
'Tis the season to obtain certainty

October 14, 2013

In brief

A pre-filing agreement (PFA) allows a taxpayer to obtain certainty on an issue before the filing of its return. Specifically, a PFA results in a closing agreement that precludes the Internal Revenue Service (IRS) from challenging the issue in any subsequent examination of the taxpayer's return.

The process is akin to having a Compliance Assurance Process (CAP) audit of a single issue (ie, the compressed time frame for entering into a PFA generally takes less than six months and eliminates protracted post-filing disputes). This allows taxpayers to conserve precious controversy resources and better manage their reserves and uncertain tax positions.

Most importantly, while once confined to straightforward, non-controversial subjects such as valuation disputes, the PFA process has recently been successfully used to resolve research and development (R&D), internal use software, medical device excise tax, and characterization of income issues before the positions are taken on a return.

Since the optimal time for requesting a PFA for a calendar year taxpayer is at the end of a filing year and the first two or three months following the close of the tax year, this is a good time to consider the use of a PFA for appropriate issues for calendar year 2013 tax returns.

In detail

The PFA process allows a taxpayer under the jurisdiction of the Large Business and International Division to request examination of specific issues relating to a tax return before the return is filed. The PFA process is outlined in Rev. Proc. 2009-14. The IRS will consider entering into a PFA for any issue that requires either a determination of facts or the application of well-established legal principles to known facts.

However, certain subjects, such as transfer pricing, certain changes in methods of

accounting or a tax year end, and issues involving penalties, tax shelters, litigation between a taxpayer and the IRS, and criminal sanctions, are not eligible for a PFA.

The objective of the PFA program is to resolve, before a return is filed, issues that are likely to be disputed in post-filing audits. If the taxpayer and the IRS are able to resolve these issues before the affected returns are filed, this revenue procedure authorizes the taxpayer and the IRS to execute a binding closing agreement with respect to the issues.

Key components of the PFA process are:

- There is a \$50,000 user fee.
- The IRS normally requires 30 days to consider a PFA application. If the application is accepted, the audit process can take four to six months.
- The IRS expects transparency and a resource commitment from the taxpayer.
- Either party may withdraw from the PFA any time prior to execution of the PFA agreement.

- The IRS will also consider entering into a PFA regarding a methodology to determine the appropriate amount of an item of income, allowance, deduction, or credit.
- holding a kick-off meeting with the IRS to discuss the timeline and any methodologies as well as addressing any areas of contention
- use of the PFA experience as a barometer for determining if CAP would be a productive use of client resources

Observations

Recent experience with the PFA process has demonstrated numerous advantages for clients. Due to the tight time constraints on both parties, the IRS has been persuaded to adopt time saving techniques that greatly reduce the difficulties associated with a normal IRS audit. For instance, the following techniques have proven very useful:

- weekly or biweekly meetings with the IRS team to discuss issues as they arise
- the use of closing agreements or memoranda of understanding to memorialize interim resolutions of issues
- allowing the IRS to participate in the selection and review of the areas under consideration (for instance review of employee surveys in an R&D study)
- fostering a positive relationship with the IRS team by engaging them in the development of the issue and encouraging them to be active participants in the process.

The takeaway

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Let's talk

For a deeper discussion of how this issue might affect your business, please contact one of the individuals listed below or a member of your local Tax Controversy and Regulatory Services practice:

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