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IRS Developments and Examination Strategies

by Aaron Grey

A panel of seven current and former IRS employees spoke about the state of the Internal Revenue Service today. This panel accumulated more than 100 years of combined experience with the IRS. The non-current IRS group consisted of Pat Chaback, Executive Director with Ernst & Young; Eli Dicker, Executive Director of Silicon Valley TEI; Larry Langdon, Partner with Mayer Brown, and Andy Mattson, Partner with Moss Adams. Tony Shabazz, Territory Manager; Gloria Sullivan, Assistant to the GHW Global High Wealth Director; and Nora Beltran, Large Business & International Territory Manager represented the IRS.

Eli Dicker commenced the discussion illustrating the constraints and trends within the IRS. The IRS has reduced itself by over 3,000 employees in 2015 and 13,000 since 2010. “The biggest catalyst,” said Dicker, “is the budget.” The budget for 2015 in the IRS was $10.9 billion, a 10% reduction since 2010’s $12.1 billion figure. These cutbacks have led to reduced labor, forcing increased call center wait times, less manpower to facilitate audits, and a demand for automated processes. Pat Chaback commented, “the amount of work isn’t going away, but IRS employee resources are.” This was represented by a continuous increase of large business return filings inverted with a decrease of total IRS employees over the last five years. The workforce decrease includes “leaders with hundreds of years of experience moving on,” says Dicker, inhibiting the agency’s progress and knowledge transfer capabilities. Not only are the budgetary issues leading to employee attrition, but the Service’s non-competitive salaries also make it difficult to recruit new talent to replace the old. Although new Silicon Valley agents are generally paid better than the ones in New York, the wages are still insufficient to attract replacements.

Another significant reduction within the budget was employee training, which has been cut by 74% since 2010. The IRS is presently implementing Lean Six Sigma and Just-In-Time training. These project management fundamentals allow employees to work more efficiently by minimizing wasteful or repetitive movements. The introduction of lean processes to the IRS workforce is crucial to alleviate the limited resources available for completing key tasks. But since “[the IRS] is so cramped in resources to roll out this vital training,” said Tony Shabazz, “[they] are forced to come up with innovative ways” to increase office productivity. As such, the Service is developing new technology and using data analytics to prioritize which companies to examine and to expedite the examination process itself.

The preceding issues yielded a necessary change to the IRS’s Large Business & International (LB&I) Division’s examination process. Nora Beltran claimed that these changes “place all taxpayers – big or middle-market companies—on the same level.” Significant changes to LB&I’s exam process include:

Modification of Information Document Request (IDR) Enforcement process:
Covered under IRC §7602 (Examination of books and witnesses), IDR allows the IRS to request financial and other information about the taxpayer, such as accrual forms, trial
balances, etc.\textsuperscript{68} Previously, taxpayers who failed to comply with IDRs endured a series of deficiency notices and potentially summons to compel providing broadly-scoped information to the IRS. This previous enforcement process took an average of 140 days. With the modification, IRS experts are using data analytics and are narrowing the scopes of their summoned information. Now, the IDR process time takes as little as 40 days.

**Piloting New Process for Coordinated Industry Cases (CIC):** CICs, as designated by the LB\&I, are large business taxpayers that are generally more complex than other-taxpaying entities. Qualifying as a CIC includes a certain level of gross assets, gross receipts, foreign assets, foreign taxes, and number of separate operating entities.\textsuperscript{69} Those that do not qualify as CICs are ICs, or Industry Cases. Usually ICs take less than a year to examine, while CICs tend to be under continuous scrutiny.\textsuperscript{70} The level of detail required by CIC examinations mandates large teams of revenue agents, which could otherwise be used examining smaller ICs and other taxpayers. Therefore, it became necessary to properly differentiate CICs from other cases. The CIC pilot, which occurred from April 2014 to October 2015, created an ongoing process to classify taxpayers as either CICs or ICs, compared to their static classification process in the past. The evolving classifications allow LB\&I to prioritize their resources to the more frequent issues.

Creation of Issue Practice Groups (IPGs) and International Practice Networks (IPNs).: Replacing Tiered Issue Process, which broadly addressed tax shelter issues, IPGs and IPNs are subject matter expert (SME) teams designated to handle specialized areas of tax.\textsuperscript{71} A few examples of IPG and IPN experts include Business Credits, IRC Section 263A, Penalties, Accounting Methods, Offshore Arrangements, and Transfer Pricing. The scope of IPGs and IPNs are domestically-focused and internationally-focused, respectively. Rather than classifying an LB\&I issue by severity (as done under the Tiered Issue regime), an issue would be classified to one of the IPG/IPN categories and managed by the team with expertise in that particular topic. By referring similar cases to the same panel of experts, “these SMEs gain consistent handling of cases,” said Gloria Sullivan.

The IRS and its LB\&I Division must continuously implement these types of initiatives to reconcile their ever-decreasing budget and resources. For true progress to be made, talented individuals—those possessing both “project management skills and tax law expertise,” states Shabazz, need to heed the agency’s call. This niche group of talent, however, desires reasonable compensation for their capabilities. Unless Congress can meet in the middle with this talent pool, it may be difficult for the Internal Revenue Service to stay on track with their audit requirements.

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\textsuperscript{69} Internal Revenue Manual §4.46.2.5.

\textsuperscript{70} The Tax Adviser.

\textsuperscript{71} LB\&I Memorandum.