

The New School of Audit Effectiveness: A Report and Evaluation of the Strategies, Tools and Tax Administration Techniques of the Large and Mid-Size Business Division of the IRS

**By
Larry R. Langdon***

Larry Langdon evaluates the tax administration tools introduced by the Large and Mid-Size Business Division (LMSB) to improve audit efficiency and explains how the improvement and use of these processes will greatly benefit both the IRS and taxpayers.

Introduction

Many tax professionals and IRS auditors practice “old school” examination techniques that include various versions of “cat and mouse” games. Some agents continue to hide or fail to disclose the exact issues they are pursuing until late in the audit cycle, and other agents make it a habit of turning audits into “financial archeological digs.” Some tax practitioners continue to ignore the disclosure rules when filing returns or at the beginning of the audit cycle, and other taxpayers encourage a continuous misuse of auditor time by strategically elongating response time to revenue agent requests and focusing agents on less relevant aspects of routine audit adjustments. These old school approaches result in a substantial ineffective use of time by both taxpayers and agents.

Contemporary, professional audit practice requires audits to be more time-efficient and effective. Good tax administration, including the IRS’s need for better audit coverage, demands more effective

enue agent requests and focusing agents on less relevant aspects of routine audit adjustments. These old school approaches result in a substantial ineffective use of time by both taxpayers and agents.

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audit planning, better disclosure of audit issues and earlier, more effective resolution techniques. This “new school” of audit effectiveness is the only cure for today’s time-pressured IRS and taxpayers.¹

This article evaluates the tax administration tools introduced by the Large and Mid-Size Business Division (LMSB) to improve audit efficiency. In particular, it focuses on the initial impacts of LMSB pre-filing and post-filing processes,² and explains how the improvement and use of these processes will greatly benefit both the IRS and taxpayers. The LMSB processes were created with consideration for the nature of its taxpayer base. Therefore, taxpayers’ comprehension of how the IRS views them will allow taxpayers to deal more efficiently with the audit process.

LMSB History

LMSB has audit responsibility for corporations and partnerships that have assets of more than \$10 million.³ This group of taxpayers includes the largest domestic and foreign-owned businesses in the United States. The typical LMSB taxpayer engages in sophisticated transactions and tax planning strategies and is well represented by external and internal financial analysts, accountants and attorneys.⁴ Historically, the Coordinated Examination Program (CEP) and the current Coordinated Industry Cases Program (CIC)⁵ only provided audit coverage for a majority of CIC taxpayers. Moreover, this organizational structure requires at least half of the direct examination time of the field audit personnel in LMSB, leaving a significant number of corporations and partnerships with very limited audit coverage.

The LMSB concept and vision originated in 1998 tax legislation.⁶ As suggested by Commissioner Charles Rossotti⁷ with the concurrence of the Clinton Administration and Congress, the legislation called for the IRS to be reorganized into four operating divisions based on its four major taxpayer groups.⁸ Since taxpayers and the respective processes for dealing with each taxpayer vary greatly, the reorganization of the IRS required the development of new techniques that were not available under the IRS’s prior regionalized structure. A design team⁹ led by Deborah Nolan¹⁰ and David Robison¹¹ developed the new techniques, the original LMSB organizational structure¹² and plans for operational implementation.¹³ The design team also developed a number of the key initiatives to be implemented from inception and expressed a vision that posited:

- We will be a world class organization, responsive to the needs of our customers in a global environment, while applying innovative approaches to customer service and compliance.
- We will apply the tax laws with integrity and fairness through a highly skilled and satisfied workforce in an environment of inclusion, where each employee can make a maximum contribution to the mission of the team.

To reflect its emphasis on service and employee satisfaction, the design team developed a number of metrics to effectively measure taxpayer and employee satisfaction, in addition to traditional revenue production. This development was aided by a significant solicitation of input from members of the American Bar

Association, American Society of Certified Public Accountants, the Internal Revenue Service Advisory Council, Manufacturers Alliance/MAPI, Tax Executives Institute and other professional and managerial groups on how to improve past IRS performance. The taxpayers voiced many concerns, but primarily they expressed the desire to (1) avoid disputes through pre-filing services; (2) seek early issue identification and resolution; and (3) use alternative dispute resolution techniques. In each of these areas, the taxpayers also requested services that would result in currency¹⁴ and improved cycle times of traditional audit periods.

The program design phases began June 1999 and were completed within a year when LMSB “stood up” as an operating division on June 6, 2000. Diagram 1 reflects the current LMSB structure and roles, updated from what was originally conceived by the design team.

LMSB spent a great deal of time and effort developing principles of tax administration based on the following concepts:

- **Disclosure** by taxpayers of aggressive and questionable transactions, through pre-filing tools, registration of products by promoters and disclosures of transactions on returns and before or at the commencement of audit processes
- **Transparency** for taxpayers of IRS positions earlier in the audit process and transparency and disclosure of IRS processes to allow taxpayers to resolve their disputes earlier with the IRS
- **Increased Published Guidance** in quantity and substantive content requiring tighter coordination and a consistent strategy among

- Appeals, Chief Counsel, the Treasury and LMSB
- **Targeted Enforcement** of rules pertaining to abusive technical tax transactions and increased coverage of middle market and partnership taxpayers
- **Consistency** of tax administration allowing consistent treatment of LMSB taxpayers within industry groups and across industry groups
- **Pre-Filing Processes** emphasizing the Pre-Filing Agreement Program (PFA) as well as the Industry Issue Resolution Program (IIR)
- **Post-Filing Processes** including Limited Issue Focused Examination (LIFE), Comprehensive Case Resolution (CCR), alternative dispute

resolution tools such as Accelerated Issue Resolution (AIR), Fast Track Settlement (FTS) process, mediation and arbitration processes, the Tax Shelter Program, as well as existing tools, such as early referrals to Appeals

In light of recent inappropriate financial reporting by major publicly traded corporations, more extensive disclosure rules under Sarbanes-Oxley,¹⁵ and continuing Congressional concerns about aggressive tax planning,¹⁶ the use of these concepts in effective tax administration should receive even more support and consideration today.¹⁷ Moreover, to the extent the IRS is not explicitly proactive about implementing reforms, taxpayers would be well served to

introduce similar concepts as best audit practices.

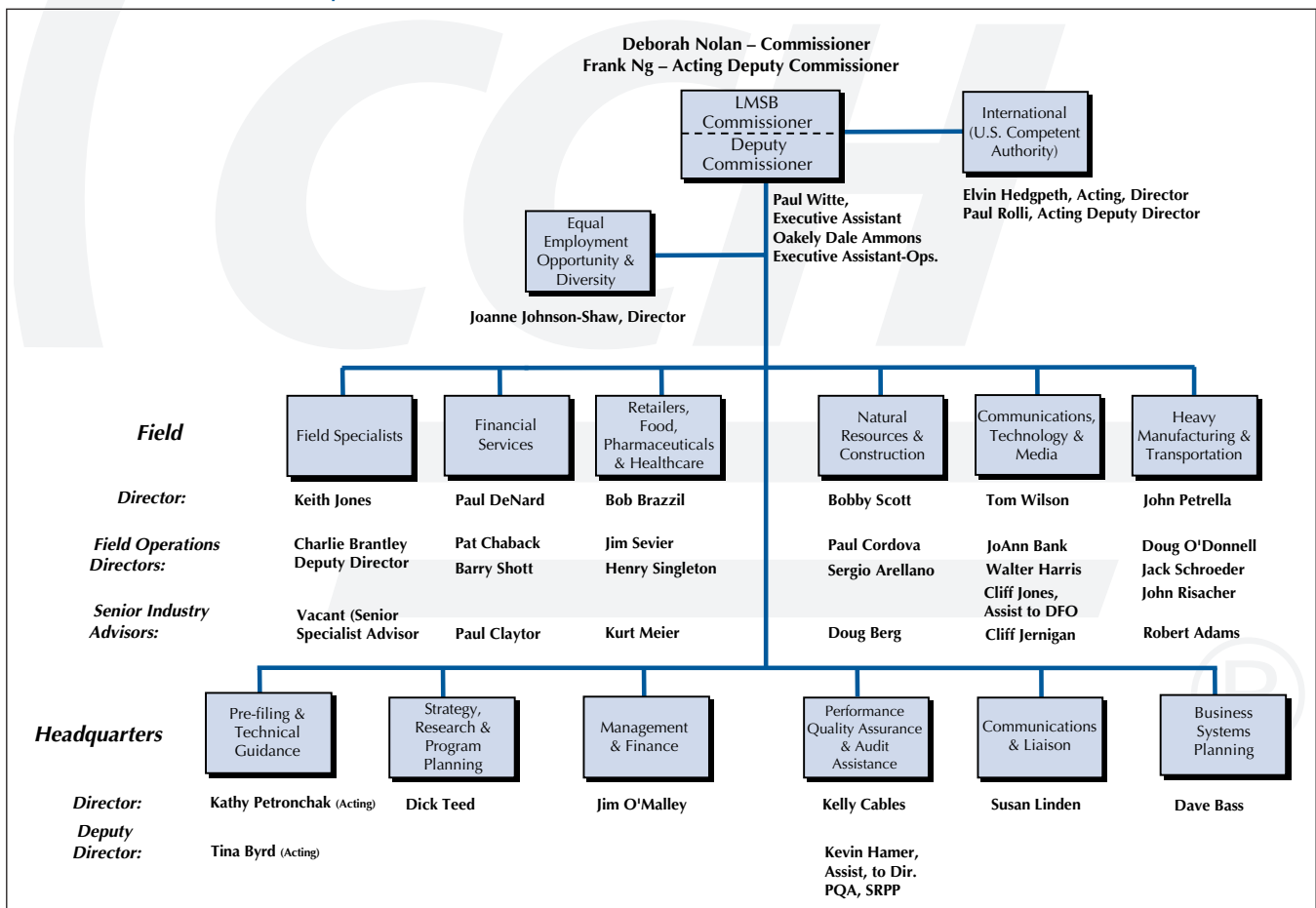
Since pre-filing and post-filing processes necessarily include the above-referenced broader concepts, the rest of this article elaborates on the different aspects of the new pre-filing and post-filing processes. Diagram 2 reflects the design team's plan for LMSB operational implementation.

Pre-Filing Processes

Pre-Filing Agreements (PFAs)

The design team developed the PFA program to resolve tax controversies and produce closing agreements in specific factual situations where established legal principles could be ap-

Diagram 1
LMSB Executive Leadership Team



plied previous to filing a return, ultimately, in compliance with settled IRS audit positions. Currently authorized under Rev. Proc. 2001-22,¹⁸ the PFA pilot program started with fewer than 10 large corporate taxpayers, who were expected to file their returns between September and December 2000.¹⁹ There were 11 issues considered in the PFA pilot program that included valuation of assets, identification and documentation of hedging transactions and in-house research expenses eligible for the “qualified research credit” under Code Sec. 41.²⁰ Notice 2000-12 also disqualifies several subjects from the PFA program, including APA issues, changes in accounting method on Form 3115 and tax-exempt and government entities issues.²¹

The Congressionally required annual reports regarding the

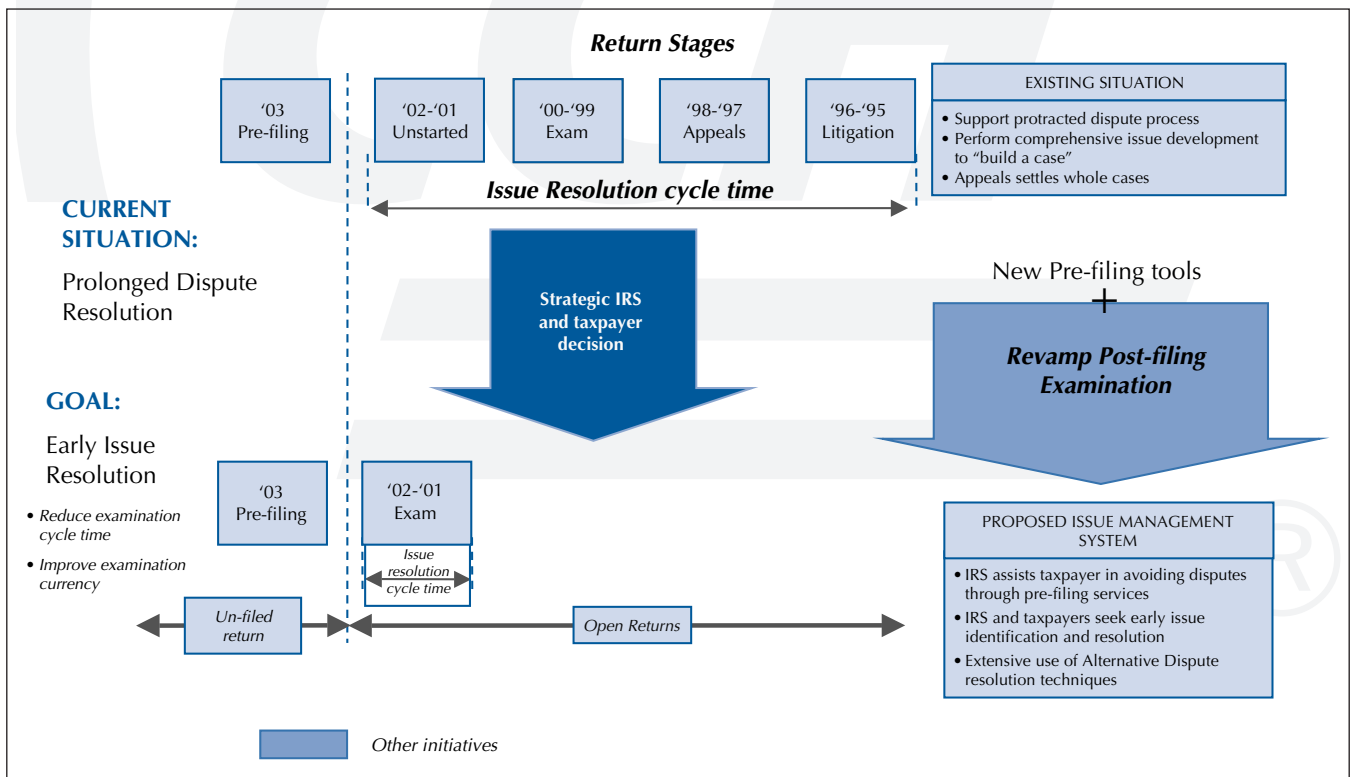
PFA program²² indicate that a wide range of issues have been submitted for PFAs. It is also not surprising that a substantial number of requests for PFAs have been rejected primarily for involving issues outside the scope of the program or relating to unsettled tax law. Through 2002, LMSB had received 89 PFA applications, accepted 55 and executed 27 closing agreements.²³ The data in the reports clearly indicates that the PFA program has reduced taxpayer burden and makes for a more effective use of IRS resources. Due to the \$10,000 fee and the time commitment by the IRS and taxpayers, the PFA program is particularly well suited for significant issues with multi-year impact, such as business acquisitions and dispositions. However, PFA closing agreements are not currently enabled to cover multi-year periods.

Results and Recommendations. Where implemented, the PFA program succeeded in substantial part, due to input from and cooperation between taxpayers and LMSB field personnel. Therefore, the PFA program needs to expand to include multi-year periods, so taxpayers do not have to renew the PFAs annually, and to provide coverage of a broader range of domestic and international issues. Ideally, general improvements to the PFA process will naturally result from greater taxpayer subscription.

Industry Issue Resolution Program (IIR)

Notice 2000-65²⁴ announced the IIR pilot program to test a procedure to resolve frequently disputed tax issues common to a significant number of LMSB taxpayers. LMSB assumed operational responsibility for this program, with full involve-

Diagram 2
Issue Management



ment of Appeals and LMSB field personnel, Chief Counsel personnel from the National Office and LMSB field counsel and Treasury representatives.

IIR forms of published guidance have varied, but generally have taken the form of revenue procedures that provide elective treatment for taxpayers.²⁵ The IIR program aims to develop published guidance that is consistent with the provisions of the Code and Treasury regulations, is administratively feasible for IRS field personnel and allows taxpayers to conform to the guidance in a manner that does not represent an undue hardship or administrative burden. One of the first IIR projects involved simplified methods that auto dealerships can use to determine dollar amounts to be included in or excluded from the income of employee “loaner” privileges for overnight and weekend use.²⁶ Each year there have been new requests for input for projects under the IIR program,²⁷ and announcements have been made regarding which projects are accepted or deferred under the program.²⁸ In its initial stages, the IIR program has had difficulty capturing the appropriate subject matters for resolution. Nonetheless, the IIR program has been made permanent,²⁹ Rev. Proc. 2003-36 further formalized IIR processes³⁰ and IR-2003-52 permits IIR submissions at any time.³¹

Results and Recommendations. The IIR program has been a success for the taxpayer groups involved and has improved tax compliance and administration in a number of key areas. Areas requiring improvement include: (1) better marketing of the program by LMSB to key industry groups; (2) a more proactive introduction

of issues by various LMSB taxpayers; (3) tighter IIR processing timelines; and (4) more careful selection of projects eligible for the program, because the program is very resource intensive. Moreover, the success of the program is dependent on taxpayer and IRS cooperation and creativity.³²

Post-Filing Processes

Limited Issue Focused Examinations (LIFE)

Soon after its inception, LMSB devoted substantial research and case development resources to the taxpayers under its jurisdiction to determine the best use of its audit resources. During its early analysis, several key trends became apparent: (1) an increased need for better and specialized training for agents to deal with increasingly sophisticated transactions both domestically and internationally; (2) a decline in the total LMSB workforce from over 6,700 to about 6,000 in a three-year period due to retirements and lack of ability to replace experienced agents; (3) an increasing threat of loss of expertise as most experienced employees retire; (4) increasing complexity of the tax law and devices used by taxpayers to limit their tax liability; and (5) an increasing need to devote resources to promoters of “technical abusive tax avoidance” (TATA) transactions,³³ the entities who engage in TATA and for audits of so-called middle market taxpayers. In addition, the need for revised examination techniques became evident in Debbie Nolan’s and my review of the unreasonably high currency and cycle time data that was used by Commissioner Rossotti and Deputy

Commissioner Bob Wenzel in their evaluation of our effective use of audit resources.

As a step toward meeting these challenges, in April 2002, a design team led by Craig Leeker³⁴ was commissioned to develop a more focused examination program to institutionalize the best audit practices from throughout LMSB.

The team was designated as the “LIFE team,” in order to emphasize a more issue-focused approach to compliance risk, whereby the best audit practices would be quickly utilized by agents and managers. Under LIFE, both the taxpayer and the examination team were responsible for focusing on risk analysis and materiality in an atmosphere where the process was less difficult, less time consuming, less expensive and less contentious. LIFE is not appropriate for every taxpayer, and, in fact, only a minority of examinations qualify for LIFE treatment. A training video and training material were created by late October 2002, and all agents were instructed to have LIFE training by December 2002.³⁵

LIFE provides the following advantages:

- It encourages better audit planning by both IRS audit teams and taxpayers.
- The issues, not resources, govern audit, while the full range of resolution tools is still available.
- It is an effort to guarantee shorter, more focused, audits, which will save both government and taxpayer resources.
- Both sides commit to a more amicable, professional relationship.

The limitations on the use of LIFE follow:

- It requires an investment in resources to accomplish the audit in a timelier manner.

- The agreed-upon audit plan eliminates the opportunity for either side to raise issues or claims late in the audit cycle.

The practices and techniques contained in the LIFE training materials represented the best of many best practices that were utilized in examinations throughout the country in the past. In fact, these best practices could, in retrospect, be described as LIFE-like or LIFE-lite audit processes. However, under the previous IRS 33 district structure, it was difficult to introduce these best practices and techniques throughout the

LIFE training materials outline materiality both qualitatively and quantitatively. LIFE requires the audit team to determine (1) which issues are significant; (2) what dollar values constitute a material amount; (3) whether timing issues have a material impact; and (4) when to apply lower thresholds of materiality for permanent issues.³⁷ Materiality does require professional judgment and no one uniform standard can be applied to every issue and taxpayer. However, using risk analysis processes to determine less and more important

items based on their projected effects will go far in effectively allocating limited audit resources. In fact, the IRS recently provided more detail

on a two-tiered LIFE process of risk analysis followed by a quantitative dollar threshold determination.³⁸

The LIFE processes are very new. LMSB did not roll out these procedures until December 2002, and in order to be effective, the revised method of auditing must commence in the planning phase. LIFE requires a wholehearted philosophical subscription to its values, as disclosure failures and old school audit techniques hinder its process. The implementation of LIFE may be further hindered by auditors' fear of losing control of the audit and auditors' inclination to not drop minor issues early in the audit process. To mollify auditors' fears, LIFE provides the audit team with the authority to terminate a LIFE examination. The most likely cause for termination is lack of cooperation by the taxpayer.

On the other hand, taxpayers may also hinder LIFE implementation by their failure to disclose erroneous or inappropriately aggressive transactions and their fear that new issues will be discovered resulting in termination of the LIFE agreement. Even so, taxpayers may take solace from the fact that the LIFE training materials outline various procedures that are complex, but not as complex as the previous traditional IRM procedures.³⁹ The IRM and IRS training materials throughout the years have had many detailed instructions to agents that have imposed high standards for audits. Accordingly, the changes contemplated in the LMSB audit standards represent a major shift in attitudes, culture and practices, which need to be effectively communicated and reinforced throughout the LMSB organization.

Results and Recommendations. It is too early to determine whether LIFE will realize its expectations of improving currency of audit cycles and use of IRS and taxpayer resources. It should be noted that early implementation of the LIFE program has been accepted in a significant minority of CIC and industry cases. The following improvements would help achieve LMSB's aggressive goals for currency and cycle time:

- Increased discipline for both agents and taxpayers in the audit planning process
- Continual planning and review of audit plans to resolve issues earlier with cooperation of taxpayers and IRS managers
- Better development and publicity of materiality standards
- Continual publicity both within and without the IRS of successes of the LIFE process

[T]here are obstacles such as the old school mind set on the part of taxpayers, practitioners and IRS personnel, which indicates that there is still much more room for progress.

IRS. The previous IRS had no effective way of ensuring uniform administration of these kinds of process improvements.

Implementation of LIFE requires five key elements: (1) risk analysis; (2) materiality; (3) scope; (4) mandatory compliance checks; and (5) a Memorandum of Understanding (MOU). Of these elements, the most difficult implementation issue involves the effective use of a materiality standard in LIFE examinations.

Materiality is clearly very important in the selection of issues for examination; however, it is a financial reporting concept that has not had uniform acceptance in tax administration or tax law.³⁶ In fact, many agents believe they have a professional and public duty to correct every error found in an examination. Therefore, the

- A better process to handle the perennial problem of taxpayer claims that arise late in the audit process
- A better discipline or means of communication for issues raised by agents late in the audit process

*Accelerated Issue Resolution (AIR)*⁴⁰

The AIR process is still available to taxpayers and is a useful tool. It is also important to note that Delegation Orders 236 (Rev. 3)⁴¹ and 4-25 (formerly 247)⁴² are still available for use by implementing Appeals settlement authority at the field level, while continuing to maintain appropriate internal controls.

Delegation Order 236 was specifically created to cover a situation that often occurs in large corporate examinations: the identification during an examination of the same issue each audit year. Often the issue identified has litigating hazards, which would make it appropriate for settlement under normal circumstances, but only at the Appeals level. Previous to Delegation Order 236, taxpayers were forced to go to Appeals for settlement each audit cycle, even though settlements would only be affected by a change in facts and law. Under Delegation Order 236, once Appeals settles an issue, LMSB can offer the same settlement in subsequent audit cycles, as long as the facts and law are essentially the same. Delegation Order 236 is a common sense answer to recurring issues, which safeguards the integrity of the settlement process while saving both taxpayer and IRS resources.

Delegation Order 4-25 recently expanded and renumbered Delegation Order 247.⁴³ The original Delegation Order allowed co-

ordinated issues in the Appeals Industry Specialization Program (ISP) or Appeals Coordinated Issue Program (ACI), whose settlements in Appeals were carefully controlled, to be settled by an LMSB Case Manager subject to the same controls. These controls included the existence of a completed Appeals Settlement Guideline and the review and concurrence of the Appeals Issue Coordinator. This process alleviated the need to bring issues to Appeals, where the Appeals Officer would have to follow a formalized version of the same process. Delegation Order 4-25 simply expands the concept to allow settlement of coordinated issues outside of LMSB. By applying the same controls, a territory manager in the Small Business/Self-Employed Division can now settle coordinated issues with the review and concurrence of Appeals. Since Appeals currently coordinates many tax shelter issues, and such issues impact both individuals as well as large corporate taxpayers, Delegation Order 4-25 could have a significant impact on many future tax shelter cases.

CCR Pilot Program

The CCR Pilot Program presented an interesting, but unsuccessful, experiment in tax administration.⁴⁴ Under this program, taxpayers were encouraged to work with the IRS to resolve all open issues for all open years currently or previously under examination. This program was to be jointly administered by LMSB and Appeals with inclusion of Chief Counsel's Office if cases were docketed; the objective was to reduce costs and administrative burdens by closing cases through cooperative effort. As a threshold requirement, the LMSB taxpayer had to have at least one year un-

der examination as a CIC case and at least a prior year in Appeals. As described, the pilot program appeared to have some interest. However, only a few taxpayers applied for the program, and those taxpayers failed to meet the procedural qualifications. Ultimately, the program was discontinued for lack of interest on the part of qualified taxpayers.

FTS Process

Effective November 14, 2001,⁴⁵ the IRS announced the LMSB Fast Track Dispute Resolution Pilot Program, as a joint effort between Appeals and LMSB to expedite case resolution at the lowest level within LMSB. Rev. Proc. 2003-40⁴⁶ formally established the FTS process. Like a partial LIFE process, a key aspect of the FTS process was the requirement that examination personnel and the taxpayer and its representative commit to work together in a process facilitated by a specially trained Appeals Officer to quickly resolve selected significant disputed issues. David Robison, now Chief, Appeals, explains:

The goal of the program is to reach agreements on cases at the earliest possible time. Often it is just a few contentious issues that hang up the whole case. So if taxpayers and the IRS can carve out these issues, send them to Fast Track and get them settled, it is much easier have the entire case resolved in Compliance.

To qualify for FTS, taxpayers must meet several conditions. The issues must be fully developed, the taxpayer must state its position in writing and it can only apply to a limited number of unagreed issues. Some of the cases

disqualified from FTS include cases designated for litigation, competent authority matters and issues outside LMSB jurisdiction or outside of Appeals settlement authority.⁴⁷ FTS is available for both legal and factual disputes. It brings mediation techniques and the full range of Appeals tools to a neutral location, where all the decision-makers will be present and will agree to the settlement. The parties must intend to reach settlement within 120 days. Should the taxpayer and LMSB not reach agreement through the FTS process, the taxpayer retains traditional Appeals rights and the *ex parte* prohibitions apply.

Some have argued that the FTS process undermines the independence of Appeals.⁴⁸ In actuality, the FTS process re-deploys Appeals resources to resolve cases at the Exam level with Exam jurisdiction before such cases are formally transferred to Appeals where they might languish for additional years. In this vein, the FTS process fosters better communication of issues by both taxpayers and IRS personnel by causing all parties to enter into a meaningful dialogue. To suggest that Appeals' independence is compromised during the FTS process, because it brings to the floor both taxpayer and IRS arguments, derogates the effectiveness of Appeals Officers. Moreover, the *ex parte* prohibitions still apply if an FTS process does not produce a settlement.

Results and Recommendations. The FTS process has exceeded the expectations of practitioners and IRS field personnel. By May 2003, "the IRS and 104 LMSB taxpayers had already successfully settled cases through the FTS Pilot Program

in and average time of 69 days."⁴⁹ Of the first 117 cases closed *via* FTS, the average days to settle have been 124, compared to 781 days within the traditional appeals process for CIC cases. According to Robison, "All parties involved with Fast Track have expressed a lot of satisfaction with the program. More significantly, the parties have stated that the settlements reached are on par with those reached in the traditional, lengthier, Appeals process." FTS has introduced a new way of doing business with the IRS that resolves tax controversies in a positive, proactive way without large cost or time delays.

Tax Shelter Program

An important strategic priority of LMSB was the effective curtailment of technical abusive tax avoidance transactions, sometimes called "abusive tax shelters."⁵⁰ These transactions were marketed by promoters to corporations and individuals during the 1990s with a view of avoiding income tax on their large earnings. First, it was important to define what constituted a TATA transaction. With the help of the Chief Counsel's Office and the Treasury, the IRS pronouncement process itself was a key strategy to define TATA transactions. Second, in IRS Announcement 2002-2, LMSB described its voluntary disclosure initiative for taxpayers to fully disclose tax shelters and other questionable transactions. This disclosure was very successful with 1,664 disclosures from 1,206 taxpayers representing undisclosed billions in tax liabilities.⁵¹ Next, the Code Secs. 302/318 and Code Sec. 351 contingent liability settlement initiatives were announced to settle

a large number of cases without litigation.⁵² One key benefit of the disclosure initiative was the identification of tax shelter promoters, which has resulted in hundreds of large and small promoter audits. In addition, additional questionable transactions were disclosed to LMSB for review by the Chief Counsel and Treasury personnel. These activities have substantially curtailed the marketing of these products to LMSB taxpayers.

Results and Recommendations.

Even though substantial progress has been made in curtailment of TATA transactions, it is important that the above action steps continue. When promoters and taxpayers do not comply with the new registration and disclosure regulations, strong penalty administration should occur.

Conclusion

Ideally, an adherence to and the use of these reforms and programs will allow effective communication between taxpayers and the IRS, will generally foster clearer administration of tax rules by the IRS and ultimately should improve the audit process. As noted earlier, there are obstacles such as the old school mind set on the part of taxpayers, practitioners and IRS personnel, which indicates that there is still much more room for progress. Taxpayers and practitioners need to proactively engage in these programs⁵³ and deal fairly and professionally with the IRS during the audit process. Effective leadership on the part of taxpayers, practitioners and IRS officials is still needed to continue to improve the audit and issue resolution and controversy practice in the United States.

ENDNOTES

- * The author acknowledges the assistance of Berwin Cohen, a tax associate in the Palo Alto office of Mayer, Brown, Rowe & Maw LLP, in preparation of this article. The views expressed in this article represent those of the author and do not necessarily reflect the views of the IRS or the Treasury.
- ¹ Although the concepts discussed in this article introduce more efficiency into the audit process, they do not guarantee that taxpayers will receive “freebies.” Naturally, good audit practices will allow good corporate citizens to progress through the audit process in a more streamlined fashion with less wasting of resources.
- ² To the IRS, the filing of a taxpayer return is the watershed event from which it defines its perspective. Therefore, it has classified these processes as “pre-filing” or “post-filing.”
- ³ LMSB would also administer the taxation of entities meeting this threshold that are treated as corporations or partnerships, such as an LLC. The \$10 million asset LMSB threshold may create concerns when determining jurisdiction over a corporation or partnership that does not complete a balance sheet. In such circumstances, the entity may automatically be treated as a Small Business/Self-Employed Division taxpayer.
- ⁴ See www.irs.gov (describing LMSB taxpayers).
- ⁵ Announcement 2001-38, 2001-1 CB 1138, references Notice 2001-12, 2001-1 CB 328, and indicates that the program was renamed as the Coordinated Issue Cases Program.
- ⁶ IRS Restructuring and Reform Act of 1998 (P.L. 105-206), effective Oct. 17, 1998.
- ⁷ Mr. Rossotti served as IRS Commissioner from early November 1997 through early November 2002.
- ⁸ Previously, the IRS was regionalized. The IRS Restructuring and Reform Act of 1998 prompted the most comprehensive reorganization and modernization of the IRS in nearly half a century. The law resulted in the IRS reorganizing itself into four major operating divisions, aligned by types of taxpayers: (1) the Wage and Investment Division, serving approximately 116 million taxpayers who file individual and joint tax returns; (2) the Small Business/Self-Employed Division, serving approximately 45 million small businesses and self-employed taxpayers; (3) the Large and Mid-Size Business Division, serving corporations with assets of more than \$10 million; and (4) the Tax-Exempt and Government Entities Division, serving employee benefit plans, tax-exempt organizations, such as charities and social welfare groups, and governmental entities. See *IRS History and Structure* at www.irs.gov.
- ⁹ The Design Team consisted of agents and managers throughout the IRS who had previously used best IRS practices and conducted efficient audits. The Design Team sought to codify these practices to universally improve the IRS audit process. The Design Team’s process of implementation included the following steps: (1) identification of good practice; (2) relabeling for universal distribution; (3) marketing; and (4) national implementation.
- ¹⁰ Deborah M. Nolan was Deputy Commissioner, LMSB during this period of time and, in May 2003, was appointed Commissioner, LMSB by Commissioner Mark Everson to succeed Mr. Langdon.
- ¹¹ David Robison was LMSB Director for Financial Services during this time; in May 2002, he was appointed Chief, Appeals by former Commissioner Rossotti.
- ¹² See Diagram 1.
- ¹³ See Diagram 2.
- ¹⁴ “Currency” is an IRS term used to measure the average number of months for which the portfolio of taxpayers’ tax years audited by LMSB remain open after filing of the tax returns.
- ¹⁵ Sarbanes-Oxley Act of 2002 (P.L. 107-24), July 30, 2002, 115 Stat. 745.
- ¹⁶ See *generally Corporate Tax Shelters: Looking Under the Roof*, S. HRG. 107-653 before the Comm. on Fin., 107th Cong., 2d. Sess. (2002).
- ¹⁷ While not everyone agrees that the IRS has yet to reap the benefits of the reforms discussed in this article, it clearly is more capable of using its administrative tools in the aftermath of the reforms. See, e.g., *Top IRS Officials, Former Commissioners Discuss Five Years of Reform*, 2003 TNT 139-2 (July 21, 2003).
- ¹⁸ Rev. Proc. 2001-22, 2001-1 CB 745.
- ¹⁹ See Notice 2000-12, 2000-1 CB 727. The PFA Program is not meant for the “run-of-the-mill” taxpayer, as it is expensive, requires a significant amount of resources and is used to provide definitive results in the case of a significant potential adjustment prior to the time the return is scheduled to be filed.
- ²⁰ *Id.*
- ²¹ *Id.*
- ²² The Conference Report to H.R. 4577 requires an annual report relating to the PFA program. The last three reports are contained in Announcement 2001-38, *supra* note 5; Announcement 2002-54, 2002-1 CB 1190; and Announcement 2003-43, IRB 2003-23, 998.
- ²³ *Id.*
- ²⁴ See Notice 2000-65, 2000-2 CB 599.
- ²⁵ See Rev. Proc. 2003-36, IRB 2003-18, 859.
- ²⁶ See IRS News Release, IR-2001-11, Jan. 23, 2001.
- ²⁷ *Supra* note 25.
- ²⁸ See IRS News Release, IR-2001-48, Apr. 26, 2001, and IRS News Release, IR-2003-92, July 24, 2003.
- ²⁹ See IRS News Release, IR-2002-47, Apr. 10, 2002.
- ³⁰ *Supra* note 25.
- ³¹ IRS News Release, IR-2003-52, Apr. 17, 2003.
- ³² The IIR program seeks to improve the efficiency of tax practice, rather than present taxpayers with “give-aways.” A good balanced resolution would not necessarily favor the IRS or the taxpayer.
- ³³ See note 51 *infra*, and associated text.
- ³⁴ The other members of Craig Leeker’s team were Amy Liberator, Kristin Moore, Bill Hunt and Galand Brunson.
- ³⁵ The interactive nature of the training materials demonstrates LIFE’s goal of reorienting IRS philosophy and making the audit process more efficient.
- ³⁶ The accounting concept of materiality is quantitative, while the LIFE concept of materiality is both quantitative and qualitative.
- ³⁷ In addition, public policy and black and white issues that are easily resolved will trump the materiality requirements.
- ³⁸ See new *LIFE Frequently Asked Questions*, as of Aug. 1, 2003, at www.irs.gov.
- ³⁹ See IRM §4.10.2.6.1.1 (May 14, 1999).
- ⁴⁰ See Rev. Proc. 94-67, 1994-2 CB 800.
- ⁴¹ Delegation Order No. 236 (Rev. 3), effective Aug. 25, 1997; See also FSA 199932015 (May 7, 1999).
- ⁴² Delegation Order No. 4-25, effective Mar. 19, 2003, formerly Delegation Order No. 247, IRB 1996-21, 7.
- ⁴³ *Id.*
- ⁴⁴ The CCR program was announced in Notice 2000-43, 2000-2 CB 209, with the application period extended until Apr. 30, 2001, in IRS News Release, IR-2001-5, Jan. 11, 2001, and Notice 2001-13, 2001-1 CB 514.
- ⁴⁵ Notice 2001-67, 2001-2 CB 544.
- ⁴⁶ Rev. Proc. 2003-40, IRB 2003-25, 1044.
- ⁴⁷ See *supra* note 45.
- ⁴⁸ See Vincent S. Canciello, *Tax Shelter Resolution Initiatives and the Independence of Appeals*, J. TAX PRAC. & PROC., Apr.–May 2003, at 15 (arguing that the FTS *ex parte* waiver impedes Appeals independence, and further discussing three settlement initiatives involving COLI, Code Secs. 302 and 318 basis shifting and Code Sec. 351 contingent liability). See also Sheryl Stratton, *IRS Appeals on the Move, Playing Offense and Defense*, 2003 TNT 115-2 (June 16, 2003) (citing Canciello’s argument and Robison’s responses).
- ⁴⁹ See IRS News Release, IR-2003-72, May 3, 2003.
- ⁵⁰ See IRS F.S. 2001-10 (Sept. 2001) Abusive Tax Shelters (outlining LMSB initiatives in dealing with abusive tax shelters. The Office of Tax Shelter Analysis activities are described as well as activities to curtail the promotion of these shelters including registering shelters, requiring taxpayers to disclose “reportable transactions,” analyzing current tax shelter cases, contacting

tax shelter promoters and using sources of information for promoter investigations.)

⁵¹ See IRS News Release, IR-2002-99, Sept. 16, 2002.

⁵² See note 48, *supra*.

⁵³ The IRS must also proactively use these programs and institute measures within the spirit of these programs. In fact, in one recent

audit, the IRS actually solicited a company's executive to change the audit climate and turn around the personality of the audit.



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