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# Looking for Clues in the IRS's Campaign Announcement



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The Internal Revenue Service's ("IRS's") long-awaited guidance on its first wave of campaigns is short on details, but offers some insight into the process.

## I. Unveiling of Campaign Audits

The IRS's Large Business and International Division's ("LB&I's") transition to a more issue-focused "campaign" enforcement model has been orchestrated by the IRS in a manner largely obscured from public view. Though LB&I representatives had offered some informal comments on campaigns at various public forums in 2016 (*see, e.g.*, Erin McManus, "Inbound Distributor Transfer Pricing an IRS Audit Priority" *BNA Daily Tax Report* (November 14, 2016); Alison Bennett, "Cross-Border Tax Avoidance Likely IRS Audit Campaign Target" *BNA Daily Tax Report* (June 22, 2016); Alison Bennett, "Inbound Distributors Target of IRS Transfer Pricing Campaign" (June 9, 2016)), no released IRS guidance had articulated the practical effect of this presumed paradigm shift on the larger examination process.

Taxpayers were encouraged, therefore, when the IRS announced in December 2016 that it would identify its first set of campaigns in late January 2017—the hope being that any released directive would include a more comprehensive statement on the structure and effect of the campaign process (*see* Alison Bennett, "IRS Audit Campaigns to Scrutinize International Issues" *BNA Daily Tax Report* (December 19, 2016)).

LB&I issued its promised, but ultimately narrowly-framed guidance in a five-page document on January 31, 2017. The document identifies and briefly describes the first set of 13 issues LB&I will be targeting in the initial wave of its campaign approach. Noticeably missing from the LB&I document is any substantive discussion on how the campaigns will be conducted or how they may affect well-understood practices and procedures within the existing examina-

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tion or administrative dispute resolution framework, including IRS Appeals. The absence of any such guidance has renewed a sense of concern over the lack of transparency in the campaign process—a concern exacerbated by the reality that a number of campaigns are now either in the later stages of ramp-up or even in process (see Alison Bennett, et al. “IRS Campaign Process Seen Cloudy Despite 13-Issue Release” *BNA Daily Tax Report* (February 6, 2017)).

Notwithstanding its limitations, the LB&I document warrants a careful analysis. While its text fails to elaborate on the moving parts of a campaign, it does set forth some illuminative points and offers a helpful glimpse into how the new process may operate. This article identifies some potentially important revelations (and related considerations) from the LB&I document and briefly explains how they might inform the LB&I campaign process. Thereafter, some best practices are set forth for taxpayers facing the first wave of LB&I’s campaign audits.

## II. Important Revelations/Considerations

### A. Campaigns on Perceived High-Risk, Low-Hanging Fruit

The first wave of campaigns appears to be directed at perceived high-risk compliance issues LB&I believes capable of being brought to light through coordinated agency efforts. The LB&I document provides that the campaigns were selected through “extensive data analysis, suggestions from IRS compliance employees and feedback from the tax community.” In public statements, IRS officials have also implied that the examiner input was in direct response to LB&I requests for lists of issues field agents specifically considered high risk—interpreted as those issues posing significant hazards to the remittance and collection of tax owed. Through this feedback process, hundreds of issues were identified from which the 13 campaigns were culled. Taxpayers, therefore, can reasonably assume that the 13 campaigns represent the foremost issues LB&I believes it can confidently audit and from which it assumes the greatest tax deficiencies may be found.

Additionally, since examiner feedback was an important catalyst to the formulation of the campaigns, taxpayers who have previously been audited on any issues associated with the 13 campaigns may also be

more susceptible to repeat audits in the future. Stated differently, examiners who participated in the campaign feedback process may now be emboldened and empowered to revisit taxpayers known to have those issues. Examiners may also be able to create profiles of taxpayers who have one or more these issues to more efficiently select taxpayers for audit.

### B. The Uncertain Impact of Campaign Lead Executives

One of the important aspects of the LB&I document is that it identifies a “lead executive” assigned to each campaign. The purpose, function, and responsibilities of the lead executives are not explained in the LB&I document, but it can reasonably be assumed that the executives will be involved in the strategic implementation of their respective campaigns. It remains to be seen, however, what role and power the lead executive will have in any specific campaign audit or settlement of campaign issues.

The presence of a lead executive also unfortunately suggests that LB&I has developed a campaign hierarchical architecture reminiscent of the IRS’s former Tiered Issue Process. The Tiered Issue Process, which focused limited IRS resources to particular high-risk compliance issues in certain industries, was beset with challenges before it was ultimately phased-out. A significant problem with the Tiered Issue Process was that requisite coordination between the IRS national office and exam teams—which historically had been given a great deal of independence to identify and develop issues as they felt best—led to dysfunctional audit dynamics.

A longstanding taxpayer concern regarding the campaign approach is that it may represent an IRS effort to reboot the Tiered Issue Process. The identification of campaign lead executives suggests these concerns may be well-grounded.

### C. Treatment Streams Depict a Multifaceted Approach

The LB&I document also identifies “treatment streams” associated with the campaigns. The listed treatment streams represent LB&I’s anticipated tactical approach to the campaigns. The scope of items included in the treatment streams is broad, ranging from the development of published guidance to full issue-based examinations. Each campaign’s treatment stream is set forth below:

Campaign Title	Treatment Streams
1. IRC 48C Energy Credit Campaign	Soft letters and issue-focused examinations
2. OVDP Declines–Withdrawals Campaign	Variety of treatment streams including examination
3. Domestic Production Activities Deduction, Multi-Channel Video Program Distributors (MVPD’s) and TV Broadcasters	Development of an externally published practice unit, potential published guidance, and issue based exams, when warranted
4. Micro-Captive Insurance Campaign	Issue-based examinations
5. Related Party Transactions Campaign (for taxpayers in “mid-market segment”)	Issue-based examinations
6. Deferred Variable Annuity Reserves & Life Insurance Reserves IIR Campaign	Develop published guidance
7. Basket Transactions Campaign	Issue-based examinations, soft letters to Material Advisors and practitioner outreach

<b>8. Land Developers–Completed Contract Method (CCM) Campaign</b>	Development of a practice unit, issuance of soft letters, and follow-up with issue based examinations when warranted
<b>9. TEFRA Linkage Plan Strategy Campaign</b>	Developing new procedures and technology to work collaboratively with the revenue agent conducting the TEFRA partnership examination (this is not specifically identified as a treatment stream, though it appears to be the driving output of the campaign approach)
<b>10. S Corporation Losses Claimed in Excess of Basis Campaign</b>	Issue-based examinations, soft letters encouraging voluntary self-correction, conducting stakeholder outreach, and creating a new form for shareholders to assist in properly computing their basis
<b>11. Repatriation Campaign (focus on “mid-market population”)</b>	Improve issue selection filters while conducting examinations on identified, high-risk repatriation issues (this is not specifically identified as a treatment stream, though it appears to be the driving output of the campaign approach)
<b>12. Form 1120-F Non-Filer Campaign</b>	Soft-letter outreach—if companies do not take appropriate action, LB&I will conduct examinations
<b>13. Inbound Distributor Campaign</b>	Issue-based examinations

The diversity of the treatment streams confirms that LB&I will not adhere to a static approach for each of its campaigns. While the campaign approach itself introduces a new approach to IRS examinations, not all campaign issues will necessarily result in audit, e.g., the Deferred Variable Annuity Reserves & Life Insurance Reserves campaign currently envisions nothing more than the development of published guidance. Some treatment streams will result in soft letters to taxpayers and practitioner outreach. In contrast, some treatment streams—e.g., the Inbound Distributor Campaign—anticipate only one possible treatment: audit. Clearly, LB&I envisions its campaigns to be dynamic processes that address the particular circumstances of each issue.

The challenge to create a unified set of procedures or guidelines for these different campaigns may partially explain LB&I’s delay in issuing more instructive guidance.

Despite the range of potential treatment streams, the use of issue-based examinations as a fundamental component of the majority of the issues reinforces the need for LB&I to explain the process in detail. Taxpayers can proceed forward with the expectation that issue-based examinations will remain the centerpiece in almost any campaign.

#### **D. Campaigns Include Both Domestic and International Issues**

The LB&I document sets forth several campaigns focusing on international tax concerns and, somewhat surprisingly, also identifies a number of campaigns addressing domestic tax issues (e.g., the Land Developers–Completed Contract Method (CCM) Campaign and the Domestic Production Activities Deduction, Multi-Channel Video Program Distributors (MVPD’s) and TV Broadcasters campaign). Prior to the release of the LB&I document, many practitioners assumed that the majority of campaigns would involve international tax issues, such as transfer pricing, and certain discrete, controversy-tested domestic tax issues (e.g., research credits under section 199). By adding more domestic issues in its first wave of campaigns, LB&I has injected a modicum of unpredict-

ability in its campaign selection process and evidenced a willingness to expand the scope of the campaigns beyond its presumed sphere.

In addition, before LB&I released its recent campaign document, many practitioners expected that campaigns would focus on broad issues that cut across various industries. By selecting very narrow issues, some directed at a small number of members in a given industry, LB&I has signaled that it may be using campaigns as a one-size-fits-all approach to address any issue of interest, even ones that affect very few taxpayers. Thus, taxpayers cannot take solace in an issue affecting a handful of taxpayers; it too can become a campaign.

It should also be noted that some of the campaigns are described in terms that have left taxpayers scratching their heads. For example, the Repatriation Campaign is given this delightfully content-free description: “LB&I is aware of different repatriation structures being used for purposes of tax free repatriation of funds into the U.S. in the mid-market population.” The issue description cites none of the notices or rulings issued by the IRS to head off disfavored repatriation techniques. Indeed, it calls to mind our favorite investment scheme from the South Sea Bubble era: “A company for carrying on an undertaking of great advantage; but nobody to know what it is.”

### **III. Best Practices for Campaign Audits Going Forward**

#### **A. Preparation**

Taxpayers with issues identified in a campaign with a treatment stream that includes issue-based examinations may want to mobilize their audit response teams and perform preliminary due diligence to ensure that they are prepared for a potentially aggressive and complex examination process. A useful approach, in this regard, could be to evaluate implicated transactions against relevant LB&I Practice Units, which set forth transaction-specific audit roadmaps for LB&I examiners. The most recently released LB&I Practice Unit addresses basket transactions—one of the identi-

fied campaigns—and manifests the detailed way LB&I examiners approach these types of factually-intensive audits (see LB&I IPU, Basket Transactions (Released January 31, 2017), available at [https://www.irs.gov/pub/int\\_practice\\_units/fin\\_t\\_73\\_05\\_08\\_01.pdf](https://www.irs.gov/pub/int_practice_units/fin_t_73_05_08_01.pdf)).

Upfront preparedness may also inhibit LB&I from pursuing a full campaign audit. LB&I examiners, eager to demonstrate the success of the campaign model, will have strong incentive to find tax deficiencies in the first wave of these audits. Taxpayers proceeding through the opening stages of a campaign who quickly demonstrate that they are equipped to defend their tax positions provide a strong signal to LB&I that a full-scale audit might fail to yield fruit. LB&I examiners, in those circumstances, may choose to quickly conclude the campaign and move on.

#### **B. Identify Roles, Responsibilities, and Authority of the Exam Team Members**

In any audit, it is critical for taxpayers to understand the roles, responsibilities, and authority of the exam team members. This assumes greater importance in a campaign audit since this information has not been delineated in any public document. Once those relationships are communicated, taxpayers will better understand the dynamics of the LB&I exam team and be better positioned to effectively advocate their case.

#### **C. Early and Continuing Communication with the Exam Team**

The lack of any substantive guidance regarding the campaign audit process leaves taxpayers in the dark regarding the procedures and protocols of a campaign audit. To prevent any major foot-faults, taxpayers will have to lean on the LB&I exam team to communicate

its expectations of the process and the manner by which it will proceed. Taxpayers should, therefore, strive to maintain a cordial working relationship with the LB&I exam team and routinely ask the exam team to articulate the anticipated next steps in the process.

#### **D. Provide Feedback and Elevate Issues if Necessary**

The LB&I campaign approach, still in its nascent stages, will likely have a number of procedural and practical issues that will need to be resolved during its rollout. LB&I examiners are considered stakeholders in this process and are expected to work to ensure that the campaign approach ultimately satisfies the needs of both taxpayers and the IRS. Taxpayers experiencing difficulties in a campaign audit should, therefore, address the issues with the LB&I exam team as soon as possible. If the exam team is unresponsive, taxpayers should thereafter elevate the issue to an LB&I Manager—and if it is unclear who has the requisite authority to act on the issue, taxpayers should contact the lead executive of the campaign.

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