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IRS Update On Large-Business Audits Too Vague, Critics Say

By **Vidya Kauri**

Law360, New York (February 1, 2017, 8:21 PM EST) -- Tax practitioners who were eagerly awaiting news on how the IRS would change its approach to auditing large corporations with assets of more than $10 million were disappointed Tuesday, when the agency released an update that is being criticized as vague and lacking in substantive guidance.

Following an earlier, June 2015 announcement of a revamp of the IRS' Large Business and International Division — the arm responsible for auditing the largest corporations in the country — the agency identified 13 so-called campaigns in which it said it will move toward issue-based examinations instead of the old approach of placing large multinational businesses under continuous audit by a rolling team of examiners.

The change essentially means that the IRS will pick specific issues to audit on a taxpayer's return instead of the entire return, but Tuesday's announcement has little information on how the campaigns will be conducted, how they affect other tools available to taxpayers to reach a resolution, and how they fit into the established appeals process.

This dearth of information adds a level of uncertainty for taxpayers and leaves them hoping that the IRS will be more transparent and forthcoming about how the audit process will be implemented, according to Brian Kittle, co-leader of Mayer Brown LLP's tax controversy and transfer pricing practice.

"The IRS has had a long period of time in order to get its head around how it wants to implement these campaigns," Kittle said. "We just haven't seen any insight into how the process is going to go with the IRS putting these campaigns in place. Without this information, taxpayers are left in the dark."

Kittle noted that although he is appreciative of the time the revenue agency is spending on identifying the most-high-risk issues for audits, there is little information forthcoming on what the IRS' primary concerns are.

"As a member of the tax community, the hope is always that we're going to get more information so that we understand how ... these campaigns are going to affect our clients," he said.

Michael Greenwald, the corporate and business tax practice leader at Friedman LLP, told Law360 that he is concerned about how it has taken the IRS nearly two years to identify 13 major high-risk areas, but that some of these issues may now become less important under the new Trump administration with new officials heading the U.S. Department of the Treasury.

“I’d like to see a lot more in the way of detail,” Greenwald said. “It’ll be interesting to see how effective it is. Normally, when we get an examination, it’s an examination of the entire return or multiple returns. So, we’re not really seeing this sort of very targeted examination.”

In addition to lacking in specificity, the guidance includes new bureaucratic language that practitioners are struggling to interpret.

For example, it makes several references to “treatment streams,” which could be construed as methods to ensure compliance by way of encouraging voluntary compliance, conducting outreach with industry stakeholders on issues that seem to create conflicts with the IRS, and developing new procedures and technology.

According to George Hani, the tax department chair at Miller & Chevalier Chtd., the term “treatment stream” might be intentionally vague so as not to bind the IRS on exactly how it is going to gain compliance, which could be done through other potential means such as issuing new regulations.

“The choice of the phrase treatment stream is new and purposely vague so as they have maximum flexibility to decide later exactly how they’re going to address a particular area of noncompliance,” Hani said.

The IRS did not return questions for clarification on the term “treatment streams.”

The agency said in its announcement that its campaigns are the culmination of extensive data analysis, suggestions from IRS compliance employees and feedback from the tax community.

IRS officials have said in the past that the LB&I reorganization is motivated by budget constraints and will allow the agency to better focus its resources and improve audit practices and compliance. The structural changes involve winding down the coordinated industry case program of continuous audits, and instead targeting areas for examination based on compliance risks.

The old regime was also denounced for taking a one-size-fits-all approach that didn’t adequately address marginal cases, Hani said.

Among the 13 campaigns listed, the guidance seeks to ensure compliance in related-party transactions, “basket transactions” in which taxpayers try to defer and treat ordinary income and short-term capital gain as long-term capital gain, accounting methods used by large land developers in residential communities, the reporting of S-corporation losses, repatriation structures, and the claiming of losses by U.S. distributors of goods sourced from foreign-related parties in transfer pricing structures.

The guidance also identifies the lead executives for each campaign, and the IRS said that it expects to launch more campaigns “in the coming months.”

Hani said that there will likely be more targeted campaigns in the contentious area of transfer pricing, and that he expects the individual campaign executives to provide more information on how issues will be audited in their particular areas.

“Perhaps more than what they included would be nice, but the anticipation is that the individual campaigns will be the ones that are more forthcoming or charged with getting the word out about what the IRS view is on a particular issue," Hani said.

--Additional reporting by Eric Kroh. Editing by Sarah Golin and Edrienne Su.