Coalition for Effective and Efficient Tax Administration ("CEETA")

Executive Summary

In the view of many taxpayers, IRS audits have become increasingly inefficient and unmanageable. CEETA welcomes the recently announced reorganization of the Large Business & International Division of the IRS ("LB&I") as a singular opportunity to collaborate with the IRS to improve the manner in which audits are conducted. CEETA believes that, done well, the reorganization of LB&I can result in more efficient and effective audits for both the IRS and taxpayers. We believe the key to improved tax administration and the success of the LB&I reorganization is the ability of LB&I and taxpayers to work together to build an effective process.

CEETA has identified several areas of concern with how audits are currently conducted. These concerns fall into three broad categories:

(1) Need for centralized management, accountability and transparency in IRS management of audits;
(2) Implementation of the new Information Document Request ("IDR") process; and
(3) Impact of litigation strategies on IRS audits.

This paper provides more detail on specific concerns and provides suggested solutions. CEETA strongly recommends the establishment of a process by which taxpayers and LB&I can collaborate on an approach to these issues that furthers our common interest in conducting audits in an effective and efficient manner.

Summary of Recommendations

(1) Need for Centralized Management, Accountability and Transparency in IRS Management of Audits

- The Coalition recommends that there be a single point of contact (team or case manager) in all IRS examinations with authority for setting and enforcing estimated completion dates and determining when issues should either be considered resolved or abandoned. The Coalition also recommends that under the reorganization, where elevation above the team manager is necessary, taxpayers have the ability to elevate issues involving audit progress and management to a single-decisionmaker below the level of the Deputy Commissioner, such as the equivalent of a territory manager in the current structure.
- The Coalition recommends that examiners/Practice Areas be required to commit to completion dates for each issue.
- The Coalition recommends that all examination team members and their roles, including the decision-making authority described above, be disclosed in the audit plan and that taxpayers have access to all specialists, experts, and other team members.

- The Coalition recommends that specialist reassignment be minimized and/or that more senior specialists be paired with more junior specialists so that there is continuity in the event of a departure.
- The Coalition recommends that team managers receive broad technical training so that they are able to identify and evaluate issues and communicate with both taxpayers and specialists, including as those personnel gain further skills through their own anticipated training. The Coalition also recommends that team managers be trained in project management and conflict resolution.
- The Coalition recommends a more transparent process with opportunities for taxpayers to engage constructively in the consideration of issues with Issue Practice Groups and Issue Practice Networks.
- The Coalition recommends that taxpayers' access to Appeals not be foreclosed due to time left on the statute at the examination level.
- The Coalition recommends that the full array of alternative dispute resolution tools be offered to taxpayers with respect to each issue and that this be documented with the taxpayer's confirmation.
- The Coalition recommends that the current procedures for obtaining advice from Chief Counsel attorneys be reviewed and revised to permit taxpayers an opportunity to participate in the process and engage with all involved.
- The Coalition recommends that Draft Publication 5125 be finalized with taxpayer input.
- The Coalition commends LB&I's request for comments on the international practice units that have been released.

(2) Implementation of the New IDR Process

- The Coalition recommends that a quality review program be instituted whereby IDRs are sampled and reviewed for consistency with the procedures. Particular emphasis should be placed on defining issues appropriately and tailoring the IDRs to the taxpayer's particular circumstances. Whether agents have met the requirements should be measured and taken into account in performance assessments.

- The Coalition recommends that the IRS select a few cases to review the IDR process and receive both taxpayer and agent feedback on how the process is working.

- The Coalition recommends that the Service publish FAQs identifying issues and solutions as they arise, similar to the process when Schedule UTP was issued.

- The Coalition recommends that agents and specialists receive ongoing training regarding the IDR procedures.

- The Coalition recommends that the procedures be revised to incorporate factors an agent or specialist may consider in establishing an IDR response deadline or granting an IDR response deadline extension. Such factors should include but not be limited to taxpayer resource constraints, including sensitivity to other business demands and deadlines such as financial statements and tax return due dates.

(3) Impact of Litigation Strategies on IRS Audits

- The Coalition recommends that all agents and specialists continue to be trained in the appropriate conduct of examinations, consistent with the principles laid out in the Quality Examination Process or other applicable guidance. The Coalition also recommends that as part of the LB&I reorganization, Draft Publication 5125 be finalized.
- The Coalition recommends that if a party, especially if from Office of Chief Counsel, authors or co-authors an IDR, the advising or co-author's name also be included on the IDR so that if further explanation is needed, all parties are clearly identified.
- The Coalition recommends that it be clarified, either by regulation or statute, that the issuance of a 30-day letter with the opportunity to go to Appeals is mandatory prior to issuance of a 90-day letter. The only exceptions should be when the taxpayer has attempted to run out the clock or for issues designated for litigation as described below.
- The Coalition recommends that the reasons for designating cases for litigation be reexamined. The Coalition recommends that if designation authority is retained, it be clarified, either by regulation or statute, that only issues meeting particular requirements should be designated for litigation, and that designation is to be made on an issue basis, not a taxpayer-by-taxpayer basis. Issues meriting designation would be limited to identified abusive transactions such as listed transactions. The Coalition also recommends that the Government should bear the taxpayer's litigation costs if unsuccessful in court on the specific designated issue.
- The Coalition recommends that the procedures for designated summonses be revised to require that the memorandum prepared by the examination team explain the length of the audit, number of statute extensions and why the audit has not been closed, or when the audit would anticipate closing if the requested documentation were received. In addition, the Coalition recommends that circumstances under which a designated summons may be issued be clarified, either by regulation or statute, and that such circumstances be limited to situations where the Service demonstrates a lack of cooperation by the taxpayer in responding to IDRs.
- The Coalition recommends that the Service's policy on retention of experts be revised to make it clear that experts should only be retained where the Service lacks the requisite expertise in-house and should not be involved in the inherently governmental functions of taking compelled testimony and examining books and records. In that regard, we recommend withdrawal of the proposed and temporary regulations under section 7602.

Coalition for Effective and Efficient Tax Administration ("CEETA")

I. Need for Centralized Management, Accountability and Transparency in IRS Management of Audits

Issue

Centralized management, accountability and transparency in audits are important to give taxpayers a meaningful opportunity to engage the Internal Revenue Service ("IRS" or "Service") and to avoid inefficiencies and delays that waste time and resources for taxpayers and the IRS. The existence of those features can help ensure that audits stay on track and follow best practices, including established IRS audit procedures and principles. The current reorganization of LB&I provides an opportunity to improve centralized management, accountability, and transparency, but there is a risk that the value of those features could be overlooked in the restructuring.

Background

2010 Reorganization of LMSB

In 2010, the IRS realigned its large corporate unit, Large and Mid-Size Business division ("LMSB"), into the Large Business and International division ("LB&I"). In an effort to place a greater emphasis on international compliance issues, LB&I established a new international chain of authority within the structure of LMSB. The international chain included examiners that specialized in international compliance issues. Prior to the restructuring as LB&I, LMSB examinations were conducted by exam teams consisting of both domestic examiners as well as examiners specializing in international issues ("International Examiners" or "IEs"). The domestic and international examiners on each exam team were led by a single team manager who reported to a territory manager, who in turn, ultimately reported to the industry director. As a result of the realignment, all IEs reported up a separate management chain to the LB&I Deputy Commissioner (International). The result has been that a single examination, containing both international and domestic issues, is now worked concurrently by domestic agents and IEs reporting up separate parallel management chains. In addition, in transfer pricing cases, specialists from the national Transfer Pricing Practice ("TPP") may be assigned to the audit.

Role of Specialists in LB&I

Two years after the LB&I realignment, LB&I implemented Issue Practice Groups ("IPG") and International Practice Networks ("IPN") and eliminated the Tiered Issue Process. IPGs and IPNs were created to act as knowledge management networks for domestic and international issues, respectively. With the creation of IPGs and IPNs, Technical Advisors transitioned to the role of technical specialists. The IPGs and IPNs function as an internal consulting team for examination teams who need assistance with particular issues. In contrast to the more rigid role of Issue Management Teams in the Tiered Issue Process, the advice provided by the IPG or IPN is not a mandate that the examination team must follow. The examination team has the discretion to decide an issue differently from the advice provided by the IPG or IPN. While IPNs evolved to be more of an internal knowledge management tool, IPGs took on more of an

advisory role to audit teams. IRS officials stated publicly that IPGs were intended to be transparent and that taxpayers should have access to the IPG if requested.

2015 Reorganization of LB&I

On September 17, 2015, the IRS announced details of another organizational restructuring of LB&I. Under the proposed changes, the roles of the LB&I Deputy Commissioner (International) and LB&I Deputy Commissioner (Domestic) will be merged into a single LB&I Deputy Commissioner who will report to the LB&I Commissioner. The international chain and the domestic industry chains will be reorganized into nine Practice Areas, four of which are geographic regions. Each Practice Area will consist of a group of employees organized to focus on one or more areas of expertise. The IRS suggested that IPGs and IPNs might also be merged into the practice areas. The Practice Areas include:

1. Passthrough Entities
2. Enterprise Activities
3. Cross Border Activities
4. Withholding and International Individual Compliance
5. Treaty and Transfer Pricing Operations

The four regions making up the other four Practice Areas are Western, Central, Eastern, and Northeastern.

IRS officials have indicated that more than one Practice Area may be assigned to a single audit. It is not yet known how the geographical regional lines of reporting will interact with the Practice Areas' lines of reporting. It is also not yet known how decision-making authority with respect to a given taxpayer's audit will be allocated between personnel from both a regional organization and personnel from the Practice Areas, including whether that authority will be shared.

The Quality Examination Process

The Quality Examination Process ("QEP") was established to provide a framework for effectively managing an examination. QEP emphasizes effective transparency and openness between taxpayers and the exam team. From the outset of the first meeting between the exam team and the taxpayer, the participants are expected to discuss the roles, expectations and responsibilities for both the exam team and the taxpayer. The taxpayer and exam team are also encouraged to work together to establish both (1) a timeline with key milestones to ensure accountability, and (2) a process for monitoring the examination plan and how changes to the plan by either party should be communicated.

In addition to developing the exam plan with input from the taxpayer, the exam team discusses the availability and accessibility of personnel assigned to the examination. This includes notifying the taxpayer if specialist or Counsel involvement is required for a particular issue. To facilitate openness between the exam team and the taxpayer, the exam team is encouraged to invite specialists or Counsel to attend key meetings between the team and the taxpayer.

Collaboration, transparency, and accountability also form the foundation of the new information document request ("IDR") process, which is discussed separately.

Revisions to the QEP were proposed in July of 2014, but the fundamental principles remain the same. Presumably these procedures will be finalized in the course of the current reorganization.

Discussion

To facilitate resolution of issues during an examination, taxpayers and the IRS should work together to resolve issues. It is difficult to have constructive interaction and dialog that leads to resolution, however, if taxpayers do not have the opportunity to engage with the functions within the IRS where decisions are made about their examinations. Transparency will help taxpayers work efficiently to resolve matters during the examination phase, and will help taxpayers and IRS management work together to ensure that the best practices set forth in the QEP are followed. The result will be increased support for and confidence in the examination process, which should reduce the resources required by taxpayers and the IRS to complete examinations.

Current LB&I Structure

The bifurcation of domestic and international chains of command in the LB&I structure has led to a lack of accountability that is a source of frequent frustration for taxpayers. IEs and domestic examiners report to different management teams, and although there may be a single team manager, the team manager may defer to IEs and their management with respect to issues of timing. In many cases, the domestic team has completed its exam while the international exam issues remain open. Taxpayers experiencing delays in audits are often left with no one clearly in charge or in control of resolving an issue, and may have to elevate issues up two chains of command. Taxpayers may even be presented with partial RARs for the non-international issues resolved during the audit. This situation is sometimes compounded in transfer pricing matters, where specialists from TPP are involved who do not appear to be working in unison with the IEs on the case.

Role of and Access to Specialists

Additional issues arise when the assistance of an IPG or IPN is sought. According to Service guidance, the team manager has discretion to follow the advice of the IPG or IPN, or to make his or her own determination on the respective issue. It has been taxpayers' experience, however, that team managers routinely defer to the advice provided by the IPG or IPN. If the team managers do not engage on the issues or do not make an independent assessment of whether or how to pursue an issue, then taxpayers are unable to have a constructive discussion with the examination team of the issues or how they might be resolved.

Nor are taxpayers uniformly provided access to specialists. As explained in the discussion of QEP, when an issue is coordinated with an IPG, IPN, or Counsel (collectively "specialists"), the exam team should schedule a meeting with the taxpayer and invite the specialists whose advice was sought. However, taxpayers are infrequently afforded the opportunity to engage the specialists, leaving the taxpayer without an opportunity to present its view of the facts, its position on a particular issue, or to resolve the issue at the examination level.

Adherence to QEP and other principles

Without centralized management or clear responsibility for an audit, it is difficult for taxpayers to seek assistance when an audit is not conducted in accordance with best practices such as the QEP.

Impact of Proposed Reorganization

The Coalition is concerned that the proposed reorganization of LB&I could mean replacing two reporting chains with multiple reporting chains, exacerbating the issues of accountability for the conduct and completion of audits and transparency to taxpayers. IRS officials have indicated publicly and at the field level that there will be "no 51%" – suggesting no single person or group will control the examination.

When we met on October 27, IRS officials indicated team managers currently are empowered to "own the case" and will continue to do so under the reorganization. However, as we discussed, this is not always the case, as team managers may lack the background, technical expertise, or other skills necessary to make technical calls or exercise judgment, instead deferring to the specialists assigned to the case. Additionally, team managers frequently appear to feel they need to support their agents' position, so that additional elevation is necessary.

We agree wholeheartedly with the goal of the reorganization to deepen technical training for examination personnel, and as discussed, will be happy to assist LB&I with this process. The development of technical expertise should extend to managers, enabling them to make strategic decisions regarding issues and the commitment of IRS resources.

Fewer Technical Advice Memoranda and Increasing Reliance on Informal Advice

Another example of lack of transparency is increasing reliance on Chief Counsel Advice ("CCAs") and other informal advice, which generally involve no taxpayer participation, over a Technical Advice Memorandum ("TAM"), which requires that the IRS and the taxpayer agree on the facts underpinning the question presented, when seeking advice from Counsel on a complex audit issue. The table below shows the number of TAMs and CCAs issued from 1990-2014.

Period	TAMs	CCAs
1990-1994	1,149	n/a
1995-1999	1,204	228 (1999)*
2000-2004	393	928
2005-2009	196	1628
2010-2014	53	1530

*CCAs were first released to the public in January 1999.

The table illustrates the dramatic decrease in TAMs issued over the past fifteen years and the corresponding increase in CCAs. Increasingly taxpayers are discouraged from pursuing TAMs, which deprives taxpayers of the opportunity to be involved in the consideration of an issue. Moreover, CCAs and other informal advice are often sought without the taxpayer's knowledge. The lack of taxpayer involvement is bound to result in a less robust consideration of the facts and the issue. The use of CCAs also can hinder the resolution of cases in the Office of Appeals

because Appeals officers may be disinclined to engage on an issue after a CCA has been issued, even if the CCA was issued in connection with a different taxpayer.

Delays in Completing Audits

The management and accountability issues discussed above contribute to an environment where it has become routine for taxpayers to experience multiple requests for statute extensions; estimated completion dates ("ECDs") established in audit plans seem to have diminishing significance. In particular, specialists and counsel frequently appear to operate on a different timetable than originally reflected in the Audit Plan. Appeals' policy of requiring that 12 months remain on the statute may also lead to examination teams' prolonging of audits – this policy is used as a justification for requesting statute extensions but then the Exam team continues its audit rather than winding up the case. Taxpayers are then effectively forced into Tax Court because insufficient time remains on the statute. It is almost always preferable for a taxpayer to have access to Appeals before incurring the added cost and burden of filing a Tax Court petition.

The recent severe resource constraints on LB&I have resulted in high levels of turnover on examination teams which also prolong examinations. Specialists in particular are spread too thinly – it is not an uncommon occurrence for there to be months of silence in an audit followed by spurts of new IDRs. It also is not uncommon for a taxpayer to have as many as three individuals successively playing the same role on a single examination as resources are reallocated. The turnover results in delays because transitions take time and resources, and the introduction of inexperienced personnel often exacerbates problems relating to unclear decision-making authority. Retirements and hiring freezes have further exacerbated this issue, with a declining workforce that is not only spread too thinly but often lacks the requisite technical skills or institutional continuity to conduct audits effectively. All of these factors combine to create inefficiencies and delays in completing audits, straining already-limited taxpayer and IRS resources.

In short, taxpayers should not be penalized by IRS-resource constraints and staffing issues – if a particular specialist cannot complete their work within a reasonable period of time, IRS audit procedures should make clear that the team manager is required to move the case, even if this means closing the case without an adjustment. Additionally, under the new system, as discussed, issue selection and resource availability should go hand-in-hand, with issues only pursued if there are qualified and dedicated resources available.

Recommendations

The Coalition recommends that there be a single point of contact (team or case manager) in all IRS examinations with authority for setting and enforcing ECDs and determining when issues should either be considered resolved or abandoned. The Coalition also recommends that under the reorganization, where elevation above the team manager is necessary, taxpayers have the ability to elevate issues involving audit progress and management to a single-decisionmaker below the level of the Deputy Commissioner, such as the equivalent of a territory manager in the current structure.

The Coalition recommends that examiners/Practice Areas be required to commit to completion dates for each issue.

The Coalition recommends that all examination team members and their roles, including the decision-making authority described above, be disclosed in the audit plan and that taxpayers have access to all specialists, experts, and other team members.

The Coalition recommends that specialist reassignment be minimized and/or that more senior specialists be paired with more junior specialists so that there is continuity in the event of a departure.

The Coalition recommends that team managers receive broad technical training so that they are able to identify and evaluate issues and communicate with both taxpayers and specialists, including as those personnel gain further skills through their own anticipated training. The Coalition also recommends that team managers be trained in project management and conflict resolution.

The Coalition recommends a more transparent process with opportunities for taxpayers to engage constructively in the consideration of issues with IPGs and IPNs.

The Coalition recommends that taxpayers' access to Appeals not be foreclosed due to time left on the statute at the examination level.

The Coalition recommends that the full array of alternative dispute resolution tools be offered to taxpayers with respect to each issue and that this be documented with the taxpayer's confirmation.

The Coalition recommends that the current procedures for obtaining advice from Chief Counsel attorneys be reviewed and revised to permit taxpayers an opportunity to participate in the process and engage with all involved.

The Coalition recommends that Draft Publication 5125 be finalized with taxpayer input.

The Coalition commends LB&I's request for comments on the international practice units that have been released.

II. Implementation of the New IDR Process

Issue

Overall, the Coalition believes the new information document request ("IDR") process, which was intended to reduce taxpayer burden, foster better communication between taxpayers and the IRS, and focus the audit on relevant information, is well-designed. There are instances, however, where some of the goals have not been achieved and there is room for improvement. The purpose of this paper is to identify some of the more common issues and to propose steps the IRS and taxpayers can take together to address them.

Background

On June 18, 2013, IRS Large Business & International ("LB&I") issued a directive that requires all IDRs issued after June 30, 2013, to meet three requirements:

1. IDRs must be issue focused.
2. IDRs must be discussed with the taxpayer prior to issuance.
3. The taxpayer and revenue agent must discuss an appropriate deadline for the IDR.

Based on comments from then LB&I Commissioner Heather Maloy (Commissioner as of the June 18, 2013 directive), an IRS peer review process had identified IDRs as a significant problem in the tax audit workflow process. The goal of the three IDR requirements was to create meaningful discussion between the revenue agent and the taxpayer as to what documentation was really needed for the audit, and ultimately, foster transparency and an open, two-way dialogue during the audit.

On November 4, 2013, LB&I issued a second directive providing more detailed guidelines for the drafting and issuance of IDRs. The second directive also announced the establishment of an IDR enforcement process. According to the directive, the new procedures were designed to make the IDR process as efficient and transparent as possible by improving the ability of the IRS to gather information quickly and reducing the need to enforce IDRs through summonses. However, the procedures were quickly critiqued by taxpayers and revenue agents as being too rigid. Consequently, on February 28, 2014, LB&I issued revised procedures that became effective on March 3, 2014.

As stated in the February 2014 directive, "Meaningful communication between the IRS and taxpayers in advance of an IDR being issued is essential to provide efficiencies for both parties." The IRS anticipated that the new IDR procedures would allow the IRS to better "manage field specialists, determine reasonable estimated closing dates, and reduce unproductive time waiting for information." Further, the IDR procedures would allow taxpayers to better "manage their tax department resources" with "focused IDR requests that have reasonable time frames."

The February 2014 directive contains two sets of procedures: "Requirements for Issuing IDRs" and "IDR Enforcement Process."

There are 12 stated requirements that LB&I examiners and specialists should follow in drafting and issuing IDRs:

1. Discuss the issue related to the IDR with the taxpayer;
2. Discuss how the information requested is related to the issue under consideration and why it is necessary;
3. After consultation with the taxpayer, determine what information will ultimately be requested in the IDR;
4. Ensure the IDR clearly states the issue that is being considered and that the IDR only requests information relevant to the stated issue. An IDR issued at the beginning of an examination that requests basic books and records and general information about a taxpayer's business is not subject to this requirement 4. Once this initial IDR has been issued, subsequent IDRs must state an issue in compliance with requirement 4;
5. Prepare one IDR for each issue;
6. Utilize numbers or letters on the IDR for clarity;
7. Ensure that the IDR is written using clear and concise language;
8. Ensure that the IDR is customized to the taxpayer or industry;
9. Provide a draft of the IDR and discuss its contents with the taxpayer. Generally, this process should be completed within 10 business days;
10. After this discussion is complete, determine with the taxpayer a reasonable timeframe for a response to the IDR;
11. If agreement on a response date cannot be reached, the examiner or specialist will set a reasonable response date for the IDR; and
12. When determining the response date, ensure that the examiner or specialist commits to a date by which the IDR will be reviewed and a response provided to the taxpayer on whether the information received satisfies the IDR. Note this date on the IDR.

The IDR enforcement process involves three graduated steps: (1) a Delinquency Notice; (2) a pre-Summons Letter; and (3) a Summons. This process begins once an IDR is deemed "delinquent," i.e., either the taxpayer does not provide information by the IDR response date, or the taxpayer provides an incomplete response by the IDR response date. The examiner determines if an IDR response is complete or not. Additionally, the examiner has discretion to grant a taxpayer 15 additional business days from the original IDR response date before triggering the enforcement process.

If the taxpayer fails to respond properly to an IDR by the response date (or by the extended response date), a "Delinquency Notice," signed by the exam team manager, is issued to the taxpayer within 10 days of the application of the enforcement process. Generally, the taxpayer has 10 business days from the Delinquency Notice date to respond. IRS Chief Counsel is notified of the issuance of the Delinquency Notice.

If the taxpayer does not respond by the Delinquency Notice deadline, a "Pre-Summons Letter" is issued by the Territory Manager, providing for a response date generally 10 business days from the letter issuance. The Pre-Summons Letter is discussed with Chief Counsel and the respective Director of Field Operations ("DFO") must be made aware of the letter prior to issuance. Additionally, the Pre-Summons Letter must be delivered to a taxpayer management official that is at "a level equivalent to the LB&I Territory Manager…a level of management above the taxpayer management official that received the Delinquency Notice."

If the taxpayer does not provide a complete response to an IDR by the Pre-Summons Letter response date, the examiner must proceed to a summons. The issuance of a summons must be

discussed with the exam team manager, the specialist manager, the respective Territory Manager and DFO, and Chief Counsel. If a taxpayer does not respond to a summons, the IRS can refer the summons to the Department of Justice to file a summons enforcement suit in the appropriate federal district court.

Discussion

Generally, the new IDR procedures have been implemented and followed to the benefit of taxpayers and the IRS. However the application of the new procedures is not universal, and taxpayers frequently encounter practices that do not conform to the procedures. In the context of an issue-focused examination, there is room for improvement in the following areas:

- Examiners issuing a "general books and records" IDR (known as "IDR 1") prior to the examination opening conference containing burdensome requests unlikely to be relevant in the context of the particular taxpayer;
- Examiners issuing IDRs that are not "issue-focused" or that define the "issue" broadly;
- Examiners issuing pro forma IDRs not customized to the taxpayer or industry;
- Examiners allowing inadequate time for taxpayers to review "draft" IDRs;
- Examiners denying taxpayers a meaningful opportunity to discuss the purpose and scope of IDRs;
- Examiners being inflexible on deadlines, including issuing multiple IDRs simultaneously with the same deadline;
- Examiners identified in the IDR as the issuing agent being unable to explain or articulate what the IDR is requesting (an indication that the named agent may not have authored that IDR);
- Examiners not informing taxpayers when an IDR is deemed complete; and
- Examiner requests for taxpayer information for tax years or entities that are not under audit.

As these examples illustrate, IDR practices are not always consistent with the letter and spirit of the IDR procedures. The issues generally are not with the procedures themselves but rather the execution.

At the same time, we note that outside of training agents attended, no guidance has been incorporated into the enforcement procedures as to what factors an examiner should consider in either establishing an IDR response deadline or granting an IDR response deadline extension. Similarly, there is no guidance as to what constitutes a "complete" IDR response. Providing guidelines on these two points would be consistent with the goals of the procedures to provide more uniformity in the enforcement of IDRs.

Recommendations

If the requirements of the IDR process are to be effective, the IRS must measure whether they are followed and there must be consequences for failing to adhere to them. To that end, the Coalition recommends that a quality review program be instituted whereby IDRs are sampled and reviewed for consistency with the procedures. Particular emphasis should be placed on defining issues appropriately and tailoring the IDRs to the taxpayer's particular circumstances.

Whether agents have met the requirements should be measured and taken into account in performance assessments. The Coalition wishes to emphasize that the intent of this recommendation is not to increase the rigidity of the process in terms of enforcing deadlines and timeframes but rather to improve both the discussions between the IRS and taxpayers around those IDRs and the quality of the IDRs themselves.

The Coalition recommends that the IRS select a few cases to review the IDR process and receive both taxpayer and agent feedback on how the process is working.

The Coalition recommends that the Service publish FAQs identifying issues and solutions as they arise, similar to the process when Schedule UTP was issued.

The Coalition recommends that agents and specialists receive ongoing training regarding the IDR procedures.

To reduce unnecessary rigidity in the IDR process, the Coalition recommends that the procedures be revised to incorporate factors an agent or specialist may consider in establishing an IDR response deadline or granting an IDR response deadline extension. Such factors should include but not be limited to taxpayer resource constraints, including sensitivity to other business demands and deadlines such as financial statements and tax return due dates.

III. Impact of Litigation Strategies on IRS Audits

Issue

The Coalition is concerned about discrete but significant examples of situations in which the examination team's focus is on preparing for litigation rather than ascertaining the correctness of a return and resolving issues. This currently arises particularly in audits of transfer pricing and other cross-border issues. In these cases, audit teams sometimes approach the examination with a litigation mentality, as opposed to an issue identification and resolution mentality, which negatively affects the cooperative relationship, impedes transparent interaction, decreases efficiency, increases costs, and delays certainty for both taxpayers and the Service.

Background

The Examination Process

The IRS examination process is largely a function of administrative procedure. Section 7602 authorizes the Secretary to examine returns to ascertain the correctness of a return and determine the proper liability for tax, but the procedures themselves are mainly described in administrative materials such as the Statement of Procedural Rules, the Internal Revenue Manual ("IRM"), various directives, and other items of internal guidance. The final step of the examination process is the legal requirement, as provided in Section 6212 of the Code, that the Service issue a notice of deficiency if a deficiency is determined. The notice of deficiency is an official notification to the taxpayer that the Service has determined a deficiency in tax for a specific tax period or periods and provides the taxpayer the opportunity to contest this determination in the United States Tax Court.

The normal course of an examination involves several steps. It begins with notification from the Service that the taxpayer's return for a year or years has been chosen for examination. For large taxpayers, this may merely be the next cycle of years, following on a previous cycle. The notification will identify the lead agent on the case, and may either propose a date and time to meet or advise the taxpayer to contact the agent to make an appointment.

The Service has several different ways of identifying taxpayers and returns to be examined, and so the scope of the examination itself may be limited to specified issues or, in the alternative, be more wide-ranging. The trend in recent years has been toward more limited-scope audits. During the course of the examination, the agent will review the taxpayer's tax reporting, gathering information primarily through informal Information Document Requests ("IDRs"). Many, if not most, issues are likely to be resolved in the course of the examination. For those that are not, the agent will prepare a summary of the issue and the Service's position with respect thereto. This is then transmitted to the taxpayer as a Notice of Proposed Adjustment ("NOPA"), which may also include a computation of any additional tax due associated with the proposed adjustment. The NOPA will provide the taxpayer with an additional opportunity to provide information supporting its position, which may lead to resolution of the issue.

For complex issues, the examination team may request assistance from the Office of Chief Counsel in developing a position or drafting the explanation of the basis for the adjustment. Similarly, specialists may be consulted within the Service, or, in instances where a particular expertise is not housed within the IRS, outside consultants (such as economists, engineers, and industry experts) may be retained.

As the examination winds down, unresolved issues are compiled into a Revenue Agent's Report ("RAR"). The RAR contains a computation of any additional tax due associated with the unresolved items, as well as an "Explanation of Items" (Form 886-A) that sets forth the position behind each adjustment. This report is normally transmitted to the taxpayer with a "30-Day Letter," which permits the taxpayer to prepare a protest of the agent's findings. The taxpayer's protest, accompanied by the IRS auditors' rebuttal, is then sent to the IRS Office of Appeals for an independent assessment of the taxpayer's and the Service's respective positions.

The Appeals Function

The Office of Appeals is a function within the Service that is independent of the compliance functions (*i.e.*, examination and collection). It was formed in 1927 and has essentially retained the same mission since then: to provide a fair and impartial resolution of tax controversies, both for taxpayers and the government. The IRS Restructuring and Reform Act of 1998 ("RRA 98") required that the Commissioner of Internal Revenue ensure the availability of an impartial Appeals function, including a prohibition on *ex parte* communication between Appeals and the Service's compliance functions. Recognizing the value of the Appeals function, RRA 98 also enacted a new provision that codified certain Appeals administrative dispute resolution programs and broadened their availability to taxpayers. These provisions are contained in Section 7123. That section also requires that Appeals establish a pilot program of binding arbitration. Appeals did so, but has recently discontinued it. Rev. Proc. 2015-44.

The Office of Appeals has broad authority to settle cases, and may consider "hazards of litigation" when determining whether to settle an issue. Thus, an Appeals Officer is permitted to assess the taxpayer's position and propose a settlement based on the likelihood that the Service would prevail on the issue in a court proceeding. This is in contrast to the authority of the examination function, which may only make a determination based on whether the taxpayer's position comports with legal or regulatory requirements. Most cases unresolved at the Examination level are settled in Appeals.

Deficiency Procedures

If the taxpayer does not respond to the 30-Day Letter to request Appeals review, or if the Appeals Office is unable to fully resolve the case, the taxpayer will be issued a statutory notice of deficiency under Section 6212, also known as a 90-Day Letter. The 90-Day Letter provides the taxpayer with the option of filing a petition with the United States Tax Court for a redetermination of the adjustments set forth in the notice of deficiency. The recipient of a 90-Day Letter must file a petition within 90 days of the date of the letter in order for the Tax Court to have jurisdiction of the case. If the taxpayer misses the 90-day deadline, or otherwise determines not to proceed in Tax Court, the taxpayer may pay the tax proposed in the notice of deficiency and then file a claim for refund. If the Service denies the claim, or does not respond within six months, the taxpayer may file a refund suit in a U.S. District Court or the Court of Federal Claims.

Special Procedures

Designated Summonses

While the examination process is, as noted, mainly a function of administrative procedures, the Code provides tools in aid of examination. Section 7602 provides the IRS the ability to summon

testimony and documents. In certain cases, the Service is authorized to issue a "designated summons" pursuant to Section 6503(j). The distinct power of a designated summons is that the assessment period for a corporate tax return under audit will be suspended when a court proceeding is brought to enforce or quash a designated summons. The congressional intent behind creating designated summonses was to solve the conflict created by taxpayer refusals to extend the assessment statute and the frequent difficulty of the Service in completing a corporate audit in the general three year assessment period of Section 6501(a) when the taxpayer, which possesses the factual information the Service needs, fails to cooperate. H.R. Conf. Rep. 101-904. As stated by an IRS executive, a "designated summons should be issued only after the taxpayer under examination refuses to extend the statute of limitations…and the examiner has exhausted all other means to obtain the needed information." *U.S. v. Derr*, 968 F. 2d 943, 946 (9th Cir. 1992) (quoting Okley D. Ammons, then-Assistant Commissioner (Examinations)).

Pursuant to Section 6503(j), a "designated summons" is any summons issued for purposes of determining the amount of any tax imposed if (1) the issuance of such summons is preceded by a review of such issuance by the regional counsel of the Office of Chief Counsel for the region in which the examination of the corporation is being conducted, (2) such summons is issued at least 60 days before the day on which the period prescribed in Section 6501 for the assessment of such tax expires, and (3) such summons clearly states that it is a designated summons. Section 6503(j)(2). A designated summons may only be issued to a corporation (or other person to whom the corporation has transferred records) if the corporation is being examined under the IRS's coordinated examination program, or any successor program, a relatively small subset of cases in LB&I's jurisdiction. The running of the applicable period of limitations on assessment provided for in Section 6501 is suspended with respect to any return of tax by a corporation that is the subject of a designated summons if a court proceeding is instituted with respect to that summons. Treas. Reg. § 301.6503(j)-d(1)(ii). Prior to a designated summons being issued by an exam team, the summons must be reviewed and approved by the Field Territory Manager, Associate Area Counsel, Division Counsel, and Division Commissioner. IRM 25.5.3.3.

Congress considered the issuance of a designated summons to be an extraordinary practice and thus imposed the following statutory requirement:

> SEC. 1003. ANNUAL REPORT TO CONGRESS CONCERNING DESIGNATED SUMMONSES. Not later than December 31 of each calendar year after 1995, the Secretary of the Treasury or his delegate shall report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate on the number of designated summonses (as defined in section 6503(j) of the Internal Revenue Code of 1986) which were issued during the preceding 12 months.

See Section 1003 of the Taxpayer Bill of Rights 2 ("TBOR 2"), Pub. L. No. 104-168, 110 Stat. 1452, 1468 (1996).

Designating Cases for Litigation

Internal IRS procedures permit the "designation" of a case for litigation. While the determination whether to designate a case or an issue for litigation requires substantial coordination, and consequently approval by high-level Service and Chief Counsel employees, it also results in the revocation of the taxpayer's right to an administrative resolution of its case short of complete concession of the issue. CCDM (IRM) 33.3.6.1(3). As described in the Chief Counsel Directives Manual ("CCDM"), designating a case for litigation should only occur with

respect to "cases [that] present recurring, significant legal issues affecting large numbers of taxpayers . . . and there is a critical need for enforcement activity with respect to such issues." CCDM (IRM) 33.3.6.1(1). The Manual provides as an example situations in which "judicial precedent may provide guidance for the resolution of industry-wide, tax shelter or other issues, thereby serving early issue resolution and conserving Service and taxpayer resources." *Id.* While a particular taxpayer is foreclosed from taking a designated issue to Appeals, Appeals may retain jurisdiction over the same issue for other taxpayers. CCDM (IRM) 33.3.6.1(3).

Discussion

The process of examining a taxpayer's return is not a static exercise, but rather involves an ongoing dialogue and frequent interaction between the taxpayer and the examination team to ascertain the correct tax liability. This is a dynamic relationship with many different facets, and does not always function smoothly. In order to address taxpayers' concerns about the examination process and clarify roles, responsibilities, and expectations of both Taxpayers and the Service, the Service has implemented various programs that, on their face, are intended to lead to smoother interactions between taxpayers and examination teams. Examples include the Joint Audit Planning Process, developed in coordination with the Tax Executives Institute ("TEI") and the Quality Examination Process ("QEP"). The Service implemented the QEP in July 2011 to provide a "systematic approach for engaging and involving taxpayers in the examination process, from the earliest planning stages through resolution of all issues and completion of the case." IRM 4.46.3.2(1). In July of 2014 LB&I proposed revisions to the LB&I Examination Process (draft Pub. 5125), which have not been finalized, but the spirit of the proposed process remains the same. Draft Pub. 5125 states, "The goal is for LB&I to complete its examination in an efficient and effective manner through the collaborative efforts of both the examination team and the taxpayer working together in the spirit of cooperation, responsiveness, and transparency. There is a greater likelihood that the taxpayer and exam team will benefit in terms of resource utilization and tax certainty when the parties have open and meaningful discussions of issues throughout the examination process."

The Coalition has noted earlier in this paper more widespread examples of breakdowns in this process. The purpose of this discussion is to highlight discrete but significant examples of situations in which the Service appears to begin an examination for the purpose of commencing litigation rather than for the purpose of identifying and resolving issues. The focus on prevailing in litigation rather than ascertaining the correct tax liability and resolving issues is inefficient and costly for both taxpayers and the Service.

While the Service clearly has the power to compel litigation with a taxpayer who does not agree with the Service's position, depriving taxpayers of the opportunity to resolve issues administratively is a particularly serious step. The taxpayer so designated must bear the extraordinary burden of litigation unless it is prepared to accept the Service's position in every respect. The Service's policy of reserving designation for litigation for issues that are significant for purposes of establishing precedent or to shut down perceived abuses provides scant comfort. Taxpayers' perception is that they are increasingly experiencing tactics early in the course of examination that have the apparent aim of developing their audits for IRS-initiated litigation, as opposed to working toward understanding and resolving issues. In some cases, taxpayers are precluded from access to dispute resolution tools, including Appeals and Competent Authority and are effectively forced into Tax Court, which is expensive and burdensome for all parties. Approaching an examination with the expectation of litigation rather than ascertaining the

correct tax liability is bound to affect the behaviors of the parties and the conduct of the examination. Some examples are discussed below.

Burdensome requests for interviews and other "discovery" tactics

The examination team may issue burdensome, extensive IDRs requesting interviews (often transcribed by court reporters) with taxpayer personnel, sometimes very early in the examination process and prior to refining the issue to be developed. Alternatively, the examination team may issue burdensome information requests that appear designed to accomplish pre-trial discovery and develop the case for litigation rather than promote resolution of the issue.

Use of designated summonses

As noted elsewhere, with increasing frequency the Service requests a corporation under audit to repeatedly extend the assessment period. Corporations routinely honor these repeat requests and sign successive statute extensions to enable resolution at the examination or Appeals level. However, when a taxpayer grants numerous extensions and audits drag on for many years, excessive resources, effort, and time are expended by the taxpayer and the Service.

The Coalition is concerned that without additional procedural safeguards, designated summonses may be used effectively to accomplish statute extensions and conduct pre-trial discovery. Based on the enforcement actions the Service has been compelled to commence, it would appear that designated summons have been used sparingly by the Service in the years since Section 6503(j) was enacted. Prior to the current highly publicized designated summons enforcement litigation between the government and Microsoft Corp., there was only a handful of cases where the Service was compelled to bring action against a taxpayer to enforce a designated summons. However, current and former IRS officials have publicly commented that designated summonses will become a more frequent IRS audit management tool. We have been unable to locate any of the statutorily required annual reports to Congress regarding the issuance of designated summonses.

Designated summonses should be limited to the situations originally intended: to prevent a taxpayer from withholding documentation and running out the period of limitations during an audit. The vast majority of taxpayers act reasonably and in the best interests of all parties when they agree to sign statute extensions. But after repeated statute extension requests, and particularly in cases where an audit has not been conducted in an efficient manner, a taxpayer should have the right to decline to sign a statute extension and request that the IRS bring an audit to conclusion thereby allowing the taxpayer to seek resolution in either Appeals or Tax Court without suffering the punitive effect of a designated summons.

Designating or threatening to designate cases for litigation

Designating specific cases for litigation is another area of concern. The Coalition is aware of recent examples of the IRS designating a particular case for litigation or threatening to do so. Several highly publicized examples have shined a light on the Service's internal standards and caused some taxpayers to express concern regarding the predictability of their own audits and in particular, the availability of Appeals.

As noted above, designating a case for litigation forecloses access to administrative dispute resolution tools such as Appeals and Competent Authority. The taxpayer is thus forced to submit

to resolution of the issue through expensive, lengthy and public litigation, or to concede regardless of the strength of the taxpayer's position. At the same time, other taxpayers with the same issue are not necessarily foreclosed from a resolution at Appeals. The Coalition believes that to the extent necessary, designating cases for litigation should be limited to extraordinary circumstances and that such designation should be issue-focused rather than taxpayer-focused to increase predictability and ensure uniformity of treatment.

Summary issuance of statutory notices of deficiency

We are aware of cases where a taxpayer received a 90-day letter without prior receipt of a 30-day Letter (even though the case was not designated for litigation) or a reasoned NOPA providing the taxpayer the opportunity to resolve or at least respond prior to filing a Tax Court petition. While Treasury Regulations permit, in limited cases, bypassing the issuance of a 30-Day Letter, doing so is generally reserved for situations when expiration of the statute of limitations is imminent. Treas. Reg. § 601.105(f).

Inefficient use of outside experts, including retention of private sector legal counsel for developing tax assessments and taking summoned testimony from taxpayers.

The Coalition believes that as a general matter, the Service makes inefficient use of outside experts. In many cases, the Service may have the requisite expertise in-house but justifies using outside experts for their objectivity. However, if the experts head down a path unfavorable to the Service they may be replaced with in-house resources in any event, creating inefficiencies and additional taxpayer burden and expense.

The Coalition is also troubled by temporary regulations (T.D. 9669) and identical cross-referencing proposed regulations (REG-121542-14) under Section 7602. The regulations provide that a person authorized to receive returns or return information under section 6103(n) and Treas. Reg. § 301.6103(n)-1(a) may receive and examine books, papers, records, or other data produced in compliance with a summons and, in the presence and under the guidance of an IRS officer or employee, participate fully in the interview of the witness summoned by the IRS to provide testimony under oath. Prop. Treas. Reg. § 301.7602-1(b)(3). The regulations further provide that "fully participating in an interview" includes, but is not limited to, receipt, review, and use of summoned books, papers, records, or other data; being present during summons interviews; questioning the person providing testimony under oath; and asking a summoned person's representatives to clarify an objection or assertion of privilege. *Id.*

The Coalition is concerned that these regulations improperly delegate the authority to perform certain examination functions outside of the IRS and will further contribute to an atmosphere that favors litigation rather than issue resolution. The Coalition concurs with the comments on these regulations submitted on October 23, 2015, by a group of twelve organizations.

Other concerns with litigation trends

As indicated, the Coalition perceives that in certain cases, rather than trying to ascertain the correct tax liability, the Service has adopted a strategy of attempting to establish law through litigation. The Coalition believes litigation is an inefficient means to develop tax law. That is, the use of litigation to establish precedents or guiding principles in areas of tax law that are not well settled should be less favored than doing so through the established process of issuing published guidance or the legislative process. Stated more directly, writing tax law is the

province of the legislative branch and not the courts. Likewise, providing regulations consistent with statutory language is the province of the executive branch, not the courts. Through the published guidance process, the Service issues regulations and other such guidance that take into account the views of the Service, the Office of Chief Counsel, and the Department of the Treasury. However, published guidance may also incorporate the views of public commentators ranging from individual taxpayers to tax professionals with deep technical expertise. The process thus results in the promulgation of guidance intended to apply on a general basis that takes into account many different aspects, while litigating an issue involves only the taxpayer and the Service, with a judge determining the outcome based solely on the facts and issues specifically presented to the court.

The Coalition believes there are increasing instances in which the Service is unwilling to settle cases with taxpayers, even when they involve well-trodden areas of tax law or where subsequent law changes have mooted the issue. Such cases have little or no precedential value, either to the Service or to the public in general.

The Coalition is also aware of situations in which designation has been proposed because of a disagreement between Appeals and the remainder of the Service over the merits of a position. If the Service is unable to convince Appeals that its views are wrong, we believe the Service should reconsider its position rather than designate a case for litigation.

Recommendations

The Coalition recommends that all agents and specialists continue to be trained in the appropriate conduct of examinations, consistent with the principles laid out in the QEP or other applicable guidance. The Coalition also recommends that as part of the LB&I reorganization, Draft Publication 5125 be finalized.

The Coalition recommends that if a party, especially if from Office of Chief Counsel, authors or co-authors an IDR, the advising or co-author's name also be included on the IDR so that if further explanation is needed, all parties are clearly identified.

The Coalition recommends that it be clarified, either by regulation or statute, that the issuance of a 30-day letter with the opportunity to go to Appeals is mandatory prior to issuance of a 90-day letter. The only exceptions should be when the taxpayer has attempted to run out the clock or for issues designated for litigation as described below.

The Coalition recommends that the reasons for designating cases for litigation be reexamined. The Coalition recommends that if designation authority is retained, it be clarified, either by regulation or statute, that only issues meeting particular requirements should be designated for litigation, and that designation is to be made on an issue basis, not a taxpayer-by-taxpayer basis. Issues meriting designation would be limited to identified abusive transactions such as listed transactions. The Coalition also recommends that the Government should bear the taxpayer's litigation costs if unsuccessful in court on the specific designated issue.

The Coalition recommends that the procedures for designated summonses be revised to require that the memorandum prepared by the examination team explain the length of the audit, number of statute extensions and why the audit has not been closed, or when the audit would anticipate closing if the requested documentation were received. In addition, the Coalition recommends that circumstances under which a designated summons may be issued be clarified, either by

regulation or statute, and that such circumstances be limited to situations where the Service demonstrates a lack of cooperation by the taxpayer in responding to IDRs.

The Coalition recommends that the Service's policy on retention of experts be revised to make it clear that experts should only be retained where the Service lacks the requisite expertise in-house and should not be involved in the inherently governmental functions of taking compelled testimony and examining books and records. In that regard, we recommend withdrawal of the proposed and temporary regulations under section 7602.