



A graphic of the United States Capitol dome, partially obscured by a large, stylized blue and white swoosh that curves around the left side of the dome. The dome is shown from a low angle, looking up at its top and the statue on top.

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**Managing Tax Audits  
and Appeals**  
September 27-28, 2018

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A graphic of the United States Capitol dome, partially obscured by a large, stylized blue and white swoosh that curves around the left side of the dome. The dome is shown from a low angle, looking up at its top and the statue on top.

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**The Attorney-Client and  
FATP Privileges and the  
Work Product Doctrine**  
Recent Developments

Robert Willmore  
Teresa Abney  
September 28, 2018

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## Overview of the Attorney-Client and FATP Privileges

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### The Attorney-Client Privilege

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#### Three Key Questions:

- Is it a direct communication to or from an attorney, or does it summarize or restate such a communication?
- Does the communication involve the seeking or rendering of legal advice, rather than business or other non-legal advice?
- Has the confidentiality of the communication been strictly preserved?

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## The Attorney-Client Privilege (cont'd)

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### Exceptions to the “Strictly Preserved” Requirement:

- Joint defense privilege;
- Common interest doctrine;
- *Kovel* doctrine.

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## Federally Authorized Tax Practitioner Privilege

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### 26 U.S.C. § 7525:

- Operates much like the attorney-client privilege.
- Applies to “tax advice” by a FATP.
- But comes with important restrictions:
  - Applies only in civil tax matters with IRS or DOJ;
  - Does not apply to communications regarding tax shelters.

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## Work-Product Doctrine

### Protects Materials Prepared In Anticipation of Litigation:

- When is a tax opinion provided in anticipation of litigation?
- Application complicated when materials are created for both business and litigation related reasons.
- Different waiver rules than attorney-client privilege.
- When are tax accrual workpapers protected?

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## Intentional, Unintentional and Implied Privilege Waivers

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## Intentional Waiver

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- Privilege nonwaiver agreements with the IRS.
- Federal Rule of Evidence 502(a):

**Disclosure Made in a Federal Proceeding or to a Federal Office or Agency; Scope of a Waiver.** When the disclosure is made in a federal proceeding or to a federal office or agency and waives the attorney-client privilege or work-product protection, the waiver extends to an undisclosed communication or information in a federal or state proceeding only if:

- (1) the waiver is intentional;
- (2) the disclosed and undisclosed communications or information concern the same subject matter; and
- (3) they ought in fairness to be considered together.

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## Unintentional Waiver

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- Can be managed, but there are conditions.
- Federal Rule of Evidence 502(b):

**Inadvertent Disclosure.** When made in a federal proceeding or to a federal office or agency, the disclosure does not operate as a waiver in a federal or state proceeding if:

- (1) the disclosure is inadvertent;
- (2) the holder of the privilege or protection took reasonable steps to prevent disclosure; and
- (3) the holder promptly took reasonable steps to rectify the error . . . .

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## Implied Waiver

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- Often a significant concern in penalty cases.
  - *Ad Investment 2000 Fund LLC v. Comm’r*, 142 T.C. No. 13 (2014);
  - *Eaton Corp. v. Comm’r*, Dkt. No. 5576-2 (Tax Court, 2015);
  - *United States v. Micro Cap Ky. Ins. Co.*, 119 A.F.T.R.2d 2017-1280 (E.D. Ky. 2017) and *United States v. Owensboro Dermatology*, 120 A.F.T.R.2d 2017-5669 (W.D. Ky. 2017);
  - *Schaeffler v. United States*, 806 F.3d 34 (2d Cir. 2015).

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## Questions?

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**Robert Willmore**  
202.624.2915  
rwillmore@crowell.com

**Teresa Abney**  
202.624.2667  
tabney@crowell.com



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## The 2018 Midterm Elections: Effects on Tax Policy

James G. Flood  
Partner  
Chair, Government Affairs Group  
Crowell & Moring LLP

W. Scott Douglas  
Senior Policy Director  
Crowell & Moring LLP

September 28, 2017

### Session Objectives

- Summarize the status of the November 2018 Congressional races and their potential impact on tax policy.
- List key Congressional legislation in 2018 and beyond.
- Outline each party's potential tax legislative priorities and how the 2019 Congressional agenda might change based on the 2018 election results.

## Agenda

- Introduction of Speakers
- The 2018 Elections
- Overview of Key Congressional Committees
- The 115<sup>th</sup> & 116<sup>th</sup> Congress & Tax
- Questions and Answers
- Conclusions

## Introduction of Speakers

- Jim Flood, Chair, Government Affairs Group, Former Counsel to the current Senate Minority Leader Charles E. Schumer (D-NY)
- Scott Douglas, Senior Policy Director; Bush 2000 Kentucky Campaign Manager; Former Finance Director & Senior Staff to the current Senate Majority Leader Mitch McConnell (R-KY)



## The 2018 Elections

## The 115th Congress: 2017-2018

### The House of Representatives (435 Members)

- 236 Republicans
- 193 Democrats
- 6 Vacant House Seats
- 218 (215) Votes Needed to Pass Bills – a simple majority of the total members in House
- Republicans currently have 18 more votes than needed to pass bills

U.S. House of Representatives Press Gallery Party Breakdown, available via:  
<https://pressgallery.house.gov/member-data/party-breakdown>

## **The 115th Congress: 2017-2018: A Closer Look at the House Numbers**

### The True Power Players

- House Speaker & Committee Chairs
- 40 Members – “The Freedom Caucus” (236 – 40 = 196)
- 50 Members – “The Tuesday Group” (236 – 50 = 186)
- 240 Republican Members
- 218 (215) Votes – needed to pass bills
- Below 218 (215) if lose either group

## **The 115th Congress: 2017-2018**

### The Senate (100 Members)

- 51 Republicans (2 or more on each end of the spectrum)
- 49 Democrats
- 51 votes needed for Budget Reconciliation Bill
- 60 Votes Needed to Beat Filibuster
- 60 Votes = 51 Rs + 9 Ds
- Republicans cannot pass most legislation without Democrats

U.S. Senate Party Division. Available via: <https://www.senate.gov/history/partydiv.htm>

## The 2018 Elections: By The Numbers

- November 6, 2018 – Election Day – 40 days to go
- The U.S. Senate - 35 Seats Up For Election
- The U.S. Senate - 26 Dem Seats Up – 10 in Trump States
- The U.S. Senate - 9 GOP Seats Up - 1 in Clinton State
- The U.S. Senate - 2 Net Senate Seat Gain – Dems Take Senate

## The 2018 Elections: Senate

- Senate — 100 Senators — 60 votes still required for legislation
- Senate — 51 Rs to 49 Ds
- Senate Democrats – “overexposed” — Good map for Rs
- Senate Democrats – win if there is a WAVE
- Senate Republicans – need to fire up base and prevent a WAVE – keep their 9 Senate Seats up and/or take some D seats
- The Deciding Factor – How Fired Up is Each Base to Come Vote?

## The 2018 Elections: Senate

### Cook Political Report predicts

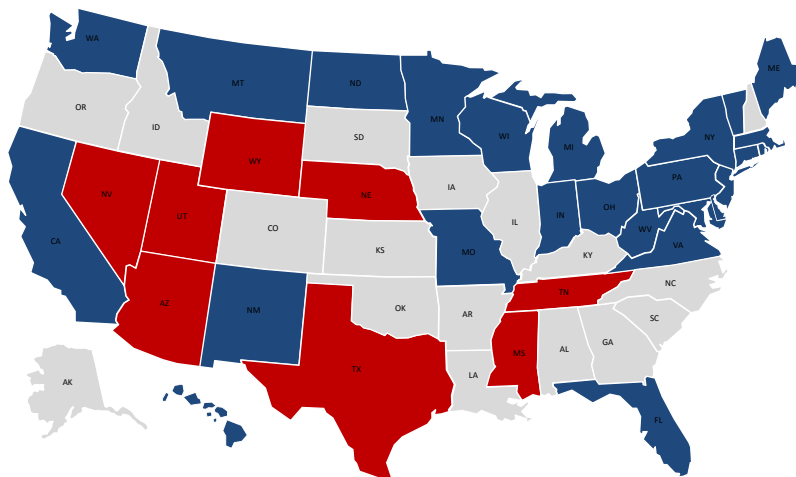
- Solid Seats: 14/26 Democratic Seats
- Solid Seats: 3/9 Republican Seats
- Likely/Lean Seats: 8/26 Democratic Seats and 2/9 Republican Seats
- Toss-Up Seats: 4 Dem and 4 GOP Seats – Enough to Change Senate.

### C&M Comments

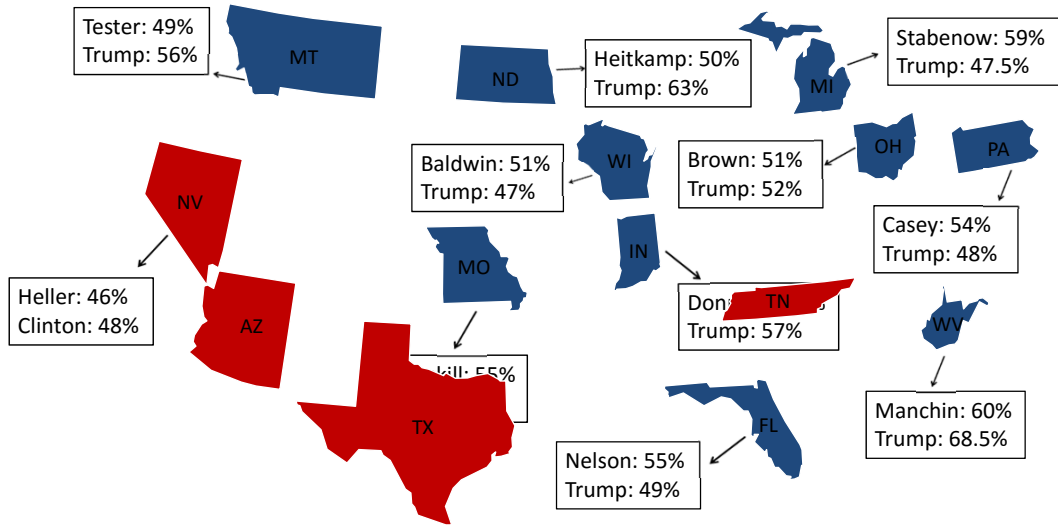
- Despite favorable national political winds, Democrats on defense
- Republicans' prospects for retaining majority hinge on:
  1. Nominating candidates who can win in November
  2. Dusting themselves off after bruising primaries

Cook Political Report: 2018 Senate Race Ratings. Available via: <http://cookpolitical.com/ratings/senate-race-ratings>

## Closer Look at 2018 Senate Races

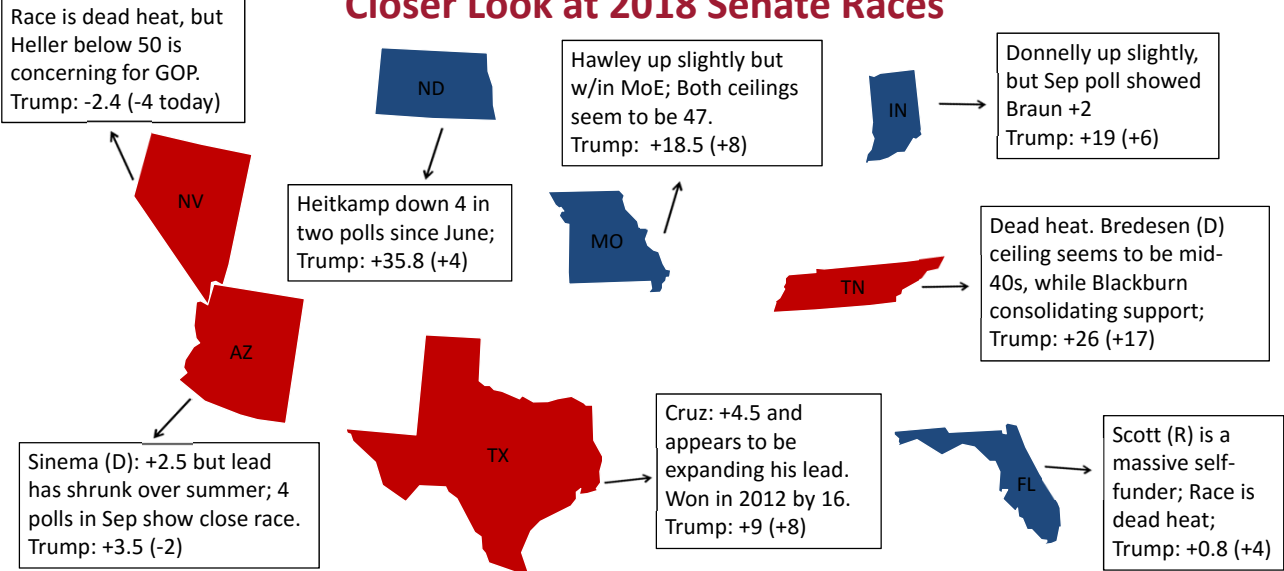


### Cluser Look at 2018 Senate Races



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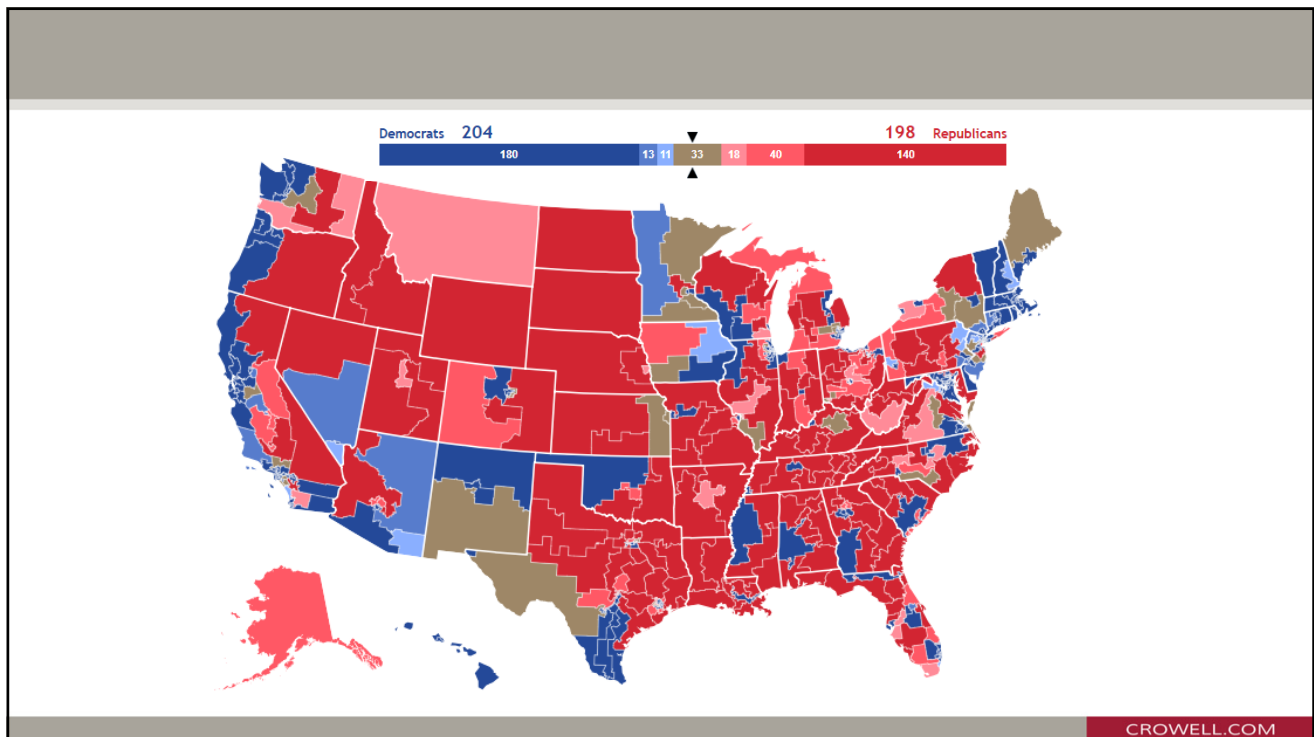
### Cluser Look at 2018 Senate Races



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## The 2018 Elections: House

- All 435 seats up
- 236 – Current Republican Seats
- 193 – Current Democratic Seats
- 6 – Open Seats
- Depending on outcome of special elections, Democrats need a net gain of 23-25 seats to take majority
  - On offense and favored to do so
- Either way, narrower majority after 2018 (likely D)



## The 2018 Elections: House

LIKELY D	LEAN D	DEM TOSS UP	REP TOSS UP	LEAN R	LIKELY R
AZ - 1 O'Halleran CA - 7 Bera CA - 16 Costa FL - 7 Murphy MN - 7 Peterson NH - 1 Open NJ - 2 Open NJ - 5 Gottheimer NV - 4 Open PA - 5 Open PA - 6 Open PA - 8 Cartwright	AZ - 2 Open CA - 49 Open IA - 1 Blum MN - 2 Lewis MN - 3 Paulsen NJ - 11 Open NV - 3 Open PA - 7 Open PA - 17 Rothfus VA - 10 Comstock	MN - 1 Open MN - 8 Open	CA - 10 Denham CA - 25 Knight CA - 39 Open CA - 45 Walters CA - 48 Rohrabacher CO - 6 Coffman FL - 27 Open IA - 3 Young IL - 6 Roskam IL - 12 Bost KS - 2 Open KS - 3 Yoder KY - 6 Barr ME - 2 Poliquin MI - 8 Bishop MI - 11 Open NC - 9 Open NJ - 3 MacArthur NJ - 7 Lance NM - 2 Open NY - 19 Faso NY - 22 Tenney OH - 1 Chabot TX - 7 Culberson TX - 32 Sessions VA - 2 Taylor VA - 7 Brat WA - 8 Open	AR - 2 Hill CA - 50 Hunter FL - 15 Open FL - 16 Buchanan FL - 26 Curbelo GA - 6 Handel GA - 7 Woodall IL - 13 Davis IL - 14 Hultgren MO - 2 Wagner MT - 0 Gianforte NE - 2 Bacon NC - 2 Holding NC - 13 Budd NY - 27 Collins OH - 12 Balderson PA - 1 Fitzpatrick PA - 10 Perry PA - 16 Kelly SC - 1 Open TX - 23 Hurd UT - 4 Love VA - 5 Open WA - 3 Herrera Beutler WA - 5 McMorris Rodgers WI - 1 Open WV - 3 Open	AK - AL Young AZ - 6 Schweikert CA - 4 McClintock CA - 21 Valadao CO - 3 Tipton FL - 6 Open FL - 18 Mast FL - 25 Diaz Balart IA - 4 King IN - 2 Walorski MI - 1 Bergman MI - 6 Upton MI - 7 Walberg NC - 8 Hudson NY - 1 Zeldin NY - 11 Donovan NY - 24 Katko OH - 10 Turner OH - 14 Joyce PA - 14 Open TX - 2 Open TX - 21 Open TX - 22 Open TX - 31 Carter WI - 6 Grothman

## The November 2018 Election: House

### Cook Political Report predicts

- Solid Seats: 182 Democratic Seats and 148 Republican Seats
- Likely/Lean Seats: 10 Democratic Seats and 52 Republican Seats
- Toss-Up Seats: 3 Democratic Seats and 40 Republican Seats (41 Seats in Play)
- More Than Enough to Flip the House Majority

### C&M Comments

- Ample pick-up opportunities for Dems to take majority
- Watch the Trump Approval Rating and Generic Congressional ballot polls, both of which have improved for GOP since January.

## 2018 Election Conclusions

- Midterm elections almost always produce a wave against party in power
- Traditional analysis says Republicans hold Senate, but a Democratic wave could sweep the Democrats into control of the Senate
- Democrats take back the House with a majority in the single digits and big question about who becomes Speaker in 2019
- The current likely January 2019 Swearing In Day is a majority Democratic House & a majority Republican Senate — a split Congress
- 2019 — gridlock on big issues, but smaller legislative wins still possible.
- Setting the stage for 2020 Presidential Election ...

## The 115th & 116th Congress & Tax



## Key Tax Committees

- House Ways & Means Committee
  - Chair Kevin Brady (R-TX)
  - Ranking Member Richie Neal (D-MA)
- Senate Finance Committee
  - Chair Orrin Hatch (R-UT) – *retiring in 2018*
    - *New Chair Likely Sen. Chuck Grassley (R-IA)*
  - Ranking Member Ron Wyden (D-OR)
- Joint Committee on Taxation

U.S. House of Representatives Committee Leadership. Available via:  
<https://www.house.gov/committees/>

## An Update from the Agency

- Charles Rettig was recently confirmed as the new Internal Revenue Service (IRS) Commissioner (Sept. 12)
- Previous experience includes private legal/tax practice with Hochman, Salkin, Rettig, Toscher & Perez, P.C.
- Described as a “Beverly Hills tax attorney”
- Rettig’s nomination was stalled due to Democratic opposition based on the nominee’s support for protecting tax exempt groups from disclosing donor information

## Congressional Priorities Overview

- Following the successful Republican effort to overhaul the U.S. tax code in December 2017, a number of more narrow tax bills were signed into law in 2018
- Senate Finance Chairman Hatch (R-UT) and House W&M Chairman Brady (R-TX) sought to solidify the 2017 reforms by making permanent the individual tax rate cut beyond 2025, though success on this front is uncertain
- Other smaller projects, even some with bipartisan support, are the focus of legislators on Capitol Hill

## Tax Bills Following the 2017 Overhaul

- Continuing Resolution (January 22, 2018) included three tax related provisions:
  - Extending by 2 years through 2019 the moratorium on the health care law's 2.3 percent excise tax on the sale of medical devices by manufacturers and importers
  - Suspending by one year through 2019 an annual fee imposed on health insurance providers
  - Extending by 2 years through 2021 the Cadillac tax on high cost health insurance plans
- The Bipartisan Budget Act (February 9, 2018)
  - Providing tax relief for hurricane victims
  - Allowing members of the Armed Forces living in "qualified combat zones" abroad to exclude foreign-earned income from U.S. tax
  - Expanding tax credits for capturing and disposing of carbon dioxide emissions

## Tax Agenda for Rest of 2018

- Tax Cuts 2.0
- IRS Reform
- Retirement Savings Plans
- Online Tax Powers

## Looking Ahead: Tax Cuts 2.0

- The Republican Congress and President have eyed legislation to extend individual tax cuts beyond 2025 (HR 6760)
- The fact that corporate tax rates were cut permanently and individual rates temporarily was a key talking point in Democratic opposition to the first tax bill passed by Republicans in 2017 (The Tax Cuts and Jobs Act).
- The House Ways & Means Committee advanced the bill on a partisan line on Sept. 13, 2018 - 40 Republican co-sponsors and 0 Democrats
- The Joint Committee on Taxation estimates that the bill would cost the government \$657.3 billion over the next 10 years.
- The bill, however, is not likely to receive enough support in the U.S. Senate to overcome the filibuster

## Looking Ahead: IRS Reform

- On a bipartisan basis, Members of Congress seek a technical and process-oriented overhaul the IRS by:
  - Updating the agency's appeals process
  - Changing enforcement rules
  - Creating IRS customer service programs
  - Improving cyber security and taxpayer ID protection
- The House passed the measure (HR 5444) by of a vote of 414-0

## Retirement Savings Plans

- Senate Finance Chairman Orrin Hatch has had a longtime interest in reforming laws around retirement savings.
- Chairman Hatch introduced legislation (S 2526) that would allow small employers to hand together to provide employees:
  - Joint defined contribution retirement plans,
  - Improved automatic escalator provisions in employee savings plans, and
  - More generous tax credits for small employer pension plan start-up costs
- Chairman Hatch leads a bipartisan bicameral panel established to recommend changes to the Pension Benefit Guaranty Corporation

## Online Tax Powers – Amazon

- July 24, 2017 – House Judiciary Committee Hearing
- South Dakota v. Wayfair
- 4 Related Bills Pending in Congress – but Not Likely Go Anywhere
- HR 2193 – the Remote Transactions Parity Act – overturn Quill
- S 976 – Marketplace Fairness Act of 2017 – overturn Quill
- HR 2887 - No Regulation Without Representation Act – codify Quill physical presence standard
- S 3180 - Stop Taxing Our Potential Act – narrow physical presence rule that calls for no remote sales tax collection by states
- Will get interesting and could raise in 2019 as online sales continue to grow

## The 116th Congress and Tax

- Option # 1 – House (Democrat) and Senate (Democrat)
- Option # 2 – House (Democrat) and Senate (Republican)
- Option # 3 – House (Republican) and Senate (Republican)
- The White House and Impact on Congress and Tax in 2019
- The 2020 Election and Impact on Congress and Tax in 2019

## Conclusions

- The 2018 midterm elections constrain the legislative calendar
- The post-election activity depends on the election result
- Republicans would prefer another tax bill to make individual rate cuts permanent, but that is unlikely in 2018
- Democrats will continue to rail against corporate cuts, but unlikely can cut deal with Rs on another bill
- Any tax bill passed in 2018 or the next Congress will need to be a bipartisan bill

## Questions



## IRS Appeals Update

### New Appeals Approaches in Practice

All great changes are preceded by chaos.

- Deepak Chopra

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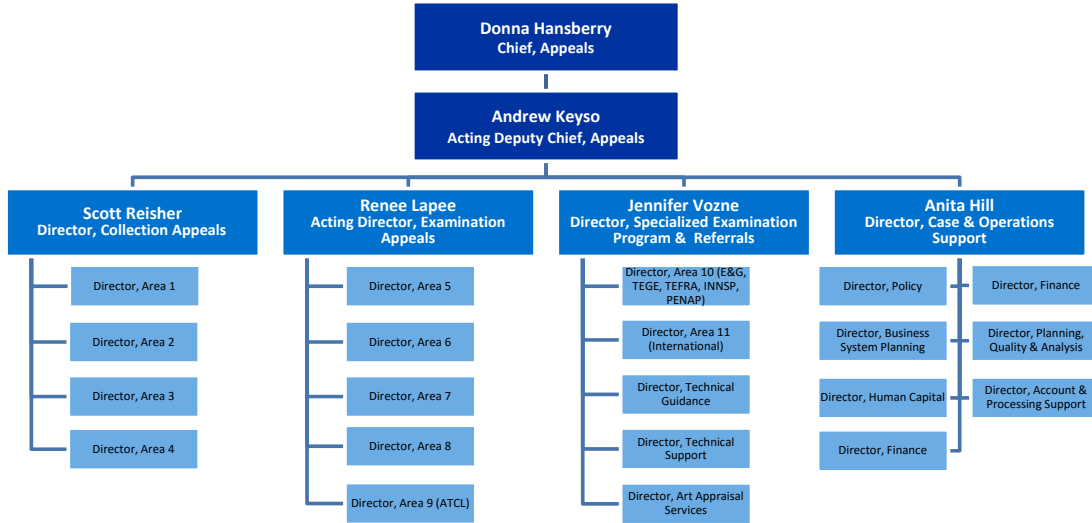
## Agenda

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- Appeals' No New Facts, No New Issues Policy in Practice
  - Acknowledgment of Facts IDR
- Concerns over Appeals' Independence
  - Exam Presence at Appeals Conferences – the “Pilot” Project
  - Erosion of ATCL Settlement Authority
- Access to Appeals
  - *Facebook v. IRS*
- Appeals Process
  - Face-to-Face Conferences and Alternatives
- Post-Appeals Conferences between Exam and Appeals
- Proposed Legislation

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# IRS Appeals Organization



September 15, 2018

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# Changes in Appeals Workforce

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Appeals Officers	800	758	996	925	857
Total Staffing	1,829	1,708	1,569	1,449	1,345
Case Receipts	123,113	113,608	113,870	114,362	103,574

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## IRS Appeals

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- Designed as “independent” settlement forum
- “Mission” of IRS Appeals: To settle cases
  - To resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer, and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service
- Consider “hazards of litigation”
- Do not consider costs of litigation (no nuisance settlements)



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## IRS Appeals

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### Operating Principles

- **Act in accord with the Taxpayer Bill of Rights in every interaction with taxpayers.**
- **Provide a prompt conference and a prompt decision in each case.** A prompt conference and decision enable the taxpayer to know with the least amount of delay, the final decision of the Service as to the amount of tax liability, or other issue in contention, and results in getting into the Treasury additional revenue involved at the earliest practicable date.
- **Make a high-quality decision in each case.** A decision of high quality is required in each case and should represent judicious application of Service policy and sound legal principles.
- **Effect a satisfactory number of agreed settlements.** It is a fundamental purpose of the Appeals function to effect settlement of contested cases - on a basis fair to both the Government and the taxpayer - to the end that the greatest possible number of nondocketed cases is closed in nondocketed status and the greatest possible number of docketed cases is closed without trial.

(IRM 8.1.1.1.2)

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## Taxpayer Bill of Rights

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### Internal Revenue Code § 7803(a)(3):

In discharging his duties, the Commissioner shall ensure that employees of the Internal Revenue Service are familiar with and act in accord with taxpayer rights as afforded by other provisions of this title, including –

- the right to be informed
- the right to quality service
- the right to pay no more than the correct amount of tax
- **the right to challenge the position of the Internal Revenue Service and be heard**
- **the right to appeal a decision of the Internal Revenue Service in an independent forum**
- the right to finality, to privacy, to confidentiality, to retain representation
- the right to a fair and just tax system

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## Appeals Policy (formerly AJAC)

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- **No new facts**
  - Not shared with Exam
  - In view of Appeals Office, merits additional analysis or investigative action
  - Will not develop additional evidence not in the case file
- **No new issues**
  - Issues not considered by Exam or previously agreed issues
  - Taxpayer can raise new issues or new theories
  - Appeals Officer may consider legal theories not raised by either party in considering hazards
- If case is returned to Exam for consideration of new facts or legal argument, Exam may revisit old issues or raise new issues at its discretion

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## Acknowledgment of Facts

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### Impact on IRS Appeals

- Before an unagreed issue is sent to Appeals, the issue team will solicit a written acknowledgement of the facts (“AOF”) to ensure all relevant facts, including those favorable to the taxpayer, are fully developed.
- The Internal Revenue Service Advisory Council (“IRSAC”) recommends an AOF provide the following to avoid a case being returned to Exam for setting forth new issues and facts:
  - A clear description of the legal issue. The IRSAC provides, “[i]t may not be possible to know what facts are relevant without a clear exposition of the legal issues involved.”
  - No legal arguments. Be sure the AOF is not being used as an advocacy tool.
  - All relevant facts must be included, which includes facts relied on by both Exam and the taxpayer.
    - See 2017 IRSAC Large Business and Int’l Report, available at <https://www.irs.gov/tax-professionals/2017-irsac-lbi-report>.

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## Impact of Appeals Policy / AOF

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- “The sky is falling”
- Appeals claims not a consistent problem, isolated incidents
- May be a change in behavior

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## Exam Presence at Appeals Conference

### Case Conferencing “Pilot” Project

- Pilot Project in which some Appeals Team Case Leaders (“ATCLs”) hold Appeals conferences with representatives Exam in attendance
  - Voluntary, approximately 1/3 of ATCLs in program (others may also elect case by case, after IRM amendment)
  - Began May 2017, Pilot through May 2019
- Starts with “Expectations call” with taxpayer and representatives, Exam, and Appeals.
- Expectations call followed by “Expectations letter”
  - New arguments and facts provided to Appeals and other side at least 45 days in advance
  - Responses to questions by Appeals must be answered within two weeks of the conference
- Exam is invited and expected to stay through the taxpayer’s presentation until settlement discussions begin
  - Taxpayers may consent to Exam staying longer while Appeals uses mediation techniques

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## Exam Presence at Appeals Conference

- Frequently asked questions:
  - Taxpayers **may not opt out** of this initiative, but Exam can decline to attend
  - Practical difficulty objecting when ATCL insists even if not part of Pilot Program
  - Exam may not raise new issues during the Appeals conference
  - Only Exam team members involved in unagreed issues will participate
- Other procedures (from ATCL):
  - Both Exam and the taxpayer are allowed to ask questions of the other side during the presentations
  - Goal is to facilitate communication between Taxpayer and Exam to more quickly identify central issues and assess the strengths and weaknesses
  - Appeals remains the decision-maker

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## Exam Presence at Appeals Conference

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### Prohibition on *ex parte* communication

- *Ex parte* communications between Appeals and IRS personnel in other functions (i.e. Exam) are prohibited (see IRM 4.2.7)
- Required by the Restructuring and Reform Act of 1998 (with the Taxpayer Bill of Rights) to assure Appeals independence
  - Taxpayer Bill of Rights prohibits *ex parte* communications “to the extent such communications appear to compromise the independence of appeals officers”
- Appeals may discuss case with Exam in presence of taxpayer (or representative) or with their consent (or opportunity to participate). (Rev. Proc. 2012-18, superseding Rev. Proc. 2000-43; IRM 8.1.10)

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## Exam Presence at Appeals Conference

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### Taxpayer Advocate Service Concerns

- In its 2017 Annual Report to Congress, the Taxpayer Advocate Service (“TAS”) expressed concerns:
  - “could have far-reaching negative consequences for Appeals’ effectiveness in resolving cases with taxpayers”
- TAS concerns:
  - Alters the relationship between the taxpayer and the Appeals Officer and makes interactions less negotiation-based
  - Makes it difficult for Appeals to serve as an unbiased participant in the case resolution process
  - Generates additional costs for the government and taxpayers in the form of fewer case resolutions, additional litigation, and reduced long-term compliance

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## Exam Presence at Appeals Conference

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### Taxpayer Concerns

- Independence (like TAS concern)
- How does Exam participation increase efficiency or certainty
- Exam continues to develop its position after case is in Appeals
- Will Exam request that issues not fully developed be sent back to Exam?

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## Exam Presence at Appeals Conference

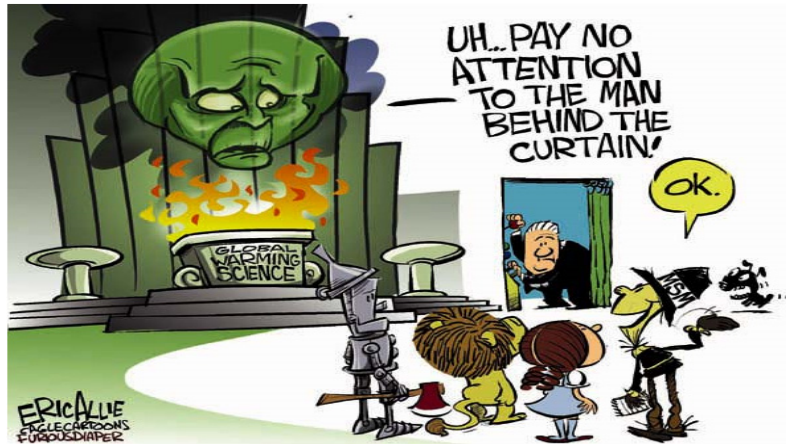
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### Experience

- Taxpayer concerns based on experience to date:
  - Is Exam now invited to every LB&I Appeals conference?
  - How to decide when to exclude exam (line between settlement discussions and case presentation)
  - Exam has begun to issue post-Protest IDRs to prepare to advocate its position at Appeals
  - Sheer number of people involved in Appeals conference
- Appeals response to date:
  - Appeals claims helpful to identifying issues faster and more clearly
  - Pilot program, Appeals claims still under consideration
  - Appeals is listening to feedback
- Decline in Fast Track (by 16%), but may be general decline in case receipts

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## Appeals Settlement Authority



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## Appeals Settlement Authority

### ATCL Review by Manager

- ATCL has settlement authority, while proposals by other Appeals Officers are subject to review and approval
- Appeals has added a requirement for the ATCL Manager to concur in settlements by an ATCL (Jan. 12, 2017, Interim Guidance)
  - Technically, now require ATCL Manager to sign closing documents
  - ATCL Manager may “propose changes”
  - If ATCL does not agree with changes, the Area Director resolves issues
- Concerns that ATCL settlement authority would be further limited have not been realized

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## Appeals Settlement Authority

### Appeals Coordinated Issues / Appeals Settlement Guidelines

- Appeals settlements, including by an ATCL, are subject to review and concurrence by the “Technical Specialist” if the settlement includes Appeals Coordinated Issues
- Informally, also have national “Subject Matter Experts,” and it appears to be policy that they be consulted
- Overall, trend is for Appeals and Appeals Management to seek consistency as much as possible
- Issues:
  - Lowers discretion
  - Lack of transparency
  - Interferes with settlement

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## Appeals Settlement Authority

### Appeals Coordinated Issues / Appeals Settlement Guidelines

- The Appeals Settlement Guidelines are published on the IRS website (without the key analysis or recommendations): <https://www.irs.gov/compliance/appeals/appeals-settlement-guidelines-asg>
  - Permits identification of issues likely to be subject to centralized review and the analysis likely to be preferred by IRS Appeals
- IRS also publishes Domestic and International Index, listing all ACI and ASG issues
  - [https://www.irs.gov/pub/irs-utl/tg\\_issues\\_index.pdf](https://www.irs.gov/pub/irs-utl/tg_issues_index.pdf)
- Names of Coordinators, Technical Specialists also published
  - Either Maggie Harris (international) or Joe Ali (domestic) is listed for nearly all 175 issues
  - Will refer taxpayer to specific individual coordinator if contact them
- IRS Appeals claims number of ACI or other centralized issues decreasing (contrary to our experience)

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## Appeals Settlement Authority

### Settlements Contrary to Published IRS Positions

- Generally Appeals has authority to fully or partially concede an issue based on litigating hazards, even if contrary to an IRS Ruling, TAM, or other guidance (IRM 8.6.3.3)
- Appeals may no longer settle an issue contrary to a National Office ruling on issues reviewed by a court under an “abuse of discretion” standard, except with approval of the National Office
  - Consent to changes in accounting methods
  - Requests for 9100 relief
- Unclear why hazards settlements should not apply in such circumstances as well
  - Risk that IRS could expand scope of limitations
  - Seems contrary to Rev. Proc. 2012-18 (permitting *ex parte* communications only if not on substantive issues affecting taxpayer’s tax liability) and Treas. Reg. §601.106(f) (imposing Circular 230 duty on Appeals to determine correct application of law)

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## Taxpayer’s Right to an Appeal

### IRS Limitations on the Ability to Refer Docketed Cases to Appeals

- IRS has revised procedures concerning referral of Docketed cases to IRS Appeals by Rev. Proc. 2016-22, “to more accurately reflect the procedures utilized in managing the flow of docketed cases between the Office of Appeals and the Office of Chief Counsel”
- Most significant change relates to right to IRS Appeals in cases docketed in Tax Court:
  - Generally refer cases to IRS Appeals
  - Not refer issue that has been “designated for litigation”
  - “In limited circumstances, a docketed case or issue will not be referred to Appeals if Division Counsel or a higher level Counsel official determines that referral is **not in the interest of sound tax administration.**”
- New standard for Docketed Cases: not in the interest of sound tax administration

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## Taxpayer's Right to an Appeal

### *Facebook, Inc. v. IRS* (N.D. Cal. May 2018)

- IRS audit of Facebook for 2008, 2009 and 2010. Facebook produced thousands of pages of documents and voluntarily extended the statute of limitations five times
- January, 2016, IRS requested sixth extension of statute of limitations
  - Facebook sought agreement that IRS would timely issue “30-day letter”
  - No agreement reached
- IRS issued Notice of Deficiency and Facebook filed a petition in Tax Court (October, 2016).
- IRS refused to refer Facebook's case to IRS Appeals, citing the Rev. Proc. 2016-22 “not in the interest of sound tax administration” standard
- Meanwhile, IRS and Facebook litigating about Facebooks' FOIA request for administrative audit files, District Court decision (June, 2017) that IRS did not have to produce metadata

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## Taxpayer's Right to an Appeal

### *Facebook, Inc. v. IRS*, (N.D. Cal. May 2018)

- Facebook brought suit against the IRS in Northern District of California, claiming under the Administrative Procedures Act that:
  - Rev. Proc. 2016-22 was invalid
  - Facebook had a right to access to IRS Appeals
- Facebook cited Taxpayer Bill of Rights, § 7803(a)(3)(E): right “to appeal a decision of the Internal Revenue Service in an independent forum”
- The IRS moved to dismiss Facebook's complaint for lack of subject-matter jurisdiction on the grounds that:
  - Facebook lacked standing, and
  - IRS decision not to refer Facebook's case to Appeals is not reviewable under the APA

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## Taxpayer's Right to an Appeal

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### *Facebook, Inc. v. IRS*, (N.D. Cal. May 2018)

- Court: "Facebook does not have an enforceable right to take its tax case to IRS Appeals or to compel the IRS to do so."
  - Lacking an enforceable right, Facebook lacked standing
  - Court granted the IRS's motion to dismiss the case with prejudice; thus, the decision is final and that Facebook cannot try again on the same issue.
  - Apparently no interlocutory appeal, which means issue will be moot on appeal
- Facebook's case filed before the Tax Court challenging its tax assessment is set for trial on August 21, 2019

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## Face-to-Face Conferences

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### Current IRS Position

- October 2017 Memo: For field cases, "if a taxpayer requests an in-person conference, Appeals will use its best efforts to schedule an in-person conference on a date and at a location that is reasonably convenient for the taxpayer and Appeals"
- Can still be limited by:
  - Workload constraints
  - Availability of subject matter experts
  - Collection Due Process regulations

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## Face-to-Face Conferences

### Statistics Pre- and Post-October 2016 Change

	FY 2013	FY 2017	Change
Total Appeals Receipts	123,113	103,574	-16%
Total in-person conferences	14,986	5,832	-61%
Transfers due to in-person request	5,853	2,461	-58%
Transfers resulting in an in-person conference	2,626	983	-63%

Taxpayer Advocate Service, Annual Report to Congress 2017, <https://taxpayeradvocate.irs.gov/reports/2017-annual-report-to-congress>

- Almost 90% of Appeals conferences are not Face-to-Face, many individuals/small businesses prefer
- Our experience (and IRS Appeals view): all LB&I cases that wish Face-to-Face are granted Face-to-Face with ATCL, subject to some team members being on the telephone

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## Alternatives to Face to Face Conferences

- Telephone
- Campus Conferences
- “Virtual Service Delivery” (VSD) via web-based screen sharing service (IRM 8.6.1.4.5)
  - VDS available 10 IRS Campuses for IRS use only
  - One case in 2017
- Pilot Program: WebEx
  - Presently limited to taxpayers with cases assigned to participating Appeals Officers
  - Appeals is determining the effectiveness and how to expand access.

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## WebEx Pilot Program

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### WebEx Pilot Program

- Test initiated in August 2017 and running through September 2018
- Taxpayers and Appeals Officers can have virtual conferences using their own computers, tablets, or any mobile device with an Internet connection
- Taxpayers must install WebEx on their own device
  - Free commercial software made by Cisco.
- Appeals enthusiastic about WebEx progress
  - Multiple users shown on screen
  - Share documents
  - Secure
  - Used internally by Appeals

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## Post-Appeals Conferences with Exam

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- Appeals re-emphasizing practice to meet with Exam following Appeals resolution
  - Response to TIGTA report criticizing communication
- Concern: *Ex Parte*
  - *Ex parte* rules permit post-Appeals conferences
  - Appeals is sensitive to subsequent audit cycles

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## Appeals Settlement of Transfer Pricing Issues

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- Appeals sustains less than 20% of transfer pricing adjustments
  - 2012-2014, studied 213 cases resolved in IRS Appeals with transfer pricing issues
  - \$10.5 billion in adjustments proposed by Exam
  - \$2 billion assessed after Appeals
  - Only \$321 million finally posted?
- 54% of Agents did not know their proposal was reduced
- 14% knew adjustment was reduced, but did not know the reason
- TIGTA argued need to educate Agents; may have been used to centralize Appeals review

(Source: TIGTA Report, Barriers Exist to Properly Evaluating Transfer Pricing Issues)

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## Proposed Legislation

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### 2018 Proposed IRS Reform

- House Ways and Means and Senate Finance Committees have been working on bipartisan legislation that, among other things, address taxpayer rights and tax administration
  - The House has passed this legislation (H.R. 5444)
- The bill provides for comprehensive reforms to the IRS, including:
  - Expanding taxpayer rights to Appeals
  - Independence of IRS Appeals
  - Taxpayer access to the administrative file

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## Proposed Legislation

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### Expanding Taxpayer Rights to Appeals

- Limits the ability of the IRS to deny a taxpayer the ability to go to IRS Appeals
  - IRS Appeals is often vital for individuals and small/medium businesses as a low-cost avenue to challenge an IRS position
- Require that denied cases receive a written letter explaining the basis for denial; eligible to request additional consideration if they were denied
- Curb cases that the IRS designates for litigation and give taxpayers more opportunities to explain to the IRS why their case should go to Appeals

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## Proposed Legislation

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### Independence of IRS Appeals

- Provide new IRS Independent Office of Appeals in the Code
- Current Appeals process, attempting to comply with Taxpayer Bill of Rights (IRS Restructuring and Reform Act of 1998), has eroded over time, with IRS exercising discretion to withhold certain taxpayers from Appeals (designated for litigation; *Facebook*)
- Provides right to a conference with an Appeals Officer that does not include personnel from the Office of Chief Counsel or Exam unless the taxpayer specifically consents to the participation of such personnel

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# Proposed Legislation

## Taxpayer Access to Administrative File

- Currently, taxpayers must submit a Freedom of Information Act (“FOIA”) request to access their case file.
- Draft legislation requires Appeals to provide “specified taxpayers” with their case file on record regarding the disputed issues no later than 10 days before the Appeals conference. Specified Taxpayer means:
  - In the case of any taxpayer who is a natural person, a taxpayer whose adjusted gross income does not exceed \$400,000, and
  - In the case of any other taxpayer, a taxpayer whose gross receipts do not exceed \$5,000,000

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## Questions?

David J. Fischer  
Crowell & Moring LLP  
dfischer@crowell.com  
(202) 624-2650

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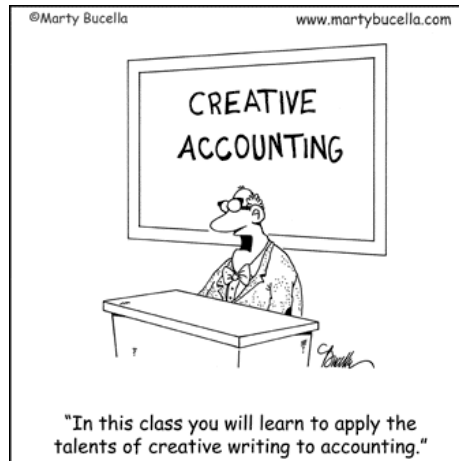
# Developments in Tax Accounting

Dwight Mersereau

September 28, 2018

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## Agenda



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# Agenda

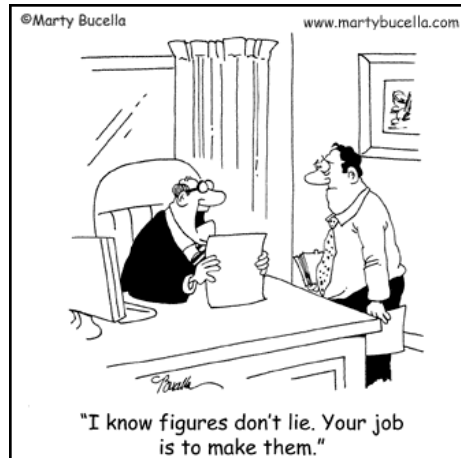
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"HOWEVER, BY USING AN ALTERNATE METHOD OF ACCOUNTING...."

# Agenda

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"I know figures don't lie. Your job is to make them."

## Section 451(b)

### In General

- As an accrual method taxpayer, generally, you must recognize income when all events have occurred to fix your right to the income and you can determine the amount of that income with reasonable accuracy (the “all events test”).
  - All events have occurred to fix your right to income the earlier of when: (1) you have performed under an agreement; (2) payment is due under the agreement; or (3) you receive payment.
- New § 451(b) fundamentally changes the all events test by adding the requirement that you must recognize income no later than when you “take it into account as revenue” for financial statement purposes.
  - Overturns *Capital One*, in which the court permitted the taxpayer to defer interchange income that it had currently taken into account as revenue for financial statement purposes.
  - Note that it does not apply to all income; only revenues. There is an issue regarding whether “revenue” is net of certain contra revenue amounts that are taken into account. The IRS plans to address this issue.
  - Is effective for taxable years beginning after December 31, 2017.

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## Section 451(b)

### Exceptions

- Section 451(b) generally does not change the rules for when you **realize** income for tax purposes.
  - For example, it does not require you to recognize gain from securities that you marked to market for financial statement purposes if you realize gain for tax purposes when you sell the securities.
    - However, Congress drafted the statute broadly and this clarification is in a footnote of the legislative history. Therefore, the IRS might take an overly aggressive approach.
- Section 451(b) does not override “special” methods of accounting.
  - Section 451(b) does not define special methods of accounting, but it is understood that they include the installment method under § 453 and the long-term contract method under § 460, for example. Other situations are not as clear, and the IRS might need to address and might take a narrow view.
- However, § 451(b) does override the OID rules for years beginning after December 31, 2018.
  - It is unclear whether § 451(b) overrides the cost recovery method, and the IRS might be aggressive.
- Section 451(b) does not apply to mortgage servicing rights.

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## Section 451(b)

### Interaction with ASC Topic 606

- FASB ASC Topic 606 could change the way you must account for revenue from contracts with customers.
- The new rules are effective for years beginning after December 15, 2017, in the case of publicly traded companies.
- In general, under the new standard you will take into account revenue using the following steps:
  - Identify the contracts with a customer;
  - Identify the performance obligations in the contract;
  - Determine the contract price;
  - Allocate the transaction price to the performance obligations; and
  - Take into account revenue as you satisfy a performance obligation.

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## Section 451(b)

### Implementation

- Section 451(b) is not a “book conformity” rule.
  - If you report revenues on your financial statements you might not recognize income for tax purposes if you do not have a tax income realization event.
  - You may be required to recognize income for tax purposes before you report revenues for financial statement purposes.
  - Safe harbor may be necessary to avoid complexity if you use PCM for financial statement purposes.
- You must allocate the transaction price of contracts containing multiple performance obligations the same way you allocate it for financial statement purposes.
  - You will need to closely coordinate with your financial accountants to ensure you meet this requirement.
- To comply with § 451(b), you likely will need to change your method of accounting.
  - Current IRS guidance, Rev. Proc. 2018-29, is not adequate.
  - The § 481 adjustment period related to the OID rules is six years.

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## Section 451(c)

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### In General

- Section 451(c) permits you to elect to defer advance payments, provided you defer them for financial statement purposes.
  - Section 451(c) is elective, and you are not required to defer advance payments for tax purposes. However, if you do not defer advance payments for financial statement purposes, you cannot defer them for tax purposes.
  - You may only defer advance payments for one year for tax purposes, regardless of how long you defer them for financial statement purposes.
    - You must include in gross income in the year you receive the advance payment the amount you report for financial statement purposes, and include any remaining amount in gross income the following taxable year.

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## Section 451(c)

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### Implementation

- If you currently defer advance payments under Rev. Proc. 2004-34, the IRS has stated that you can continue to use that method of accounting until they provide further guidance on section 451(c).
  - That is, the IRS will not challenge your use of Rev. Proc. 2004-34 to satisfy the requirements of § 451(c), but the IRS may examine whether you are properly applying Rev. Proc. 2004-34.
- However, if you currently defer advance payments that you receive for the sale of goods under Treas. Reg. § 1.451-5, which provides for a longer deferral period than provided under section 451(c), you may need to change your method of accounting to defer them under section 451(c).
  - Congress stated that they expected the Treasury to withdraw the regulation, but the Treasury has not yet done so.
  - There is an issue of whether you can take into account an estimate of costs of goods sold against any advance payment that you must accelerate into income in the year following the year you received it. The IRS is likely to address this issue in forthcoming guidance.

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## Section 451(c)

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### Open Issues

- Section 451(c) allows you to defer advance payments you receive for goods and services, a much narrower set of advance payments than the IRS allows under Rev. Proc. 2004-34. The IRS has allowed you to continue to rely on Rev. Proc. 2004-34, but it is not clear whether future guidance will continue to allow you to defer advance payments you receive for the license of intellectual property or software, for example.
- The IRS is considering whether to expand the types of payments that you are not allowed to defer under § 451(c).
- If you are already deferring advance payments under Rev. Proc. 2004-34, are you deemed to have elected to defer advance payments under § 451(c), or will you need to make an election?

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## Section 451(c)

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### Open Issues

- Will the IRS provide an exception for short taxable years similar to the exception they applied in Rev. Proc. 2004-34?
- Will the IRS provide exceptions to the acceleration rules for § 381 and 351 transactions, similar to the exceptions in Rev. Proc. 2004-34?
- What will be the impact on Treas. Reg. § 1.451-4, regarding sales of trading stamps and premium coupons?

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## Section 199

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### Controversy Continues

- After Congress repealed § 199, the Treasury Department shelved its regulation project that could have resolved some of the controversy we are seeing.
- The IRS continues to aggressively audit and deny § 199 benefits that were intended by Congress.
  - Third largest compliance issue as measured by proposed adjustments, with no end in sight.
- IRS Appeals is continuing to make very low settlement offers.
  - Eleven cases were docketed; a very large number for one Code section in such a short period of time.
  - This is a troubling development at IRS Appeals, where “issue specialists” seemingly are controlling the settlement authority delegated to Appeals Officers.

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## Section 199

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### Controversy Continues

- There are currently two docketed cases involving the “benefits and burdens of ownership” issue:
  - *AT&T Advertising* (U.S. Court of Federal Claims)
  - *Meredith Corp.* (U.S. District Court for the Southern District of Iowa)
- Three other cases that were docketed in the Tax Court have settled:
  - *Bare Escentuals*
  - *Hibu*
  - *Limited Brands*

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## Section 199

### Controversy Continues

- There are currently three docketed cases involving the computer software issue:
  - *Vesta* (Tax Court – two cases)
  - *Bloomberg* (Tax Court)
  - BATS Global (Tax Court – two cases)

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## Questions?

**Dwight N. Mersereau**  
Crowell & Moring LLP  
[DMersereau@crowell.com](mailto:DMersereau@crowell.com)  
(202) 624-2856

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