The Compliance Assurance Process (CAP), Today and Tomorrow

Panelists:

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Changes in the CAP Program

Reasons for Change:

• CAP has an overall objective: Improved service to taxpayers and compliance with tax laws through real time monitoring, review and issue resolution.
• With this objective came expectations of significant savings of time in terms of hours spent per tax year by the IRS and reduced duration of months spent on each tax year.
• While progress has been made in several areas, LB&I determined that hours charged and months spent have been much greater than expected resulting in a program that, on an average return basis, is more resource intensive than normal post-filing examinations of similarly sized taxpayers.

Q: How many timely expressions of interest did the IRS receive from prospective 2020 applicants?
Q: Should taxpayers that expressed an interest expect any response from the IRS or will that only come when/if a formal 2020 application is submitted?
New CAP: How Will Success be Measured?

• Success of the program is dependent on consistent application of procedures and accountability in all phases of the process. Both taxpayers and IRS must adhere to program requirements:
  - Admission
  - Participation
  - Post-Filing Review

• The IRS believes that greater discipline is needed by both the IRS and taxpayers to ensure adherence to program requirements
New CAP Eligibility Criteria

• **Current program:**
  - Asset Size ($10 million)
  - Access to Certified Financial Statements (Publicly and Privately Held)
  - Access to Corporate Tax Records
  - Number of Open Filed and Unfiled Returns (Exceptions for “claims” and returns that have been reopened, placed in LB&I suspense or Closed from Group)

Anticipated new requirements for the future:
  - New applicants must be publicly held C-corporations
  - All applicants must adhere to the tax control framework requirement

• **Benefits**
  - Simplify and clarify the rules for counting the number of open filed and unfiled returns

**Q:** Will there be a pre-CAP program or other means of helping large corporate taxpayers who are continuously under exam, to become eligible and be able to meet the 1 open year and 1 unfiled year criteria?

**Q:** Will there be any discretion for LB&I management in applying exceptions to the eligibility criteria, or any process for elevating the decision?
CAP Suitability Criteria

• Since the CAP Program is based on the transparent and cooperative interaction between the taxpayer and the IRS, a taxpayer that does not exhibit this type of behavior is not suitable for this Program.

• Examples of significant or material failures include:
  - Not adhering to IDR response times or providing incomplete responses to IDRs;
  - Not engaging in meaningful or good faith issue resolution discussions;
  - Failing to thoroughly disclose a material item in a timely manner;
  - Failing to disclose a tax shelter or listed transaction;
  - Failing to disclose an investigation or litigation that limits IRS access to current corporate records;
  - Frequently filing claims or failure to resolve issues in pre and post filing; and
  - Not adhering to any other commitment in the relevant MOU.
CAP Application and Selection Process

- No new applications accepted for 2019.
- The IRS expects to accept new applications for the 2020 CAP year.

Q: When will the 2020 Application Season Open? Given the changes in the program, is it appropriate to permit some additional time for potential applicants to meet eligibility rules?

Q: Is there an estimate of the optimum number of new applicants that could be accommodated in 2020?

Q: What is the longer term view of the numbers and types of taxpayers the IRS would like to see in CAP? Does LB&I have a model for the geographic, industry and size demographics that it wants reflected in the CAP population?

Q: Given IRS resource limitations and goals for recalibrating CAP - Does LB&I have a model or goal for what the right time allocation for CAP program participants should be compared to normal post-filing examinations of similarly situated taxpayers?
Additional documents required with CAP application

- If the taxpayer has international cross-border activity it is required to complete the Material Inter-Company Transaction Template (MITT) and provide a copy of its Worldwide Tax Organization Chart
  - Subject Matter Expert (SME) team will review these documents and assist the CAP team with identifying transfer pricing issues in addition to determining the most efficient way to work, e.g., APA
- If the taxpayer has R&E activities it is required to complete the Research Credit Questionnaire
  - SME team (Engineer, Research Credit Risk Team etc.) will review this document and assist the CAP team with selecting or deselecting research credit issues
- Preliminary Issues List – List of material recurring and non-recurring issues that the taxpayer expects to disclose and be worked in the upcoming tax year
  - Preliminary list will act as the starting point for the joint development of an issues list

Q: Have the questionnaires for transfer pricing and Research Credit resulted in any companies being deselected from CAP?

Q: The IRS webpage for CAP addresses the potential of APAs being required for the continued CAP participation of some taxpayers. Given the relatively protracted time frames currently associated with APAs, does the IRS currently have the capacity to push CAP taxpayers to APAs?

Q: Is there any thought of employing a similar approach to taxpayers with material Research Credits (i.e., pursuing a PFA like agreement or methodology), which would thereby reduce the review time and accelerate completion of the CAP year?)
Will Compliance Maintenance Continue with New CAP Program

- A key difference between the CAP and Compliance Maintenance Phases is the volume and complexity of the material issues for the taxpayers selected for these phases.
- A taxpayer in the CAP program has a history of generally receiving partial acceptance letters and has more issues to be considered.
- A taxpayer in Compliance Maintenance has a history of generally receiving full acceptance letters and has relatively few issues to be considered.
- The processes and procedures for the Compliance Maintenance Phase are fundamentally the same as the process and procedures for the CAP Phase.
- The expectation is that there is much less time required for the IRS and taxpayers in the Compliance Maintenance Phase.
- The IRS still expects all taxpayers to reach Compliance Maintenance at some point.

Q: Is it true that only taxpayers in Compliance Maintenance will be considered for, or placed in the Bridge phase?
Compliance Maintenance Bridge Phase

- The new Bridge Phase is reserved for taxpayers whose risk of noncompliance does not support the continued use of LB&I compliance resources.
- While in this Phase, taxpayers remain in the CAP program.
- For any year selected for this phase, the team will not accept any disclosure, conduct any review, or provide any assurance.
- If the taxpayer has a specific issue that it wants certainty on, the taxpayer may request a pre-filing agreement (PFA) for that issue.
- Taxpayers will apply for CAP annually. A taxpayer selected for the Bridge Phase will be considered as a returning taxpayer when applying for CAP the following year.
- The length of the Bridge Phase is currently limited to one year and may increase in the future.

Q: How many taxpayers have been moved to “Bridge” status? Is there an expectation for what percentage of CAP taxpayers may ultimately be so categorized? Do we understand correctly that moving to bridge was voluntary for 2019 but for 2020 and beyond, the IRS will determine who is placed in that status for any given year?

Q: Is a bridge year treated as a skipped year for audit purposes, or will the IRS look back to the bridge year when reviewing a subsequent year, for possible audit issues?

Q: If a taxpayer is moved to the bridge phase, are they still considered returning CAP taxpayers the next year, for purposes of considering their CAP application?
CAP: Issues List

- LB&I will request the Initial Issues List from taxpayers with the CAP application.
- This list is preliminary and expected to be updated throughout the CAP year, subject to established materiality thresholds.
- Taxpayers are still required to provide material disclosures throughout the CAP year, and CAP teams may still identify additional issues as well as be subject to established materiality thresholds.
- In addition to the Issues List, if applicable, transfer pricing (referenced earlier) and research credit information is also required with the CAP application.
- IRS will use this information for initial risk assessment and planning.
- Transfer pricing and research credit are two areas that have historically presented challenges to IRS in a pre-filing environment, and for that reason, IRS is requesting additional information upfront.
- The Opening Conference is expected to be held by March 31st for calendar year taxpayers or the end of first quarter of the CAP year for fiscal year taxpayers.

Q: How have the initial issues list, or the materiality threshold aspects, influenced the 2019 CAP experience so far?
Prior to the Opening Conference, LB&I expects to 1) choose not to work an issue included on the Issues List, 2) work the issue, or 3) recommend an APA for transfer pricing issues. These decisions are based on the materiality of the issue or transaction (both from a quantitative and qualitative perspective), resource availability and other factors.

An Updated Issues List will be prepared and discussed prior to the Opening Conference. It serves as the starting point for the planning and allocation of resources (e.g., time budget).

Process will be in place to add issues that are identified or disclosed during the CAP year that meet the established materiality threshold guidelines.

The Taxpayer and the Territory Manager must discuss any addition of issues. The IRS expects that Taxpayers will notify the DFO if issues are added without consultation.

This process provides consistency and accountability for both LB&I and Taxpayers. Taxpayers only disclose material items while the IRS only reviews those issues that are strategic, material issues or transactions that we believe as an organization resources should be allocated.
New CAP Timing Goals: 90-Days to Develop and Resolve Issue

• Current CAP program does not have a standard timing deadline to resolve issues
• Updates to Timing Goals:
  - Establish a target for all disclosures to be completed by 90 days from the close of the tax year
  - Establish a target of 90 days, from the date the taxpayer has provided all relevant information including the planned tax position, to work and resolve the issue
  - Taxpayer to notify team when all of the relevant information has been provided, taxpayer and team must agree
  - Exception process - Territory Manager approval required to extend the 90 days
  - The LB&I case management system, IMS, will also now track the 90 day timeframe
New CAP Requirement: Mandatory Fast Track (Pilot Process)

- Prior program encouraged the use of Fast Track but it was not required
- New CAP Requirement for Fast Track:
  - If issue is not resolved within 90 days of submission of all relevant information, an application to Fast Track will usually be submitted
  - If offered to taxpayer, the Fast Track process must be used
  - Taxpayers retain access to Appeals in the normal course if Fast Track does not result in an agreement
- Benefits
  - Will encourage issue resolution in the pre-filing time period
New CAP Requirement: Post-Filing Representation Letter

- Within 30 days of the date the return is filed, the taxpayer will provide a Post-Filing Representation Letter executed by an officer of the taxpayer with authority to sign the return that includes:
  - A statement from the taxpayer that all the material issues were disclosed and resolved as of the date that the return was filed or a full description of all the material issues that were not disclosed or resolved as of the date that the return was filed;
  - A statement from the taxpayer that all the resolved issues were reported as agreed as of the date that the return was filed or a full description of all the resolved issues that were not reported as agreed as of the date that the return was filed; and
  - A declaration under penalties of perjury that the representations in the letter are true, correct, and complete.
CAP Full or Partial Acceptance Letters

- Partial and Full Acceptance Letters will not be provided until after the return is filed and the Post-Filing Representation Letter is received and reviewed.
- After the receipt and review of the Post-Filing Representation Letter, the IRS will make a determination as to whether the taxpayer has fully complied with the terms of the MOU and whether all material issues have been disclosed and resolved.
- The IRS will then provide a Full Acceptance Letter.
- If, after the receipt and review of the Post-Filing Representation Letter, the IRS determines that the taxpayer has not disclosed all material issues or that material issues remain to be resolved, the IRS will then provide the taxpayer a Partial Acceptance Letter.
CAP Post-Filing Review

- After a taxpayer files its return, the Account Coordinator will secure a copy of the return and initiate the post-filing review. The goal for completing this review is within 60 days of the filing of the return.

- During the post-filing review, the IRS and the taxpayer will jointly review the filed return to verify that all material issues were disclosed and resolved and that all resolved issues were reported as agreed.
  - If the review verifies that all material issues were disclosed and resolved and that all resolved issues were reported as agreed, the IRS will issue a No Change Letter concluding the examination of the taxpayer's books for purposes of IRC § 7605(b).
  - If material issues remain to be resolved, these will be examined through the post-filing examination process.