

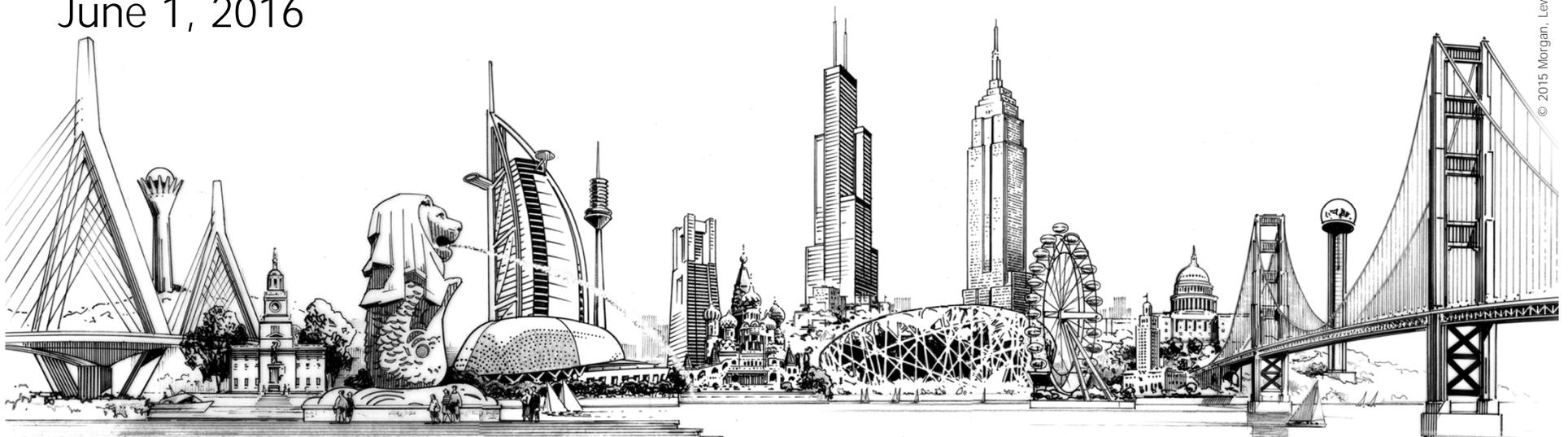
Morgan Lewis

IMPLEMENTING THE LB&I DIVISION REORGANIZATION AND ENACTMENT OF THE STREAMLINED PARTNERSHIP AUDIT RULES: WHAT SHOULD TAXPAYERS BE THINKING ABOUT NOW?

Tax Executives Institute

Houston Roundtable

June 1, 2016



Roadmap

- § Concept of Operations (“CONOPS”) and the “Future State”
- § LB&I Reorganization
- § Changes to the Exam Process: Publication 5125 and Updates to the IRM
- § Overview of the Bipartisan Budget Act (“BBA”) Legislation and Reasons for Change
- § Interplay of the LB&I Reorganization and BBA
- § What Should Taxpayer’s Do to Prepare for Audits Under the New Regime?
- § Appendix

CONOPS and the “Future State” of the IRS

- § **Began development in 2014 in response to challenges the IRS was facing**
 - 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 times of declining resources

- § **Became the cornerstone of the LB&I reorganization**
 - Intended to fundamentally transform the way in which the IRS interacts with taxpayers

Objectives of the Reorganization

- § **Change the way LB&I is structured**
 - One LB&I, practice areas, compliance areas

- § **Move to selecting work based on compliance risk**
 - Choose issues by employing data analytics and specialized staff

- § **Develop better training and career paths and better tools and support**
 - Knowledge management, deployment, mentors

- § **Define the compliance outcomes of all LB&I work**

LB&I Reorganization in Context

§ Trajectory of the Redesign of the Exam Process

- CONOPS in Development (2014)
- IDR Directive (March 2014)
- Centralized Risk Assessment Pilot Program (April 2014)
- Appeals Judicial Approach & Culture (July 2014)
- IRS Enterprise Concept of Operations (CONOPS) released March 2016 (dated Jan. 5, 2015)
- LB&I Reorganization Announced (Sept 2015)
- Pub. No. 5125 (Released February 2016)
- IRM Updated (March 2016)
- New process for cases starting as of May 1, 2016; transition for cases in process May 1st

How Far Along is the Process?

§ Restructured LB&I

- Executives in place
- Practice groups identified and staffed
- Individual managers assigned

§ Publication 5125, LB&I Exam Process, released

§ IRM updated

§ No campaigns announced yet

§ Years to fully implement

Overview of the LB&I Reorganization

§ Changes to LB&I Organization Chart Create “One LB&I”

- Single Deputy Commissioner
 - International/Domestic Deputy Commissioners merge
- Two Assistant Deputy Commissioners: International, and 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

The Practice Areas

§ 5 Substantive Practice Areas:

- Passthrough Entities
- Enterprise Activities
- Cross-Border Activities
- Withholding & International Individual Compliance
- Treaty and Transfer Pricing Operations

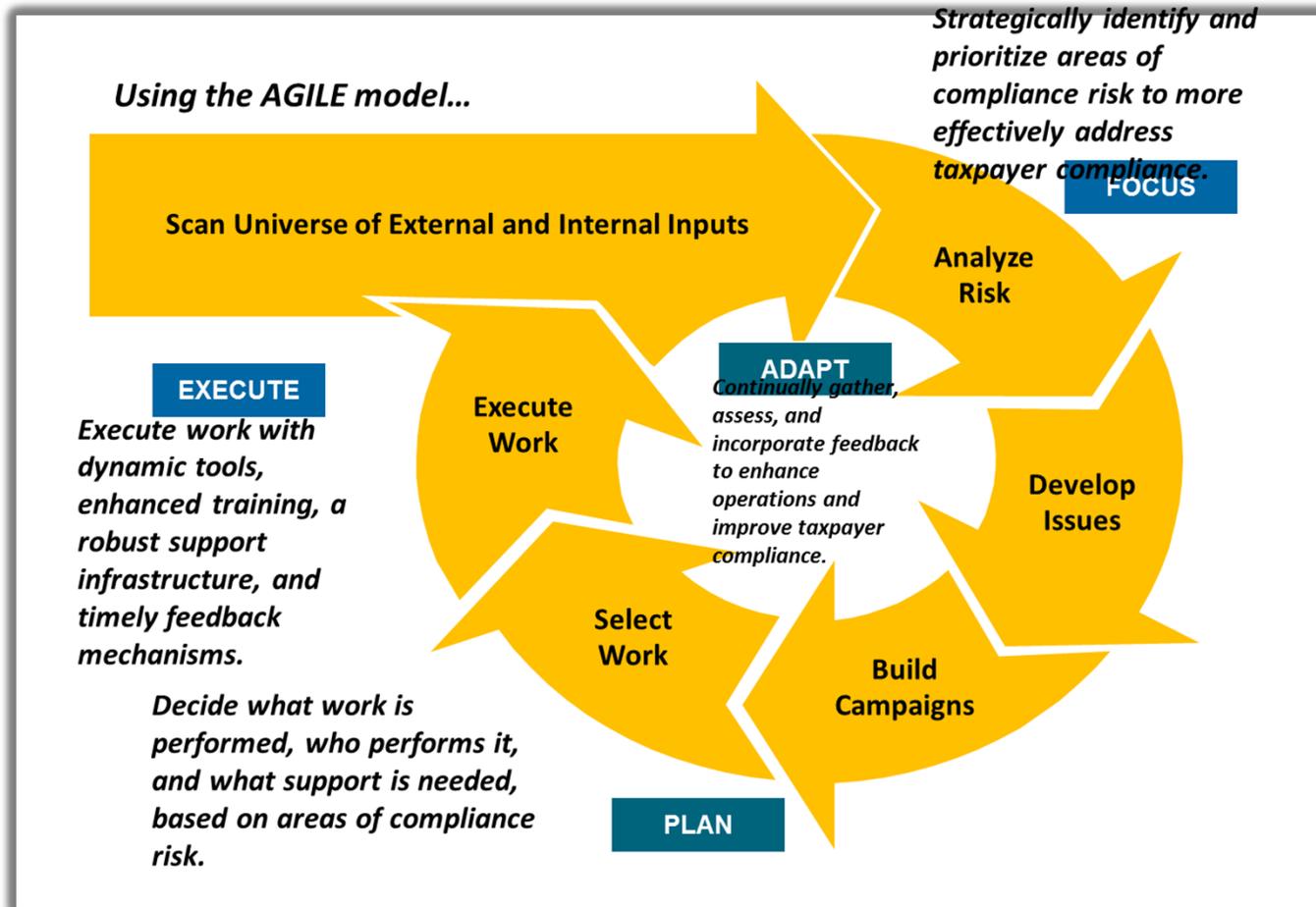
§ 4 Geographic Practice Areas:

- Western (Oakland)
- Central (Houston)
- Eastern (Downers Grove)
- Northeastern (New York)

Issue Focused Exam Process

- § 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

Use of an Integrated Feedback Loop



New LB&I Examination Process (“LEP”): Publication 5125 (February 2016)

- § Replaces current “Quality Exam Process” incorporating
 - Information Document Request Directive
 - Appeals Judicial Approach and Culture
- § Updates to IRM 4.46 sections 1-6 issued March 2016 to reflect LEP
- § Effective for examinations starting as of May 1, 2016
- § For cases in process as of May 1, transition to the new process by adopting changes in the Execution and Resolution phases
- § <https://www.irs.gov/Businesses/Corporations/Large-Business- and-International-Examination-Process>

LEP: Publication 5125 (cont.)

- § Designed to implement the issue-based approach for conducting examinations
- § Emphasizes collaboration
 - Exam Team and taxpayer expected to work together in spirit of collaboration, responsiveness and collaboration
- § Introduces the “issue team concept” and defines the roles and responsibilities of the issue team members and taxpayer
- § Mandates new claim procedures for submitting informal claims for refund within 30-days of opening conference

Three Stages of the LB&I Examination Process

1. Planning Phase

- § The issue team and taxpayer are encouraged to work collaboratively to establish audit steps, agree to an examination timeline, and develop the issues selected for examination
- § Limitation on submission of affirmative adjustments

2. Execution Phase

- § Failure to respond to IDRs timely triggers mandatory LB&I IDR enforcement policies
- § Both parties are expected collaborate to arrive at a written acknowledgement of all relevant facts and disputed facts for unagreed issues
- § Pro-forma – “IDR for Acknowledgement of Facts on Unagreed Issues” (See IRM Exhibit 4.46.4-3)
- § Closest equivalent is Stipulation of Facts in litigation, but at the administrative level

3. Resolution Phase

- § The parties are also expected to work together to resolve issues at the earliest opportunity using the appropriate issue resolution tool

Pro Forma IDR -- IRM Exhibit 4.46.4-3

Form 4564 (Rev. September 2006)	Department of the Treasury — Internal Revenue Service Information Document Request		Request Number
To: (Name of Taxpayer and Company Division or Branch)		Subject	
		SAIN number	Submitted to:
		Dates of Previous Requests (mmddyyyy)	
<i>Please return Part 2 with listed documents to requester identified below</i>			
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).			
<ul style="list-style-type: none"> (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.			
Information Due By		At Next Appointment <input type="checkbox"/>	Mail in <input type="checkbox"/>
From:	Name and Title of Requester	Employee ID number	Date (mmddyyyy)
	Name, Title	Badge #####	MM/DD/YYYY
	Office Location		Telephone Number
	Street Address City, State Zip code e-Fax ###-###-####		(###) ### -####
Catalog Number 23145K	www.irs.gov	Part 1 - Taxpayer's File Copy	Form 4564 (Rev. 9-2006)

LEP: Expectations with Respect to Claims

§ Informal Claims for Refund

- Provide to the exam team within 30 days of the opening conference
- After 30 days, must file formal claims (unless issue has been identified for examination and no IRS published guidance specifically requiring formal claims)
- In limited circumstances exceptions to the formal claims process may be granted by LB&I senior management.

§ Claims will be disallowed if Treasury Regulation Section 301.6402.2 standards are not met

Summary: Issue Focused Exam Process

§ 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

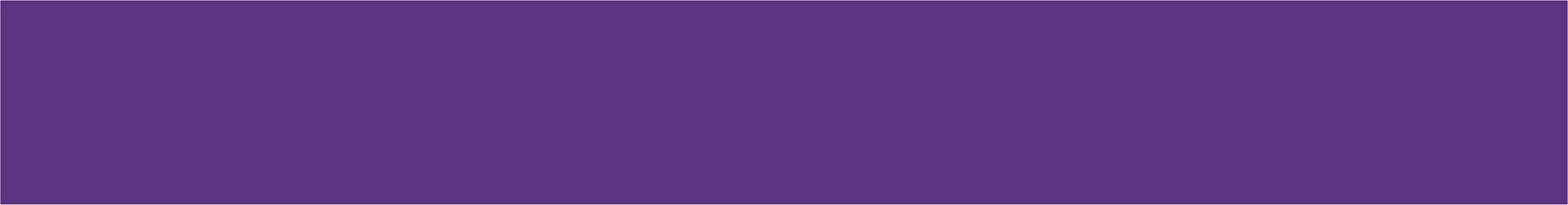
How will the process work when the taxpayer has multiple issue teams working their return?

§ Issue Elevation Process

- Root causes of taxpayer hesitation
- Gather feedback from taxpayers to develop solution
- Develop proposed procedures for IRS
- Taxpayers and TEI to suggest Rules of Collaboration
- IRS to establish Rules of Engagement
- Increase pressure to change what is not working
- Communicate, Communicate, Communicate!!

Next Steps: Open Questions

- § Keeping case management/discretion at field level?
- § How will Practice Areas work together?
- § Rev. Proc. 94-69 disclosures
- § Impact on settlement negotiations?
- § Impact on CAP?
- § Is currency still important?
- § What about training for LB&I agents?
- § How will Counsel be affected?
- § How will this impact litigation as a resolution tool?



Bipartisan Budget Act

While LB&I Was Restructuring . . .

§ Congress completely changed the rules for auditing partnerships

§ **Attributable to:**

- Explosion in the use of partnerships as a business entity
- Very low audit rates and very high “no change” results
- Because it wasn’t believed that partnerships were more compliant, Congress and the GAO began to focus on TEFRA’s faults

The Bipartisan Budget Act: An Overview

§ Objective: Make it easy for the IRS to assess and collect taxes attributable to partnership operations

- Creates a single, “streamlined” set of partnership audit rules
- Default rule is assessment and collection of tax at the partnership level
- Administrative ease and simplicity at the expense of accuracy and “due process”
- Result is “rough justice” at best and only with careful planning
- No one-size fits all

§ Repeals TEFRA and the electing large partnership rules

§ Applies to taxable years beginning after December 31, 2017, or via election for taxable years beginning after the enactment date

- Transition examinations will continue and require careful management

§ The new regime appears to be good for IRS certainty, possibly good for collection of revenues, and bad for accuracy

The Bipartisan Budget Act: An Overview

§ **By default, determination at the partnership level** - §§ 6221(a) and 6225

- Any adjustment to items of partnership income, gain, loss, or credit (and any partner's distributive share thereof) determined at the partnership level
- All tax, penalties, and interest attributable to any adjustment assessed and collected at the partnership level as an "Imputed Underpayment"
- All partnership favorable adjustments are allocated as deductions to partners in the year that the partnership proceeding closes ("Adjustment Year"), not the reviewed year ("Reviewed Year")
- Any payments, including interest, paid by the partnership or partners are not deductible
- Limited and problematic mechanisms to shift liability from the partnership to the partners

The Bipartisan Budget Act: An Overview

§ The new regime provides 4 mechanisms to ameliorate distortions that could arise under default rule

- Modifications to the Imputed Underpayment that the partnership pays - § 6225(c)(3) and (c)(4)
- Reduction of the Imputed Underpayment to the extent that partnership adjustments are shifted to partners through filing amended returns for the reviewed year - § 6225(c)(2)
- Shifting of the liability to reviewed year partners through election and issuance of amended statements - § 6226
- Election out, if eligible - § 6221(b)

§ Each of these mechanisms has flaws and comes with trade-offs

Procedural Aspects: The Partnership Representative

- § **A sole “Partnership Representative” controls the examination and binds the partnership and all partners**
 - Replaces the TEFRA concept of a “tax matters partner”
 - The partnership representative need not be a partner
 - Partnership selects representative
 - Must be a “person” with a “substantial presence” in the United States
 - In absence of a selection, the Secretary may appoint
- § **No participation by partners in partnership examination**
 - Partners not entitled to participate and have no notice rights
 - Partners bound by Partnership Representative
 - New rules eliminate “due process” rights found in TEFRA

Procedural Aspects: Statute of Limitations

§ Statute of limitations

- Runs at the partnership level
- Generally creates a 3-year period of limitations
- Partner statute of limitations is irrelevant
- Some exceptions in the case of modifications to Imputed Underpayment, where an FPA was issued, and in cases where a petition has been filed

Interplay with the LB&I Reorganization

§ Realignment of resources into nine “Practice Areas”

- One devoted to “Pass Through Entities”
- Cheryl Claybough recently appointed Director of Pass Through Entities PA

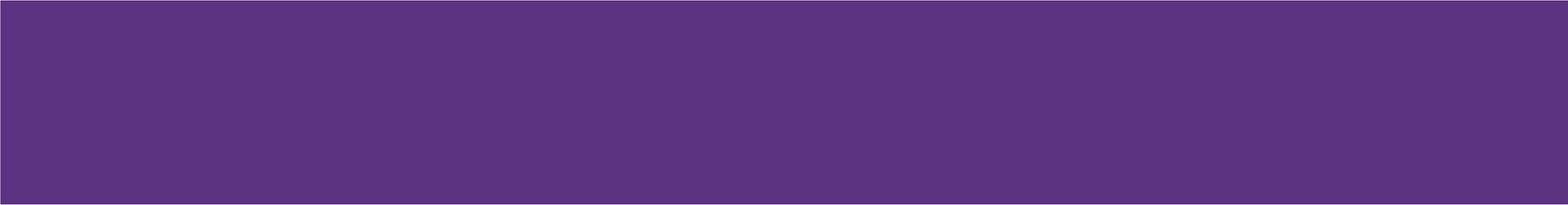
§ Centralized risk model for case/issue selection

§ Objective to direct resources to cases with highest compliance risk

§ Focus on streamlined audits with issue-focused approach

§ Development of “Compliance Campaigns” and tailored compliance treatments to address current emerging compliance concerns

-



Building Your Audit Management Strategy: What Should Taxpayers Do Now?

How to Prepare for an Issue-Based Exam

§ Start with Internal Resources

- Risk assess returns to identify reporting positions that suggest an issue or campaign
- Review financial statement disclosures and analysts reports
- Research whether your reporting positions or transactions have received press coverage

How to Prepare for an Issue-Based Exam (cont.)

§ Make Use of IRS Resources

- Audit techniques guides
 - <https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Audit-Techniques-Guides-ATGs>
- International Practice Units
 - <https://www.irs.gov/Businesses/Corporations/International-Practice-Units>
- Transfer Pricing Audit Roadmap
 - <https://www.irs.gov/pub/irs-utl/FinalTrfPrcRoadMap.pdf>
- IRS taxpayer transcripts
 - <https://www.irs.gov/Tax-Professionals/e-services---Online-Tools-for-Tax-Professionals>
- Recent IRS guidance (CCAs, etc. on your potential issues or issues identified as campaigns)

How to Prepare for an Issue-Based Exam (cont.)

§ Prepare defense file

- Gather transaction and substantiation documents
- Identify witnesses and consider interviewing
- Consider third parties and their roles
- Draft or outline fact statements for key return positions or transactions

§ Review transactions and return for potential application of penalties

- Prepare Rev. Proc. 94-69 disclosures
- Develop facts to support penalty defenses

How to Prepare for an Issue-Based Exam (cont.)

§ Review internal controls and processes to ensure sufficiency and appropriate documentation exists

- FACTA compliance
- Employment tax reporting
- Information reporting, e.g., Form 1042
- BEPS country-by-country reporting

§ Consider resolution strategies

- Model alternative scenarios
- Understand impacts of carryforwards, carrybacks, interest, potential penalties, other limitations

Informal Claims for Refund

- § May be asked to submit within 30 days of opening conference
- § Prepare prior to audit
 - Detailed statement of facts with documentation
 - Legal authority to support claim for refund

Strategies to Reduce Audit Risk

§ Consider IRS Early Resolution Tools

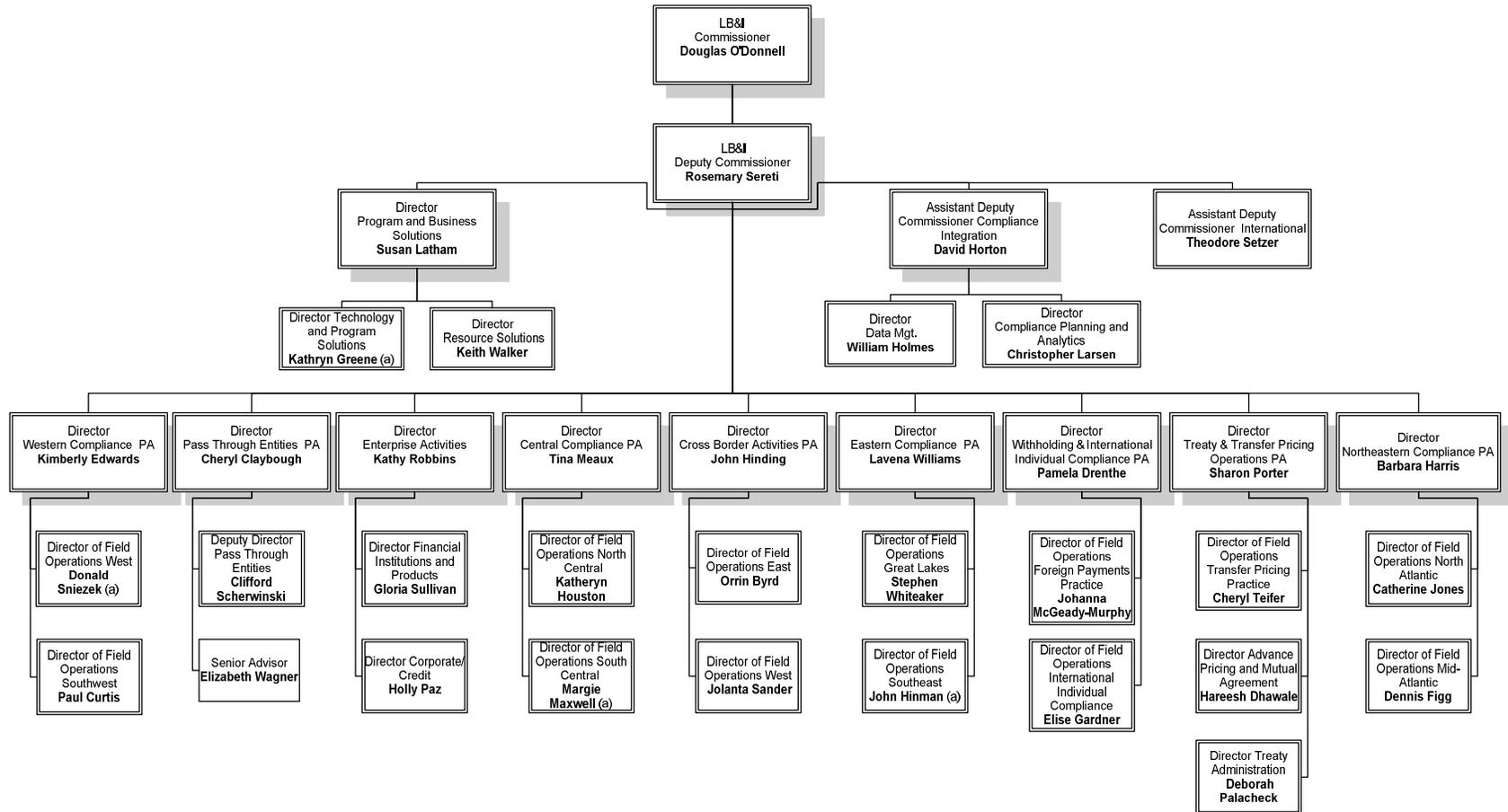
- Industry Issue Resolution Program
- Pre-filing Agreements
- Advance Pricing Agreements

§ What About the Compliance Assurance Process (“CAP”)?

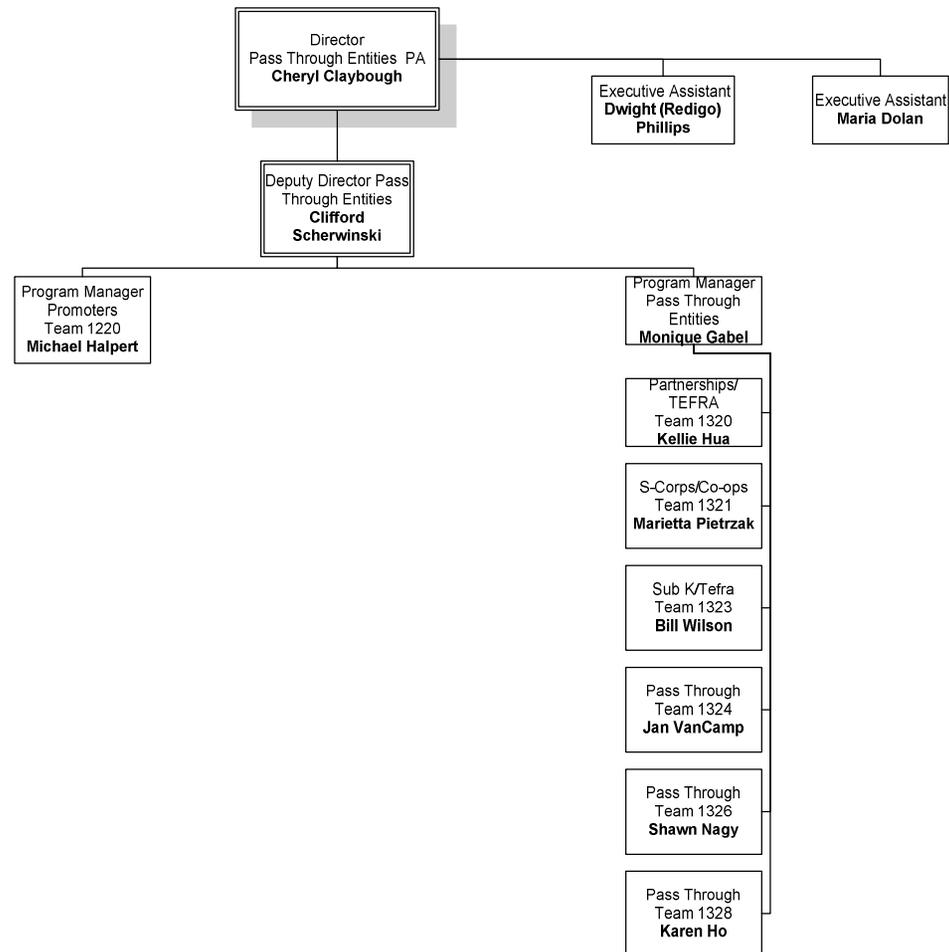
Questions?

Appendix

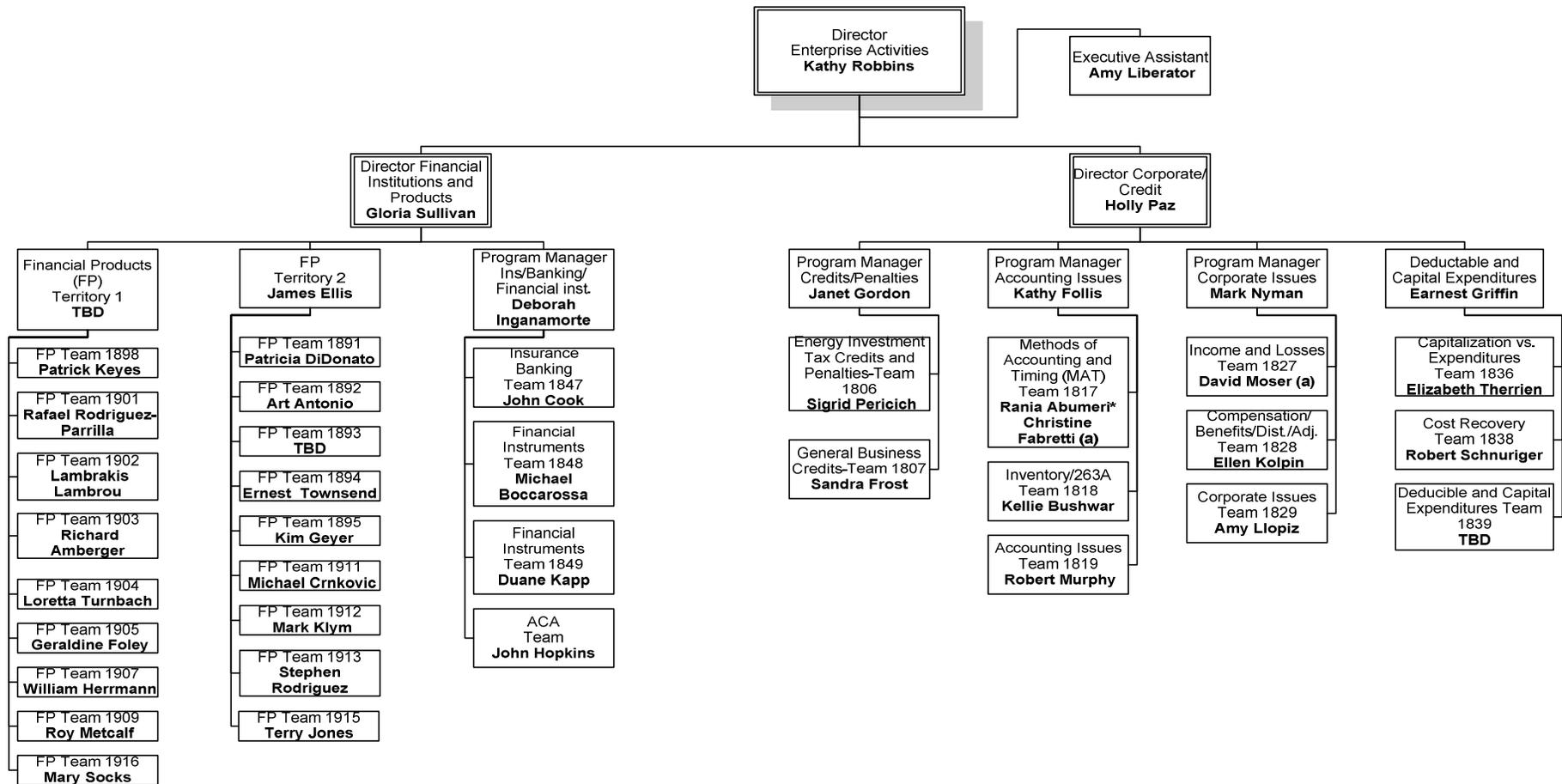
LB&I High Level Organization Chart



PA: Pass Through Entities



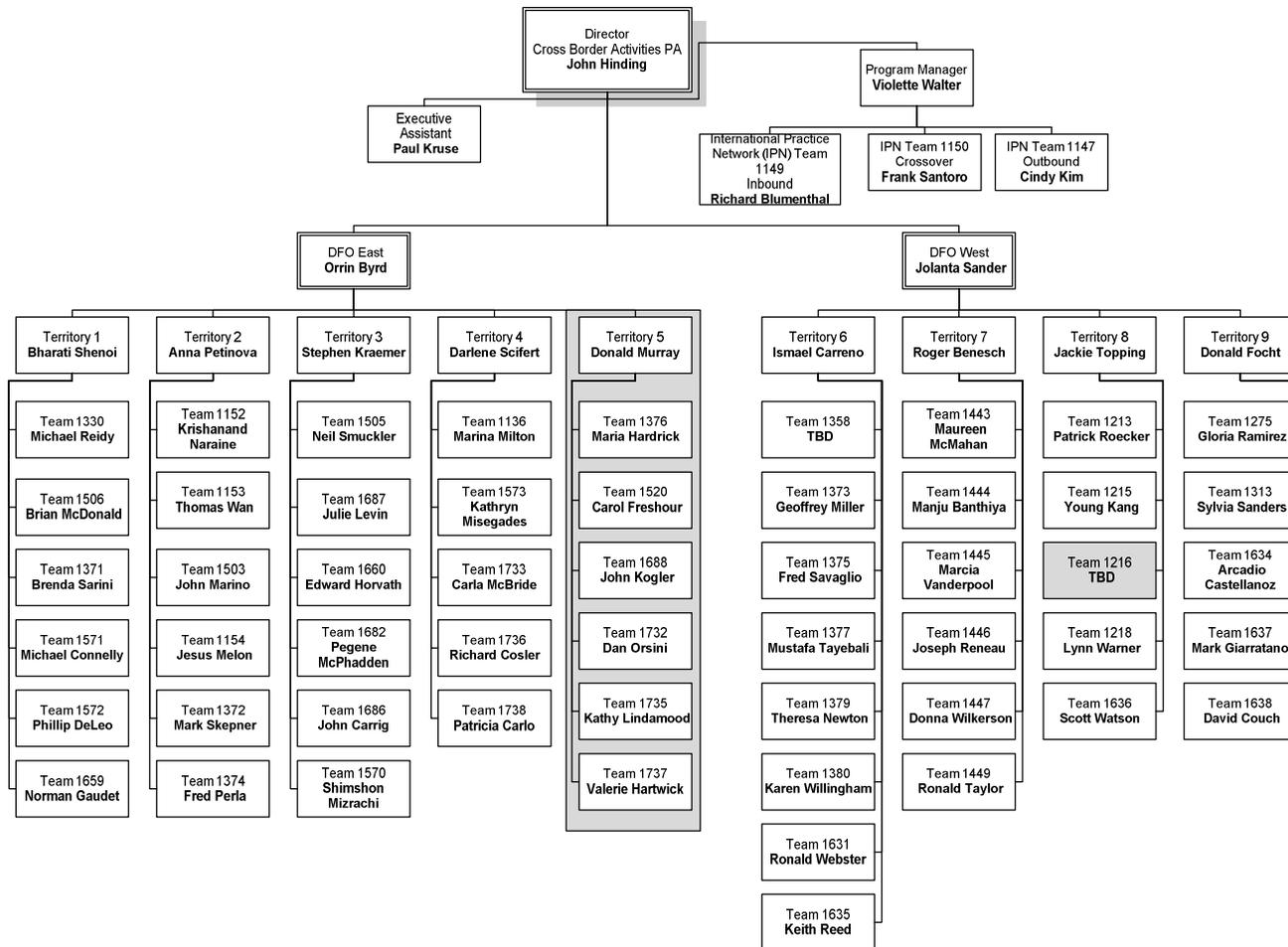
PA: Enterprise Activities



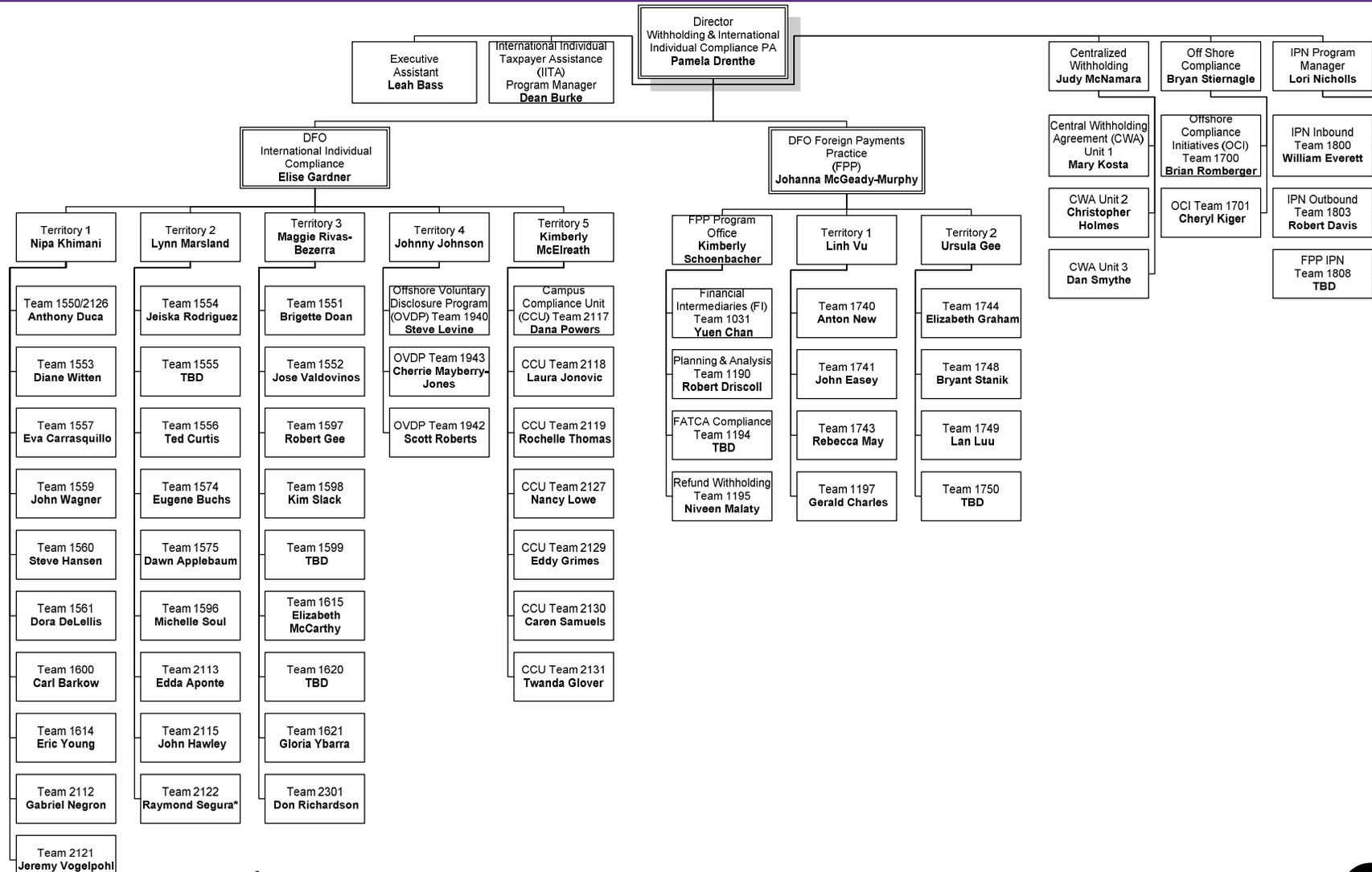
Double-lined boxes indicate Executive Level
TBD – To Be Determined Includes vacant
positions and positions currently occupied by

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

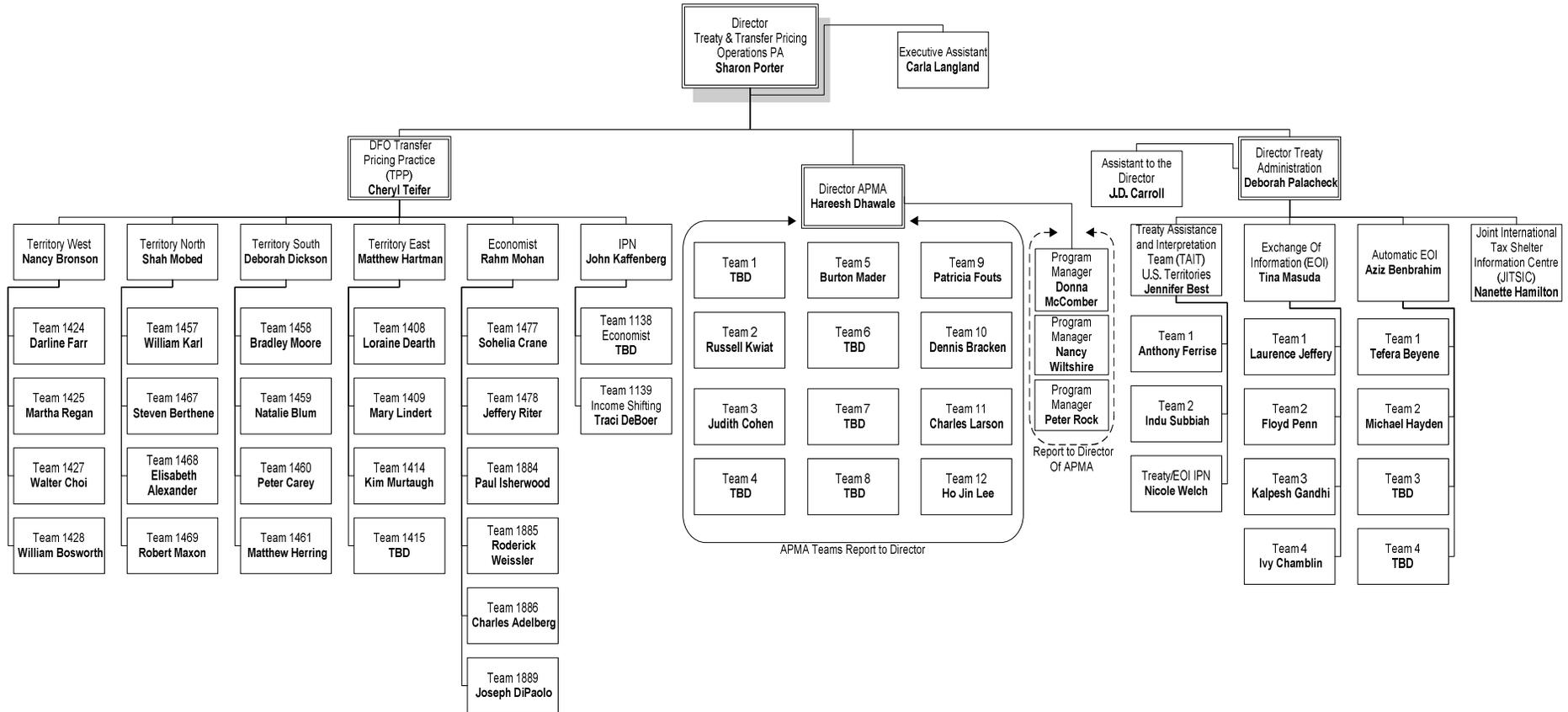
PA: Cross Border Activities



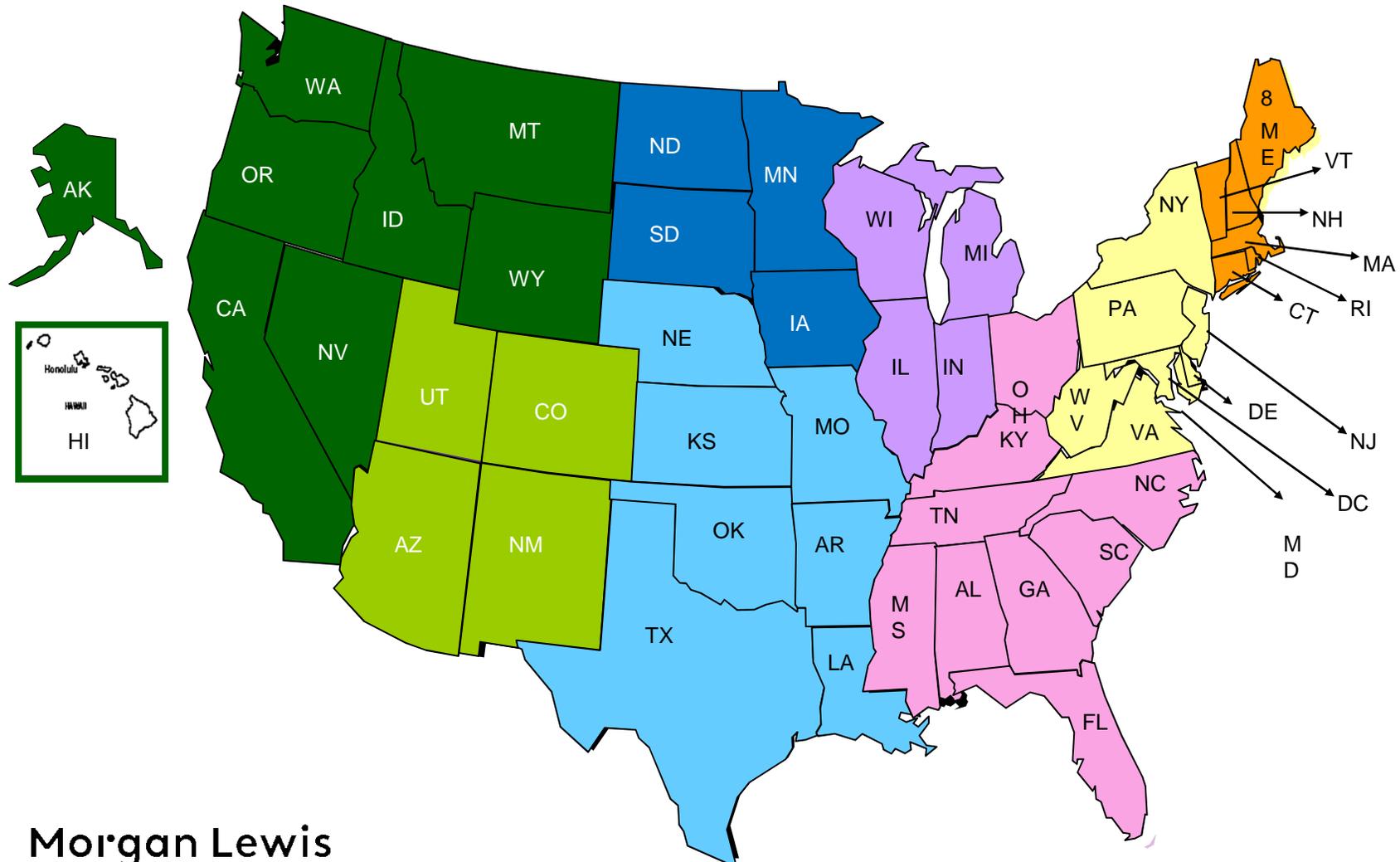
PA: Withholding & Int'l Individual Compliance



PA: Treaty & Transfer Pricing Operations



Geographic Practice Area Map



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Updates to the IRM 4.46.1, .3, .4 and .5 Published March 2016

§ IRM 4.46.1, *General Information and Definitions*, updates:

- Defines the roles and responsibilities of the exam team members:
 - 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

Updates to the IRM 4.46.1, .3, .4 and .5 Published March 2016 (cont.)

§ IRM 4.46.3, *Planning the Examination*, updates:

- 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)

Updates to the IRM 4.46.1, .3, .4 and .5 Published March 2016 (cont.)

§ IRM 4.46.3 – Refunds/Affirmative Adjustments

- Added new LB&I refund claim (affirmative adjustment) process described in Publication 5125
- Once the examination commences, LB&I will only accept informal claims that are submitted within 30 days of the opening conference
- Claims filed after the 30-day period must be filed using formal claim procedures (Form 1120X, 1040X or Form 843)
- Requirement may be waived for a claim relating to an issue that has been identified for examination (unless published guidance requires a formal claim to be filed for the issue)
- Both formal and informal claims for refund must meet Treas. Reg. § 301.6402-2 the standards
- Determination of claim sufficiency should be manifest without the need to use IDRs
- Deficiencies in claim are to be discussed with taxpayer and taxpayer should have chance to correct

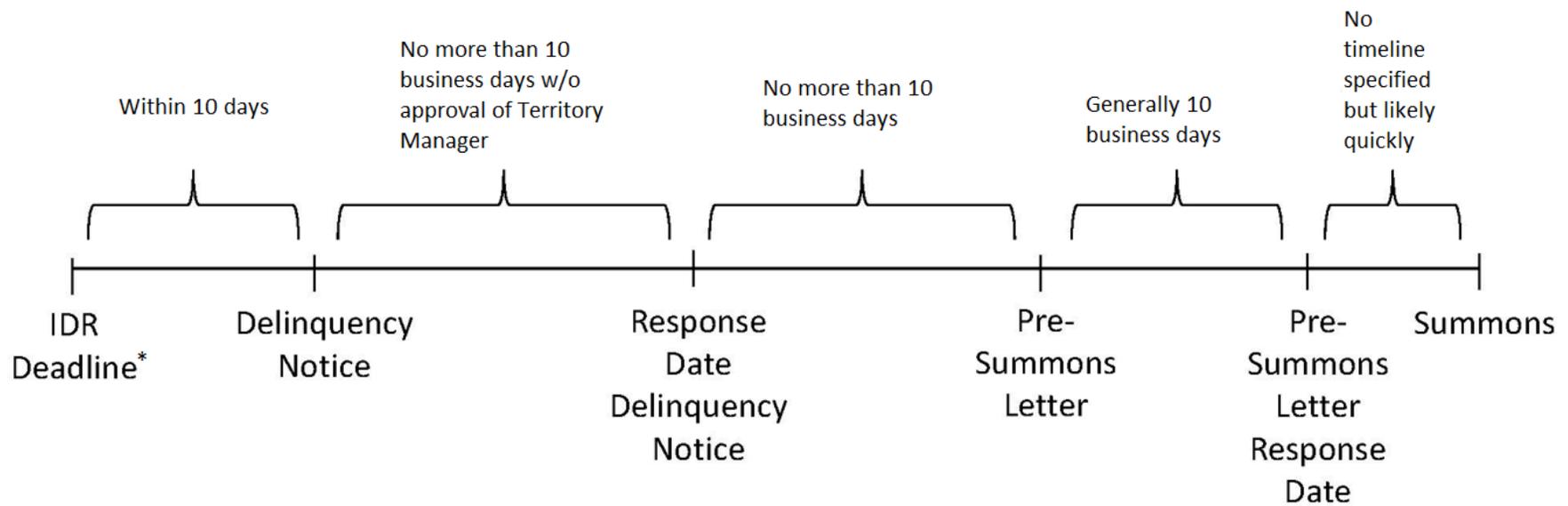
Updates to the IRM 4.46.1, .3, .4 and .5 Published March 2016 (cont.)

§ IRM 4.46.4, *Executing the Examination*, updates:

- Focuses on cooperation and transparency between the issue team and the taxpayer
- Exchange of information
- Develop facts
- Mutually agree upon timelines
- Implements the IDR procedures published in the LB&I Directive (LB&I-04-0214-004) *Updated Guidance for Examiners on IDR Enforcement Process*
- Added *Written Acknowledgment of the Facts (AOF)* (4.46.4.9) to provide guidelines for working with the taxpayer to obtain acknowledgement of facts before an unagreed issue can be sent to Appeals
- Added new guidance on issuing Form 5701, *Notice of Proposed Adjustments*

Updates to the IRM 4.46.1, .3, .4 and .5 Published March 2016 (cont.)

§ IRM 4.46.4, *Executing the Examination* (cont'd):



*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

Updates to the IRM 4.46.1, .3, .4 and .5 Published March 2016 (cont.)

§ IRM 4.46.5, *Resolving the Examination*, updates:

- Combined former IRM sections 4.46.5, *Issue Development, Proposal and Resolution*, and 4.46.7, *Post Examination Activities*, into a streamlined set of guidelines focusing on issue resolution and examination closing procedures
- Encourages issue team to use all appropriate issue resolution tools
- Must consider Fast Track Settlement for all unagreed issues
- Modified guidelines for coordination with Appeals including dissent procedures and added new Appeals Policy

Biography



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Sheri Dillon focuses on federal tax controversy and tax-planning matters, guiding clients through the IRS examination and appeals and the administrative claims process. Sheri also counsels clients on a variety of tax-planning matters that involve acquisitions, dispositions, combinations, and debt restructuring and reorganizations, with a special focus on partnership transactions and closely held businesses.

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