality and results in significant revenue losses to the States.”
- “When considering whether a State may levy a tax, Due Process and Commerce Clause standards may not be identical or coterminous, but there are significant parallels.”
• “Physical presence is not necessary to create a substantial nexus.”

• “[T]he administrative costs of compliance, especially in the modern economy with its Internet technology, are largely unrelated to whether a company happens to have a physical presence in a State.”

• “[A] company with a website accessible in South Dakota may be said to have a physical presence in the State via the customers’ computers.”

• “Quill’s physical presence rule intrudes on States’ reasonable choices in enacting their tax systems”
• “Statutes of this sort [cookie nexus, click through nexus etc.] are likely to embroil courts in technical and arbitrary disputes about what counts as physical presence.”

What about retroactivity?

• Unlike a statute, a Supreme Court case usually does not have transition rules.
• While South Dakota enacted a statute that had protections for small sellers and avoided retroactivity, other states may not do the same.
Reaction from other states?

- North Dakota: collect beginning 10/1/18
- Vermont: 7/1/18
- Iowa: 1/1/2019
- Alabama: 10/1/18
- Massachusetts: 10/1/17 (based on cookie nexus statute)
- Hawaii: 7/1/18 (or first day of next tax year if fiscal year taxpayer)
- Idaho: 7/1/18
- Indiana: 10/1/18 (pending litigation resolution)
- Wisconsin: 10/1/18

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Reaction from Congress?

- While various legislative vehicles have been introduced, unlikely that much will happen in an election year
- Even with the new Congress, will there be a desire to do something in the absence of a crisis?
**Reaction from taxpayers?**

- Are taxpayers collecting sales taxes based on Wayfair?
- What about FIN 48?

**Questions?**

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