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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Inside The IRS' New Large Corporate Compliance Program

By **Jenny Austin and Andrew Allen** (June 11, 2019, 4:53 PM EDT)

Jenny Austin

Andrew Allen

The Large Business and International Division, or LB&I, of the Internal Revenue Service recently announced that it will roll out a new program, the Large Corporate Compliance, or LCC, program, to replace the Coordinated Industry Case, or CIC, program in selecting the largest and most complex corporate taxpayers.[1]

The primary objective of the LCC program will be to “efficiently focus its resources on noncompliance” by using data analytics to identify which large corporate taxpayers to audit, beginning with the 2017 tax year. The elimination of the CIC program was first hinted at in 2015 when the IRS moved toward more “risk-based” audits.

The New Large Corporate Compliance Program

Some of the key features of the LCC program’s use of data analytics will be in identifying case-pointing criteria such as gross assets and gross receipts. This automated pointing, LB&I explains, allows for a more “objective determination” of which taxpayers properly belong in the category of the largest and most complex corporate taxpayers. LB&I will then use data analytics to identify which tax returns are susceptible to the highest compliance risk, regardless of whether the taxpayer has recently been under audit or the geographical proximity between the IRS exam team and the taxpayer’s location.

For calendar year taxpayers, 2017 returns could include, among other new provisions, the Internal Revenue Code Section 965 transition tax, and the LCC program rollout may help LB&I identify which taxpayers initially to select for audit of the 2017 Tax Cuts and Jobs Act provisions.

It is no secret that the IRS has been contending with budget shortfalls for many years, resulting in fewer overall audits. The most recent statistics show that the audit rate for large corporations fell to under 50% in 2018 from over 91% in 2013.[2]

Nor is it a secret that the IRS has already been using data analytics to achieve what it calls “more efficient mission delivery.”[3] The IRS’ strategic plan for 2018 through 2022 emphasized the importance of using data analytics in conjunction with qualitative information to “select high-priority work.”[4] This includes investing in analytics and visualization software and tools as well as training for proper utilization.[5] Moving away from the CIC program may also enable LB&I to use remote audits to manage its declining resources.

The use of data analytics to identify large corporate taxpayers for auditing is consistent with LB&I's campaign approach over the last several years, as it has slowly rolled out new campaigns periodically. Both the LCC program and the focus on campaigns allow LB&I to do more with less, but continue to raise questions about how much a taxpayer's facts still matter or if everything is coming up "ratios."

Existing CIC Procedures Remain in Effect — Until Further Notice

There are several features of the CIC program that will continue to be in effect under the LCC program, at least until further notice from the IRS.[6] Pending CIC cases will be completed and closed as CICs. Existing Internal Revenue Manual provisions addressing CIC procedures will remain in effect for new LCC cases until such provisions are replaced by IRM 4.50.3 within the next two years.

Taxpayers will still be allowed to make affirmative disclosures during the first 15 days of the audit to avoid certain Internal Revenue Code Section 6662 penalties under Revenue Procedure 94-69. However, the IRS cautioned that Revenue Procedure 94-69 is currently under review. If this aspect of the LCC program is abandoned, taxpayers may risk an increase in penalties and face even more pressure on return reporting positions — while at the same time digesting all of the new TCJA guidance that continues to be released.

Coordinated Industry Case taxpayers were also able to submit informal refund claims at the beginning of an audit and have those claims considered during the audit. This is another beneficial aspect of the CIC program that, if removed, will require a taxpayer not under audit to submit a formal claim and wait for the IRS to audit the claim, or file a refund suit six months after submitting the formal claim.

Data Analytics

Taxpayers need not acquire a Ph.D. in computer sciences to understand data analytics. It is the process of examining categories of information, data sets and drawing conclusions from the patterns of recurrence or relationships. In fact, the IRS has been implementing data analytics since the 1960s, when it began using computers for selecting tax returns for audit. The IRS first created the Taxpayer Compliance Measurement Program, which evolved into the automated program called the Discriminant Inventory Function System, or DIF. The DIF system is a pure example of data analytics — a computer assigns a score to tax returns based on the probability of noncompliance.

In 2016, the IRS merged the Office of Research, Analysis and Statistics with the Office of Compliance Analytics to form the IRS' primary statistical analysis organization called the Office of Research, Applied Analytics and Statistics, or RAAS.[7] According to a 2018 Treasury Inspector General for Tax Administration, or TIGTA, report, RAAS is staffed with 350 employees, including economists, statisticians, and other technical researchers, bolstered by another 300 independent contractors and 50 employees detailed from other agencies.[8] RAAS houses five directorates, including the Statistics of Income Office, Data Management, Knowledge Development and Application, Strategy and Business Solutions, and Data Exploration and Testing. These research organizations are embedded within the larger IRS business units, including LB&I, Small Business/Self-Employed and Criminal Investigation.

The Office of Research, Applied Analytics and Statistics performs a wide range of analytical activities, including "econometric modeling, forecasting, compliance studies, analysis of proposed legislative initiatives, and strategic program evaluations." One way it accomplishes these activities is through the creation of focused units, or "Labs," including Data Exploration, Emerging Risks, Issue Identification and Compliance Modeling, to name a few.[9]

The LCC has not identified precisely which divisions within RAAS will be tapped; however, it appears RAAS is well equipped to support the LCC. The automated pointed criteria, such as gross assets and gross receipts, will be used to classify LCC returns into risk categories. Data analytics also includes looking at trends by comparing, for example, a taxpayer's current results with a prior year or taxpayers within the same industry, to look for anomalies. Global revenue authorities are routinely sharing information now so it is possible that the data being analyzed under the LCC is not limited to U.S. tax return information. Tax returns that present a degree of risk that warrants examination will be referred for audit, and the LB&I case manager and team will determine what issues will be scrutinized.[10]

Impact on Taxpayers

What does the LCC program rollout mean for corporations and businesses that have not been under continuous audit or audited in recent years? Now is a good time to perform an audit risk assessment. The IRS and other global revenue authorities have been using data analytics for years, so taxpayers should be analyzing their own data to identify any potential red flags or issues. Taxpayers can proactively prepare for potential audits or even make corrections by filing amended tax returns.

If a taxpayer is trying to determine where to begin, LB&I has now identified more than 50 compliance campaigns.[11] For each compliance campaign, LB&I provides an explanation of the issues it is concerned with and, generally, there is a practice unit available on the issue.[12] Practice units are training tools for LB&I employees with explanations of general tax concepts as well as information about a specific type of transaction. They also provide taxpayers an overview of how LB&I is looking at an issue. Reviewing the campaigns and practice units for issues relevant to the taxpayer is an easy place to start.

As the IRS migrates to the LCC program, taxpayers that have been part of the CIC program for decades may eventually learn that they are no longer under continuous audit while other taxpayers may find themselves going through an audit for the first time in recent memory. LB&I's enhanced use of data analytics will hopefully result in more focused examinations of specific issues for taxpayers and ensure that LB&I's limited resources are spent on tax returns with the highest compliance risk. This is what LB&I has been striving for since its restructuring in 2016 when it first introduced compliance campaigns as part of the move toward issue-based examinations.

Jenny A. Austin is a partner and Andrew D. Allen is an associate at Morgan Lewis & Bockius LLP.

[1] IRS News Release, IR-2019-95, LB&I Announces Large Corporate Compliance Program (May 15, 2019), https://www.irs.gov/newsroom/lbi-announces-large-corporate-compliance-program.

[2] 2018 IRS Data Book, https://www.irs.gov/pub/irs-soi/18databk.pdf.

[3] IRS Strategic Plan for 2018-2022, pp. 19-20, https://www.irs.gov/pub/irs-pdf/p3744.pdf.

[4] Id.

[5] Id.

[6] LB&I-04-0419-004 (May 21, 2019), Interim Guidance on Implementation of the Large Corporate Compliance (LCC) Program. The attachment to the Interim Guidance provides a list of IRM sections affected by the implementation of the LCC program.

[7] IRM 1.1.18 (Sept. 28, 2018).

[8] https://www.treasury.gov/tigta/auditreports/2018reports/201810026fr.pdf.

[9] IRM 1.1.18.1(1) (Sept. 28, 2018).

[10] LB&I-04-0419-004 (May 21, 2019).

[11] https://www.irs.gov/businesses/full-list-of-lb-large-business-and-international-campaigns.

[12] https://www.irs.gov/businesses/corporations/practice-units.