

The LB&I Campaign: An Empty Trojan Horse?

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In this article, the authors examine difficulties that the IRS's campaign approach to audits has experienced, and they offer some practical steps for those involved in a campaign audit.

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Over three years ago, the IRS announced a new way to conduct audits: the campaign. In a campaign, the IRS Large Business and International division would identify a tax *issue* — rather than a taxpayer — posing a risk of noncompliance. Born of budgetary necessity, campaigns were intended to make the best use of limited IRS and LB&I resources.

Although LB&I had high hopes for the campaign approach, it has been a bumpy ride so far. Late last year, Treasury's watchdog found serious problems with the way LB&I selected campaigns. In practice, we have observed how individual exam teams have implemented campaigns inconsistently. Recent campaigns have appeared directionless and unfocused.

As the IRS returns to work and audits heat back up, now is an ideal time for a refresher and an update on the campaign approach. Several years down the road, it is still unclear what the future holds for that approach. But even though a fair amount of uncertainty remains, there are some practical steps you can take if you find yourself in a campaign audit.

The Need for a New Approach

LB&I announced the first campaigns against a grim backdrop. Congress had slashed the IRS's funding, leading to a big drop in headcount. The IRS employed 38 percent fewer examiners in 2017 than it had seven years before.¹ And, as a result of a hiring freeze, the IRS was facing a "baby bust," with more than 40 percent of the workforce reaching retirement age by 2019.²

With a diminished workforce, the IRS was unable to open as many audits. Between 2013 and 2017, the number of audits fell by 31 percent, from 1.6 million to 1.1 million.³ The falloff was even more dramatic in LB&I: Audits there fell 41 percent, from 54,211 to 31,880.⁴

Given those challenges, it is not surprising that the IRS reevaluated its audit methods. The IRS believed it needed "to improve return selection, identify issues representing a risk of noncompliance, and make the greatest use of limited resources."⁵ The IRS designed the campaign approach to achieve these goals.

The Early Days of the Campaigns

LB&I announced the first 13 campaigns in January 2017. Since then, LB&I has announced new campaigns in batches; all told, it has announced in excess of 60 campaigns. Over time,

¹Treasury Inspector General for Tax Administration, "Initial Compliance Results Warrant a More Data-Driven Approach to Campaign Issue Selection," at 5 (Sept. 27, 2019) (TIGTA Campaign Report).

²John Koskinen, "Remarks at the National Press Club" (Mar. 24, 2016).

³TIGTA Campaign Report, at 5.

⁴TIGTA, "Trends in Compliance Activities Through Fiscal Year 2017," at 18 (Sept. 13, 2018).

⁵IRS, "IRS Announces Initial Rollout of Large Business and International Campaigns" (Jan. 31, 2017).

it has also quietly retired 12 campaigns with little explanation.

From the start, understanding individual campaigns has been an exercise in Kremlinology. When LB&I released a new campaign, a terse paragraph about it appeared on the IRS website. The short blurbs typically described the tax issue and specified a “treatment stream,” such as examinations, “soft letters,” or “outreach.” But in many cases, LB&I provided no more detail about individual campaigns.

LB&I did provide general guidance about the campaign approach in eight webcasts. A few key details emerged:

- The campaigns were designed to function as a return-selection tool.
- The campaigns would be directed toward more midmarket or privately held companies than LB&I had reached in the past with its focus on large corporate taxpayers in the Coordinated Industry Case (or CIC) program.
- Campaign audits would still follow the LB&I examination process in Publication 5125.⁶ If a particular issue in an audit coincided with a campaign, the audit case manager would then be able to coordinate with the campaign specialists and executive lead on an as-needed basis.
- The IRS would strive for transparency. If the taxpayer had concerns, it would be permissible for the taxpayer to contact the executive lead for that topic or campaign issue specialists, if those specialists were involved in the audit.

LB&I had big ambitions for the campaigns. In the webcasts, LB&I suggested that a majority of its audit activity in the future would be campaign driven.

The Inspector General Takes the IRS to Task

So how have the campaigns fared in the past three-plus years? Not well, according to the Treasury Inspector General for Tax Administration. In a September 2019 report, TIGTA concluded that the “campaign program as

⁶ IRS Publication 5125, “Large Business & International Examination Process.”

a whole has not met initial expectations” and that traditional return-selection methods were more effective than many campaigns.⁷

TIGTA’s criticism centered on how LB&I selected campaigns. According to TIGTA, “Issues for campaigns were not selected or prioritized based on past compliance results or potential impact on compliance.”⁸ Instead, in the early days, LB&I selected issues “that [it] felt were ready for the campaign approach, for which training had previously been developed or would not be difficult to set up, or for which there was institutional knowledge available.”⁹ This amounted to a first-in, first-out selection method.

LB&I also selected some campaigns based on ad hoc suggestions from IRS examiners. While these suggestions were theoretically valuable, TIGTA concluded that they did not help LB&I pinpoint the areas of greatest compliance risk.¹⁰

To make matters worse, TIGTA also concluded that LB&I’s campaign-selection process did not improve. In June 2018 LB&I began using a prioritization scoring tool to evaluate the campaigns. But TIGTA found that LB&I did not use the tool to effectively prioritize the approval or implementation of campaigns.¹¹

Finally, TIGTA revealed how little the campaigns were displacing traditional return-selection methods. In 2017 an LB&I executive stated that the IRS did not ever “expect that campaign work will ever be 100 percent of our work.”¹² But that turned out to be an understatement: As of February 2019 only 15 percent of LB&I’s inventory was generated from campaigns.¹³ The remainder came from traditional return-selection methods.

Recent Experience

Recent experience has suggested that the campaigns are not moving in a positive direction. For one thing, LB&I is announcing fewer of them.

⁷ TIGTA Campaign Report, at 5.

⁸ *Id.* at Highlights.

⁹ *Id.* at 8.

¹⁰ *Id.*

¹¹ *Id.* at 9.

¹² *Id.* at 6.

¹³ *Id.* at Highlights.

There were 11 new campaigns in 2019, compared with more than 25 in 2018. Since TIGTA issued its report, there have been only six.

And the available evidence does not suggest that the newer campaigns are more likely to uncover noncompliance in an especially cost-effective manner. In fact, some of the most recent campaigns have seemed particularly directionless.

Case in point: a May campaign on the Tax Cuts and Jobs Act that seeks “to identify transactions, restructuring and technical issues and better understand taxpayer behavior under the new law.”¹⁴ In a world in which taxpayers are desperately looking to the IRS for guidance on the TCJA, the IRS is apparently looking back at taxpayers. It is difficult to see how it is even a true campaign because, according to the LB&I commissioner, “this is looking at the entirety of a return, giving examiners the authority to look beyond any specific issue.”¹⁵

Our practical experience with campaign issues has run the gamut. In some audits, we have seen examiners treat campaigns as if they require the examiner to pursue any campaign issue that might apply to the taxpayer. In other audits, we have seen examiners treat campaigns as discretionary guideposts that do not require the examiner to do anything in particular.

Predictions and Best Practices

We see the campaign approach as being at a crossroads. Down one road, the IRS could allow the campaigns to wither on the vine. Eventually, they could become indistinguishable from the practice units.¹⁶ Down the other road, the IRS could focus on the campaigns as a way of ramping up revenue collection.

Which road is chosen may depend on how Congress and the White House choose to tackle the huge pandemic-related budget gap. It might also depend on how the IRS reacts to a recent

report¹⁷ that LB&I was routinely initiating audits that led to no adjustments.

No matter which road the IRS chooses, there are a few best practices to consider:

- *Be attuned to the IRS’s cost-benefit analysis.* In the wake of the TIGTA report, LB&I should recognize the need to direct campaign resources to the areas of greatest compliance risk. Consider adopting the language of a cost-benefit analysis when you interact with IRS examiners concerning campaign issues. Any evidence you can muster to show that the IRS’s time might be better spent elsewhere might turn down the heat on a campaign audit. Recent FAQs on transfer pricing documentation, which discuss audit “deselection” if the taxpayer comes forward with facially plausible documentation, suggest this approach may work.
- *Consider escalation.* There should not be anyone “behind the curtain” with campaigns. LB&I publicly discloses the contact info of the lead executive and the point of contact. If you have a question about a campaign-related issue, you should ask the point of contact.
- *Be prepared for future enforcement.* We believe that there will be an increased focus on enforcement in the post-COVID-19 landscape. And one way the IRS could choose to ramp up enforcement would be to renew its enthusiasm for the campaigns. Take the opportunity now to monitor new campaigns and IRS pronouncements on campaign issues. This does not take much effort on your part: As noted, LB&I’s public comments on the campaigns are usually brief. It also can’t hurt to stay in touch with your advisers to keep abreast of how campaign issues are playing out in audits. ■

¹⁴ IRS, “Tax Cuts and Jobs Act (TCJA) Campaign.”

¹⁵ Andrew Velarde, “LB&I Commissioner Emphasizes Breadth of TCJA Compliance Campaign,” *Tax Notes Federal*, June 22, 2020, p. 2163.

¹⁶ IRS, “Practice Units.”

¹⁷ TIGTA, “The Large Case Examination Selection Method Consistently Results in High No-Change Rates” (June 22, 2020).