

IRS Hot Topics

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New Compliance Assurance Process procedures promote tax certainty

The Internal Revenue Service (IRS) recently announced new procedures for the Compliance Assurance Process (CAP) program for taxpayers who are interested in obtaining tax certainty prior to filing their federal tax returns. The CAP program now consists of three phases: Pre-CAP, CAP and "Compliance Maintenance."

Participants in the program are able to achieve tax certainty sooner and with less administrative burden than in the traditional post-filing examination process. The program requires a contemporaneous exchange of information related to proposed tax return positions and to completed events and transactions that could affect federal tax liability. The latest IRS statistics show that 159 taxpayers have participated in the CAP program during the year ending September 30, 2012, an increase over the 140 taxpayers that participated in the CAP program in the year ended September

30, 2011. Also, as of December 30, 2011, 20 taxpayers were participating in the Pre-CAP phase of the program.

Background

The IRS initiated the CAP program in 2005 as a pilot program for large business return filers. The CAP program is structured to conduct real-time compliance reviews to establish the correct tax treatment of tax return positions prior to the filing of a federal tax return. The program began with 17 taxpayers. During the piloting phase, the IRS conducted reviews of the CAP cases to assess the operational effectiveness of the program. The result was to make the CAP program permanent for taxable years beginning after December 31, 2011.



The three phases of the program

In the Pre-CAP phase, taxpayers work with the IRS to become current in the examination of their returns. This means that the IRS works with the taxpayer in the traditional post-filing examination process to close the open tax years within an agreed upon timeframe. These open years are known as the transition years. [NOTE: Taxpayers that do not have open years under examination may bypass the Pre-CAP phase and apply directly to CAP. However, this does not preclude the IRS from examining the open years.]

To be eligible, the taxpayer must have assets of \$10 million or more, be a publicly held entity with SEC filing requirements and not be under investigation or in litigation with the IRS. An application is filed, and, upon approval, a "Memorandum of Understanding" (MOU) is signed that outlines the program requirements and serves as an agreement between the parties to meet those requirements.

In the CAP phase, participating taxpayers work collaboratively with the IRS to identify and resolve potential tax issues before the return is filed. Taxpayers must meet the same eligibility requirements from the Pre-CAP phase. In addition, if the taxpayer is currently under examination by the IRS, two additional requirements must be met. First, no more than one tax year can currently be under IRS examination. Second, the taxpayer must have filed all required tax returns; an exception is made only for

a tax year that has ended but for which the due date of the return has not yet passed.

An application must be filed between September 1 and October 31 of the year immediately preceding the CAP year. If approved, an MOU must be executed before January 31 of the CAP year. As in Pre-CAP, the MOU outlines the requirements and serves as an agreement between the parties to meet the requirements.

Once a taxpayer is accepted into the program, the IRS will assign an "Account Coordinator" who acts as the IRS point of contact. Other team members will be assigned as needed. As the taxpayer completes material and significant business transactions, it discloses its tax position regarding those transactions to the IRS. The IRS may issue Information Document Requests that require a review of documentation. After the IRS and the taxpayer are in agreement on an issue, the IRS will draft an Issue Resolution Agreement (IRA). At the conclusion of the pre-filing stage of CAP, the Account Coordinator may incorporate all of the agreed IRAs in a Form 906 Closing Agreement. If all issues are resolved, the IRS will issue a "Full Acceptance" letter.

After the return is filed, the IRS will perform a post-filing review. If all disclosures were made in accordance with the MOU, the IRS will issue a "No Change" letter. If any unresolved issues remain, the IRS will issue a "Partial Acceptance" letter and commence a traditional audit of those unresolved issues. Taxpayers will still retain access to consideration by the Office of Appeals.

Taxpayers that continually meet the CAP eligibility requirements and expectations may progress to the Compliance Maintenance phase. In this phase, the taxpayer will continue to disclose material items that will impact its federal tax liability. However, the IRS may reduce the level of review for these transactions. The IRS may move the taxpayer back and forth between the CAP phase and the Compliance Maintenance phase depending upon the complexity and volume of transactions.

PwC observations

In recent years, the IRS has assigned more of its resources to work with taxpayers in a pre-filing environment. The CAP program provides many benefits, such as tax certainty before a return is filed, the retention of all appeal rights for issues that are not resolved in the pre-filing phase and a closing agreement for the resolved issues that can prevent the reopening of those same issues in the future.

We believe the CAP program may not be appropriate for all clients; however, clients who are regularly audited by the IRS should be aware of this program.

There are several factors that should be considered before entering any of the CAP related programs, such as:

- Does the taxpayer have the resources to address shortened turnaround times?
- What issues are in the prior cycles, current cycles or future cycles?
- Are there any extensive time expenditure issues, such as a new transfer pricing

transaction, and what post-CAP period impact might those issues have?

- Would any uncertain IRS tax issues benefit from an early IRS determination?
- Has the taxpayer been examined on a consistent basis?
- Has the taxpayer increased its IRS audit exposure through an expansion of operations, and does it therefore expect to be under IRS scrutiny in the near future?
- Are potential issues recurring in subsequent years or is the issue a one-time issue?

In conclusion, taxpayers need to do their own risk assessment and make an informed decision before entering these programs.

Participating in the CAP program does not mean taxpayers relinquish their rights to take exception to issues raised by the examination team or to push back when they feel the document requests are not focused. They should not be reluctant to raise issues with the case manager, territory manager or Director of Field Operations if they believe the audit team is being unreasonable or difficult to work with. Again, full Appeals rights for unsettled issues are retained.

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