

# IRS Audits and Appeals

Tax Executives Institute

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## IRS Mission: Then

- **MISSION CIRCA 2000:** “Provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.”

Translation: “We’re your friend, not those bad guys you saw in the hearings.”

## ... And Now

- **2004 Operating Premise:**

**“Service + Enforcement = Compliance”**

**Translation: “. . . the agency’s motto could be:  
We’re your friend. But if you push that  
friendship too far, we’ll ruin your life and then  
throw you in jail.” – *Christopher Bergin***

# IRS Audits and Appeals

- **How the process is changing**
- **How to approach an audit and appeal**

# IRS Enforcement Priorities

- **Combat abusive tax shelters, both for corporations and high-income individuals**
- **Assure that attorneys, accountants and other tax professionals adhere to professional standards and follow the law**
- **Detect and deter domestic and off-shore based criminal tax activity and related financial criminal activity**
- **Discourage and deter noncompliance within tax exempt and government entities, and misuse of such entities by third parties for tax avoidance purposes**

# “Coming Revolution” in LMSB Exams

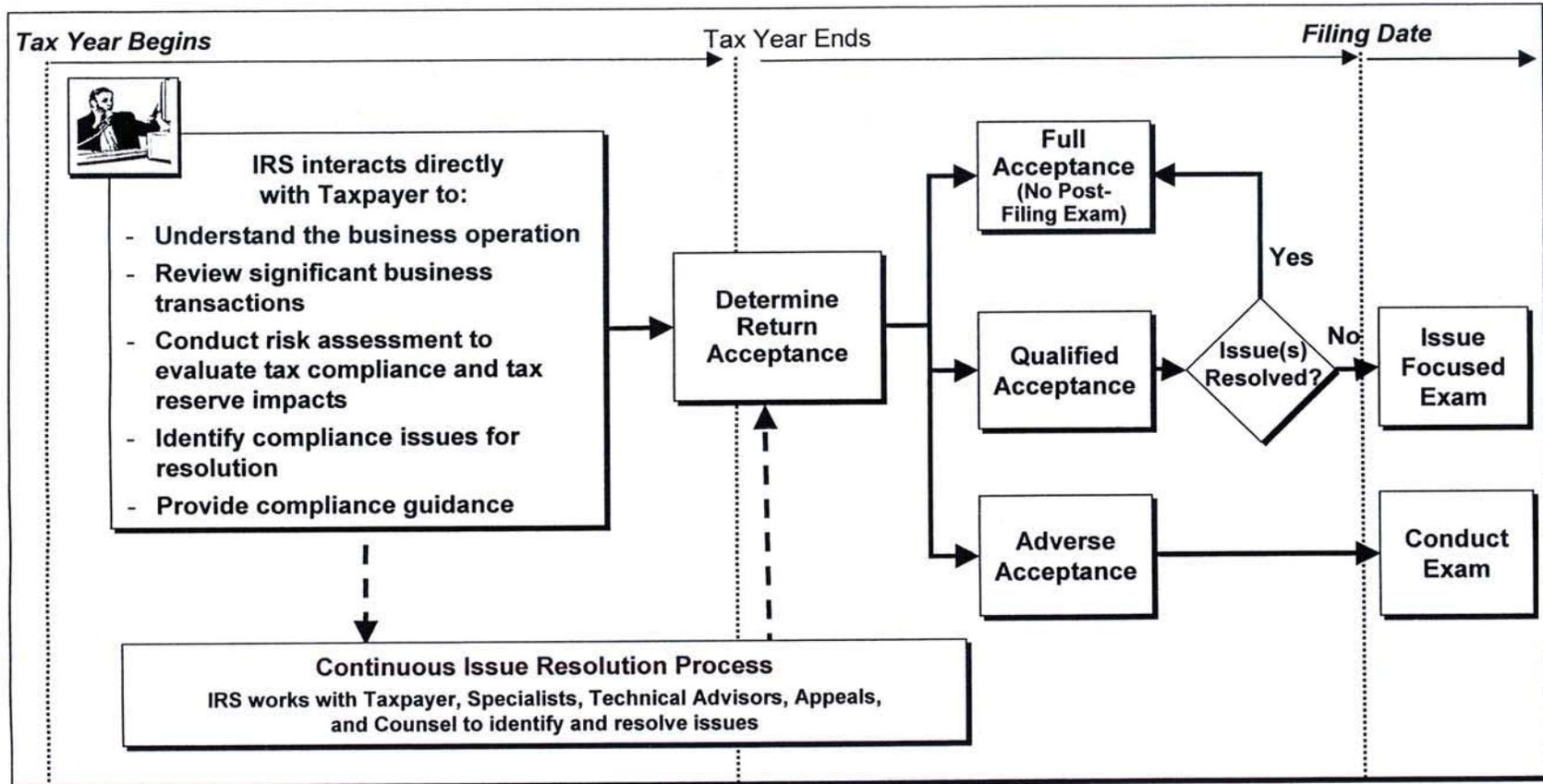
(Jan. 2006 speech by IRS Chief Counsel Donald Korb)

- **Schedule M-3**
  - ▶ More transparency
- **Corporate e-filing**
  - ▶ Speedier exams
  - ▶ Increased ability to analyze data
- **Compliance Assurance Process**
  - ▶ Real-time audits

# Compliance Assurance Process

- Identify issues and material transactions as they arise
- Continuous issue resolution
- May avoid or limit need for post-filing exam
- Fewer resources required to review contemporaneously (when records and personnel are readily available) than to reconstruct after the fact
- Pilot program in 2005 with 17 taxpayers (selected as leaders in their industries and interested in improving tax administration)

# Key CAP Components Are Real-Time Taxpayer Interaction With Issue Identification and Resolution



LMSB

Thompson & Knight  
ATTORNEYS AND COUNSELORS



# IRS Audits and Appeals

- How the process is changing

→ How to approach an audit and appeal

## Audit Starts: Questions to Ask

- What part(s) of IRS are involved in this audit?
- Why is this audit being conducted?
- Is this audit part of special audit program?
- Do we have basis for objecting to this audit?
- Where and when will this audit be conducted?
- How long will this audit take?

## Audit Starts: Questions to Ask (Cont'd)

- **What problems or issues are expected during this audit?**
- **Where are data, documents, and people needed to support tax return?**
- **What issues or adjustments are likely?**
- **Should we disclose mistakes to IRS?**

# The Audit Process

- **Initial conference and ground rules for audit**
  - ▶ **Identify players and contact person for each side**
  - ▶ **Discuss scope, purpose and timetable for audit**
  - ▶ **Agree to rules for IRS access to facilities, copies, computer data and taxpayer**
  - ▶ **Agree to IDR process and responses**
  - ▶ **Discuss IRS third party contact policies**
  - ▶ **Discuss potential extensions of limitations**
  - ▶ **Address potential refund claims**

## The Audit Process *(cont'd)*

- **Responding to IRS requests during audit**
  - ▶ Taxpayer's responsibilities and risks
  - ▶ Practitioner's responsibilities and risks
  - ▶ Dealing with unclear, overbroad, or imprecise IDRs
- **Taxpayer interviews**
  - ▶ Recording interview
  - ▶ Taxpayer's rights at interview
  - ▶ IRS right to bypass representative

## The Audit Process *(cont'd)*

- **Third party contacts by IRS**
  - ▶ IRS right to contact third parties
  - ▶ Notice of IRS intent to contact third parties
  - ▶ List of IRS third party contacts
  - ▶ Exceptions to notice and list requirements
  - ▶ **Caution:** Practitioner contacts with third parties

# Penalties

- New penalty for failure to disclose reportable transactions, with restricted authority to abate
- Narrowing of reasonable cause/good faith exception for accuracy-related penalty
  - ▶ Requires disclosure; substantial authority; and that taxpayer reasonably believed more likely than not correct
  - ▶ For reasonable belief, can't rely on disqualified advisor or opinion, and must assume issue will be raised in audit and decided on merits
- IRS increasingly imposes penalties, regardless of "reasonable cause/good faith" evidence, even on bread and butter issues

# Appeals Function

- **Appeals Mission: 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 IRS.**
- **Appeals Independence (but subject to “coordinated issues” and “emerging issues”)**

## But If It Involves a Tax Shelter?

“For eligible persons that forgo resolving eligible transactions under this settlement initiative and take their issues to Appeals, Appeals will carefully consider both the issue merits and the penalty, but such persons should not expect to receive a better offer in Appeals than that offered under this settlement initiative and may in fact receive a less favorable outcome.”

Announcement 2005-80

# Risks of Appeals

- **New issues – Standards for raising**
  - ▶ **Must be “quite certain” IRS will prevail if litigated**
  - ▶ **Necessary facts for new issue are readily available**
  - ▶ **Amount of tax liability in new issue is material in absolute sense**
- **Reference back to Exam**
  - ▶ **New facts or arguments raised by Appeals**
  - ▶ **Likely if taxpayer presents new facts or arguments to Appeals**

## Benefits of Appeals

- Possible \$25,000 Tax Court penalty for unreasonable failure to pursue available administrative remedies – § 6673(a)(1)(C)
- Prerequisite to (i) recovery of attorney's fees and costs under § 7430(b)(1), and (ii) shifting burden of proof under § 7491
- Actual participation in or denial of request to participate in Appeals conference required

# Appeals Settlement Process

- **Written protest by taxpayer and Exam response**
- **Informal conference(s)**
- **Appeals relationship with Exam**
  - ▶ **Ex parte communications with Exam on substance prohibited**
  - ▶ **Exam (and IRS Counsel) may attend Appeals conference if Appeals consents**
  - ▶ **Appeals may refer case back to Exam if taxpayer presents new evidence**
  - ▶ **Appeals may share new evidence presented by taxpayer with Exam**

## Appeals Settlement Process *(cont'd)*

- Appeals rules of practice
  - ▶ Will determine correct amount of tax with “strict impartiality” between taxpayer and IRS
  - ▶ Will settle based on relative merits in light of hazards of litigation – No nuisance settlements
  - ▶ Will inform taxpayer of basis on which Appeals will settle, if taxpayer makes good faith offer to settle
  - ▶ Will offer taxpayer opportunity to meet with reviewer if reviewer disagrees with officer’s recommendation to accept taxpayer’s offer

# Words of Wisdom

**IRS motto:**

**“The unexamined life is not worth living.”  
– *Socrates***