Resolving Large Corporate Tax Disputes

Moderator/Panelist
Rebecca B. Carey, EY, Philadelphia, PA

Panelists
Kevin M. Brown, PwC, Washington, DC
John E. Hinding, Director, Cross Border Activities Practice Area, Large Business and International, Internal Revenue Service, Washington, DC
Gary Wilcox, Mayer Brown, Washington, DC
State of the IRS

• New leadership
• Staffing continues to decline
• Budget woes continue
• Implementation of new tax law
• Key legacy computing systems developed over 50 years ago
• Critical cyber security concerns
• Audits and post filing collections continue to decline
Current state of LB&I

• Realignment of resources to “Practice Areas”
• Focus on centralized identification of issues
• Rollout of 45 campaigns
• New audit rules in IRM 4.46 and Publication 5125
• New CAP participants anticipated in 2019
What is the scope of the audit?

- Only issues selected in advance and identified in audit plan?
- Under what circumstances may Exam pursue issues not identified at opening conference?
- Are taxpayers told whether they are part of one or more campaigns?
- Are certain large taxpayers still audited the old fashioned way?
- What time constraints should Exam be operating under?
What should taxpayers expect if they are part of one of these Cross-Border Campaigns?

• Repatriation
• Form 1120-F Non-Filers
• Corporate Direct (Section 901) Foreign Tax Credit
• Section 956 Avoidance
• Foreign Base Company Sales Income: Manufacturing Branch Rules
• Repatriation via Foreign Triangular Reorganizations
• Section 965 Transition Tax
Best practices for using the IDR process to build the taxpayer’s case

- Use IDR process to educate Exam and frame the issues
- Anticipate IRS concerns and address them
- Ensure that responses provide complete statement of facts in record for Appeals
- Address your audience. Is it counsel? IRS specialist? IRS coordinated issue team?
- Don’t miss response deadlines without discussing with Exam team in advance
- Avoid absolute statements regarding lack of responsive data
Common objections to IDR

- IDR fails to comply with LB&I’s issue-focused policy (e.g., “fishing expedition” IDR)
- Information is already in Exam’s possession
- Overly burdensome (e.g., “any and all” IDR)
- Irrelevant to underlying issue
- Requests for electronic data
  - Emails
  - Spreadsheets
  - Data sites
Handling requests for privileged documents

• Opinions and memoranda
  – What if documents shown to financial auditor?
  – Subject matter waiver doctrine

• Slide decks

• External emails with advisors

• Internal emails between company employees

• Board minutes and presentations

• Invoices

• Tax accrual workpapers
Handing requests for interviews

• Question why information could not be provided through written IDR response

• Consider offering taxpayer presentation in lieu of interviews

• If inevitable, negotiate scope, ask for list of questions and topics, and set time limits

• Interviewee also should receive in advance copies of any documents that are subject of questions

• Taxpayer or IRS can transcribe interview – helpful or harmful?

• Remember ability to assert privilege
Ways to help channel the examination toward resolution

• Obtain Exam’s audit plan and risk analysis
• Offer presentation of transaction by taxpayer?
• Regularly ask Exam to provide its working theory
• Ask to speak with technical experts or counsel advising Exam team
• Understand role of issue managers and establishing relationships with their managers
• Set up bi-weekly calls to monitor progress, discuss issues
• Regularly remind Exam of audit timeline
• Escalate when necessary to keep things on track
Taxpayers should leverage the various LB&I directives and policies, for example:

1) **Transfer Pricing.** LB&I issued five memos in 2018 for LB&I employees relating to transfer pricing enforcement. All five memos speak to curtailing IRS resources on TP exam issues:

   - Exam teams are no longer required to issue the “mandatory TP Information Documents Requests (IDRs)” on all cases
   - Exam teams are required to obtain Technical Transfer Pricing Office (TTPO) review panel approval before changing the taxpayer’s selection of “best method”
   - Reiteration of the appropriate assertion of penalties on TP cases
   - Stop developing adjustments on CSAs based on changing the taxpayer’s Relative Anticipated Benefits (RAB) until they have a service-wide position on the issue
   - Stop opening Stock based compensation (SBC) Cost Sharing Agreement (CSA) issues until an opinion is reached in *Altera*
Taxpayers should leverage the various LB&I directives and policies, for example:

2) **Economic Substance.** In 2011, LB&I listed 20 factors that tend to show ESD is not appropriate (and, conversely, that opposite of each factor tends to show ESD is appropriate).

   • If Exam determines ESD may be appropriate, Exam must address a series of inquiries before seeking approval to apply ESD:
     - For example, if precedent exists that either rejects the application of ESD or upholds the transaction and makes no reference to ESD
     - Further, ESD is likely not appropriate if transaction in JCT “angel list”

   • If Exam still believes ESD is appropriate, it must obtain DFO approval

   • Until further guidance is issued, penalty is limited to ESD and may not be imposed due to application of any other “similar rule of law” or judicial doctrine (e.g., step transaction doctrine, substance over form or sham transaction)
Taxpayers should leverage the various LB&I directives and policies, for example:

3) Publication 5125/IRM 4.46.
   • Exam will discuss all issues with taxpayer prior to issuance of Form 5701, and identify specific areas of legal contention
   • Exam will engage in earnest and collaborative effort to resolve all issues
   • Issue resolution tools such as Fast Track and early referral to Appeals will be utilized. If Exam still believes ESD is appropriate, it must obtain DFO approval

4) Transfer pricing roadmap
   • Share initial risk analysis with taxpayer with audit plan/timeline
   • Meet with taxpayer to discuss working hypothesis
   • Prepare mid-cycle risk analysis to reflect updated risk assessment
Responding to AOF IDR

• Strategic considerations regarding the AOF IDR.
  – No response
    • Pros—additional information, which may be sensitive, is withheld. No summons enforcement
    • Cons—possible summons enforcement on other IDRs and Appeals considerations
  – A marked-up response
    • Pros—allows for a seamless procession to Appeals
    • Cons—risks prolonging examination
• Always reserve the ability to amend or supplement.
Is it possible to settle at Exam?

• Settlement is often preferable to pursuing Appeals and, potentially, litigation:
  – Risk mitigation
  – Lower legal expenses
  – Certainty with respect to reserves and cash flows
  – Avoid adverse publicity

• Earlier is better:
  – Interest is always running
  – Reputational concerns

• IRS Incentives:
  – Budget and limited resources
  – Settling to preserve a legal point/precedent
Planning for Appeals Process

• Respond to NOPA, or go straight to 30 day letter?

• Ensure that all relevant facts are in Protest, if not otherwise in record
  
  – If taxpayer raises new issues or theories, Appeals can request review and comment from Exam.
  
  – If new information or evidence, Appeals can return the case to Exam. (New information or evidence means not shared with Exam and meriting additional analysis or investigative action)

• Request Appeals Office in other region if contentious Exam team?

• Request to see administrative file? File FOIA request?

• Push back on Exam attending opening conference of taxpayer?
Should you consider going to Fast Track Appeals?

• Advantages:
  – Speedy: 120 days or less
  – No formal protest, only a NOPA response
  – If unsuccessful, traditional Appeals is still available

• Disadvantages:
  – Exam retains jurisdiction, and taxpayer waives *ex parte*
  – Issues have to be fully developed by Exam early – rarely the case for transfer pricing
  – No Post-Appeals Mediation
Should you consider requesting Rapid Appeals Process (RAP)?

• Advantages:
  – Quick: generally one day
  – Appeals acts as mediator

• Disadvantages:
  – Exam retains jurisdiction, and taxpayer waives *ex parte*
  – Some issues, particularly transfer pricing, might benefit from more than one day
  – Only recommended where both sides expect to concede something

• Given the recent initiative to involve Exam in regular Appeals, consider how regular Appeals might evolve into a process more like RAP
Should you consider bypassing Appeals and filing in Tax Court?

• Reasons to consider filing in court first, then returning to Appeals:
  – If litigation is inevitable, gets process under way
  – Demonstrates you are not afraid to litigate
  – Oversight of court or counsel can spur Appeals to move faster
  – Getting a Notice of Deficiency first locks in the IRS position

• Reasons to consider filing litigation first, then returning to Appeals:
  – Counsel can conduct some discovery
  – Additional cost
  – Counsel has discretion not to allow (see Facebook’s ongoing litigation in district court regarding Chief Counsel’s denial of access to docketed Appeals)
Summary of Trends in Appeals

- Number of experienced Appeals Officers is declining
- Perception that Appeals is less independent
- Exam participation in Conferences moves Appeals closer to a mediation
- Taxpayers cannot assume that an agreement with an Appeals Officer will be approved
- Taxpayers are less likely to get a more favorable outcome at Appeals based on better facts
- Yet, Appeals remains the best alternative to litigation
Consider seeking relief from double tax through MAP – When can a taxpayer access MAP?

**Access to MAP begins**
- 30-Day Letter/RAR

**Administrative Stages**
- Notice of Deficiency
- IRS Answer
- Petition
- Trial
- Decision
- ~ 2-3 years for large cases

**Litigation**
- Notice of Deficiency
- IRS Answer
- Petition
- Trial
- Decision
- ~ 2-3 years for large cases

**Access to MAP if joint motion to sever issue**

**Correlative Relief Only**
- Trial
- Decision

**Access to MAP ends**

**Bypass Appeals**
- NOPA

**Appeals Route**
- NOPA
- Protest
- Opening Conference
- 60 days
- 90 days
- ~ 1-2 years

**Avoid “Hot Interest”**
- 30-Day Letter/RAR

**Exam**
- ~ 1-2 years
Why Use MAP?

• Avoid Double Tax. MAP can simultaneously resolve an issue in the US and another jurisdiction on consistent terms that avoid double taxation

• Remove Exam. Takes issue out of hands of US or foreign examination team and into hands of the competent authorities

• Cost Effective. MAP can be a cost effective means to resolve a dispute involving transfer pricing or other issue covered by an income tax treaty

• Exhaustion of remedies. In the case of a foreign initiated transfer pricing adjustment, invoking MAP is generally necessary for a taxpayer to show “exhaustion of remedies”

• Flexibility. Taxpayers are not required to accept the tentative resolution negotiated by competent authorities

• Potential Pitfall. Taxpayers that protest a transfer pricing issue to Appeals are now completely barred from seeking double tax relief through MAP, unless they sever the issue from Appeals and request competent authority assistance within 60 days of the Appeals opening conference
When MAP may not be advisable

- Country asserting adjustment does not have a tax treaty with US
- One competent authority believes that the taxpayer is not entitled to competent authority relief under the Treaty
  - E.g., section 367(d) deemed royalties, non-Treaty country entities interspersed in the value chain
- Pursuing MAP early (e.g., right after receiving NOPA) could prematurely end an effective Exam team engagement
- No Double-Tax. The asserted adjustment may not give rise to double taxation
  - E.g., one party has NOLs
  - In these situations, MAP may still be available, but a lack of adversity among the competent authorities can skew incentives
- Taxpayer believes that the asserted adjustment should be withdrawn entirely, and therefore correlative relief is not sufficient
Combining Years/Cycles

• U.S. Revenue Procedures 2015-40 and 2015-41 view the MAP and APA processes as interrelated and encourage resolution of multiple years on consistent terms

• Procedures specifically encourage and facilitate:
  – “Rollbacks” of APAs to prior years (which may or may not be subject to a MAP);
  – Accelerated Competent Authority Procedures (APA) – extending a MAP resolution to subsequent filed but unexamined years;
  – “Rollforwards” of MAP resolutions into APAs

• Use of these procedures to resolve 10-15 or more tax years on consistent terms is not uncommon.
International Compliance Assurance Programme (ICAP)

• ICAP is a voluntary risk assessment process available to large MNE groups headquartered in participating jurisdictions

• The multilateral risk assessment conducted under ICAP will focus on transfer pricing, permanent establishments and any other material international issues agreed between the group and participating tax administrations

• Participating tax administrations: Australia, Canada, Italy, Japan, the Netherlands, Spain, UK and the US

• Too soon to know if it will be an efficient tool
QUESTIONS?

THANK YOU!