

Tax Executives Institute: Audits and Appeals

Effective Use of Alternative Dispute Resolution Strategies

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Changes in the Rules of Engagement

- **IDR Directives** (LB&I-04-0613-004, LB&I-04-1113-009, LB&I-04-0214-004)
- **Issue Focused Examinations** (Draft Pub. 5125)
- **Informal claims limitation (first 30 days of audit)** (Draft Pub. 5125)
- **Appeals Judicial Culture and Approach (AJAC)**
(AP-08-0713-03)
- **Transfer Pricing Audit Roadmap** (Feb. 14, 2014)
- **APA and Competent Authority draft Revenue Procedures** (Notice 2013-78, Notice 2013-79)

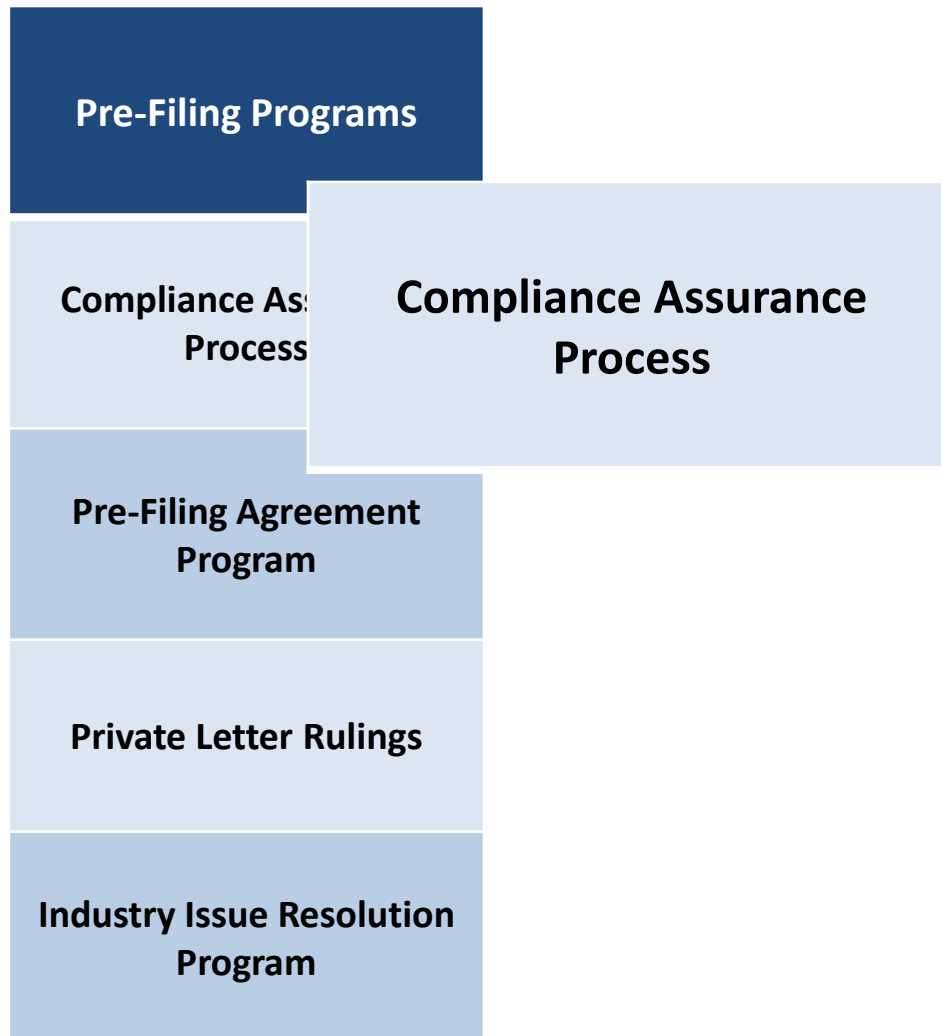
Changes in IRS Organization

- Issue Practice Groups
- International Practice Networks
- Transfer Pricing Practice
- Personnel Turnover
- Budget Crisis

Alternative Dispute Resolution Programs

Pre-Filing Programs	Audit Programs	Appeals Programs	International Programs
Compliance Assurance Process	Technical Advice Memoranda	Early Referral	Advance Pricing Agreements
Pre-Filing Agreement Program	Fast Track Settlement	Rapid Appeals Process	Competent Authority
Private Letter Rulings	Delegation Orders 4-24 and 4-25 (Appeals settlements, coordinated issues)	Appeals Arbitration	Simultaneous Examination Program
Industry Issue Resolution Program	Accelerated Issue Resolution	Post-Appeals Mediation	Simultaneous Appeals/Competent Authority

Pre-Filing ADR Programs



Compliance Assurance Process (CAP)

- Announcement 2005-87, made permanent on March 31, 2011 (IR-2011-32). IRM 4.51.8.
- 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
- Potential to transition to less burdensome “Compliance Maintenance” phase

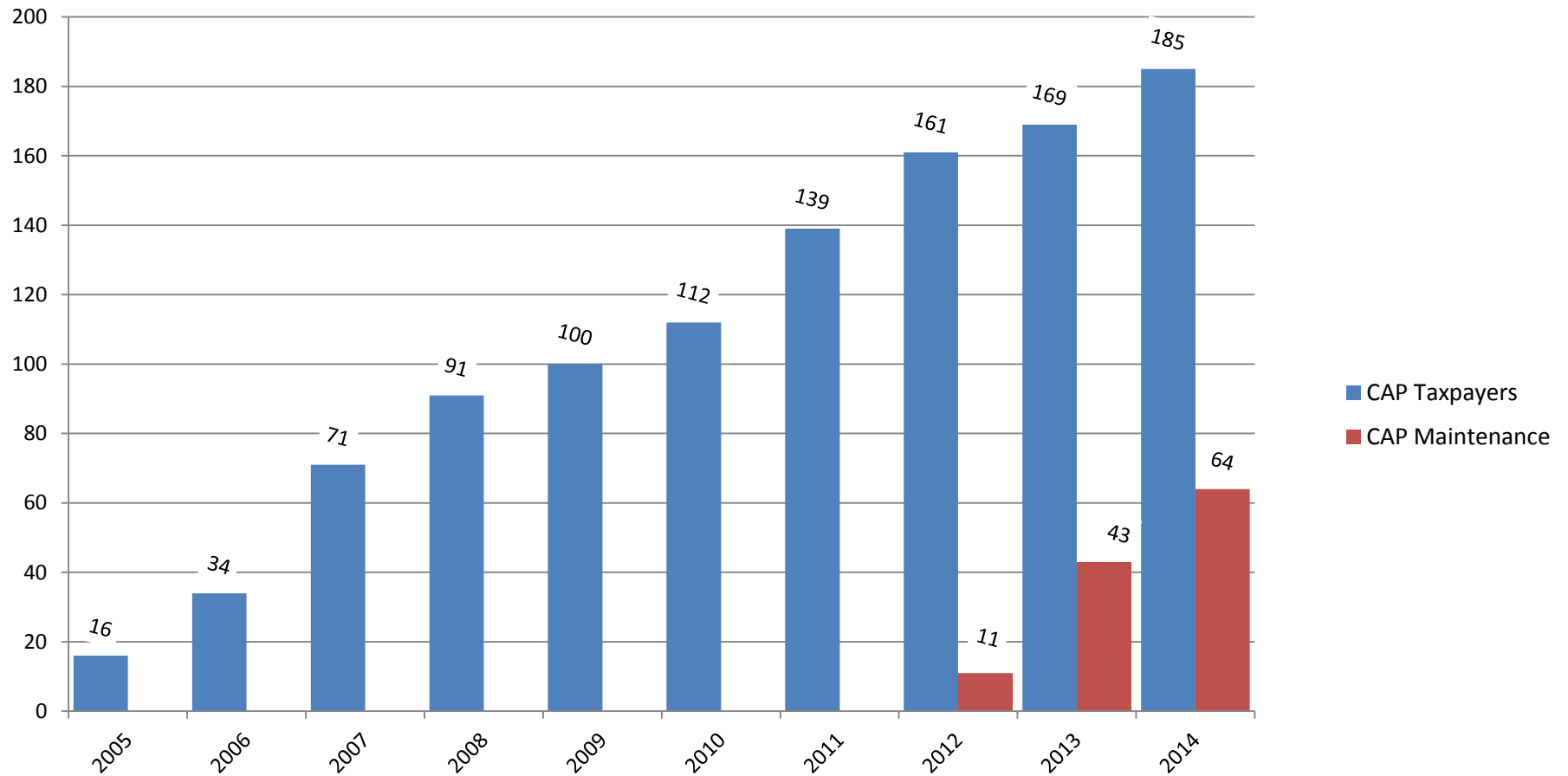
Compliance Assurance Process

- Assigned team with specialists
- Agree to Memorandum of Understanding
- Initial meetings, training, materiality thresholds
- Risk analysis and issues identification
- Quarterly assessment: Transparency and Cooperation
- Issue Resolution Agreements (IRAs), Form 906, and Acceptance Letters
- Post-filing activities
- Critique

CAP Cooperation and Transparency

- CAP Program anticipates:
 - Collaborative working relationship to identify and resolve material issues
 - Providing open and honest communication
 - Contemporaneous disclosures of completed business transactions, including steps with material tax effect
 - Providing information, documentation, and access to personnel
 - Participating in regular, productive meetings during CAP, post-filing review, and CAP critique

CAP Taxpayers



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)

CAP Considerations

- Advantages:
 - File agreed return
 - No tax reserves or disclosures
 - Current
- Disadvantages:
 - Requires taxpayer transparency
 - Resource intensive
- Need strategy for difficult issues and to keep on track
 - Transfer pricing excluded
- Normal ADR / Appeals / Litigation alternatives remain available

Compliance Maintenance

- CAP team has discretion to reduce level of review of issues raised following normal CAP procedures
- Eligibility criteria considered by IRS:
 - Completion of two CAP cycles
 - Quality of communication
 - Consistency in taxpayer personnel
 - Transparency
 - History of low-risk transactions and limited controversy
 - Quality of internal controls

Pre-Filing Agreements

- Rev. Proc. 2009-14
- On request by taxpayer, resolve specific issues in return for which there is “well-settled law” prior to filing
- Extend for as many as 4 years
- In 2013, 38 PFAs received, 35 were accepted, and 22 resulted in Closing Agreements

Pre-Filing Agreements

- Advantages
 - Certainty, currency
 - Up to four future years
 - Narrower disclosure requirements, efficient
- Disadvantages
 - Limited to issues involving well-settled law
 - Disclosure
 - Not resolve other issues

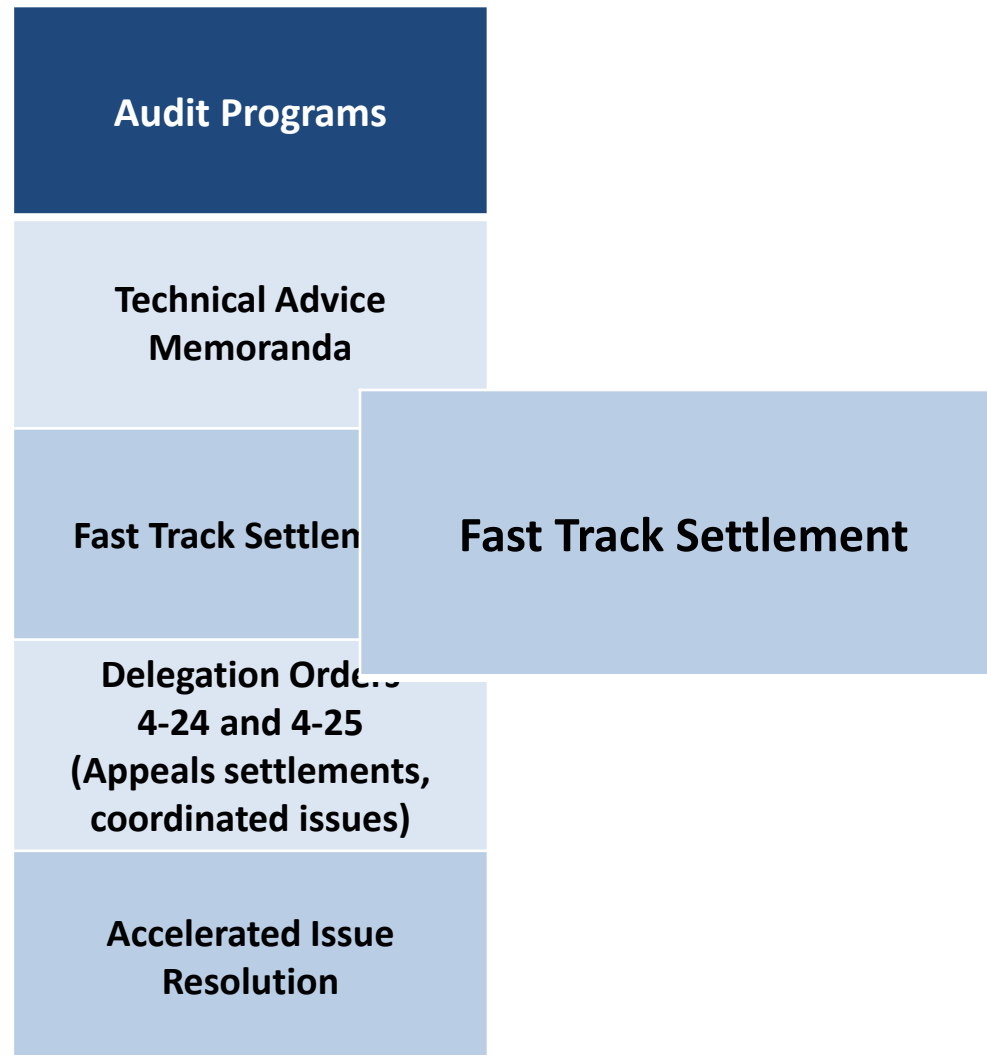
Industry Issue Resolution

- Rev. Proc. 2003-36
- Guidance for proper tax treatment of common factual situations where uncertainty leads to frequent, repetitive, and burdensome examinations
- Significant issues with large number of taxpayers in industry
- Issues selected have often involved methods counting (including repair versus capitalization)

Industry Issue Resolution

- Advantages
 - Resolve industry-level issues without examination of particular taxpayer
 - High level IRS involvement
- Disadvantages
 - May not cover each taxpayer
 - May require disclosure of confidential information

Audit ADR Programs



Fast Track Settlement

- Rev. Proc. 2003-40
- Mediation (by Appeals officer acting as mediator) between taxpayer and Exam
- Provides settlement authority to Exam, including “hazard” settlements
- All subsequent ADR and litigation procedures remain available, including Appeals

Fast Track Settlement

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

Fast Track Settlement

- Available after Notice of Proposed Adjustments (NOPA) and before 30-day letter
 - No “hot” interest
- Either party may suggest Fast Track, both must approve
 - Can withdraw at any time
- Must fully develop fact issues, taxpayer submits memorandum in response to NOPA
- Designed for resolution within 120 days
 - Taxpayer and IRS must have decision-maker present

Fast Track Considerations

- Advantages
 - Fast
 - “Two bites”
 - “Gold star” program, high degree of success
- Disadvantages
 - Ex parte not applicable
 - AJAC has changed ability to present new information to Appeals

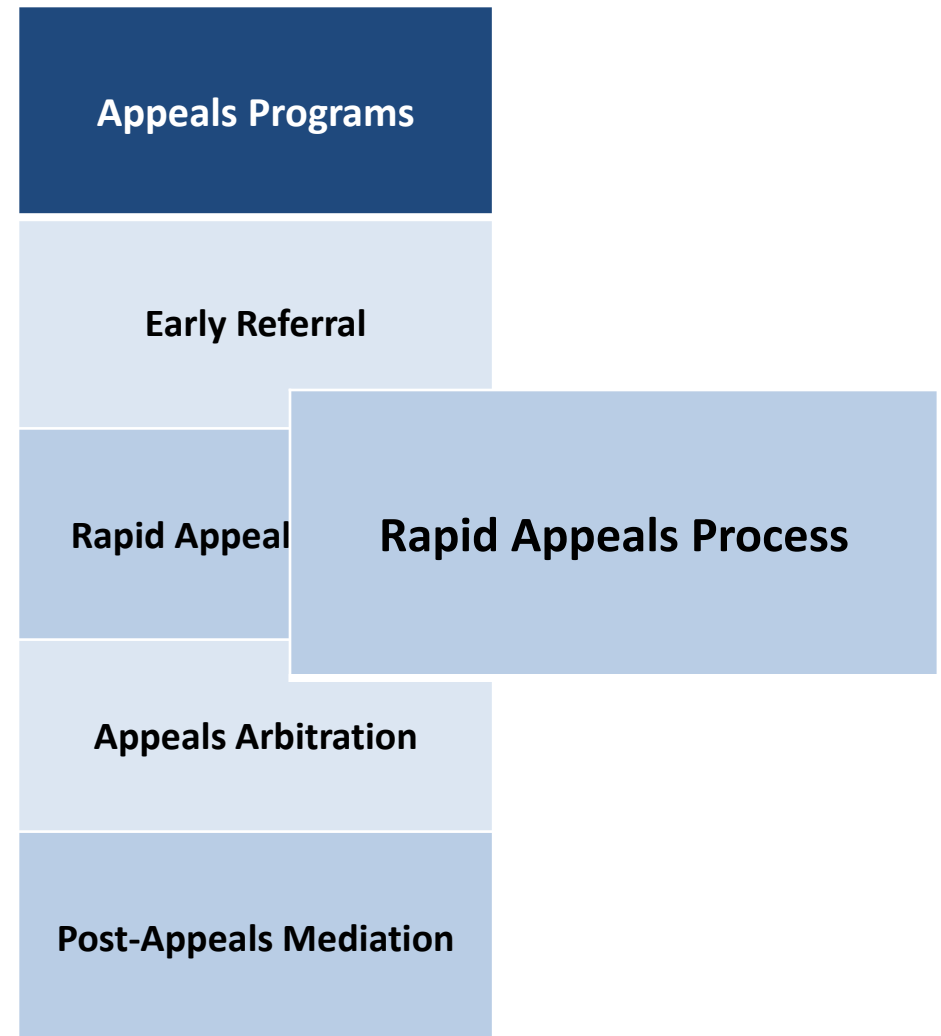
Delegation Orders 4-24 and 4-25

- Delegation Order 4-24: Exam can offer prior Appeals settlement (including Fast Track Settlement) in subsequent audit cycles if facts and law unchanged
- Delegation Order 4-25: Exam can offer settlement on coordinated issues in accordance with Appeals written settlement guidelines

Accelerated Issue Resolution

- Rev. Proc. 94-67
- In LB&I cases, Exam can apply the resolution of the same or similar issues arising from one or more previous periods to the current cycle
- Results in Closing Agreement
- Long-standing program

Alternative Dispute Resolution Programs



Appeals Judicial Approach and Culture (AJAC)

- Appeals will not engage in fact-finding
 - Appeals will not consider new facts not presented to Exam
 - Factual issues that are not properly developed are returned to Exam
- Appeals will not raise new issues
- Appeals will not reopen previously agreed issues

Rapid Appeals Process

- IRM 8.26.11
- Appeals program similar to Fast Track Settlement
- Appeals (rather than Exam in FTS) has settlement authority
- Mediation (by Appeals officer acting as mediator) between taxpayer and Exam
- Exam remains part of Appeals process, ex parte waived

Rapid Appeals Process

- All parties must agree, usually suggested by Appeals or taxpayer
- Can withdraw at any time
- Designed to permit resolution quickly, in one session
 - Decision-makers should be present

Rapid Appeals Process Considerations

- Difficult to resist Appeals suggestion of Rapid Appeals Process
 - Can create informal procedure
- Advantages
 - Fast
 - “Gold star” program
- Disadvantages
 - Ex parte difference from normal Appeals

Early Referral

- Rev. Proc. 99-28
- Referral of fully developed issues to Appeals prior to issuance of 30-day letter
 - NOPA issued on one issue, but other issues still under development
- Designed to permit faster disposition of case than if entire case was referred to Appeals
- Used for 13 cases in 2012, 10 cases in 2013

Early Referral Considerations

- Advantages
 - Separate stronger issues from weaker, less “trade-off”
 - Resolve faster
 - Ex parte rules apply
- Disadvantages
 - “One bite:” no further Appeals consideration
 - May impact later normal Appeals on other issues

Post-Appeals Mediation

- Rev. Proc. 2009-44
- Non-binding mediation following unsuccessful Appeals process
- Designed to be used if limited number of issues remain unresolved
 - Factual or legal issues
- Appeals Officer as mediator, taxpayer may use non-IRS co-mediator at taxpayer expense

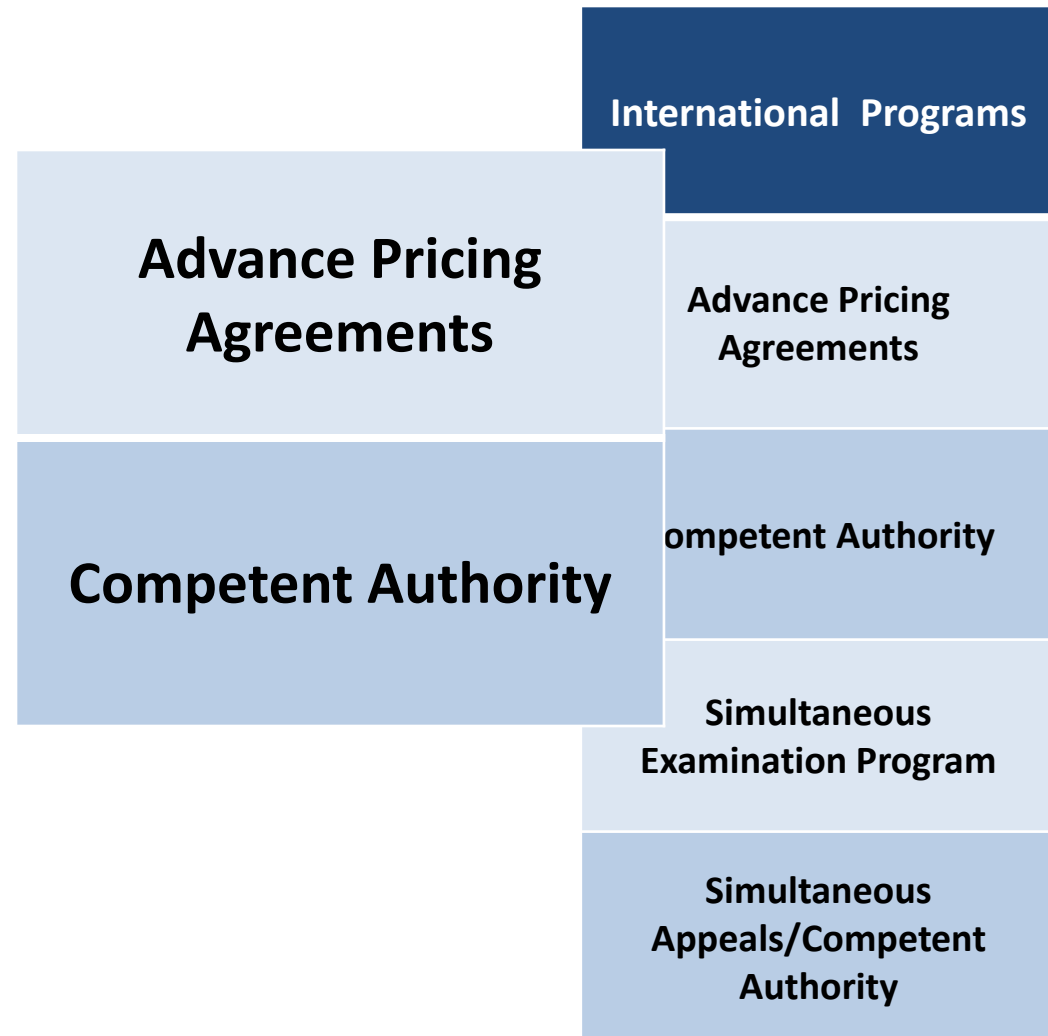
Post-Appeals Mediation

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

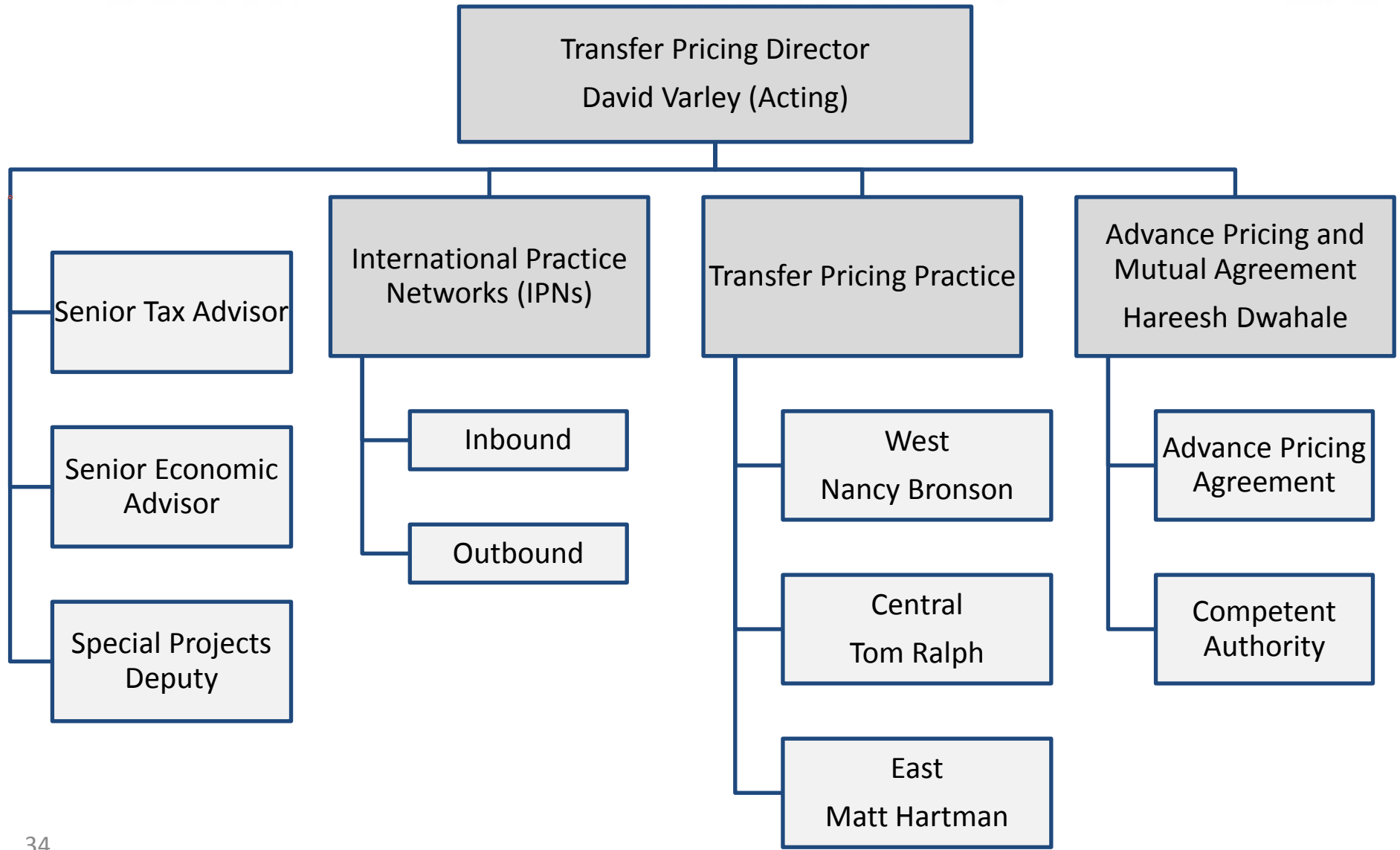
Appeals Arbitration

- Rev. Proc. 2006-44
- Binding arbitration, generally following unsuccessful Appeals process
- Taxpayer request for arbitration may be denied by Appeals (without further appeal)
 - Some treaties include binding arbitration after 2 years
- Appeals Officer as mediator, taxpayer may use non-IRS co-mediator at taxpayer expense
- Limited to factual issues
- No appeal of decision by arbitrator

International ADR Programs



IRS Transfer Pricing Operations



Advance Pricing Agreements

- Rev. Proc. 2008-31 (Notice 2013-79, proposed update)
- IRS and taxpayer contract that, so long as the taxpayer follows the APA Transfer Pricing Method, the IRS will not seek a transfer pricing adjustment
 - Typical term is 5-7 years, current year and into the future, with the chance to renew
 - Annual report required
- Generally binding absent change in facts
 - But see *Eaton Corp.* (revocation of APA pending challenge in Tax Court)

Advance Pricing Agreements

- May be bilateral (with foreign tax competent authority), unilateral, or multilateral
 - Many countries have APA programs, OECD provides guidelines
 - IRS encourages bilateral / multilateral
- Intended to be prospective, Transfer Pricing Method agreed before or as transactions occur and return filed
 - In practice, can take several years to complete, may be largely retroactive
 - Taxpayers can partially manage retroactivity through timing of APA request

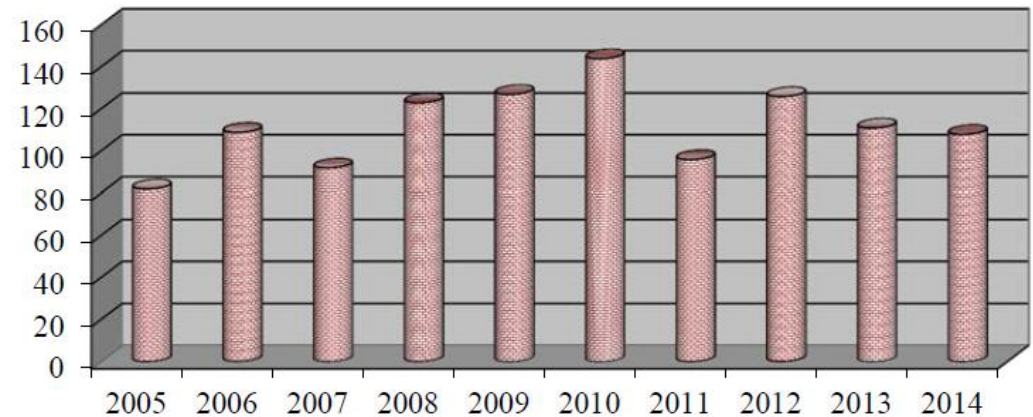
APA Considerations

- Advantages
 - Certainty on Transfer Pricing Method without the traditional audit, Appeals, litigation cycle
 - Makes more sense if potential double taxation by countries with roughly similar tax rates
 - Taxpayers can request that Transfer Pricing Method be “rolled back” to prior taxable years (Consider as audit strategy to escape from intransigent audit team)
- Disadvantages
 - Significant up-front costs, and uncertain benefit
 - Alerts IRS to transfer pricing issue
 - Makes less sense if agreement unlikely (e.g., unilateral APA where the transactions shift significant income to a tax haven)

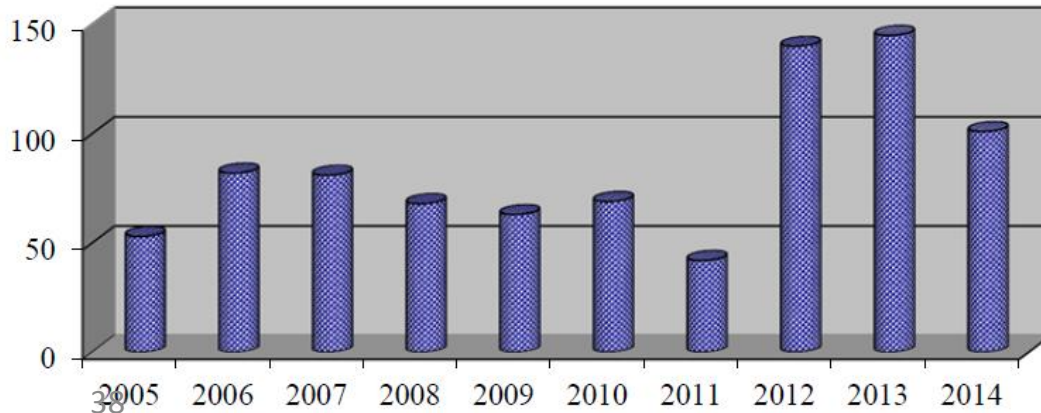
APA Applications and Completions

- 108 Applications in 2014
- 1,964 total for program

**Applications Filed
2005-2014**



**APAs Executed
2005-2014**

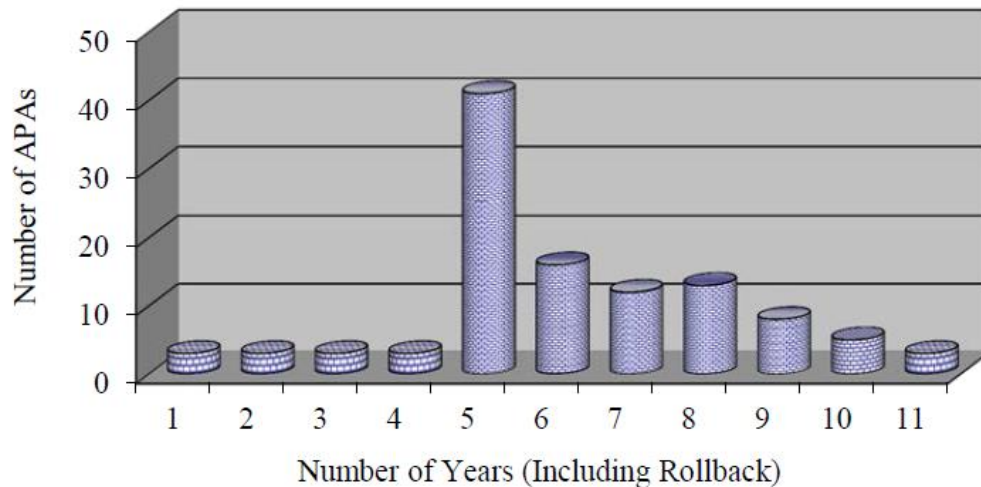


- 101 APAs executed in 2013
- 1,401 total for program

* All charts from 2014 APA Report

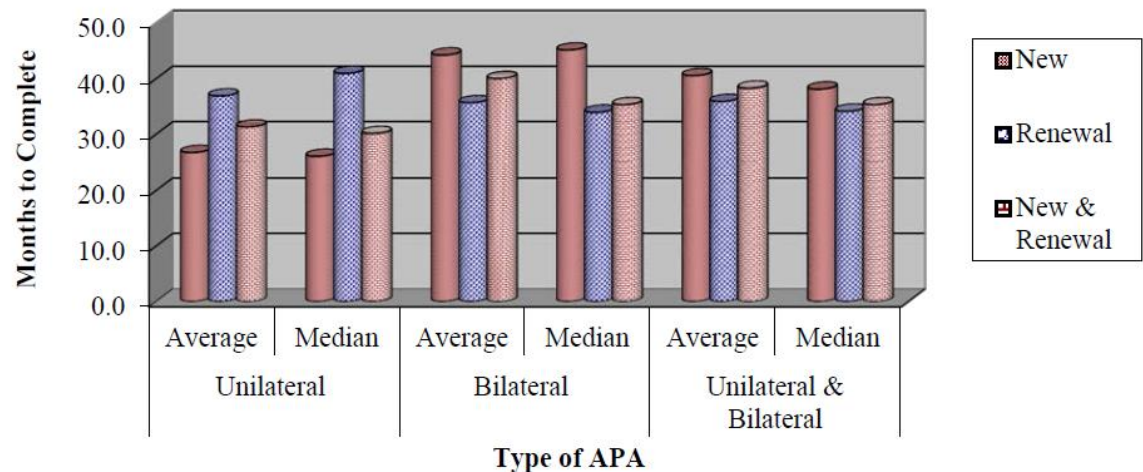
APA Term and Time to Complete

Term Length of APAs 2014



- The APA Revenue Procedure requires taxpayers to request at least 5-year APA term
- 41% of APAs signed in 2014 had 5-year term; less than 10% had less than 10-year term

- On average, it takes 40.5 months to complete a new APA, and 35.9 months for a renewal APA (time period getting shorter)



Double Taxation

- Unilateral transfer pricing adjustments can cause double taxation of income
- Tax treaties provide mechanism to avoid double tax
 - “Associated Enterprises” article – transfer pricing adjustments must conform to arm’s-length standard; other country will provide correlative relief if it agrees with the adjustment
 - “Mutual Agreement Procedure” (MAP) article – competent authorities can resolve transfer pricing cases where a taxpayer is threatened with double taxation
- US has 68 income tax treaties

Competent Authority Procedures

- Rev. Proc. 2006-54 (Notice 2013-78, proposed update)
- Double tax relief is Government-to-Government negotiation
 - Taxpayer not directly involved
 - Treaty merely obligates good faith negotiation
 - No or partial agreement – 13% of cases
- “Correlative relief”

Competent Authority Procedures

- Request as soon as the tax authority takes action that may result in taxation inconsistent with the treaty
- Preserve statute of limitations in treaty countries
- Request suspends administrative action with respect to issues before Competent Authority; for other issues normal administrative actions continue
- Competent Authority will not accept a case that is before a US court, unless the IRS Chief Counsel approves
- If a taxpayer settles with the IRS in Appeals or in court, the Competent Authority will not alter that settlement, but will present case to other country Competent Authority

Competent Authority Considerations

- Advantages
 - Allows use of US Competent Authority as taxpayer advocate with foreign taxing authority
 - Provides relief from double taxation in most cases
 - May be required for US foreign tax credits
 - Less costly than other methods
- Disadvantages
 - Taxpayer loses control of proceedings and presentation
 - Process can be very lengthy
 - Some CA relationships are better than others
 - Taxpayer may end up getting no relief (or “split the baby”)

Competent Authority Arbitration

- Emerging issue for IRS
- Baseball arbitration in several treaties
- Both sides submit position, arbiter selects one
- Current Treaties with arbitration:
 - Canada
 - Belgium
 - France
 - Germany
- Positive impact on U.S. / Canada relationship

CA Arbitration Considerations

- Advantages:
 - Reduces risk of double taxation
 - Shortens timeline
- Disadvantages
 - Not appealable if lose
 - Suffers from lack of transparency and lack of record the same as regular Competent Authority

Questions / Comments ...

