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LB&I Update

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Agenda

- Changes to CIC Program
- Campaigns Update
- Changes to CAP Program
- Experiences with the New IDR Procedures
- Use of Interviews
- Developments in Transfer Pricing Audits



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Changes to CIC Program

- LB&I 2019 Focus Guide: Coordinated Industry Case Program will be replaced with Large Corporate Compliance Program.
- Use of data analytics to classify returns as high, medium, or low risk.
- More details forthcoming.



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LB&I Campaigns Update

Overview of Campaigns:

- Important part of LB&I's Portfolio
- Involves LB&I's harnessing the combined intellect of its people coupled with data analytics to make intentional decisions about compliance risks
- Campaigns achieve intended compliance outcomes by:
 - Focus on selected compliance risks
 - Identification of proper resources
 - Application of proper combination of treatment streams
 - Implementation of feedback loops and adjusting based on such feedback



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LB&I Campaigns – Update

- Every LB&I employee continues to be encouraged to submit compliance issues for evaluation.
- This effort recognizes the importance of LB&I's capturing and relying upon the vast knowledge and expertise of its work force to best use our resources to maximize compliance.
- The overall concept behind campaigns is to improve resource deployment to respond to compliance risk.
- LB&I has stated that the purpose is not to examine more returns, but to respond with a variety of treatments to maintain high compliance across the LB&I filing population.



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LB&I Campaigns – What are They

A campaign is a plan focused on “strategic” issues. It uses the right resources and combination of treatment streams to achieve intended compliance outcomes.

A treatment stream is a compliance action or combination of actions that LB&I will implement to achieve the compliance goal of the campaign.

Campaign workload selection will key off defined compliance goals.



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LB&I Campaigns

1. Section 48C Energy Project Credit
2. Offshore voluntary disclosure program declines and withdrawals
3. Domestic production activities deduction under section 199
4. Micro-captive insurance
5. Related-party transactions
6. Deferred variable annuity reserves
7. Basket transactions
8. Completed contract method of accounting
9. Linkage plan strategy under the 1982 Tax Equity and Fiscal Responsibility Act
10. S corporation losses claimed in excess of basis
11. Repatriation
12. Form 1120-F non-filers
13. Inbound distributors



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LB&I Campaigns (cont'd)

14. Form 1120-F Chapter 3 and Chapter 4 withholding
15. Swiss bank program
16. Foreign earned income exclusion
17. Verification of Form 1042-S Credit claimed on Form 1040NR
18. Agricultural chemicals security credit
19. Deferral of cancellation of indebtedness income
20. Energy efficient commercial building property
21. Corporate direct (IRC section 901) foreign tax credit
22. IRC section 965 avoidance
23. Economic development incentives
24. Individual foreign tax credit (Form 1116)
25. Costs that facilitate an IRC section 355 transaction
26. SECA tax



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LB&I Campaigns (cont'd)

- 27. Partnership stop filer
- 28. Sale of partnership interest
- 29. Partial disposition of election for buildings
- 30. Interest capitalization for self-constructed assets
- 31. F3520/3520-A Non-Compliance and campus assessed penalties
- 32. Forms 1042/1042-S compliance
- 33. Nonresident alien tax treaty exemptions
- 34. Nonresident alien schedule A and other deductions
- 35. NRA tax credits
- 36. Restoration of sequestered AMT credit carryforward
- 37. S Corporation distributions



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LB&I Campaigns (cont'd)

38. Virtual currency
39. Repatriation of foreign triangular reorganizations
40. Section 965 transaction tax
41. Section 199 – claims risk review
42. Syndicated conservation easement transactions
43. Foreign base company sales income: manufacturing branch rules
44. 1120F interest expense/home office expense
45. Individuals employed by foreign governments and international organizations
46. Individual Foreign Tax Credit Phase II
47. Offshore Service Providers
48. FATCA Filing Accuracy
49. 1120-F Delinquent Returns Campaign
50. Work Opportunity Tax Credit

More to come? (last set announced in October 2018)



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LB&I Campaigns – Potential Treatment Streams

- IRS will consider multiple compliance approaches for campaigns
- Focusing limited resources in the right areas that drive a specific compliance impact
- Using data analytics combined with input from employees to identify areas of compliance risk and
- A campaign treatment stream could include:
 - Examinations
 - Soft letters
 - Outreach
 - Industry Issue Resolution program
 - Tax form changes, or
 - Published guidance



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LB&I Campaigns – Feedback Loops

- When campaigns were initially announced, the IRS also stated that there were “integrated feedback loops” to hear from IRS employees and taxpayers/practitioners regarding specific campaigns.
- Information received through feedback loops is important to the IRS to evaluate campaigns and determine whether any modifications are necessary, including terminating a campaign where no longer necessary.



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LB&I Campaigns – Lessons Learned

- Best Practices identified from the Campaign program include:
 - Robust Feedback Loops – the IRS feedback process has shown that establishing these chains of communication allows the IRS to adapt sooner
 - Providing pre-identified training and tools when delivering campaign inventory
 - Identification of a campaign executive lead with strategic responsibility for all aspects of the campaign has helped the IRS in its implementation of the program and also provides a contact person for its feedback loop



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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



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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



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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



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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.



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CAP Application and Selection Process

- No new applications accepted for 2019.
- The IRS expects to accept new applications for the 2020 CAP year.
- Additional documents required to be submitted with the application form:
 - 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



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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



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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.



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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.



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CAP: Issues List (cont'd)

- 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.



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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



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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



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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.



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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.



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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.



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Experiences with the New IDR Procedures

- Agents seem to be following the letter of the Manual
- There are disputes over several matters:
 - Reissuance of the draft IDR in final form notwithstanding taxpayer concerns;
 - Failure to state an issue or stating an issue so broadly as to be uninformative;
 - Overly broad requests;
 - Procedural foot faults.
- Proper way to address and elevate



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Use of Interviews

- Interviews are used more and more frequently
- How many interviews is enough
- Selection of interviewees
- Advance notice of topics
- Role of taxpayer's advisors



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Recent LB&I Developments – Transfer Pricing

- Replacement of Transfer Pricing Roadmap with Transfer Pricing Examination Handbook (now part of IRM)
- Instructions regarding issuance of Mandatory Transfer Pricing IDR
- Instructions for Examiners on Transfer Pricing Selection-Cost Sharing Arrangement Stock Based Compensation
- Instructions for Examiners on Transfer Pricing Selection-Reasonably Anticipated Benefits in Cost Sharing Arrangements
- Instructions for LB&I on Transfer Pricing Selection and Scope of Analysis – Best Method Selection
- Instructions for Examiners on Transfer Pricing Issue Examination Scope – Appropriate Application of IRC §6662(e) Penalties



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Transfer Pricing Examination Changes to IRM

- Comprehensive description of the audit process
- The §6662(e) IDR is no longer mandatory in all cases
- Provides that “if the facts of the case show that the taxpayer’s results fall within an appropriate arm’s length range, then our resources should be applied elsewhere”
- Instructs agents to examine CbC reports and prepare ratio analyses, but cautions that ratios, without functional analysis, are inadequate



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Transfer Pricing Examination Changes to IRM (cont'd)

- Highly focused on opportunities for resolution throughout the process.
- Directs that the taxpayer provide a transfer pricing orientation shortly after the opening conference and financial statement orientation, but limits the presentation to “selected intercompany transactions,” not all such transactions.
 - Discuss transfer pricing transactions, including business operations, worldwide structure, transfer pricing policies, and background, history, rationale, and value drivers related to the transactions.
- Focuses more on evaluating the taxpayer’s selection of the best method than on formulating an independent best method analysis.
- Anticipates use of the Acknowledgment of Facts IDR.
- Instructs agents to request attendance at taxpayer’s appeals presentations.
- Discusses collaboration with APMA.



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Mandatory Transfer Pricing IDR

- No longer required for all cases
- If the examination is part of a campaign, follow the directions in the campaign
- Where examinations have initial indications of compliance risk, Transfer Pricing Practice or Cross Border Activities agents assigned will issue the IDR
 - If no such personnel are assigned, the IDR will not be issued



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Stock Based Compensation

- While *Altera* is on appeal, no new examinations of Cost Sharing Agreements' stock based compensation will be started
- Further instructions will be issued once a decision is announced by the Ninth Circuit
- If the issue has already been raised, then if the taxpayer extends the statute, work will stop until the decision; otherwise it may continue



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Reasonably Anticipated Benefits

- Acknowledges that new platform contributions to existing cost sharing arrangements may produce benefits in different proportions from existing RAB shares
- Notes that some agents assert that the regulations require a single RAB share for subsequent PCTs
- The Instructions disagree, stating that:
 - “[I]f a taxpayer could choose to set up multiple CSAs to accommodate the different IP and corresponding different RAB shares, incorporating different RAB shares in the same CSA is conceptually comparable.”
- The document states that the Service is reviewing this issue to determine a Service-wide position, and in the interim, teams should not “develop adjustments based solely on changing a taxpayer’s multiple RAB shares to a single share for subsequent PCTs.”



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Best Method Selection

- Highlights the importance of the issue
- Notes that ignoring the taxpayer's analysis and starting from scratch is inefficient
- Directs instead that the analysis should focus first on analyzing the taxpayer's best method selection
- Instructs agents to consider adjustments to the chosen method rather than an entirely new method, where possible
- To change the method, the exam team must get approval of a TTPO Transfer Pricing Review Panel
 - Should address why the taxpayer's method is not reliable
 - Should address whether the method can be adjusted to make it more reliable
 - Should address why the proposed method is more reliable



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Instructions re Penalties

- Penalties apply when taxpayers fail to create or provide the required documentation in a timely fashion
- Penalties encourage taxpayers not to take unreasonable positions and to document their reasoning
- Highlights that documentation does not automatically protect against penalties – the documentation must be adequate and reasonable
- Evaluation of whether to apply the penalty should only occur after the team has a “deep factual background” of the issue



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Change in Definition of Intangible

- TCJA changed the definition of intangible to include goodwill, going concern value, workforce in place, or any other item the value of which is not attributable to tangible property or the services of any individual
- Includes “no inference” language
- Does this influence disputes under pre-TCJA law?



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