

I.R.S. LB&I ANNOUNCES 13 NEW “CAMPAIGNS” FOR AUDIT GUIDANCE

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On January 31, 2017, the I.R.S. Large Business and International (“LB&I”) division announced the identification and selection of 13 campaigns targeting specific areas for audits and other enforcement activity. These campaigns represent the first wave of LB&I issue-based compliance work, with further campaigns to be identified, approved, and launched in the coming months. The campaigns may involve a combination of examinations, outreach, or guidance, as well as other possible treatment methods.

BACKGROUND

The issue-based campaigns are part of LB&I restructuring that was introduced last year in response to resource constraints. As of February 2016, the organization has moved to a structure based around “Practice Areas.” This represents a more centralized issue selection approach that focuses on how to identify and address compliance risks. Returns will now be selected for audit based on issues rather than risks.

The new LB&I structure is divided into four geographic compliance areas – Western, Central, Eastern, and Northeastern – and five subject matters – Pass Through Entities, Enterprise Activities, Cross-Border Activities, Withholding & International Individual Compliance, and Treaty & Transfer Pricing Operations. LB&I plans to identify areas of noncompliance and strategically focus resources on those areas. Each Practice Area consists of a group of employees organized together to focus on one or more areas of concentration and expertise.

In the LB&I Fiscal Year 2016 Focus Guide, LB&I Commissioner Douglas W. O’Donnell laid out the operational goals for 2016, which included executing the new LB&I structure and operations. The new structure, as described by the LB&I Commissioner, focuses the organization’s resources on different campaigns that represent observed or perceived noncompliance. The campaigns are intended to

- identify specific areas of potential noncompliance;
- identify intended compliance outcomes;
- identify specific tailored treatment streams to achieve those outcomes;
- identify the resources needed to execute these tailored treatment streams;
- identify training, guidance, mentors, and other support needed; and
- effectively use feedback from LB&I employees to quickly modify LB&I’s approach as needed.

THE CAMPAIGNS

The initial campaigns were identified to improve return selection and identify issues representing a high risk of noncompliance. With respect to each announced campaign, the I.R.S. included a short description and identified the Practice Area, the lead executive responsible, and the treatment method. Because the 13 campaigns are “tailored,” it is likely that a group of business taxpayers has already been identified by the I.R.S. and that taxpayers will be contacted by the I.R.S. in the coming months.

The 13 campaigns selected for this initial rollout are as follows:

- I.R.S. 48C Energy Credit Campaign

This campaign aims to ensure that the credit is claimed only by those taxpayers whose advanced energy projects were approved by the Department of Energy (“D.O.E.”), and who have been allocated a credit by the I.R.S. These credits must be pre-approved through an extensive application submitted to the D.O.E.

The treatment stream for this campaign will be soft letters and issue-focused examinations.

- O.V.D.P. Declines-Withdrawals Campaign

This campaign addresses Offshore Voluntary Disclosure Program (“O.V.D.P.”) applicants who applied for pre-clearance into the program but were either denied access to O.V.D.P. or withdrew from the program of their own accord.

The I.R.S. will address continued noncompliance through a variety of treatment streams, including examinations.

- Domestic Production Activities Deduction, Multi-Channel Video Program Distributors (“M.V.P.D.’s”) and T.V. Broadcasters

This campaign targets M.V.P.D.’s and T.V. broadcasters that claim that “groups” of channels or programs are a qualified film eligible for a Code §199 deduction for domestic production activities. This is a 9% deduction – limited to 50% of wages paid – for qualified production activity income. Some taxpayers assert that they are the producers of a qualified film when distributing channels and subscription packages that include third-party produced content. LB&I has developed a strategy to identify taxpayers impacted by these issues and will develop training to aid revenue agents to address the issue in the course of an examination.

The campaign will include the development of an externally published practice unit, published guidance, and issue-based exams where warranted.

- Micro-Captive Insurance Campaign

This campaign addresses transactions described in Notice 2016-66, in which a taxpayer attempts to reduce its aggregate taxable income using contracts that are treated as insurance contracts and a related company that is treated as a captive insurance company. The contracts are interpreted, administered,

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and applied in a manner that is inconsistent with arm's length transactions and sound business practices. The campaign aims to review insurance premium deductions claimed by each entity treated as an insured entity under the contracts.

The treatment stream for this campaign will be issue-based examinations.

- Related-Party Transactions Campaign

This campaign focuses on transactions between commonly controlled entities that provide taxpayers a means to transfer funds from a corporation to related pass through entities or shareholders. The campaign is aimed at the mid-market segment.

The treatment stream for this campaign is issue-based examinations.

- Deferred Variable Annuity Reserves and Life Insurance Reserves I.I.R. Campaign

This campaign is targeted at developing guidance to address uncertainties regarding issues relevant to the life insurance industry. The campaign's objective is to collaborate with industry stakeholders, Chief Counsel, and the Treasury to develop published guidance that provides certainty to taxpayers. The issues to be addressed include amounts to be considered in determining tax reserves for both deferred variable annuities with guaranteed minimum benefits and life insurance contracts.

- Basket Transactions Campaign

This campaign addresses structured financial transactions, described in Notices 2015-73 and 201-74, in which a taxpayer attempts to defer and treat ordinary income and short-term capital gain as long-term capital gain. The taxpayer treats the option or other derivative as open until a "barrier event" occurs. Current period gains are deferred until the contract terminates, at which time the overall net gain is reported as a long-term capital gain.

The treatment for this campaign will be issue-based examinations, soft letters to material advisors, and practitioner outreach.

- Land Developers – Completed Contract Method ("C.C.M.") Campaign

This campaign targets large land developers that construct residential communities and may improperly be using C.C.M. accounting to defer all gain until the entire development is completed.

The treatment includes development of a practice unit, the issuance of soft letters, and issue-based examinations when warranted.

- T.E.F.R.A. Linkage Plan Strategy Campaign

This campaign focuses on developing new procedures and technology to work collaboratively with revenue agents conducting partnership examinations under the Tax Equity and Fiscal Responsibility Act ("T.E.F.R.A.") in order to identify, link, and assess tax to terminal investors that pose the most significant compliance risk.



- S-Corporation Losses Claimed in Excess of Basis Campaign

This campaign focuses on S-corporation shareholders that claim losses and deductions to which they are not entitled because they do not have the sufficient stock or debt basis to absorb these items.

The treatment streams for this campaign will be issue-based examinations, soft letters encouraging voluntary self-correction, conducting stakeholder outreach, and creating a new form for shareholders to assist in the proper computation of basis.

- Repatriation Campaign

The goal of this campaign is to simultaneously improve issue selection filters while conducting examinations on identified high-risk repatriation issues, thereby increasing taxpayer compliance, including the proper reporting of repatriation of income on filed returns.

- Form 1120-F Non-Filer Campaign

In this campaign, LB&I will use various external data sources to identify foreign companies doing business in the U.S. that are not meeting their filing obligations and encourage them to file the required tax returns.

The treatment stream for this campaign will involve soft-letter outreach. If the companies do not take appropriate action, LB&I will conduct examinations to determine the correct tax liability. The goal is to increase voluntary compliance from foreign corporations with a U.S. business nexus. For companies that have neither a permanent establishment nor a subsidiary in the U.S., the opportunity to conduct an examination seems to be limited.

- Inbound Distributor Campaign

This campaign will aid revenue agents as they examine U.S. distributors of goods sourced from foreign-related parties. In many cases, the U.S. taxpayer would be entitled to higher returns in arm's length transactions, and LB&I will review the losses and (small) profits reported, compared to the functions performed and risks assumed, by using Code §482.

The treatment stream for this campaign will be issue-based examinations.

As each of the campaigns was assigned its own Practice Area, it is yet to be seen how the different Practice Areas will interact with one another, especially with regards to taxpayers with activities involving multiple Practice Areas and campaigns.

CONCLUSION

As LB&I moves toward issue-based examinations, LB&I will be able to decide which tax issues present a risk that requires a campaign while maintaining flexibility on the best steps to achieve compliance. As of today, no related practice unit has been published following the announcement, however, as LB&I begins implementation of the campaigns, certain practice units will likely be published to assist taxpayers (especially those who have identified any of the issues described above as applicable to them) in evaluating and preparing for the anticipated audit process.