

WNTS Insight



IRS makes CAP program permanent, available to more taxpayers

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The IRS Large Business & International (LB&I) Division has issued guidance to make permanent and expand the Compliance Assurance Process program (CAP). Under CAP, large corporate taxpayers work with the IRS to identify and resolve issues prior to the filing of the taxpayer's tax return. In making the program permanent, the IRS also has made more taxpayers eligible to participate in it. The new guidance also expands CAP to implement preparatory (Pre-CAP) and monitoring (CAP Maintenance) phases (IR-2011-32).

Background

Many LB&I taxpayers are under constant audit, and scarce resources may be devoted to examining returns that have little potential for adjustment. In 2005, the IRS announced the establishment of CAP as a pilot program to reduce taxpayer burden and uncertainty, while at the same time decreasing or eliminating post-filing review of returns by the IRS (Ann. 2005-87). The program has expanded over the past six years and currently has 140 participating taxpayers.

Operation of CAP

Under CAP, taxpayers and the IRS engage in a contemporaneous exchange of information about completed events and transactions that affect tax liability. This is expected to be an open dialogue in a collegial environment.

A taxpayer wishing to participate in CAP must apply for acceptance. If accepted, the taxpayer and the IRS enter into a Memorandum of Understanding (MOU) setting forth the parameters of participation. The MOU identifies the objectives of participation in CAP and addresses disclosure of information and methods of communication. It serves as a statement of the parties' commitment to act jointly in good faith to resolve material issues. Participation in CAP does not waive protection from disclosure as provided by Code section 6103, and good-faith claims to privilege may be asserted without the taxpayer being removed from the program.

The taxpayer's main contact with the IRS is the CAP Account Coordinator. The Account Coordinator becomes familiar with the

taxpayer's account history, the taxpayer's current business practices, and relevant business trends affecting the taxpayer's industry. The Account Coordinator also consults with other IRS personnel, including specialists and Appeals employees, and attorneys in the Office of Chief Counsel.

As taxpayers and the IRS progress through CAP, issues are resolved through "issue resolution agreements." Following the close of the tax year, these are incorporated into a closing agreement. The closing agreement may address some or all of the material issues with respect to a taxpayer's return. A taxpayer that files its return consistent with the resolution achieved through CAP receives assurance that the IRS will not examine the return after filing with respect to those issues.

The official signing the taxpayer's return must represent that all material issues have been disclosed to the IRS. This representation is subject to post-filing review to confirm the consistency of the return with the closing agreement. Any inconsistent or inadequately disclosed items will result in examination of those items. Issues that the taxpayer and the IRS are unable to resolve through CAP will be addressed by the IRS through traditional examination. A CAP taxpayer can exercise Appeals rights with respect to examined items.

Expansion of CAP

After six years working with CAP as a pilot program, the IRS has established CAP as a permanent program in LB&I. In a brief, internal memorandum issued to all LB&I employees on March 29, 2011, LB&I Commissioner Heather C. Maloy outlined the current CAP program and announced two new aspects to expand the scope of the program. The IRS subsequently issued provisions to be published in the Internal Revenue Manual and a set of Frequently Asked Questions that provide guidance on each phase of CAP and the criteria for participation.

Pre-CAP is intended to assist taxpayers in becoming eligible for participation in CAP. The IRS guidance explains that the IRS will work with taxpayers to resolve open examinations. It is expected that taxpayers in Pre-CAP will be as transparent and cooperative as required when participating in CAP itself. CAP Maintenance is intended for

taxpayers that have participated in CAP and have established a record of cooperation with the IRS. Depending on the complexity of issues that arise while a taxpayer is in CAP Maintenance, the IRS may, in its discretion, move the taxpayer back into CAP. More detailed descriptions of these extensions of the program are available on the revised CAP page at <http://www.irs.gov/businesses/corporations/article/0,,id=237774,00.html>.

The changes to the program are effective January 1, 2012, but taxpayers may apply for, and potentially be accepted into, the Pre-CAP phase in 2011.

Observations

The IRS decision to make the CAP program permanent, and simultaneously to expand it, should prompt taxpayers to assess whether their participation in the program would be beneficial. While CAP may offer certain benefits to taxpayers, they should consider all aspects of the program prior to making any decision.

One potential benefit to participation in CAP will be greater certainty regarding matters required to be reported on Schedule UTP, *Uncertain Tax Position Statement*. Taxpayers are not required to reveal the amount of reserves they have recorded with respect to any of their uncertain tax positions, but they must rank them based on the size of those reserves. For taxpayers concerned that the IRS will use this schedule as a roadmap during examinations, participation in CAP could allay those concerns by allowing taxpayers to work with the IRS to address such issues prior to filing their returns.

An additional benefit to taxpayers is the opportunity to become current in their audit cycles and close out old years. Once a taxpayer is accepted into CAP, the IRS is committed to currency. Furthermore, taxpayers that participate in CAP for a number of years may become eligible to move into CAP Maintenance. Those clients able to demonstrate to the IRS that they are responsible, compliant taxpayers then could reduce their interaction with the IRS.

Taxpayers also should consider the logistics of participation in CAP. This requires a strategic assessment of the benefits of participation against

the taxpayer's specific facts and circumstances. In this regard, a taxpayer's early years in the CAP program would require an investment in both systems and personnel. This requirement arises from the need to provide the IRS with real-time information and data on significant transactions prior to the taxpayer filing its return for the relevant year. While this is an investment that should spread over the years of the taxpayer's participation in CAP, it does have up-front costs.

Note that expanding CAP and opening it to increased participation could be accompanied by operational difficulties. While CAP was a pilot program, taxpayers in the program were specifically invited by the IRS to participate. Having moved CAP out of pilot status, the IRS will have to implement objective criteria for acceptance into the program and, depending on the number of taxpayers determined to be qualified, participation in CAP could increase very rapidly.

An increase in participation will require more LB&I personnel assigned to all phases of CAP; these employees will require training to become familiar with the program and its objectives. Given the current federal budget environment and potential cuts to the IRS budget, less experienced employees could be spread thin among accepted participants.

For more information on this WNTS Insight, please contact Kevin M. Brown at (202) 346-5051 or kevin.m.brown@us.pwc.com; Linda Stiff at (202) 312-7587 or linda.stiff@us.pwc.com; or Andrew Stroot at (202) 312-7615 or andrew.m.stroot@us.pwc.com.

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