



IRS Identifies High-Priority Enforcement Issues

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February 10, 2017

On January 31, 2017, the IRS's Large Business and International Division ("LB&I") announced the long-anticipated selection of its "first wave" of 13 "campaigns," or high-priority compliance projects. The announcement puts taxpayers on notice of specific compliance issues that LB&I is closely scrutinizing. The campaigns are issue-focused but affect a wide range of taxpayers, including U.S. individuals, partnerships and their partners, midsize U.S. corporations, and foreign corporations.

During 2016, LB&I reorganized into nine "practice areas" and updated its audit procedures. LB&I's overall strategy is to target system or industry-wide compliance issues using "campaigns" of "issue-focused" audits and other tools. A centralized LB&I governance board selects the campaigns. LB&I has previously provided little information on what campaigns they are working on. The rollout of the first 13 campaigns signals how LB&I will direct audit resources in the future.

One campaign ("Deferred Variable Annuity Reserves & Life Insurance Reserves IRR") is unique in that compliance is not its direct goal. Rather, LB&I will publish guidance to reduce uncertainty, and the frequency of disputes, for the life insurance industry.

The awkwardly-named "TEFRA Linkage Plan Strategy Campaign" is an internal LB&I project to optimize a process that has long plagued IRS enforcement against partnerships (especially large partnerships) and their partners assessing and collecting taxes and penalties against partners based on IRS adjustments to "partnership items" in audits under the TEFRA partnership audit procedures. The Bipartisan Budget Act of 2015 repealed and replaced the TEFRA procedures, generally effective for taxable years beginning on or after January 1, 2018. In the meantime, LB&I is increasing its audits of partnerships



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under TEFRA, followed by appropriate enforcement against partners.

Five of the announced campaigns target very specific transactions or return positions: they are titled "IRC 48C Energy Credit," "Micro-Captive Insurance," "Basket Transactions" (structured financial transactions in which a taxpayer attempts to defer and treat ordinary income and short-term capital gain as long-term capital gain), "Land Developers - Completed Contract Method," and "Domestic Production Activities Deduction, Multi-Channel Video Program Distributors (MVPD's) and TV Broadcasters."

The "OVDP [Offshore Voluntary Disclosure Program] Declines-Withdrawals Campaign" focuses on U.S. persons who submitted pre-clearance requests for the OVDP but were either denied access to, or withdrew from, the program. The OVDP is part of a larger, multi-year program focusing on offshore financial accounts and assets owned by U.S. persons. U.S. persons who maintain foreign financial accounts or assets are generally required to disclose their ownership of such assets and declare all related income annually. Various options are currently available to U.S. persons who have yet to resolve past-year non-compliance regarding their foreign financial assets.

The "S Corporation Losses Claimed in Excess of Basis Campaign" targets losses and deductions claimed by S corporation shareholders in excess of their basis in the corporation.

The "Repatriation Campaign" targets the vague category of "different repatriation structures being used for purposes of tax free repatriation of funds into the U.S. in the mid-market population." LB&I does not define "mid-market," and this campaign could have implications for repatriation techniques used by U.S. multinationals of all sizes. The "Related Party Transactions Campaign" also focuses on "mid-market" taxpayers, examining their level of compliance in transactions between commonly controlled entities whereby corporations transfer funds to or through related pass-through entities and shareholders.

The "Form 1120-F Non-Filer Campaign" is perhaps the broadest in scope, focusing on whether foreign companies doing business directly (and not through subsidiaries) in the United States are complying with obligations they may have to file a U.S. return on IRS Form 1120-F, if they have a U.S. trade or business or a permanent establishment in the U.S.

Finally, the "Inbound Distributor Campaign" is examining whether foreign producers are charging arm's-length transfer prices to their controlled U.S. distributors for goods sold in the United States. LB&I contends that those distributors have generally "incurred losses or small profits on U.S. returns, which are not commensurate with the functions performed and risks assumed."



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As LB&I no doubt intended, taxpayers should be cautious when planning transactions or taking return positions that implicate a campaign issue. Taxpayers with filed or unfiled federal tax returns that raise a campaign issue should prepare for heightened LB&I scrutiny, including by re-assessing their positions, ensuring that files are audit-ready, and preparing to articulate their positions early in any audit.

The campaign announcement leaves many questions about LB&I's latest approach unanswered. For example, how will LB&I handle an audit under a campaign differently from other audits? Will LB&I managers and Appeals officers take a harder line on campaign issues than on other issues? Is LB&I working on non-public campaigns, and what additional public campaigns are in the pipeline? Finally, what, if anything, do campaigns mean for the vast majority of issues that are not part of a campaign? For example, how will LB&I respond to complaints that an agent is wasting resources on an unproductive non-campaign issue?

Our attorneys have helped clients in multiple industries resolve LB&I audits involving a variety of tax issues. We have particular experience with the completed contract method, the domestic production activities deduction, the options for U.S. persons with undisclosed foreign accounts, the taxation of partnerships and S-corporations, and the U.S. tax issues of foreign corporations.

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