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USA: Law & Practice
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USA: Trends & Developments
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Mayer Brown LLP is a distinctively global law firm, uniquely positioned to advise the world’s leading companies and financial institutions on their most complex deals and disputes, with offices in the Americas, Europe and Asia. The firm’s 100-plus tax lawyers are committed to delivering sound, creative and practical tax advice, representing clients at the global, national and local levels. Mayer Brown’s deep experience allows it to effectively represent clients in a variety of situations, including during the structuring of transactions, during tax audits and administrative appeals of audit results, in litigation of tax matters at the trial court and appellate court levels, and in ongoing international tax matters, such as transfer pricing. The firm’s clients include many of the world’s largest food, transportation, banking and financial, apparel, healthcare, industrial, pharmaceutical and technology companies, as well as high net worth individuals and high-value estates.

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1. Tax Controversies

1.1 Tax Controversies in This Jurisdiction
In the USA, federal taxes, including income, estate and gift, employment, and many excise taxes, generally follow a self-assessment system. Withholding regimes facilitate collection for many of these types of taxes. As a broad matter, tax controversies, including those related to the most complex and largest income tax matters, arise following Internal Revenue Service (IRS) examinations. Other controversies may arise out of claims for refund or credit of taxes that have been overpaid.

1.2 Causes of Tax Controversies
While significant controversies related to excise taxes are not uncommon, the most typical tax disputes involve income taxes both at the individual and corporate levels.

By number, individual disputes are the most common. Although individual disputes involving high net worth individuals or their estates can sometimes reach into the tens of millions of dollars or more, most individual controversies are small dollar value disputes, relatively speaking. The nature of these disputes may run the gamut, though over time certain patterns may emerge around vogue tax structures made available by tax advisers.

Corporate disputes, on the other hand, tend to be less common, but the amounts can often reach into the billion-dollar range. Significant corporate disputes include complex questions of international tax, intercompany transfer pricing, and substance-over-form challenges, just to name a few.

1.3 Avoidance of Tax Controversies
The IRS’s published “data book” for the year ended September 2022 reports that over the past decade, the IRS has seen an increase in the number and complexity of returns filed coupled with a decrease in available resources for examinations. It further reports that the current IRS headcount is approximately one third less than it was 30 years ago. Statistics such as these might encourage some taxpayers to play the “audit lottery.” However, with IRS headcount trending upward since 2018, and given a generational influx of agency funding brought by the recent Inflation Reduction Act of 2022, many corporate taxpayers find that a more prudent course is to assume that their returns may be audited and pattern themselves accordingly. This starts with careful compliance at the time of filing the tax return. For issues that may be particularly attractive from an audit perspective, taxpayers may choose to assemble an “audit ready” set of files to produce to the examiner when and if the issue is audited later.

1.4 Efforts to Combat Tax Avoidance Documentation
The US tax regulations have included transfer pricing documentation requirements for three decades. Where there is a transfer pricing adjustment, taxpayers may face penalties of 20% or 40% depending on its size; however, taxpayers who prepare documentation explaining the basis for the transfer pricing position taken on their return, and produce that documentation to the IRS on audit, may avoid such penalties. Since the early 2000s, the IRS has typically requested transfer pricing documentation at the outset of most corporate audits. Under 2018 internal directives, the IRS reminded examiners that merely having a documentation study is not enough and instructed examiners to look care-
fully at the reasonableness of the selection of the best method in the taxpayer’s documentation.

**Global Reporting**

BEPS Action 13, as reflected in the OECD’s 2015 Final Report and 2017 OECD Transfer Pricing Guidelines, recommended certain Country-by-Country (CbC) reporting of the manner in which a company’s income, tax burden, and other indicators of activities such as headcount may be distributed globally. The USA has adopted final regulations requiring a US parent of a multinational group over a certain size to file CbC reports with the IRS. In addition, the USA will exchange CbC reports with the tax authorities of foreign countries under bilateral competent authority arrangements which are implemented under the auspices of double tax treaties, tax information exchange agreements, or mutual administrative assistance in tax matters conventions.

In practice, however, even prior to the advent of CbC, in the most complex transfer pricing audits, the IRS was already accustomed to unilaterally seeking information directly from the taxpayer to try to assess the locus of a company’s worldwide profits distribution through, for example, the construction of worldwide “system profits” models. In 2020, the IRS issued informal guidance in the form of a frequently asked questions (FAQs) document describing the use of “system profits” models as helpful self-evaluation tools for taxpayers to use in preparing for an audit. Also, in 2019, the US Advance Pricing & Mutual Agreement (AMPA) programe began to use its “functional cost diagnostic model” in certain APA cases, which when used facilitates many of the same objectives. As a result, any data the IRS sees on a CbC report obtained from a foreign government may be of limited additional value.

**Top-Line US Corporate Rate**

In 2018, the top-line US corporate income tax rate was significantly reduced, which in theory reduces some of the rate-arbitrage opportunities associated with transfer pricing. It remains to be seen whether that change will reduce future transfer pricing controversies. Under the revised statute, transfer pricing risk is reduced not eliminated, and significant additional international tax complexities have been added.

**1.5 Additional Tax Assessments**

The US generally follows a voluntary self-assessment model. Prior to any collection, the tax must first be “assessed.” Amounts voluntarily report-ed on tax returns are immediately assessed by the IRS. Payments of the amounts self-reported are generally made through prior withholding, or at the time of filing the return.

For any involuntary collection, the IRS initiates as assessment by sending a written notice of deficiency, which matures into an assessment unless the taxpayer first files a written petition to challenge the deficiency by litigating in the US Tax Court.

Alternatively, the taxpayer may first pay the tax, triggering a self-assessment, and then file a claim for refund of tax it believes it has overpaid.

**2. Tax Audits**

**2.1 Main Rules Determining Tax Audits**

According to the IRS, most returns are simply accepted as filed. The largest taxpayers are commonly under continuous audit by the IRS. For other taxpayers, some returns are selected for examination using various methods, including random sampling and computerised screening tools.
2.2 Initiation and Duration of a Tax Audit
Under the normal statute of limitations, tax must be assessed within three years of filing a return. In cases of fraud, however, the statute of limitations never expires. In cases in which there is a substantial omission of items on the return, the three-year period may be extended to six. And, most importantly, the three-year period may be extended by written agreement.

A tax audit can be initiated any time after the filing of the return and before the expiration of the statute of limitations. Once an audit is initiated, the duration depends on the nature of the taxpayer and the complexity of the return. A simple return might require only a single office visit to audit, while audits of multiple returns with complex issues in a single cycle can last for years.

While the audit is ongoing, the statute of limitations does not stop running. Similarly, if an administrative appeal is initiated (see 3. Administrative Litigation), the statute of limitations is not suspended and IRS Appeals (“Appeals”) will seek written statute extensions in order to continue the appeal.

It is always the taxpayer’s prerogative, of course, to refuse to sign a statute extension requested by IRS auditors or Appeals officers. In practice, however, taxpayers seldom refuse a statute extension that is reasonable in length simply because the IRS has onerous tools that it can bring to bear. First, the IRS may issue a statutory “formal document request”, which can have the effect of suspending the statute of limitations while the taxpayer attempts to respond. Second, the IRS may simply issue a statutory notice of deficiency, forcing the taxpayer into litigation, perhaps prematurely, thus suspending the statute while the case is being litigated.

2.3 Location and Procedure of Tax Audits
IRS examinations generally fall into one of two categories. First, there are mail audits, which are conducted through correspondence. Second, there are “field” audits that are conducted face-to-face, either at a local IRS office or, as may be the case with corporate audits, at the taxpayer’s place of business. For its fiscal year 2022, the IRS reports that 21.4% of audits were conducted in the field while the other 78.6% were performed via correspondence.

The IRS’s data book reports that, as far as individual audits are concerned, from 2012 to 2020, less than half a percent of returns were audited, though that percentage jumped to 8.5% when it comes to individuals who reported more than USD10 million of income. Meanwhile, over the same period, only 0.84% of corporate returns were examined.

Correspondence or mail audits will generally be conducted on the basis of printed documents. Field audits, which include audits of the largest taxpayers, will include printed documents as well, though it is increasingly common for the IRS to request electronic “native” copies of spreadsheets and other large-format data. The IRS has adopted certain encryption procedures that may allow for communication and transmission of information by email and other electronic means.

For the most complex audits, the IRS’s data gathering may take many forms. First, the IRS may review the taxpayer’s public filings and transfer pricing documentation studies. The IRS may then ask for one or more presentations, which provide an opportunity for the taxpayer to proactively explain its accounting records and transfer pricing positions. Then, the IRS most
2.4 Areas of Special Attention in Tax Audits

The IRS periodically identifies certain structured or tax-advantaged transactions as “listed,” which it may view as tax shelters. In 2017, the IRS announced a new way to conduct audits: the so-called “campaign” approach. In a campaign, the IRS Large Business and International (LB&I) division would identify a tax issue – rather than a taxpayer – posing a risk of non-compliance. 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 well over 60 campaigns. Once an issue was identified as a campaign, the IRS would pursue a number of different “treatment streams,” such as examinations, “soft letters,” or other taxpayer “outreach.” In a September 2019 report, however, the Treasury Department’s Inspector General concluded that the “campaign program as a whole has not met initial expectations” and that traditional return-selection methods were more effective than many campaigns as a matter of return selection. The authors’ practical experience with campaign issues has run the gamut. In some audits, examiners have treated campaigns as a mandate requiring the examiner to pursue any campaign issue that might apply to the taxpayer. In other audits, examiners have treated campaigns as discretionary guideposts that do not require the examiner to do anything in particular.

2.5 Impact of Rules Concerning Cross-Border Exchanges of Information and Mutual Assistance Between Tax Authorities on Tax Audits

As described in more detail in the US Trends & Developments portion of this Guide, the prospect of burdensome foreign information-gathering efforts by the IRS is not new to US taxpayers. What is increasingly new, however, is that US companies are receiving similarly broad document requests from foreign taxing authorities. The United Kingdom and countries in Europe have been particularly aggressive. And taxing authorities worldwide have been ramping up their information gathering on US companies.

2.6 Strategic Points for Consideration During Tax Audits

Transparency and Proactiveness

For most taxpayers, a key strategic point is the extent to which the taxpayer intends to be transparent and proactive in its interactions with the IRS auditors. Given the tendency of taxpayers to extend the statute of limitations when an exam team seeks one, a taxpayer’s chief tool to expedite an audit is to be proactive and prepare in advance for questions the exam team is likely to ask, and to share information with them in order to “cut to the chase.” Other taxpayers may choose to be less transparent and operate more reactively, focusing on questions and issues only when pressed by the exam team. The level of transparency can have important implications for taxpayers that may have legal or tax opinions that they wish to withhold from the IRS on the basis of privilege. Meanwhile, taxpayers that wish to be as proactive as possible can consider mechanisms described in 6.4 Avoiding Disputes by Means of Binding Advance Information and Ruling Requests, such as private letter rulings, advance pricing agreements, and pre-filing agreements.
Statute Extensions
The IRS has some draconian tools that may be used if a taxpayer refuses to extend the statute. For this reason, taxpayers often agree to statute extensions. The key strategic issue, however, may be the length of time by which the statute is extended in writing. Exam teams often ask for unreasonably long periods of time, with taxpayers negotiating for shorter periods. If an exam cycle is destined not to be agreed and the taxpayer wishes to file a protest with Appeals (see 3. Administrative Litigation below), it is important to keep in mind that IRS Appeals generally follows a policy by which it will not consider an appeal if there are less than six months remaining on the statute of limitations. Exam agents know this, of course, and frequently cite IRS Appeals’ policy in seeking extensions at the exam level.

Audit Scope
For most large taxpayers with complex returns, the IRS will choose to audit two or more years as a group, called an “audit cycle.” Often, when the IRS is mid-way through an audit cycle on a particular type of tax, it may notify the taxpayer that it wishes to add another year to the cycle, or it may wish to expand the audit to include other types of taxes filed on different returns (such as employment or withholding or other non-consolidated returns). Assuming the statute of limitations is open, the IRS is within its rights to do so, but that does not mean that taxpayers cannot have constructive conversations with the exam team about the practicality of increasing the scope of the audit.

3. Administrative Litigation

3.1 Administrative Claim Phase
The IRS data book reports that, in 2022, the IRS closed examinations for over 700,000 tax returns, with only about 2.1% of these resulting in “unagreed” audits in which the taxpayer did not agree with the IRS’s determinations.

For most taxpayers, when a federal income tax audit results in adjustments to the return, the IRS will issue a revenue agents’ report, commonly referred to as a “30-day letter.” Where the taxpayer does not agree with the adjustments, it has the opportunity to file a written protest to the IRS’s administrative Appeals division.

The mission of Appeals is to resolve tax controversies without litigation in a way that is fair and impartial to both the taxpayer and the US. IRS Appeals handles not only unagreed exam cases, but also requests to abate penalties and challenges to the due process of tax collections. The IRS reports, for example, that during its fiscal year ended 2022, Appeals closed over 72,000 cases, one third of which resulted from unagreed examinations.

Appeals is 100% voluntary; a taxpayer that wishes to go directly to court and litigate its dispute may simply ignore the 30-day letter, in which case it will mature into a statutory notice of deficiency. Then, as noted in 1.5 Additional Tax Assessments, it may pursue litigation in US Tax Court, or pay the tax and sue for refund.

Over the past decade or more, Appeals has become increasingly formalistic. For large cases, a case may be heard by a panel of Appeals officers, who may be assisted by one or more specialists such as economists or international tax experts. Appeals follows a “judicial approach”
that strives to maintain its independence. Under this approach, Appeals prefers not to serve as a fact-finder. New factual material, if presented for the first time during an Appeals conference, may prompt Appeals to transfer the case back to the IRS’s examination function for factual evaluation. As a result of this approach, for this reason, Appeals may not be a speedy path to resolve a tax controversy.

3.2 Deadline for Administrative Claims
As the moniker suggests, a taxpayer that receives a 30-day letter from its exam team generally has 30 days to file a written Appeals protest. The 30-day period may be extended by agreement of the exam team. Historically, 30 or 60-day extensions were routinely granted. Recently, however, the IRS has gotten stingy and grants extensions only where the taxpayer can point to a burden, such as where there are numerous issues or if the issues are particularly complex.

Once Appeals has taken a taxpayer’s case, there is no firm deadline by which Appeals must resolve (or not) the issues under review. In the authors’ experience, it is not uncommon for large or complex Appeals cases to span a period of years.

4. Judicial Litigation: First Instance

4.1 Initiation of Judicial Tax Litigation
There are three trial courts that hear federal tax disputes: the US Tax Court, US district court, and the US Court of Federal Claims.

Taxpayers do not have to pay any disputed tax or penalties before filing a petition in the US Tax Court. After a taxpayer receives a notice of deficiency or a 90-day letter from the IRS, the taxpayer has 90 days to file a petition in the US Tax Court disputing the tax or penalties.

District courts and the Court of Federal Claims are refund jurisdictions. In order to sue the US for a refund, a taxpayer must first pay any tax and penalties due and file an administrative refund claim with the IRS. Only after six months has passed or the IRS denies the refund claim may a taxpayer file a complaint in district court or the Court of Federal Claims seeking a refund.

4.2 Procedure of Judicial Tax Litigation
There are three stages of any litigation: pre-trial, trial, and post-trial. During the pre-trial stage, parties engage in discovery by which they seek to learn more about the other party’s position. Parties also engage in a motions practice in which they generally try to narrow the scope of the dispute before trial.

In the US Tax Court, all cases are tried before a judge. The judge may request post-trial briefing following the trial before issuing their opinion. For most cases, the parties must then complete Rule 155 computations to determine the final amount of any additional tax owed, if any. The judge then will issue a final decision in the case.

In the refund forums, cases may be tried to a judge or a jury (in district court only). If the case is tried to a judge, the court will issue an opinion following the trial. The judge may ask the parties for help determining the amount of tax the taxpayer owes, if any, before entering a final judgment in the case.

Once a final judgment or decision is reached, the case may be appealed to the US Court of Appeals that has jurisdiction.
4.3 Relevance of Evidence in Judicial Tax Litigation
Documents and witness evidence are relevant in all forums of tax litigation. Taxpayers must produce documents in response to discovery requests during the pretrial stage. Witnesses may be deposed as well, although depositions are an extraordinary tool of discovery in the US Tax Court. Documents or witnesses may also be subpoenaed by either party to the dispute.

During trial, documents must be moved into evidence in order to be considered by the court. In the US Tax Court, the parties are encouraged to stipulate (or agree) to facts or documents prior to trial, but all stipulations of fact must be moved into evidence. Direct and cross-examinations of witnesses are a critical part of the evidence presented at trial.

Parties may present experts to assist the court in all the forums. In US Tax Court, parties exchange expert witness reports and lodge them with the Court before trial. At trial, the parties still have to seek to have the expert reports admitted into evidence, and if the court agrees, then the expert report serves as the experts’ direct testimony. In the refund forums, experts do not generally have expert reports, but instead provide testimony that summarises their opinions.

4.4 Burden of Proof in Judicial Tax Litigation
The burden of proof in tax litigation generally rests on the taxpayer, except in exceptional circumstances or in criminal litigation.

4.5 Strategic Options in Judicial Tax Litigation
Tax litigation requires a host of strategic considerations, starting from the choice of venue. Taxpayers must first consider whether they think their chances of success would be higher in the US Tax Court, district court, or the Court of Federal Claims. This decision determines whether the taxpayer should pay the tax up front or not.

There are many other strategic options that are common across any litigation, such as whether to use experts, how best to present evidence, witness selection, whether to depose any fact or expert witnesses, and whether to file any dispositive motions.

4.6 Relevance of Jurisprudence and Guidelines to Judicial Tax Litigation
In the USA, jurisprudence is always relevant. Each trial court is generally bound by its own precedent, the appellate court to which the decision in the case would be appealed, and to the US Supreme Court. It is not bound by other forums’ jurisprudence, but it can consider it in forming its own opinions.

In the USA, treaties have the force and effect of law and are binding on the courts. International guidelines, such as the OECD Model Convention or OECD BEPS reports, are not binding on the courts and may or may not be taken into consideration by the courts in any particular case.

5. Judicial Litigation: Appeals
5.1 System for Appealing Judicial Tax Litigation
The US Courts of Appeals hear all federal cases on appeal in the USA. Cases decided by the US Tax Court are appealed to the US Court of Appeals for the circuit in which the taxpayer resides. Cases decided by US district courts are appealed to the US Court of Appeals for the circuit in which the court sits. Cases decided by the US Court of Federal Claims are appealed
to the US Court of Appeals for the Federal Circuit. Appeals to any of the 13 Circuit Courts of Appeals are typically made as a matter of right.

Appeals from the US Courts of Appeals can be further appealed to the US Supreme Court. In the Supreme Court, four Justices must agree to review the case – i.e., grant certiorari – in order for an appeal to be heard. The vast majority of cases are denied certiorari by the US Supreme Court.

5.2 Stages in the Tax Appeal Procedure
Following a final judgment or decision in the trial court, the party has a deadline by which it must file a notice of appeal (typically 60 days in refund forums and 90 days in Tax Court). The Court of Appeals typically issues a briefing schedule by which each party must submit written briefs arguing the issues being appealed. Appeals are usually heard by a panel of three judges. In some cases, the judges will hear oral argument, but this is not mandatory. The three judges will decide the issue on appeal and may affirm, reverse, or remand the trial court decision.

A party can request a further appeal to the US Supreme Court within 90 days after entry of a judgment in the US Court of Appeals. As discussed in 5.1 System for Appealing Judicial Tax Litigation, appeals to the Supreme Court are not a matter of right, and the Supreme Court only hears appeals in a small number of cases every year.

5.3 Judges and Decisions in Tax Appeals
All judges on the 13 US Courts of Appeals and the Supreme Court are nominated by the US president, approved by the US Senate, and have life tenure.

The US Courts of Appeals have a varying number of judges, but typically appeals are heard by a three-judge panel. There are nine Supreme Court justices.

6. Alternative Dispute Resolution (ADR) Mechanisms

6.1 Mechanisms for Tax-Related ADR in This Jurisdiction
For most taxpayers, an audit is an iterative process that can provide many opportunities to resolve tax issues with the IRS’s examination division. For those audits that do not end favourably, the single most common alternative dispute resolution mechanism is the traditional IRS administrative Appeals process described in 3. Administrative Litigation. For the vast majority of tax issues, Appeals can be a good option.

Examinations, however, can take years, and traditional Appeals cases can add even more years to the dispute resolution timeline. In response to criticisms about the slow pace, the IRS has implemented additional ADR tools that can be used at either the examination or Appeals stages to resolve issues quicker.

Compliance Assurance Process (CAP)
Over the last two decades, the IRS has offered the largest taxpayers an opportunity to participate in its CAP programme, by which the IRS and the taxpayer agree to contemporaneously exchange information related to completed transactions to reduce taxpayer burden, eliminate uncertainty, and reduce the need for post-return filing examinations. US publicly traded corporations with assets in excess of USD10 million may be eligible to participate.

Accelerated Issue Resolution (AIR)
Revenue Procedure 94-67 provides a mechanism by which resolved issues in the current
audit cycle will be extended to all future years for which returns have been filed. An AIR agreement is a closing agreement between the IRS and certain large corporate taxpayers related to one of the more specific issues arising from an audit for taxable periods ending prior to the date of the agreement.

Early Referral
Revenue Procedure 99-28 provides a process by which issues that have been fully developed (but for which there may not be agreement) may be referred immediately to Appeals prior to the completion of the audit by the examination division. This process is optional and may be requested by the taxpayer.

Fast Track Settlement
Revenue Procedure 2003-40 provides a voluntary mediation mechanism by which taxpayers with unagreed issues at the exam stage may seek mediation before an Appeals officer trained in mediation techniques. Unlike traditional Appeals, where the exam team may participate only in the initial portions of the process, in a Fast Track mediation, the exam team is an active participant and the Appeals function is to broker a deal between exam and the taxpayer. Fast Track is optional for the taxpayer and the taxpayer may withdraw at any time. Fast Track may be requested any time after the issuance of a notice of proposed adjustment.

Rapid Appeals
The Rapid Appeals Process (RAP) is a tool used to improve the efficiency and timeliness of Appeals resolutions. If all parties agree, the Appeals pre-conference becomes a working conference where Appeals uses mediation techniques to resolve unagreed issues. Where successful, RAP results in a resolution after a single meeting. If the process is unsuccessful, the traditional Appeals process continues.

Post-appeals Mediation
Where a taxpayer pursues a traditional Appeals path but is unsuccessful in reaching a resolution with the IRS Appeals officer assigned to the case, Revenue Procedure 2014-63 provides one final bite at the apple before resorting to litigation. Here, a different IRS Appeals officer serves as mediator between the taxpayer and the Appeals officer assigned to the case.

6.2 Settlement of Tax Disputes by Means of ADR
Typically, the ADR mechanisms described in 6.1 Mechanisms for Tax-Related ADR in This Jurisdiction all have the potential to resolve issues administratively and avoid the burden of litigation. For some of these tools, formal jurisdiction is retained by IRS exam while, in others, jurisdiction resides in Appeals. As a result, where these ADR tools are successful, the settlement may be achieved by exam or by Appeals, depending on which function retains jurisdiction for that ADR tool. Each path has its pros and cons which need to be evaluated carefully in light of the tax issues at stake and the personalities of the exam and Appeals team members likely to be involved. Moreover, each path has its own unique rules established under IRS procedures for (i) whether the path is voluntary, (ii) how the taxpayer initiates the process, (iii) what the relative roles of various IRS functions may be under the process and (iv) what options the taxpayer has if it terminates the process.

6.3 Agreements to Reduce Tax Assessments, Interest or Penalties
Any of the mechanisms described in 6.1 Mechanisms for Tax-Related ADR in This Jurisdiction may be effective in reducing the amount
of tax or penalties asserted by the IRS. While the IRS does not separately bargain for interest, any reduction to the amount of tax or penalty will automatically reduce the interest charge by operation of law.

6.4 Avoiding Disputes by Means of Binding Advance Information and Ruling Requests

There are various mechanisms that provide key opportunities for taxpayers that want to be proactive.

Private Letter Rulings

Under Revenue Procedure 2023-1, the IRS will issue a written statement to a specific taxpayer that interprets and applies tax laws to the taxpayer’s particular facts. A ruling may also be issued with a closing agreement, which is final unless fraud, malfeasance, or misrepresentation of a material fact can be shown.

Pre-Filing Agreements

Under Revenue Procedure 2016-30, a large business taxpayer may request that the IRS examine specific issues relating to tax returns before those returns are filed. Taxpayers may seek a pre-filing resolution of a controversy for (i) specific factual situations involving established legal principles, (ii) issues involving methodologies, and/or (iii) issues under jurisdiction of other IRS divisions, such as international. The Revenue Procedure contains a list of issues, such as transfer pricing, that are not eligible for resolution. If the taxpayer and the IRS are able to resolve the examined issues before the tax returns that they affect are filed, this revenue procedure authorises the taxpayer and the IRS to memorialise their agreement by executing an LB&I Pre-Filing Agreement (PFA). A user fee applies.

Advance Pricing Agreements

Although transfer pricing issues are not eligible for consideration under the PFA programme described above, they are instead eligible for advance pricing agreements. See 8. Cross-Border Tax Disputes.

6.5 Further Particulars Concerning Tax ADR Mechanisms

Traditional Appeals

Traditional IRS Appeals remains by far the most popular ADR tool for nearly any type of federal tax dispute, with some 70,000 taxpayers seeking consideration by Appeals. While there is no specific deadline by which Appeals must resolve one or more issues under its consideration, it necessarily operates within the confines of the statute of limitations. When an issue is resolved with Appeals, a taxpayer may enter into a closing agreement with the IRS, resolving the issue or year with finality.

Resolutions between a taxpayer and Appeals are not made a matter of public record. As a result, a resolution by Appeals of a dispute with one taxpayer does not establish a formal precedent for another taxpayer. Moreover, Appeals is not technically bound to follow its own resolution of an issue for the same taxpayer in an earlier tax year, but as a practical matter, in the absence of changes in the law or facts, it is likely to do so.

Other ADR Tools

Some of the ADR tools described throughout 6. Alternative Dispute Resolution (ADR) Mechanisms may only be available for certain large corporate taxpayers. While these tools are often useful for a broad range of topics, some of them may except certain issues (like transfer pricing) from their scope. Compared to the traditional Appeals path described above, these ADR tools are much less frequently used; in May of 2023,
an Appeals official noted that during fiscal year 2022, Appeals received only 130 requests from taxpayers for review under one of these ADR mechanisms.

6.6 Use of ADR in Transfer Pricing and Cases of Indirect Determination of Tax

The traditional IRS Appeals process can be an effective mechanism for resolving almost any type of dispute, particularly those that are based on economic or valuation differences of opinion. Appeals is not always the right forum if either side expects a 100% concession; instead, Appeals prides itself on helping the taxpayer and the IRS exam team “meet in the middle”. There are some transfer pricing disputes, however, that may become “too big to settle” or where the positions of the taxpayer and exam are too entrenched and too far apart for even Appeals to bridge the gap.

Many of the other ADR mechanisms described above may specifically call out transfer pricing issues as ineligible on the theory that the better, more tried-and-true, way to reach a binding agreement with the IRS on transfer pricing is through the advance pricing agreement programme described in more detail in 8. Cross-Border Tax Disputes.

7. Administrative and Criminal Tax Offences

7.1 Interaction of Tax Assessments With Tax Infringements

The vast majority of US tax controversies are civil proceedings conducted at either the administrative or judicial level as described above. Charges of violations of federal criminal tax statutes are reserved for the most egregious cases. This is because the IRS has at its disposal various civil penalties and other civil tools that are quite effective at encouraging compliance. For example, failure to comply with filing, reporting, and payment requirements may result in civil penalties including inaccuracies, failure to file, and failure to pay. For more significant behaviour, the IRS may also assert civil fraud, which can carry a significant monetary penalty and, as noted above, operate to keep the statute of limitations open. While the US Internal Revenue Code does not feature a general anti-avoidance rule (GAAR) or other specific anti-avoidance rule (SAAR), it does feature certain anti-abuse regimes that discourage certain behaviour or transactions that the IRS believes are “abusive.”

In the rare cases in which criminal investigations and charges occur, the IRS may involve its Criminal Investigation Division (CID). The role of CID is to investigate matters referred by the IRS examination division or another source and to co-ordinate efforts with other law enforcement agencies, such as the Federal Bureau of Investigations and Department of Justice (DOJ), as appropriate.

7.2 Relationship Between Administrative and Criminal Processes

Normally, when a criminal investigation results from a referral from an ongoing civil audit, the civil proceeding is suspended while the criminal investigation is pending. Criminal and civil investigations rarely operate in parallel but when they do, a taxpayer may simultaneously face both criminal sanctions and civil tax, penalties, and interest.

7.3 Initiation of Administrative Processes and Criminal Cases

The initiation and processing of criminal matters differ from civil proceedings in several respects. First and most notably, in civil matters, it is the
taxpayer that bears the burden of showing by a preponderance of the evidence that the IRS was wrong. In criminal matters, on the other hand, it is the government that bears the burden of showing the taxpayer’s guilt beyond a reasonable doubt. Second, the forum can also differ. Civil matters may be brought by the taxpayer in the US Tax Court, the Court of Federal Claims, or federal district court, but criminal matters can only be heard by the federal district court. Third, the identity of the government representatives may differ. In civil matters, a taxpayer choosing to litigate in the Tax Court will be up against an IRS Counsel attorney, while in criminal matters, cases are referred by CID for prosecution by the DOJ and/or local US Attorney.

7.4 Stages of Administrative Processes and Criminal Cases
After CID conducts an investigation, it makes a decision to either pursue the criminal matter or not. If CID decides to move forward, a special agent report is typically issued and reviewed internally before being referred to the DOJ or US Attorney’s office. Following their review, a US Attorney is assigned to prosecute the case. From there, the process closely resembles most federal criminal proceedings: a grand jury may assist the US Attorney in developing the evidence and to approve formal criminal charges (indictments) against the taxpayer. After an indictment is issued and the charges are explained to the taxpayer at a formal arraignment, the taxpayer may have an opportunity to settle (plea bargain). If a plea bargain is not reached, the matter proceeds to trial, which may occur in front of a jury.  

7.5 Possibility of Fine Reductions
Payment of asserted tax, interest, and penalties does not obviate or preclude further criminal proceedings. However, a taxpayer’s attempts to comply and payment of asserted deficiencies may be a factor relevant in plea bargaining proceedings, or for matters that have proceeded to trial and conviction, to sentencing.

7.6 Possibility of Agreements to Prevent Trial
As noted in 7.4 Stages of Administrative Processes and Criminal Cases, following arraignment, a taxpayer typically has an opportunity to plea bargain with the US Attorney. Less onerous fines, penalties, and terms of imprisonment can typically be achieved through plea bargaining than through sentencing following a conviction.

7.7 Appeals Against Criminal Tax Decisions
Following a trial in the federal district court, appeal to the federal Courts of Appeal and, if necessary, the US Supreme Court may occur in the same manner as any tax case. See 5. Judicial Litigation: Appeals.

7.8 Rules Challenging Transactions and Operations in This Jurisdiction
As noted in 2. Tax Audits, the IRS identifies certain transactions or activities which it considers abusive and may “list” these transactions as tax shelters. While individual taxpayers who participate in listed transactions may certainly find themselves embroiled in civil tax controversies, criminal referrals of these taxpayers are not as common. However, where one or more accountant or attorney advisors are identified as “promoters” of these transactions, civil promoter investigations and even criminal referrals to CID can occur.
8. Cross-Border Tax Disputes

8.1 Mechanisms to Deal With Double Taxation
US taxpayers may generally challenge transfer pricing and other adjustments in cross-border matters administratively through IRS Appeals, and (typically) as a last resort, may litigate in the US Tax Court, US district court or Court of Federal Claims. Alternatively, if the transaction at issue gives rise to double taxation in a jurisdiction with which the USA has a double tax treaty (DTT), the taxpayer may seek resolution by filing a mutual agreement procedure (MAP) request with the IRS’s Advance Pricing & Mutual Agreement (APMA) programme. While use of both IRS Appeals and MAP to resolve transfer pricing disputes are common, the IRS MAP revenue procedure generally prohibits taxpayers from seeking MAP relief from double taxation after initiating Appeals unless the taxpayer files a MAP request within 60-days of the Appeals opening conference. Therefore, in cases where the MAP process is available and the potential for double taxation is significant, US taxpayers are incentivised to seek MAP resolution rather than IRS Appeals review in the first instance. Although less often used, taxpayers can also seek review of proposed transfer pricing adjustments through the Simultaneous Appeals Procedure (SAP), which is a type of MAP in which an Appeals officer rather than an APMA analyst conducts the initial review of the taxpayer’s MAP request. A further option for taxpayers to resolve transfer pricing disputes is to initiate a request for a unilateral, bilateral or multilateral advance pricing agreement (APA) with a rollback of the agreed APA method to the prior tax years at issue.

The US has not adopted the OECD’s Multilateral Convention (MLI).

8.2 Application of GAAR/SAAR to Cross-Border Situations
The US Internal Revenue Code does not feature a general anti-avoidance rule (GAAR) or other specific anti-avoidance rule (SAAR).

8.3 Challenges to International Transfer Pricing Adjustments
Transfer pricing adjustments are commonly challenged both through IRS Appeals and the MAP process under existing DTTs, and (typically) as a last resort, are challenged in the US Tax Court and other federal courts. See 8.1 Mechanisms to Deal With Double Taxation.

8.4 Unilateral/Bilateral Advance Pricing Agreements
Unilateral, bilateral and multilateral APAs are very commonly used to obtain certainty and avoid the potential for future disputes and litigation. Per the APMA Program’s 2022 APA Annual Report, APMA received 183 APA requests (22 unilateral, 154 bilateral and 7 multilateral) in 2022, and had 564 APA requests (54 unilateral, 480 bilateral and 30 multilateral) pending as of 31 December 2022. The main stages of the APA process are set out below.

Pre-filing
During the optional pre-filing stage, the taxpayer may submit a pre-filing memorandum and/or hold a pre-filing conference with the APMA programme in order to obtain preliminary feedback on the proposed APA. Pursuant to new Interim Guidance, the taxpayer may also request a review of its pre-filing memorandum to obtain APMA’s preliminary view as to whether the APA process or an alternative workstream such as the International Compliance Assurance Program (ICAP) or a joint audit would be the most appropriate process for the particular transactions at issue.
APA Request
The Taxpayer prepares and submits a detailed APA request to the APMA programme and applicable foreign competent authorities containing, inter alia, a detailed description of the taxpayer’s business operations and proposed covered transactions, a functional analysis, organisational charts and diagrams, financial statements and a proposed transfer pricing method(s) and supporting economic analysis.

Review and Due Diligence
The APMA programme will review the taxpayer’s APA request to determine whether it is substantially complete, and pursuant to the new Interim Guidance, whether the request is appropriate for the APA process. The APMA programme will then request additional information through due diligence requests, occasionally conduct fact-finding interviews, and hold meetings with the taxpayer to discuss the APA request. After concluding due diligence, the APMA programme will prepare a position paper for the foreign competent authority in bilateral and multilateral cases.

Negotiations
The APMA programme will negotiate a mutual agreement for an appropriate transfer pricing method(s), critical assumptions and other key APA terms with the relevant foreign competent authority. In the case of a unilateral APA, these negotiations will take place directly with the taxpayer.

Implementation
After a mutual agreement with the foreign competent authority (or agreement with the taxpayer in the case of a unilateral APA) is reached, the APMA programme and the taxpayer will sign an APA agreement. The taxpayer will then be required to file annual compliance reports with the APMA programme for each covered APA year by the deadline specified in the APA.

8.5 Litigation Relating to Cross-Border Situations
The cross-border situations that generate the most litigation in the USA are transfer pricing disputes involving large corporate taxpayers. The potential for such litigation can be mitigated by preparing robust transfer pricing documentation, audit defence files, and other measures to be as prepared as possible for a transfer pricing audit and to resolve disputes at an early stage on as favourable terms as possible. In appropriate cases, the potential for litigation can be effectively eliminated by seeking an APA to obtain certainty, or substantially mitigated by seeking advance review through the ICAP to obtain assurance (but not binding certainty) from the IRS and other relevant tax administrations.

9. State Aid Disputes
9.1 State Aid Disputes Involving Taxes
Not applicable as the USA is not an EU member state.

9.2 Procedures Used to Recover Unlawful/Incompatible Fiscal State Aid
Not applicable as the USA is not an EU member state.

9.3 Challenges by Taxpayers
Not applicable as the USA is not an EU member state.

9.4 Refunds Invoking Extra-Contractual Civil Liability
Not applicable as the USA is not an EU member state.
10. International Tax Arbitration Options and Procedures

10.1 Application of Part VI of the Multilateral Instrument (MLI) to Covered Tax Agreements (CTAs)
The US has not entered into the MLI. However, the US’s existing bilateral DTTs with Belgium, Canada, France, Germany, Japan, Spain and Switzerland have mandatory “baseball” arbitration provisions.

10.2 Types of Matters That Can Be Submitted to Arbitration
As noted, the USA has not entered into the MLI. However, under the USA’s DTTs with mandatory arbitration provisions, the arbitration procedure is generally available to resolve all types of disputes that the competent authorities are not able to resolve by mutual agreement within a specified time period, typically two years from the “commencement date” of the MAP at issue. Notwithstanding the foregoing, the USA’s DTTs with mandatory arbitration provisions generally do allow the competent authorities to agree that certain cases or types of cases (eg, those subject to a court decision or an Appeals settlement) are inappropriate for arbitration.

10.3 Application of the Baseball Arbitration or the Independent Opinion Procedure
As noted in 10.1 Application of Part VI of the Multilateral Instrument (MLI) to Covered Tax Agreements (CTAs), the USA has negotiated mandatory “baseball” arbitration provisions in certain of its DTTs. Mandatory “baseball” arbitration is favoured largely because of its potential positive effects on the MAP process for the vast majority of cases that are resolved by mutual agreement rather than through arbitration. Specifically, “baseball” arbitration is viewed as encouraging quicker resolutions by imposing a time limit (typically, two years) on competent authority negotiations before a case is referred for arbitration, and by encouraging both competent authorities to take less extreme positions given the nature of the process in which the arbitration panel resolves the case by adopting one of the competent authority’s positions in its entirety, with no authority to reach a compromise between the two positions.

10.4 Implementation of the EU Directive on Arbitration
Not applicable as the USA is not an EU member state.

10.5 Existing Use of Recent International and EU Legal Instruments
Not applicable as the USA is not an EU member state and has not implemented the MLI.

10.6 New Procedures for New Developments Under Pillar One and Two
While it is generally assumed that neither Pillar One nor Pillar Two will take effect in the USA in the near future, US corporate taxpayers will likely face controversies related to Pillar One and Pillar Two in adopting countries that may give rise to double taxation of income that has already been subject to tax in the USA. Assuming the USA does not itself adopt Pillar One or Pillar Two, the envisaged pillar-specific dispute resolution procedures may not be available. Nevertheless, the taxpayer might be able to avail of other processes to resolve the underlying dispute, including domestic administrative appeals or litigation in the relevant foreign jurisdiction, MAP, an investor-dispute settlement claim (ISDS) under a bilateral investment treaty (BIT), or if an EU member state is involved, through “action for annulment” before the European Court of Justice. The availability of these processes and
the specifics of how they will work in practice to resolve Pillar One or Pillar Two disputes is yet to be determined.

10.7 Publication of Decisions
In the USA, judicial decisions are published but all other resolutions of disputes, including but not limited to Appeals settlements, MAP resolutions, treaty arbitration decisions and APAs, are strictly confidential.

10.8 Most Common Legal Instruments to Settle Tax Disputes
MAP through bilateral DTTs is available to US taxpayers. Under certain of the US DTTs, “baseball” arbitration is available to resolve MAPs that the competent authorities are not able to resolve through mutual agreement within a specified timeframe. US taxpayers also have access to IRS Appeals and the US Tax Court and other courts to resolve tax disputes, and in appropriate cases, may resolve or avoid a transfer pricing dispute by requesting an APA (with or without rollback). See 8.1 Mechanisms to Deal With Double Taxation, 8.4 Unilateral/Bilateral Advance Pricing Agreements, 10.1 Application of Part VI of the Multilateral Instrument (MLI) to Covered Tax Agreements (CTAs) and 10.2 Types of Matters That Can Be Submitted to Arbitration.

10.9 Involvements of Lawyers, Barristers and Practitioners in International Tax Arbitration to Settle Tax Disputes
Taxpayers commonly hire outside lawyers and other tax professionals to advise on all stages of international tax disputes, beginning with the audit through resolution through Appeals, MAP, the APA process or litigation. The role of the outside lawyers or other professionals and the timing of their involvement may vary depending on numerous factors, including the capabilities of the company’s in-house resources and the stage, materiality and complexity of the issue. The IRS generally does not engage outside lawyers or advisors, but in litigation or high stakes audits with the potential for litigation, may engage outside economists or other experts.

11. Costs/Fees

11.1 Costs/Fees Relating to Administrative Litigation
There are no filing fees to initiate an administrative review by IRS Appeals. The taxpayer may incur costs for outside counsel and outside experts, such as economists or accountants, and the magnitude of such costs will vary depending on the complexity of the issues.

11.2 Judicial Court Fees
Taxpayers other than low income taxpayers will incur small filing fees to initiate litigation in any forum. Where a taxpayer wishes to appeal an adverse decision at the trial level, other small fees may apply.

11.3 Indemnities
Court rules may provide limited circumstances in which a taxpayer that prevails can recover litigation costs, including attorney’s fees, but such instances are quite rare.

11.4 Costs of ADR
The ADR mechanisms described in 4. Judicial Litigation: First Instance carry more significant user fees than judicial or administrative litigation. For example, a taxpayer requesting a private letter ruling currently incurs a fee of USD38,000, while a taxpayer seeking an APA pays a fee of USD113,500.
12. Statistics

12.1 Pending Tax Court Cases
The US Tax Court does not publish case statistics. Most tax cases are heard by the US Tax Court as the only pre-payment forum. According to the IRS 2022 Data Book, in FY 2022, 34,645 Tax Court cases involving a taxpayer contesting an IRS determination that they owed additional tax were filed. These cases involved over USD16 billion in disputed taxes and penalties.

12.2 Cases Relating to Different Taxes
There is no published data available.

12.3 Parties Succeeding in Litigation
There is no published data available.

13. Strategies

13.1 Strategic Guidelines in Tax Controversies
There are many different decision points in a US tax controversy, all the way from audit to administrative appeals to trial to judicial appeals. This section focuses on the salient dynamics in deciding to litigate in the US Tax Court, where many large corporate income tax cases are docketed.

Initial Decision to Litigate
Not surprisingly, the initial decision to pursue litigation must be grounded on a hard assessment of the facts and law. This should be accomplished prior to filing a Tax Court petition.

Law
A thorough assessment of the governing law is a predicate to bringing an action in any court. Both a taxpayer’s legal and tax departments must appreciate the taxpayer has the burden of proof.

Facts
With regard to facts, both the availability and evaluation of witnesses and documents is essential. In particular, it is imperative to evaluate documents, including electronically stored documents such as emails, that will be requested and need to be produced in discovery as well as for witness testimony.

Witnesses
With regard to witnesses, early development of a list of witnesses “competent” to testify about events during the years in dispute is crucial. Importantly, witnesses who are no longer employed by the taxpayer should be contacted and advised of any prospective litigation. Finally, where necessary, expert witnesses should be engaged.

After forensic collection of relevant documents, typically with the assistance of a vendor specialising in electronic discovery, documents should be evaluated overall against the issues in dispute and matched with potential witnesses. At this point, first-time interviews of key employees, including high-level executives, should be scheduled. Careful preparation for these interviews is advisable to instil confidence in prospective witnesses that they understand the issues and why their prospective testimony is important.

Petition
In the authors’ experience, the deeper the facts and law are woven into the Tax Court petition the more likely a persuasive first impression is made on the judge assigned to the taxpayer’s case. Additionally, a fulsome petition will facilitate a robust written trial plan.
Management Support

Significant corporate tax cases often require years of discovery, trial preparation, pre-trial motions, stipulations, and pre-trial memoranda culminating in an actual trial which can generally range from a few days to several months. After post-trial briefing, it may be two to three years before the trial court renders an opinion. If either party appeals, the appellate opinion may take another two years. The appeal process can be further extended if there is a petition for certiorari and litigation in the US Supreme Court. In short, the litigation process necessarily means management must be thoroughly briefed about all facets of prospective tax litigation including the timeline of litigation, the consumption of executive and employee time in pre-trial preparation and trial testimony, and litigation expense. Top management must be committed.
Mayer Brown LLP is a distinctively global law firm, uniquely positioned to advise the world’s leading companies and financial institutions on their most complex deals and disputes, with offices in the Americas, Europe and Asia. The firm’s 100-plus tax lawyers are committed to delivering sound, creative and practical tax advice, representing clients at the global, national and local levels. Mayer Brown’s deep experience allows it to effectively represent clients in a variety of situations, including during the structuring of transactions, during tax audits and administrative appeals of audit results, in litigation of tax matters at the trial court and appellate court levels, and in ongoing international tax matters, such as transfer pricing. The firm’s clients include many of the world’s largest food, transportation, banking and financial, apparel, healthcare, industrial, pharmaceutical and technology companies, as well as high net worth individuals and high-value estates.

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John Hildy is an experienced advocate in federal tax disputes faced by multi-national corporations. He has represented clients in some of the most complex tax litigation in the country. John frequently advises clients in addressing the types of evidentiary privileges most commonly encountered by in-house tax practitioners and represents taxpayers in associated administrative summons enforcement matters. John also frequently counsels corporate taxpayers on how to navigate transfer pricing audits using the IRS’s transfer pricing “roadmap.” As a complement to John’s controversy practice, he also regularly advises clients on how to structure and defend transactions with significant transfer pricing implications.
Overview

In 2023, several trends and developments will likely converge to substantially impact tax controversies in the United States. Significant increases to the funding of the Internal Revenue Service (IRS) will facilitate a more aggressive agency that has been mandated to focus on enforcement of large corporations, large partnerships, and high net worth individuals. And more multilateral, international engagement continues to enhance the ability of the IRS to coordinate with foreign taxing authorities, increasing global pressure on US companies.

Increased Enforcement

The Inflation Reduction Act of 2022 granted the IRS USD80 billion in additional funding to use over the next ten years. More than half of the USD80 billion is allocated to enforcement and
much of this enforcement is targeted at large corporations, large partnerships, and high net worth individuals. The IRS has already started to use the additional funds to hire international examiners, transfer pricing specialists, partnership experts, and counsel, with thousands of more new employees on the horizon. While it is unclear specifically how the IRS will adapt to increase the audit rates of large corporations, large partnerships, and high net worth individuals, it is undisputed that these taxpayers will face more scrutiny than they have in the last ten years.

Even so, the IRS learned some lessons during the “less-with-less” era that it will likely carry with it going forward. Among those lessons is that the IRS should focus its enforcement activity on “issues,” rather than taxpayers. Traditionally, the IRS initiated audits by selecting particular taxpayers for examination, but in the last few years, the IRS started selecting a tax issue for audit, rather than auditing every potential issue on a taxpayer’s return. It is likely that these issue-based examinations will continue, at least in part, particularly as the IRS puts more emphasis on using data analytics to select issues to audit.

The IRS has also been more assertive in imposing accuracy-related and other penalties. Historically, taxpayers were able to provide the IRS with a copy of a tax opinion from an advisor that would satisfy the reasonable cause defence, and penalties would not be imposed. Recently, however, the IRS has been asserting penalties despite having received a copy of the tax opinion. This trend is expected to continue, which will make it harder for taxpayers to resolve issues at the audit level. The IRS’s enforcement priorities can also be glimpsed in the agency’s so-called “Priority Guidance.” The stated goal of the guidance is to identify and prioritise tax issues that should be addressed through regulations and other administrative guidance. But the IRS has been focusing its enforcement efforts on many of the very same topics. As an example, the guidance announces several regulatory projects on issues related to crypto and other virtual currencies, which the IRS has also aggressively pursued in audits and court cases.

The Aftermath of COVID-19

During COVID-19, the IRS transitioned to performing audits remotely. While the pandemic is over (for the most part), lessons learned during this period continue to affect how audits are conducted.

Before the pandemic, the IRS typically audited large corporate taxpayers in person. It was common for large companies to set aside dedicated office space for IRS examiners in their corporate offices. IRS examiners might request in-person interviews (or even depositions) of key company employees to carry out the audit. And, for certain issues, IRS examiners would make in-person “site visits” to manufacturing plants or other important company locations (this is especially true in transfer pricing where the “value-add” of a manufacturing plant might be the crux of the issue in the case).

The transition to remote audits impacted how the IRS and taxpayers approached audits. The biggest change of all was interpersonal: it was far less common for the taxpayer and the IRS agents to be in the same room together. The logistics of a remote audit were drastically different. Witness interviews were particularly challenging, because witnesses, taxpayers’ counsel
and representatives, and IRS questioners were usually in different locations, sometimes in different countries. Additionally, draft information document requests (IDRs) that would typically require an in-person conversation before being finalised were now being discussed by phone.

While some audits are now being conducted in person once again, other audits are still being conducted remotely. The IRS is more willing to use videoconferencing capabilities, like Microsoft Teams or Zoom, to conduct meetings or witness interviews. Audit teams are more likely to be staffed with team members from across the region or even the country rather than from a single office. The IRS has also expanded its permissible methods to receive and transmit documents, even allowing taxpayers the option to send documents to the IRS as email attachments. It remains to be seen what the long-term effects of this new working model for audits will be, but it seems that even the IRS has learned to be more flexible following the pandemic.

Similarly, during the pandemic, the US Tax Court had transitioned (for the most part) to remote trial and other litigation proceedings, while curtailing or heavily restricting access to in-person hearings. But in May 2023, the Court announced the end of these policies and a return to open access and in-person proceedings. Still, the Court has internalised the lessons learned from the remote environment by allowing virtual status conferences while simultaneously taking steps to make electronic access to documents more easily accessible.

Transfer Pricing Disputes

Transfer pricing issues continue to be a significant area of dispute between taxpayers and the IRS. Historically, taxpayers were more often than not successful in defending their transfer pricing in court, but, in the last few years, the IRS has been successful in the US Tax Court and in other courts, particularly in disputes that involve the arm’s length value for intangibles with high profit potential. The IRS is likely to try to build upon its momentum by pursuing greater transfer pricing enforcement in 2023 and beyond.

Specifically, the IRS has stated that one of its priorities for 2022–23 is to issue regulations under Section 482 of the US Internal Revenue Code that clarify the effects of group membership (ie, “passive association”), in determining arm’s length pricing, specifically with regard to financial transactions. Whether the IRS issues proposed regulations (which are persuasive but non-binding), temporary regulations (which have the force of law), or fails to issue new regulations at all this year, multinational enterprises should expect more scrutiny of their transfer pricing allocations – and perhaps, a departure from the traditional interpretation of the arm’s length principle.

While the top-line corporate tax rate reductions enacted in 2018 conceptually removed some US rate arbitrage opportunities and thus took some pressure off transfer pricing, those rate reductions came at a cost: namely the enactment of a US minimum tax regime and other international tax complexities that may further confound taxpayers for years to come. The US minimum tax, coupled with the OECD’s Pillar 2 initiative, may portend a slow breakdown of the very arm’s length standard that was championed by the US over five decades ago, and implemented in the developed countries of the world.

Beyond the IRS, taxpayers have faced more transfer pricing focus at the state level. Historically, states relied on their discretionary power to adjust income in transfer pricing disputes. But
as more and more states have adopted Section 482 or Section 482-like statutes, state taxing authorities are more likely to challenge transactions using the arm’s length principle.

**Administrative Disputes Challenging Treasury Regulations and IRS Notices**

An increasing area of dispute in the USA is regulatory challenges under the Administrative Procedure Act. In the USA, there are specified procedures spelled out in the Administrative Procedure Act that have to be followed before promulgating a regulation or issuing other administrative guidance. Historically, it was unclear whether “tax” regulations were even subject to the Administrative Procedure Act, but the courts have since clarified that tax is not special; the Treasury Department and the IRS are subject to the Administrative Procedure Act, just like other agencies.

As a result, taxpayers have been challenging an increasing number of regulations and notices. The IRS has limited access to IRS Appeals if a taxpayer is challenging the validity of a regulation or an IRS Notice, leaving the courtroom the only option for a taxpayer to make such challenges. Taxpayers have scored a number of victories recently in courts invalidating a regulation or an IRS Notice. These disputes will only continue to increase in the forthcoming years.

**Cross-Border Information Gathering and Sharing**

US companies have always faced the prospect of burdensome information-gathering efforts by the IRS. Through IDRs, the IRS often requests hundreds, thousands, or even tens of thousands of documents from taxpayers under audit.

Increasingly, US companies have been confronting a new challenge: they are receiving similarly broad document requests from foreign taxing authorities. The United Kingdom and Australia and certain countries in Europe and Asia have been particularly aggressive. And taxing authorities worldwide have been ramping up their information-gathering on US companies.

These requests come in one of two ways. The taxing authority could request documents directly, issuing the request either to the US parent or to the foreign subsidiary. Or the taxing authority could invoke the “Exchange of Information” provision in a bilateral tax treaty with the USA. In that case, the IRS issues an IDR to the taxpayer on behalf of the taxing authority and has the power to pursue the request as if it were itself auditing the taxpayer.

Either way, these requests are presenting US companies with unique challenges:

- **Privilege** – US companies often withhold from the IRS some types of tax-planning documents on the basis of privileges, such as the attorney-client privilege. But with these foreign-initiated requests, US companies have been forced to wrestle with difficult choice-of-law questions when making privilege determinations.
- **Data privacy** – US companies must consider burdensome data privacy rules in Europe and elsewhere when collecting, reviewing, and producing foreign-based documents to the IRS (through the exchange of information process) or the foreign taxing authority.
- **Possession** – it is not always clear which entity in the corporate structure possesses the documents. For example, documents held by a foreign subsidiary might be subject to the request, whereas documents held by the US parent might not be.
Consistent with a global trend towards multilateralism, the IRS and foreign taxing authorities are also sharing more information. Bilateral tax treaties give the USA and many foreign jurisdictions the power to share documents among themselves, even spontaneously. So when US companies produce documents to a foreign taxing authority, they must assume there is a substantial likelihood that the same documents will wind up in the hands of the IRS eventually.

It is unlikely that any substantial tax legislation will be passed in 2023, but taxpayers should pay close attention to any proposed legislative changes as it is possible they will be reintroduced in the next several years. Eventually, the US will have to decide what to do about the implementation of Pillar 2, but its implementation globally will undoubtedly increase tax controversies for US taxpayers.

Looking Forward
In the authors’ view, the biggest open question hanging over the rest of the year is how quickly taxpayers will feel the effects of the IRS’s increased funding for enforcement. Large corporations, large partnerships and high net worth individuals who have not been audited in recent years should expect to be audited in the near future and should consider preparing by performing a risk assessment. Taxpayers who are under audit should expect an emboldened IRS that is already imposing penalties in situations where it would not have done so only a few years prior. Audit rates for large corporations, large partnerships, and high net worth individuals are going to increase exponentially in the foreseeable future, which will increase the number of tax controversies at all levels.
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