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Internal Revenue Service
LB&I Commissioner, Douglas W. O'Donnell
Washington, D.C.

Submitted Electronically: lbi.lcc.program@irs.gov

Dear Commissioner O'Donnell:

On August 19, 2020 the IRS Large Business and International Division requested comments from large corporate taxpayers currently utilizing the procedures under Revenue Procedure 94-69 to disclose changes in tax positions after the opening of an examination. KPMG LLP respectfully offers the following comments based on our experience with the revenue procedure.

Background

On August 19, 2020, the IRS Large Business and International Division (LB&I) announced that it was considering "obsoleting" Revenue Procedure 94-69, which provides certain large taxpayers the ability to avoid potential penalties by making disclosures after the filing of an original return. The IRS announcement explains:

> Revenue Procedure 94-69 provides special procedures for taxpayers that are subject to the (former) Coordinated Examination Program ("CEP")[1] to show additional tax due or make disclosures to avoid the imposition of accuracy-related penalties for negligence, disregard of rules or regulations, or substantial understatement of income tax under IRC sections 6662(b)(1) and (b)(2). In general, in lieu of filing a qualified amended return as defined in Treasury Regulations section 1.6664-2(c)(3), the procedure allows taxpayers to avoid the accuracy-related penalty to the extent that adjustments resulting in additional tax are reported, or a position contrary to a rule is adequately disclosed, in a written statement within a 15-day window beginning with the IRS's first written information request.

Given certain organizational changes in LB&I since Revenue Procedure 94-69 was issued,[2] including most recently the IRS's transition from return-based examinations to risk-assessed, issue-based examinations that form the basis of LB&I's compliance campaigns, the IRS solicited comments from stakeholders on the continuing suitability of the Revenue Procedure:

[1] Since the original issuance of the revenue procedure, the IRS large-case program has been restructured and renamed first the Coordinated Industry Case (CIC) program and then the Large Corporate Compliance (LCC) program.
[2] The predecessor of the revenue procedure was Rev Proc. 85-26, 1985-1 C.B. 580, which was issued following the enactment of the substantial understatement penalty as part of the Tax Equity and Fiscal Responsibility Act of 1982.

Revenue Procedure 94-69, which is available to a small group of large corporate taxpayers, creates a disparity among the LB&I filing population, as well as the broader IRS filing population who must use the qualified amended return process. It also does not support the broader tax administration effort to improve the accuracy and reliability of returns at the time of filing, a factor that is important to the successful administration of the new LCC. In addition, the LB&I Examination Process allows all taxpayers to submit informal claims for refunds to the exam team within 30 calendar days of the opening conference. See IRS Publication 5125 (PDF). Accordingly, the IRS is considering obsoleting Revenue Procedure 94-69.

Discussion

We suggest the IRS update, rather than obsolete, Revenue Procedure 94-69. Considering the salutary effect that the Revenue Procedure has on tax compliance by providing a mechanism to encourage self-correction of errors, the better approach is to expand the Revenue Procedure's application to a broader class of taxpayers. As the Service noted, as a formal matter Revenue Procedure 94-69 is available only to a specific group of large corporate taxpayers, creating a disparity among the LB&I filing population as well as the broader IRS filing population that must use the qualified amended return process. We also note that, regardless of the technical disparity, in practice experienced revenue agents apply the principles of Revenue Procedure 94-69 informally to various-sized taxpayers because doing so furthers IRS policies.[3]

The solution to the technical disparity, in our view, is to broaden the reach of the Revenue Procedure so that the guidance reflects and establishes consistent best practices across LB&I. The policies underlying the Revenue Procedure apply equally to the full range of large taxpayers that identify errors and seek to come forward voluntarily to correct them.

Below we set out the principles supporting Revenue Procedure 94-69, its predecessors, and any potential superseding guidance. We then note three significant developments in large-case tax administration since the 1990s. Finally, we offer substantive recommendations on any successor Revenue Procedure.

1. Guiding Principles

IRS penalty administration is founded on the principle that penalties exist to encourage voluntary compliance.[4] To make the most efficient and effective use of penalties, the Service designs, administers, and evaluates penalty programs to most efficiently encourage voluntary compliance.[5] Further, "[t]he Service commits to continue to develop, monitor, and revise programs to help taxpayers voluntarily comply with the law and avoid penalties."[6]

2. Developments in Large-Case Tax Administration

There have been three significant developments in large-case tax administration since the Revenue Procedure was last updated in 1994. First, generally accepted accounting principles and standards now demand more rigor, detail, and controls as large taxpayers account for income taxes. Second, business operations, while never simple, have become even more complex: the use of partnerships has increased, international transactions have become the norm and not the exception, and detailed data collection, reporting, and analysis that could not

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[3] *E.g.,* Policy Statement 4-40, Early Agreement Primary Objective, I.R.M. 1.2.1.5.16.
[4] P.L. 101-239, Revenue Reconciliation Act of 1989 (Title VII of the Omnibus Budget Reconciliation Act of 1989), Conference Report 101-386 at 661 (Nov. 21, 1989).
[5] Policy Statement 20-1, Penalties Are Used to Enhance Voluntary Compliance ¶ 2, IRM. 1.2.1.12.1.
[6] *Id.* ¶ 10.

have been contemplated in 1994 has become commonplace. Third, tax law and compliance obligations have become much more complicated—consider the volumes of new tax laws and guidance (formal, published, and informal) enacted, issued, and implemented by Congress, Treasury, and IRS, in the last generation.

This complexity is exemplified by the 2017 Tax Cuts and Jobs Act,[7] a law so complicated that LB&I recently announced that IRS will focus on learning how taxpayers have interpreted and implemented its provisions.[8] We respectfully submit that the IRS struggles with tax law complexity just as taxpayers do. One result is that much of the recent TCJA guidance issued by the IRS has been informal, *e.g.*, FAQs, which taxpayers cannot formally rely upon in determining their federal tax compliance obligations. Informal and shifting guidance present an additional hurdle to the ability for taxpayers to establish with certainty a one true and correct tax liability at the time an original federal income tax return is filed. Moreover, for large taxpayers, income tax return compliance is an interconnected process involving state, local, and foreign tax filings, all of which need to be coordinated with federal tax returns (including income, withholding, excise, and trade and customs returns).

These developments have had a direct effect on voluntary compliance expectations, particularly for LB&I taxpayers. First and foremost, changes to accounting standards and principles mean that very few large companies engage (or have an incentive to engage) in "the audit lottery."[9] The vast majority of taxpayers with audited financial statements do not take income tax positions that are unlikely to be sustained on audit. For income tax positions that are not likely to be sustained, these taxpayers must post a financial statement reserve, which generally must be reported to the IRS on Schedule UTP. As a result, LB&I already has this information disclosed by these taxpayers when it conducts its data analytics for purposes of examination and campaign selection.

More fundamentally, the increased complexity in business and the tax law means that it is even more difficult now to establish with certainty one true and correct tax liability at the time the original federal income tax return is filed. "Underlying the qualified amended return rules of Treas. Reg. § 1.6664-2(c) and Rev. Proc. 94-69 is a recognition that a large taxpayer's understanding of the operative facts underlying a transaction (or position) and the state of the governing legal rules could change between the time a return is filed and its examination."[10]

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[7] An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, Pub. L. No. 115-97, 131 Stat. 2054 (sometimes referred to as the "Tax Cuts and Jobs Act" or "TCJA").""The Act was the most significant revision of the U.S. tax code in more than 30 years." TIGTA Report 2019-34-064 (September 16, 2019), https://www.treasury.gov/tigta/auditreports/2019reports/201934064fr.pdf. We commend the IRS for its transparency by publicly releasing its extensive TCJA training materials, https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-tcja-training-materials.

[8] IRC Section 965 for Individuals & IRC 965 – Treatment of Deferred Foreign Income Upon Transition to Participation Exemption System of Taxation, https://www.irs.gov/businesses/corporations/lbi-active-campaigns.

[9] Detection risk is irrelevant under both GAAP and IFRS. *See* ASC 740-10 (formerly styled "FIN 48"); IAS 12. Combatting taxpayer use of the audit lottery was the principal reason Congress enacted the substantial understatement penalty in the first place. Staff of the Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982, 216 (Dec. 31, 1982).

[10] IRSAC Annual Report, Publication 5136 (11-2015) at 110.

For the largest corporate taxpayers, establishing the income tax liability for a given tax year requires dynamic multivariate calculations. Partnerships report tax information to their corporate partners using estimates that are sometimes “trued-up” in subsequent years. Foreign taxes are determined and redetermined after the original federal income tax return is filed. Regulations are proposed and finalized after the original federal income tax return is filed. These are just examples of variables that undermine the assumption that LB&I taxpayers will always be able to establish a one true and correct tax liability on their original federal income tax returns. These variables can and do generate reporting errors, despite the exercise of ordinary business care and prudence by taxpayers.

3. Encouraging Voluntary Disclosures

A formal qualified amended return offers taxpayers one way to avoid penalties via self-correction, but it should not be the only way.[11] Filing one or more federal QARs generally triggers an obligation to file amended state and local returns, which can be costly and burdensome, especially for those taxpayers that operate in multiple jurisdictions, as do many taxpayers in LB&I’s filing population. We continue to share the concern set out in the 2015 IRSAC Report that obsoleting the Revenue Procedure may lead to fewer taxpayer-adverse disclosures.[12] And for some issues, QARs are not an option. For instance, improper accounting methods cannot be corrected through the filing of an amended return.

The best compliance systems encourage self-reporting by participants throughout the process.[13] Some errors are only identified as a taxpayer prepares a subsequent year’s return or prepares for an IRS examination. Upon discovery of errors, taxpayers often want to be forthcoming and transparent—they want to correct and disclose the error quickly. Such self-correction should be encouraged under a system of tax administration that depends on voluntary compliance. Taxpayer disclosures create efficiencies for both taxpayers and IRS—adjustments readily identified by taxpayers save the IRS examination time, and they produce corrected agreed adjustments and corrected returns. On the other hand, taxpayers are inevitably reluctant to raise adverse issues with IRS examiners when threatened, explicitly or implicitly, with the risk of penalties. This reluctance is compounded in the case of complicated, multi-year issues like accounting methods and section 965 calculations.

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[11] *See* Policy Statement 20-1 ¶ 10, Treas. Reg. § 1.6664-2(c)(4)(ii).

[12] IRSAC Annual Report at 111.

[13] *See* U.S. Department of Justice Criminal Division Evaluation of Corporate Compliance Programs, Updated June 2020, https://www.justice.gov/criminal-fraud/page/file/937501/download (“[I]f a compliance program did effectively identify misconduct, including allowing for timely remediation and self-reporting, a prosecutor should view the occurrence as a strong indicator that the compliance program was working effectively.”); 17 C.F.R. 229.406(b) (Securities & Exchange Commission Code of Ethics); New York Stock Exchange Rule 303A.10 (“Encouraging the reporting of any illegal or unethical behavior. The listed company should proactively promote ethical behavior. The listed company should encourage employees to talk to supervisors, managers or other appropriate personnel when in doubt about the best course of action in a particular situation. Additionally, employees should report violations of laws, rules, regulations or the code of business conduct to appropriate personnel. To encourage employees to report such violations, the listed company must ensure that employees know that the listed company will not allow retaliation for reports made in good faith.”)

We respectfully submit that more voluntary disclosures at the beginning of examinations should be welcomed, not discouraged. Our view is consistent with the Mission of the IRS as expressed in Policy Statement 1-1 to help taxpayers meet their tax responsibilities.[14] Encouraging taxpayer disclosures also supports the goals of cooperation and collaboration set forth in Publication 5125 and its predecessor Publication 4837.

In our experience as tax practitioners and advisors, we have routinely observed that most experienced revenue agents and managers wisely exercise the discretion vested in them to apply Policy Statement 20-1 and exercise common sense to ensure that penalties are not imposed on taxpayers who voluntarily and timely bring errors to the examination team's attention, whether or not those taxpayers fall within the scope of the current Revenue Procedure. These best practices of wise tax administration and prudent case management should be adopted across LB&I in the form of published guidance applicable to a broad range of taxpayers and not just those who have historically benefitted from the technical application of Rev. Proc. 94-69.

Recommendation

We recommend that the existing treatment for taxpayers under continuous examination be preserved. We further recommend that Revenue Procedure 94-69 be expanded to include all LB&I taxpayers with audited financial statements in scope. Adequate disclosures granted qualified amended return treatment "clear the air" at the beginning of the examination and allow the taxpayer and the examination team to collaborate and focus on resolving technical tax issues. We respectfully submit that our recommendations, if adopted, will further the policy objective of the IRS to obtain the greatest possible number of agreements to tax determinations by enhancing quality and integrity of those determinations, and to dispose of tax differences at the lowest level.[15]

We appreciate the opportunity to comment on this important matter and would be pleased to respond to question or to further discuss the future of the revenue procedure or any potential successor provision. Please feel free to contact Sharon Katz-Pearlman (skatzpearlman@kpmg.com), Thomas Greenaway (tgreenaway@kpmg.com), Michael Dolan (mpdolan@kpmg.com) or Thomas Kane (thomaskane@kpmg.com) if we can be of further assistance.

Thank you

[14] Policy Statement 1-1, IRM 1.2.1.2.1. *See* Rev. Proc. 64-22, 1964-1 C.B. 689.
[15] Policy Statement 4-40, I.R.M. 1.2.1.5.16.