

WHAT TO DO WHEN THE IRS COMES CALLING

Dealing with IRS Controversies

Moderator:

Linda M. Watson

Panelists:

Steven S. Brown

Farley P. Katz

Rachael E. Rubenstein

Josh Wu

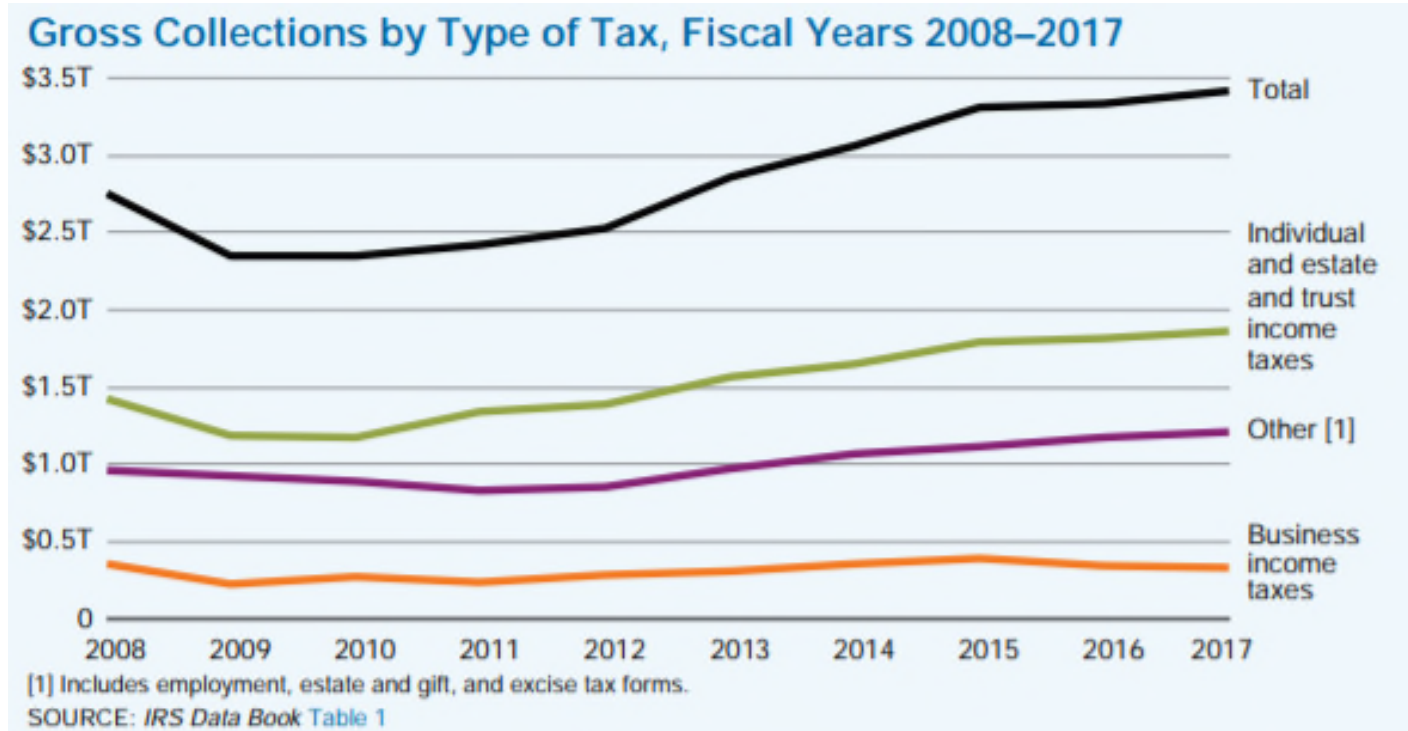
CLARK HILL

AGENDA

- Introduction
- IRS Enforcement Capabilities & Priorities
- IRS Examinations
- IRS Administrative Appeals
- Tax Litigation
 - U.S. Tax Court
 - Refund Forums
- IRS Collection Matters

IRS ENFORCEMENT CAPABILITIES & PRIORITIES

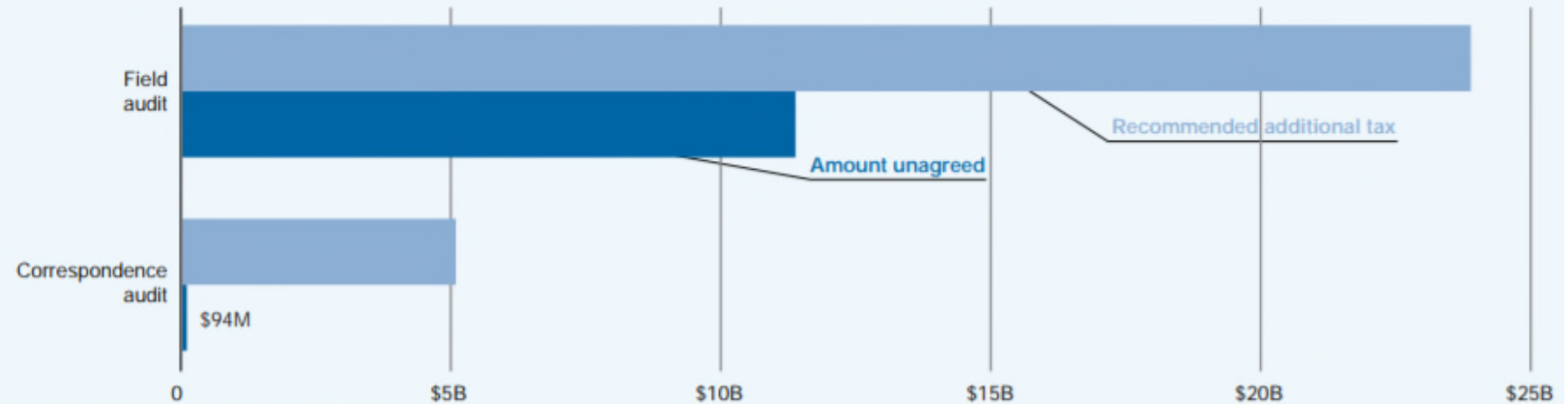
GROSS TAX COLLECTION BY TYPE



IRS ENFORCEMENT

INTERNAL REVENUE SERVICE DATA BOOK, 2017

Amount of Recommended Additional Tax and Amount Unagreed, Fiscal Year 2017

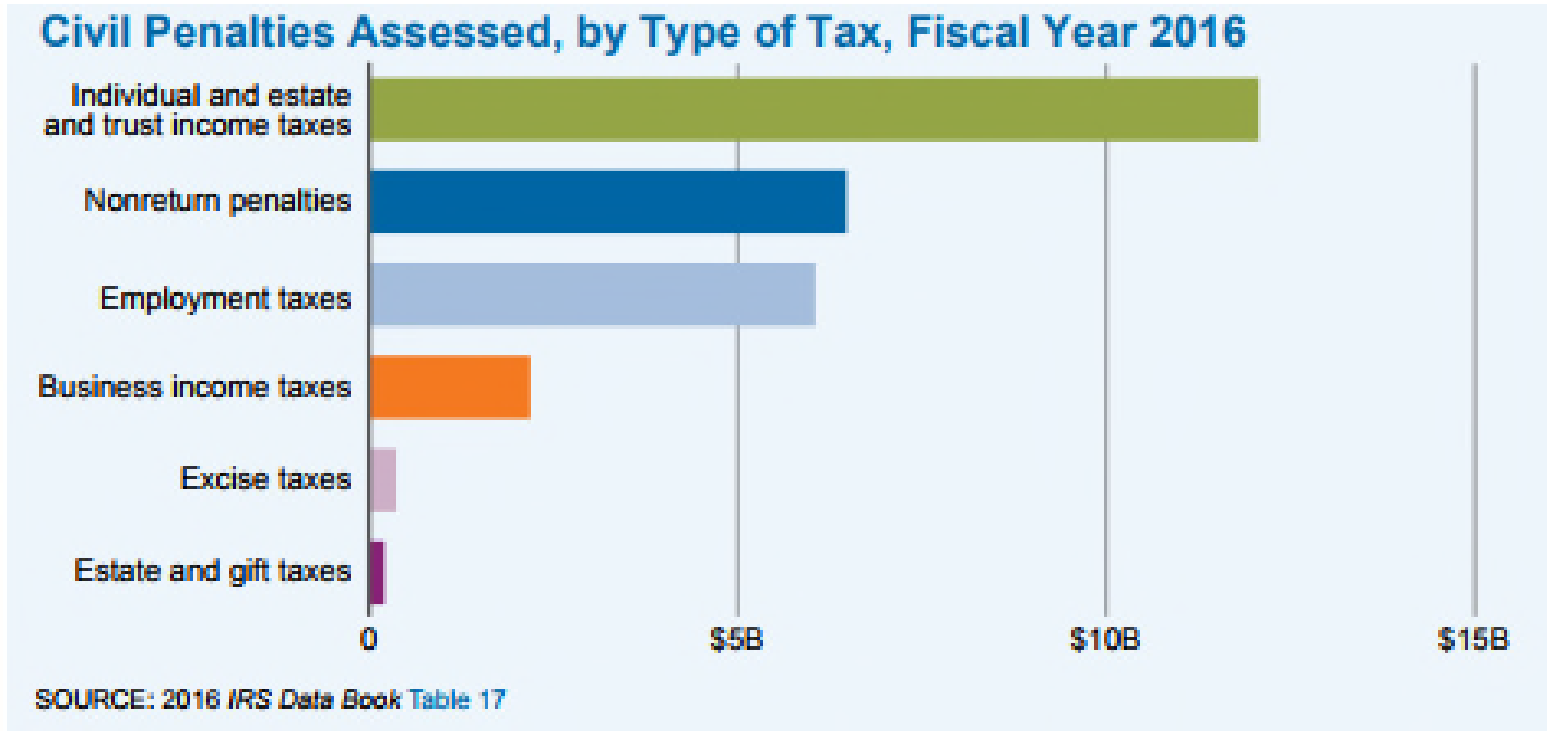


SOURCE: 2017 IRS Data Book Tables 9a and 10

HOT AREAS FOR ENFORCEMENT

- Offshore assets and accounts
- Private aircraft deductions
- Partnership audits
- Employment tax (civil and criminal)
- Cryptocurrency and the digital economy
- Plus, always civil penalties...

CIVIL PENALTIES ASSESSED



IRS EXAMINATIONS & ADMINISTRATIVE APPEALS

HOW ARE RETURNS SELECTED FOR AUDIT?

- Information Reporting/DIF score
- Referrals or public sources
- Whistleblowers
- Similar issue to one adjusted in previous year
- Related returns

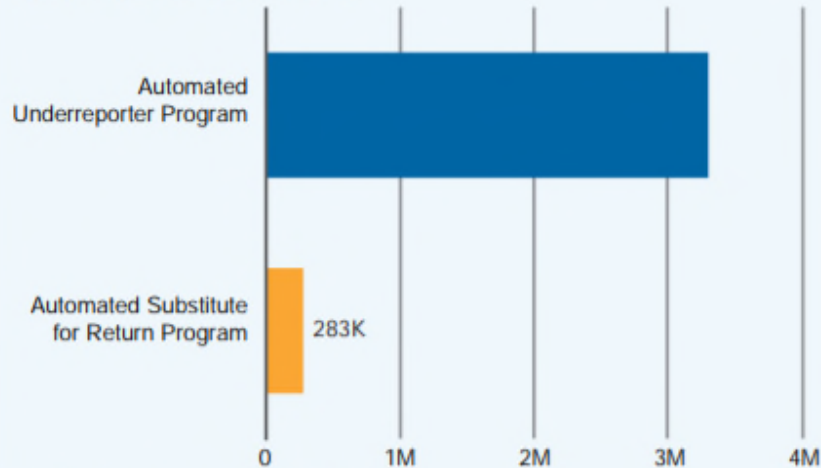


INFORMATION REPORTING PROGRAM

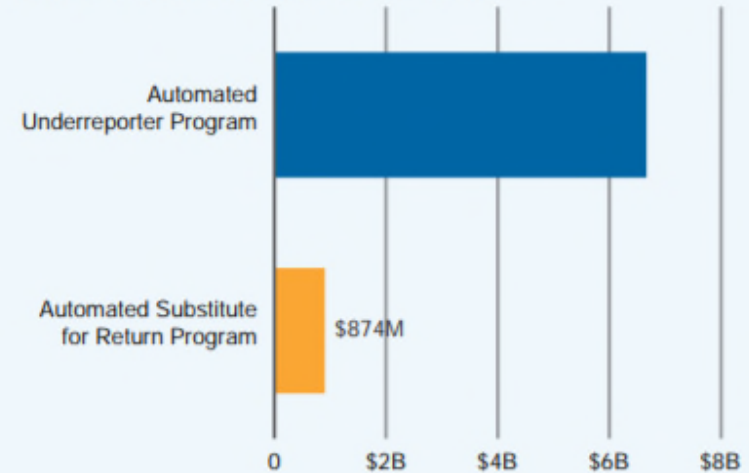
INTERNAL REVENUE SERVICE DATA BOOK, 2017

Information Reporting Program, Fiscal Year 2017

Number of cases closed



Amount of additional assessments



SOURCE: 2017 IRS Data Book Table 14

STATUTE OF LIMITATIONS ON ASSESSMENT

- 3 years – IRS has 3 years from date of filing return or due date of return, whichever is later, in normal case
- 6 years – IRS has 6 years where there has been an omission of over 25% of gross income
- Unlimited time – false or fraudulent returns, willful attempt to evade tax, no return
- Extended pursuant to agreement with taxpayer
 - E.g., Form 872
- Why agree to extend?

DEALING WITH THE IRS

- Candor and honesty
- Be prepared and have documentation
- Expect delays by the IRS
- Consider strategic and tactical goals
 - Strategically – where do you want to end up?
 - Exam, Appeals, Tax Court, district court
 - Depending on that answer – tactically how do you get there?

PREPARING FOR THE AUDIT

- Have outside counsel and in-house tax conduct self-exam to identify potential issues (disallowed deductions or credits or unreported income)
- Think about who will be the face of the audit
- Consider conflicts issues with return preparer and whether Kovel arrangement is needed
- Organize books and records to support tax positions

DEALING WITH PRIVILEGE ISSUES

- Attorney-Client, Work Product and IRC 7525 Privilege
 - Kovel arrangements
- Exceptions
 - Tax Shelters
 - *Doe v. Wachovia*, 268 F. Supp. 2d 627 (W.D.N.C. 2003). The court held that in marketing the same tax opinion to more than one client, a firm acting as promoter could not expect that the communications were confidential.
 - Crime-Fraud
 - *In re Grand Jury Investigation (The Corporation)*, 87 F.3d 377, 380 (9th Cir. 1996). To invoke the crime-fraud exception successfully, the government has the burden of making a prima facie showing that “the client was engaged in or planning a criminal or fraudulent scheme when it sought the advice of counsel to further the scheme.”
 - Waiver
 - Example: *AD Investment Fund 2000 LLC v. Comm’r*, 142 T.C. No. 13 (2014). Tax Court held that reasonable cause defense puts the taxpayer’s understanding of the law at issue and, under the doctrine of implied waiver, waives privilege as to communications related to the transaction.

AMENDING RETURNS

- Circular 230, Section 10.21
 - A practitioner who knows a client has not complied or has made an error in or omission from any return, document, affidavit, or other paper which the client submitted or executed under the revenue laws, must advise the client of such error and the consequences thereof
- 26 C.F.R. 1.451-1(A)
 - If a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, he should, if within the period of limitation, file an amended return and pay any additional tax due
- AICPA Statement on Standards for Tax Services No. 6
 - A member should inform the taxpayer promptly upon becoming aware of an error in a previously filed return, an error in a return that is the subject of an administrative proceeding, or a taxpayer's failure to file a required return. A member also should advise the taxpayer of the potential consequences of the error and recommend the corrective measures to be taken.

IRS INFORMATION GATHERING

- Code authorizes the IRS to:
 - Examine records
 - Issue a summons
 - Take testimony as may be relevant to determining the correctness of a return, determining the liability of a taxpayer, making a substitute return, collecting tax, or inquiring into any criminal tax offenses
- Information Document Requests (IDRs)
- Summonses
 - Traditional summonses
 - Third-party summonses
 - John Doe summonses



IRS ADMINISTRATIVE APPEALS

IRS APPEALS

- Mission statement
 - To resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service
- Independence from Exam
 - To resolve disputes effectively, Appeals must show itself to be objective, impartial, and neutral in fact as well as appearance
- Hazards of litigation settlement authority
 - Resolution vs Settlement

APPEALS DATA

INTERNAL REVENUE SERVICE DATA BOOK, 2015

Table 21. Appeals Workload, by Type of Case, Fiscal Year 2015

Type of case	Cases received	Cases closed [1]	Cases pending September 30, 2015
	(1)	(2)	(3)
Total cases [2]	113,870	117,673	52,969
Collection Due Process [3]	41,849	42,505	19,929
Examination [4]	35,430	37,096	20,762
Penalty Appeals [5]	10,504	10,533	3,538
Offers in Compromise [6]	9,622	9,880	4,178
Innocent Spouse [7]	2,622	3,120	1,284
Industry Cases [8]	986	1,528	1,254
Coordinated Industry Cases [9]	131	191	298
Other [10]	12,726	12,820	1,726

[1] Cases closed includes cases received in Fiscal Year 2015 and in prior fiscal years.



APPEALS PROCESS

- Protest
 - Drafted by taxpayer/counsel and responds to Revenue Agent's Report (RAR)
 - IRS Exam has opportunity to send "rebuttal" to Appeals
- Appeals Pre-Conference and Conference
- Settlement
 - Hazards of litigation
 - Some areas where authority to settle limited
 - Compliance Coordinate Issues, Technical Advice Memoranda issued, change of accounting methods, foreign bank account penalties

TAX LITIGATION

TAX LITIGATION

- If taxpayer cannot resolve issue within the IRS, it can proceed to:
 - U.S. Tax Court
 - Civil bench trials only
 - U.S. Court of Federal Claims
 - About 5 percent civil tax
 - Bench trials only
 - U.S. District Court
 - About 7 percent civil tax, 4 percent criminal tax
 - Bench or jury trial
 - U.S. Bankruptcy Court
 - Bench trials only

U.S. TAX COURT

- Established under Article I
 - 19 Presidentially-appointed judges
 - Judges appointed for 15-year terms
- Opinions issued by the court
 - Bench, Summary, Memorandum, Tax Court
- Both attorneys and non-attorneys may represent taxpayers in Tax Court
 - Attorneys must be barred in a state
 - Non-Attorneys must first pass a written test

U.S. TAX COURT JURISDICTION – NOTICE OF DEFICIENCY

- Advises the taxpayer of delinquent taxes owed plus penalties and interest
- IRS must issue valid notice of deficiency to taxpayer prior to assessing a tax
- Notice must be mailed to taxpayer's address prior to expiration of statute of limitations
- No assessment or collection action may be taken by IRS during period for filing a petition (or, if filed, until the Court reaches a final decision)

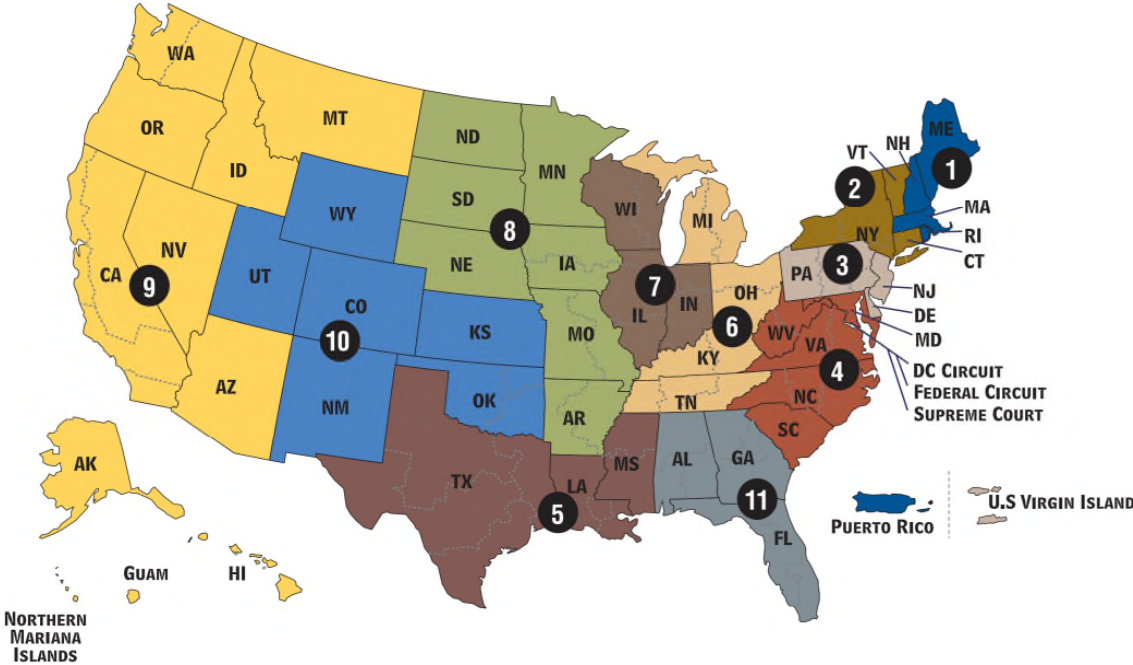
U.S. TAX COURT JURISDICTION – NOTICE OF DEFICIENCY

- Person filing Tax Court Petition must be taxpayer to whom deficiency notice is addressed
- Provide clear assignment of error as well as a prayer for relief
- Must be filed within 90 days
- Must Include
 - Designation of place of trial (no restrictions)
 - Name and address of taxpayer
 - Prayer setting forth relief sought
 - Copy of notice of deficiency

U.S. TAX COURT – RESOLUTION

- Court can order higher or lower tax deficiency, or a refund for the year
- Per latest IRS statistics, of the amounts originally in controversy in U.S. Tax Court cases, the IRS lost 75% of them after trial/settlement
- Decision only binding on years at issue in the case
- Either party may appeal a Tax Court decision in a regular case

U.S. DISTRICT COURTS AND COURTS OF APPEAL



DISTRICT COURTS AND REFUND FORUMS

- Jurisdiction
 - Taxpayer must file refund claim with IRS before initiating suit
 - If claim denied by IRS (or not acted upon within six months), taxpayer can file complaint in district court or Court of Federal Claims
 - Refund claim can be filed by the later of three years after the return is filed or two years after the amounts owed have been paid

DISTRICT COURTS AND REFUND FORUMS

- If refund suit instituted before time to issue NOD has expired, IRS may issue NOD for same tax period
- IRS may re-examine tax year and if there is an offset it will reduce the refund amount
 - Allowed even though statute of limitations would bar assessing additional amount owed

COLLECTIONS MATTERS

DEALING WITH COLLECTIONS

- We help business clients with tax debts
 - Fallout from employee embezzlement
 - Trust fund recovery penalties
 - Tax shelter and other large issue tax debts and penalties

IRS COLLECTION TOOLS

- Federal tax lien
 - Arises upon assessment, notice and demand, and failure to pay
- Levy
 - IRS can levy upon all property and rights to property belonging to the taxpayer as well as property subject to tax lien that has been transferred or sold by the taxpayer
- Seizure
 - IRS takes physical possession of tangible personal property and constructive possession of real property
- DOJ actions to reduce liability to judgement or foreclose property

DEFENSIVE MEASURES

- Challenge the assessment
- Seek extension of time to pay
- Request installment agreement
- Submit offer in compromise
- Contact the Taxpayer Advocate
- File a bankruptcy petition
- Etc.

CONCLUSION

- With proper planning and strategy, IRS tax adjustments can be managed
- Taxpayers often make mistakes early in the audit that make the case difficult to resolve later
- If an audit involves one of the IRS priority enforcement areas, immediately engage counsel
- IRS assessed \$26 billion in civil penalties but abated \$12 billion of such penalties in 2017
 - A good strategy can reduce penalties

QUESTIONS?

THANK YOU

Moderator:



Linda M. Watson
(248) 988-5881
lwatson@clarkhill.com

Panelists:



Steven M. Brown
(312) 360-5010
sbrown@clarkhill.com



Farley P. Katz
(210) 250-6007
farely.katz@clarkhillstrasburger.com



Rachael E. Rubenstein
(210) 250-6006
rachael.rubenstein@clarkhillstrasburger.com



Josh Wu
(210) 250-6078
josh.wu@clarkhillstrasburger.com

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