Current Trends and Traps in Federal Tax Controversies

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Planning to Avoid the Controversy
Planning to Avoid the Controversy

• Compliance
• Solid Legal and Factual Foundation
• Prepare and Maintain Documents and Other Records
• Pay Attention to/Manage Examination
• Utilize Available Alternative Dispute Resolution Techniques
• Utilize Other Available Tools/Techniques Where Appropriate
Privileges – Attorney Client/Work Product/§7525
• Attorney-Client Privilege

• Attorney Work Product Doctrine

• “Accountant-Client” Privilege (§7525)
Attorney-Client Privilege

Policy:

Encourage clients to consult their lawyers in order to comply with the law.
Attorney-Client Privilege

Elements:

1. Confidential communication;
2. Between a lawyer and his/her/its client;
3. For the purpose of securing legal advice;
4. The privilege is claimed; and
5. The privilege is not waived.
Statement of the Rule: “The [attorney-client] privilege applies only if (1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate, and (b) is acting as a lawyer in connection with the communication; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion of law or (ii) legal services or (iii) assistance in some legal proceeding, and (d) not for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.” U.S. v. United Shoe Mach. Corp., 89 F. Supp. 357, 358-359 (D. Mass. 1950).
Attorney-Client Privilege -- “Kovel”

Issues

- *U.S. v. Kovel*, 296 F.2d 918 (2d Cir. 1961). Communications made by client to an accountant hired by the law firm to assist the law firm in giving legal advice were held to be privileged.
“[w]hat is vital to the [attorney-client] privilege is that the communications be made in confidence for the purpose of obtaining legal advice from the lawyer. If what is sought is not legal advice but only accounting service. . . or if the advice sought is the accountant’s rather than the lawyer’s, no privilege exists.”
Attorney-Client Privilege--Additional Rules

1. Privilege belongs to the client
2. Strictly construed against the claimant
3. Burden of establishing existence of privilege is on claimant-

   “A claim of privilege must be supported by a statement of particulars sufficient to enable the court to assess its validity. . . . In the case of a document, such a statement should specify the privilege relied on and include the date, title, description, subject and purpose of the document; the name and position of the author and the addresses of other recipients.”
Attorney Work Product Doctrine

Policy:

Zone of privacy in adversary system that allows an attorney to prepare a defense without intrusion by the opposing counsel.
Attorney Work Product Doctrine

Elements:

1. Materials prepared by or for a party
2. In anticipation of litigation
“Accountant-Client” Privilege-- I.R.C. § 7525

“Extends” Attorney-Client Privilege to Accountants and Others Authorized to Practice Before the IRS Who Provide “Tax Advice”
“Accountant-Client” Privilege—
I.R.C. § 7525

• § 7525(a)(1)—

• “GENERAL RULE.—With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.”

• BUT . . . .
“Accountant-Client” Privilege--
I.R.C. § 7525

BUT: The Privilege is Limited:

• May only be asserted in:
  – any noncriminal tax matter before the IRS; and
  – any noncriminal tax proceeding in Federal court brought by or against the U.S.

• Does Not Apply to Written Communications Promoting Tax Shelters

• Does Not Apply to “Work Product”
“Accountant-Client” Privilege--
I.R.C. § 7525

- “Federally Authorized Tax Practitioner”--an individual authorized under Federal law to practice before the IRS if such practice is subject to regulation under § 330 of Title 31, U.S. Code. I.R.C. § 7525(a)(3)(A).

- “Tax Advice”... “means advice given by an individual with respect to a matter which is within the scope of the individual’s authority to practice described in” I.R.C. § 7525(a)(3)(A). I.R.C. § 7525(a)(3)(B).
“Accountant-Client” Privilege--
I.R.C. § 7525

• “Tax Shelter”--Defined as
  — a partnership or other entity,
  — any investment plan or arrangement, or
  — any other plan or arrangement.
  — If a significant purpose of such partnership, entity, plan or arrangement is the avoidance or evasion of Federal income tax
  — I.R.C. §§ 7525(b) and 6662(d)(2)(C)(ii).
Attorney-Client Privilege
Attorney Work Product Doctrine
“Accountant-Client” Privilege

Strategic Issues:

- Privilege claim increases likelihood of conflict with IRS
- Subject matter waiver
- Cost
  - Setting up
  - Maintaining
  - Asserting
“In Anticipation of Litigation”
Tax Accrual/UTP Workpapers – Authorities

• Split in Circuits
  – Majority of circuits permit work product privilege if, considering the document and the factual situation, document prepared “because of” prospect of litigation. *See, e.g., Adlman*, 134 F.3d 1194 (2d Cir. 1998)
  – Fifth Circuit adopts narrow standard whether “primary motivating purpose” behind creating document was to aid future possible litigation. *See, e.g., El Paso Co.*, 682 F.2d 530 (5th Cir. 1982)
“In Anticipation of Litigation”
Tax Accrual/UTP Workpapers – Authorities

• **Regions Financial Corp.**, 101 A.F.T.R.2d 2008-2179 (N.D. Ala. 2008) (three outside legal tax opinions plus other documents that discussed and explained the opinions were prepared in anticipation of litigation and thus were protected by the work product doctrine)

• **Textron**, 577 F.3d 21 (1st Cir. 2009) (TAWs not protected by the work product doctrine because prepared for financial statement purposes rather than for litigation)

• **Deloitte LLP**, 610 F.3d 129 (D.C. Cir. 2010) (work product protection applied to memorandum of taxpayer’s in-house attorney’s analyzing tax issues and tax opinion prepared by the taxpayer’s outside counsel)
“In Anticipation of Litigation”
Tax Accrual/UTP Workpapers – Authorities

• *Wells Fargo*, 2013 TNT 110-21 (D. Minn. 6/4/13)
  – IRS requested taxpayer’s 2007/2008 tax year TAWs and uncertain tax position workpapers
  – **Work product privilege applied to:**
    1. FIN 48 MLTN analysis
    2. measurement of largest amount of tax benefit exceeding 50% likely to be realized
    3. qualification of monetary amount of taxpayer’s reserve
    4. information regarding FIN 48 “units of account”
    5. other materials containing legal analysis
“In Anticipation of Litigation”
Tax Accrual/UTP Workpapers – Authorities

- **Wells Fargo** (cont.), No privilege for:
  1. identification of uncertain tax position
  2. historical facts and transactions associated with uncertain tax positions
  3. process of identifying uncertain tax position
  4. uncertain tax position opinions/materials prepared by taxpayer’s accounting firm, unless incorporates legal analysis of taxpayer’s attorneys
“In Anticipation of Litigation”
Tax Accrual/UTP Workpapers – Authorities

- **IRS Ann. 2010-76, 2010-41 I.R.B. 432** – policy of restraint applies to UTP workpapers disclosed to an outside auditor
Schedule UTP

• **Schedule UTP**: Corporate taxpayers’ disclosure of uncertain FIN 48 tax positions

• **Application**
  – 2012 tax returns - assets ≥ $50 million ($10 million starting in 2014).
  – audited financial statements that reflects FIN 48 reserve
  – not applicable to partnerships, LLCs and S corporations
Schedule UTP

- **Disclosure**: For each tax position:
  - identify primary Code sections involved (up to three)
  - whether temporary or permanent timing difference, or both
  - Ranking of the tax positions (based on size of tax reserve)
  - Concise description of tax position, including reasonably apprising IRS of the identity of position and nature of issue.
Schedule UTP

Exempt Information: No disclosure of --

• rationale for reserving for an uncertain tax position
• assessment of the hazards of a tax position
• analysis of the support for or against the tax position
IRS Case Development – Sources of Information/Case Development Tools
Type of Requests for Information by the IRS Examiner

• **Required Filings and Documentation**
• **Information Document Requests (“IDRs”)**
  – New IDR Procedures
• **Summons**
  – Summons to Taxpayer, § 7602
  – Summons to 3rd Party Recordkeepers, § 7609(a)
  – Designated Summons, § 6503(j)
  – § 6038A Summons, § 6038A(e)(2)(A)
  – John Doe Summons, § 7609(f)
• **Formal Document Requests, § 982**
• **Interviews, § 7602(a) and (c)**
• **Treaty Requests**
  – Specific Requests
  – Spontaneous Exchanges
  – Simultaneous Examination Programs
  – Industry-wide Exchanges
• **Other**
The IRS Examination – What will the IRS Examiner request?

- Books and records
- Plant Tour
- Personnel Interviews
- Tax Accrual Workpapers
- The Tax Shelter IDR
- Request for Transfer Pricing Documentation
  - New Roadmap for Transfer Pricing Audits
- Other
Administrative Resolution

- Letter Rulings
- Pre-Filing Agreements
- Exam Settlements
  - Traditional Exam Settlements
  - Deleg. Order No. 236 Settlements
  - Accelerated Issue Resolution
  - Deleg. Order 247 Settlements
  - Pre-Filing Agreements for LB&I Taxpayers
- APAs (Unilateral, Bilateral, & Other)
- Comprehensive Case Resolution Pilot Program
- Industry Issue Resolution Program
- Compliance Assurance Program
Administrative Resolution

- Competent Authority Consideration
  - Accelerated Competent Authority Consideration
  - Simultaneous Competent Authority/Appeals Consideration
  - Competent Authority Consideration Post-Appeals
  - Arbitration

- Technical Advice Procedures
- Field Service Advice Procedures
Preparing a Case for IRS Appeals/Post Appeals Mediation
IRS APPEALS

• Traditional Protest
• Early Referral to Appeals
• Consideration after Tax Court Petition
• Simultaneous Appeals and Competent Authority Consideration
• Mediation
• Arbitration Procedure
• Mutually Accelerated Appeals Process
The Decision to Litigate
Litigation

- U.S. Tax Court
- U.S. District Court
- U.S. Court of Federal Claims
- U.S. Bankruptcy Court
Litigation

- Some Factors--
  - Payment of Taxes
  - Claims for Increased Deficiencies
  - Applicable Precedent
  - Applicable Discovery Rules
  - Availability of Jury Trial
  - Opposing Counsel, Management & Settlement Procedures
  - Nature of Cases Heard
  - Other, e.g., Place of Trial, Service of Process, Case Load, etc.
IRS Statutes of Limitation for Assessment
IRS Statutes of Limitation

1. General limitation on assessment is 3 years from the date a return is filed. § 6501.

2. Exceptions:
   a. 6 year – substantial omissions. § 6501(e).
   b. Unlimited
      b. Failure to file returns.
      c. Fraud or willful attempt to evade taxes.
Claims for Refund/Refund Litigation
Claims for Refund

1. Timely filed claim for refund
   a. 3-year look-back – if the taxpayer filed a return, the refund amount is limited to the tax paid within three years before the taxpayer filed the claim, plus any extensions for filing the tax return. §6511(b)(2)(A).
   b. 2-year look-back – if the taxpayer filed a return, but files a refund claim more than 3 years after the return was filed, or if the taxpayer did not file a return, the amount of the refund is limited to the tax paid within two years before the taxpayer filed the claim. §6511(b)(2)(B).
Claims for Refund

1. Broad claim – variance rule
   a. Refund claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof. Treas. Reg. § 301.6402-2(b)(1).
   b. Courts do not have jurisdiction if the complaint sets forth a ground for refund that was not included in the claim for refund.
Claims for Refund

2. Informal claims
   a. Generally, a claim for refund should be on the proper form.
   b. However, courts have long recognized the “informal claims doctrine” whereby a claim is treated as timely if:
      1) Has a written component,
      2) Describes the legal and factual basis for the refund,
      3) Apprises the IRS that the taxpayer is asserting a right to a refund, and
      4) Is perfected by the filing of a formal claim for refund after the expiration of the statute of limitations, but before the IRS denies the claim.
9100 Relief in Midst of IRS Examination
Section 9100 Relief

• Extension of time to file late regulatory elections
• Examples: (i) S corporation election, and (ii) check the box election.
• Request ruling from IRS National Office under Reg. §301.9100 (streamlined procedures exist for certain elections)
• Includes relief from due dates in regulations, revenue ruling, revenue procedures, etc. (excludes statutory elections).
• Establish taxpayer acted reasonably / in good faith, and relief won’t prejudice government’s interest
  • reasonable reliance on tax professional regarding the election (affidavit)
Section 9100 Relief Continued

- other acceptable reasons for missed election (e.g., reliance on written IRS advice)

- **Available in midst of an IRS exam.** Reg. §301.9100-3(b)(1)(i) deems taxpayer to act reasonably if relief is requested before discovery by the IRS. But, under certain circumstances, relief is available after an IRS exam has commenced.
IRS Collection Issues
IRS Collection Issues
Notices of Federal Tax Lien and Levy

1. Tax lien – government’s claim or charge on a taxpayer’s property for the payment of a tax debt.

2. If taxpayer fails to pay an assessed tax after a notice and demand by the IRS, the amount of tax and any additions “shall be a lien” on all the taxpayer’s property. IRC § 6321.

3. IRS often records tax liens with the state or county in which property is located, or may not record the liens if the filing of the lien adversely affects the taxpayer’s ability to pay.
Mitigating the Consequences of a Lien

1. Avoiding a lien – Revenue officers and collections personnel have wide discretion in handling collection matters, including the filing of notices of federal tax lien (“NFTL”).

2. Lien subordination – Form 14134, Application for Certificate of Subordination of Federal Tax Lien

   IRS will subordinate its lien with respect to certain property, where:
   
   a. the U.S. will receive an amount equal to the lien or interest to which the certificate of subordination is issued; or
   
   b. the issuance of the certificate of subordination will increase the government’s interest and make collection of the tax liability easier.

3. Administrative appeal of filing of NFTL where there was an error in filing – not used to challenge underlying assessment. § 6326.
Lien Release and Withdrawal

Lien Release - § 6325

1. Liability satisfied

2. Liability unenforceable - as a matter of law, e.g., barred by the statute of limitations

3. Acceptable bond guaranteeing the payment of the amount assessed, including interest.

4. Immediate release
Lien Release and Withdrawal

Lien Withdrawal – IRS “Fresh Start Program”

1. Form 12277, Application for the Withdrawal of Filed Form 668(Y), Notice of Federal Tax Lien

2. Eligible for “Fresh Start Program” if
   a. Tax liability has been satisfied and lien has been released
   b. In compliance for the past three years in filing:
      i. All individual and business returns
      ii. All information returns
      iii. Current on estimated tax payments and federal tax deposits, as applicable.

3. After entering into a direct debit installment agreement – available only for tax liabilities of $25,000 or less.
Collection Due Process or Equivalent Hearing

CDP Hearing - §§ 6320, 6330

1. When available?
   a. Must be requested in writing during the 30-day period after taxpayer receives final notice of intent to levy or the filing of an NFTL.
   b. Form 12153, Request for a Collection Due Process or Equivalent Hearing

2. What can you request
   a. Installment payment or other collection alternatives – IRS will usually still attach a lien.
   b. Waive penalties
   c. Substantive reason why no tax is not owed

Equivalent Hearing

1. Taxpayer fails to make timely request for CDP hearing.
2. Generally follows procedures for CDP hearing, but Appeals will issue a decision letter rather than notice of determination.
3. Appeals will consider same issues as in a CDP hearing.
4. No statute suspension, no retained jurisdiction, no suspension of collection action, and taxpayer generally does not have the right to seek judicial review of Appeal’s decision.

Balance Sheets/Financial Information

Form 433A – Collection Information Statement for Wage Earners and Self-Employed Individuals

Form 433B – Collection Information Statement for Businesses
Offer in Compromise

1. Settles tax liability for less than the full amount. § 7122.
2. Only for cases not referred to DOJ for prosecution or defense.
3. Legal opinion must be obtained from Chief Counsel, except where amount of assessed tax is less than $50,000.
4. Grounds for compromise are listed in § 301.7122-1(b).
   1) Doubt as to liability – demonstrated genuine dispute about tax liability.
   2) Doubt as to collectability – taxpayer’s assets and income are less than the liability.
   3) Promotion of effective administration – collection of full amount would cause taxpayer “economic hardship” – e.g., where taxpayer is unable to earn living because of long-term illness or disability
   4) Or, if compelling public policy or equity considerations provide sufficient basis to compromise liability.
Collection Appeals Program

1. Taxpayer has right to appeal an NFTL, levy or seizure of property, or proposed denials or terminations of installment agreements.

2. Form 9423, Collection Appeal Request

3. Delays collection activity until appeal settled, unless IRS has reason to believe collection is in jeopardy.

4. Available both before and after lien or levy is imposed.

5. Appeal’s decision is binding and is not subject to judicial review.

6. IRS will not consider trust fund recovery penalties, offers in compromise, or other penalty appeals under CAP procedures.
The Criminal Tax Investigation
Examples of Criminal Violations Investigated by IRS

Title 26

§ 7201 – Income Tax Evasion

§ 7202 – Willful Failure to Collect or Pay Over Tax

§ 7203 – Willful Failure to File Return, Supply Information, or Pay Tax

§ 7204 – Fraudulent Statement or Failure to Make Statement to Employees

§ 7205 – Fraudulent W/H Exemption Certificate or Failure to Supply Information

§ 7206 – Fraud and False Statements

§ 7202 – Fraudulent Returns, Statements or Other Documents

§ 7210 – Failure to Obey Summons

§ 7212 – Attempts to Interfere with Administration of Internal Revenue Laws
Examples of Criminal Violations Investigated by IRS

Title 18
§ 2 – Aiding and Abetting
§ 371 – Conspiracy
§ 1001 – False Statement
§ 1956 – Money Laundering

Title 31
§ 5321 – Willful Failure to File Foreign Bank Account Report

See IRM 9.1.3 and following.
Willfulness

Government must prove willfulness beyond a reasonable doubt, i.e., that the defendant committed the act or failed to act and that such commission or failure was the result of an intentional violation of a known legal duty.

Statutes of Limitation

26 U.S.C. § 6532 – Generally 6 year statute of limitations for felonies and failure to file returns and 3 years for most tax misdemeanors

18 U.S.C. § 3232(a) – 5 years

Tolling Provisions (E.g., filing of an information or indictment; defendant outside the United States; I.R.C. § 7609(e); formal request for foreign evidence outstanding and court orders suspension)

Refreshing Events (E.g., overt act in case of tax evasion; overt act in furtherance of a conspiracy)
The Criminal Tax Investigation

• Usually investigated by IRS Special Agents
• May involve use of grand jury
• May follow start of civil investigation (usually not casually commenced)

Methods of Proof
• U.S. has burden of proof (proof beyond a reasonable doubt)
• Taxpayer and return preparer statements can be very significant
• Privileges may be very important

Sentencing Guidelines
• Penalties/asset seizures
• Voluntary disclosure as remedial measure
Voluntary Disclosure Program
Voluntary Disclosure Program

General Information

• Internal Revenue Manual ("IRM")
  – Part IX -- IRM 9.5.3.3.1.2.1
  – Chief Counsel’s Directives Manual ("CCDM") -- IRM 31.3.3.1

• U.S. Department of Justice ("DOJ")

Foreign Bank Accounts

Circular 230 and Return Preparer Penalty Issues
Circular 230

1. Circular 230
   a. US Treasury rules regulating tax practice before IRS
   b. Prohibits bad conduct (giving tax advice or signing returns based on unreasonable assumptions, ignoring facts or tax rules, etc.)

2. §10.33: Best Practices for Tax Advisors –
   a. Provide highest quality representation re: Federal tax issues
   b. Aspirational only; no sanctions

3. §10.34: Federal Tax Return Advice Regarding Tax Position – Requires Advisor to
   a. Support return position either by (i) “substantial authority” or (ii) disclosure and a “reasonable basis”
b. Inform taxpayer of likely penalties

c. Inform taxpayer of possible return disclosure to avoid penalties

4. §10.35: Covered Opinion Advice –

a. Applicable Practitioners. Applies to CPA, attorneys, and others

b. Reliance Opinion. Written advice (including email) regarding a federal tax issues:
   i. from transaction having a significant purpose of avoiding federal tax, and
   ii. advice concludes at “more likely than not” or greater comfort level
Circular 230 Continued

c. **Exclusions**
   i. oral
   ii. not significant tax issue
   iii. conclusion below more likely than not

d. **Covered opinion requirements**
   i. full blown due diligence opinion requirements,
   ii. limited scope opinions permitted, or
   iii. disclaimer of penalty reliance avoids opinion requirements

5. **§10.52: Sanctions**
   a. Sanctions imposed if practitioner:
Circular 230 Continued

i. willfully violates Circular 230 (other than 10.33)
ii. violates § 10.34 or § 10.35 by recklessness or gross incompetence

b. Sanctions
i. suspension or disbar from tax practice before IRS
ii. monetary penalties
Circular 230 Continued

6. September 2012 Proposed Regulations
   a. Eliminate § 10.35 covered opinion rules
   b. Subject written tax advice to new streamlined § 10.37
   c. Eliminate Circular 230 disclaimers on emails and other writings
   d. Other changes
Return Preparer Penalties

1. **IRC § 6694** Imposes penalties on “tax return preparers” for understatements from “unreasonable positions”
   a. applies to income, estate, gift, excise, and employment tax returns

2. **Exceptions**
   a. position adequately disclosed and supported by reasonable basis, or
   b. reasonable cause exists and preparer acted in good faith

3. **Tax Return Preparer (IRC § 7701(a)(36))** One who:
   a. prepares (or employs other to preparer) for compensation any return or refund claim, or
Return Preparer Penalties - Continued

b. prepares substantial portion of a return or refund claim

4. Penalty (Excluding Willful or Reckless Conduct)
   a. greater of (a) $1,000 or (b) 50% of the income derived from preparation of return
   b. harsher penalties for willful behavior

5. Adequate Disclosure of Tax Position
   a. Signing Preparers
      • return disclosure
Return Preparer Penalties - Continued

b. Non-signing Preparers
   • inform taxpayer of possible return disclosure to avoid penalties
   • contemporaneously document advice in preparer’s files
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