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2020-2021

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October 20, 2020

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments on Revenue Procedure 94-69

Dear Commissioner Rettig:

Enclosed please find comments regarding Revenue Procedure 94-69. These comments are submitted on behalf of the Section of Taxation and have not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Joan C. Arnold
Chair, Section of Taxation

Enclosure

cc: Hon. David Kautter, Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Jeffrey Van Hove, Senior Advisor, Office of Tax Policy, Department of the Treasury
Brett York, Deputy Tax Legislative Counsel, Department of the Treasury
Hon. Michael J. Desmond, Chief Counsel, Internal Revenue Service
Douglas O'Donnell, Commissioner (Large Business & International), Internal Revenue Service
Nikole Flax, Deputy Commissioner (Large Business & International), Internal Revenue Service
Robin Greenhouse, Division Counsel (Large Business & International), Internal Revenue Service

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments on Revenue Procedure 94-69

These comments ("**Comments**") are submitted on behalf of the American Bar Association Section of Taxation ("**Section**") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Matt Cooper, Clint Massengill, Mary McNulty, Lee Meyercord, Alina Solodchikova, Kevin Stults, and Todd Welty. Committee review of these Comments was exercised by Mary I. Slonina, Chair of the Administrative Practice Committee. Significant contributions to these Comments were made by Jeremiah Coder, George Hani, Colin Handzo, and Mark Thomas. These Comments were reviewed by John Colvin of the Committee on Government Submissions and Kurt L. Lawson, Vice Chair for Government Relations for the Section.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section's diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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Date: October 20, 2020

Executive Summary

On August 19, 2020, the Large Business & International Division ("**LB&I**") of the Internal Revenue Service (the "**Service**") issued a request for comments on the proposed obsoleting of Revenue Procedure 94-69 ("**Rev. Proc. 94-69**").[1]

Rev. Proc. 94-69 provides procedures for taxpayers that were subject to the former Coordinated Examination Program ("**CEP**") to show additional tax due or make adequate disclosure with respect to an item or a position in order to avoid the imposition of certain accuracy-related penalties under section 6662(b)(1) (disregard of rules or regulations) and (b)(2) (substantial understatement of income tax).[2] The procedures allow a taxpayer to provide the Service a written statement, showing the additional tax due or making a disclosure, within 15 days from the written information request from Service personnel.[3] If a disclosed position has a reasonable basis, the substantial understatement and disregard penalties will not apply.[4] Thus, a Rev. Proc. 94-69 statement acts as substitute to the filing of a qualified amended return ("**QAR**") pursuant to Treas. Reg. § 1.6664-2(c)(3), and, if the information included in the written statement includes the information that would have been reported on a properly completed Form 8275, *Disclosure Statement*, or Form 8275-R, *Regulation Disclosure Statement*, it is treated as "adequate disclosure" attached to a QAR.[5]

When the Service eliminated the CEP in 2000, it continued to apply Rev. Proc. 94-69 to taxpayers subject to the Coordinated Industry Case Program (the "**CIC**"). In May 2019, the Service replaced the CIC with the Large Corporate Compliance Program (the "**LCC**"), effective for LB&I examinations for tax years 2017 and later. When it established the LCC, the Service announced that Rev. Proc. 94-69 would continue to

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[1] 1994-2 C.B. 804. *See IRS seeks comments on Revenue Procedure 94-69*, available at https://www.irs.gov/newsroom/irs-seeks-comments-on-revenue-procedure-94-69 (the "**Request for Comments**").

[2] Unless otherwise indicated, references to a "section" are to a section of the Internal Revenue Code of 1986, as amended (the "**Code**"), and all "Treas. Reg. §" references are to the Treasury Regulations promulgated under the Code, all as in effect (or, in the case of proposed regulations that remain outstanding, as proposed) as of the date of these Comments.

For returns filed after March 14, 1994, disclosure pursuant to Rev. Proc. 94-69 does not avoid the negligence penalty, and a reasonable basis is required in addition to disclosure to avoid the disregard of rules or regulations penalty. Rev. Proc. 94-69, § 4; *see* Treas. Reg. § 1.6662-7. The Service also allows disclosures pursuant to Rev. Proc. 94-69 to avoid the section 6662(b)(3) substantial or gross valuation misstatement penalty. *See* I.R.C. § 6662(b)(3), (e), (h); Treas. Reg. § 1.6662-6(a)(2); FSA 200031025 (April 28, 2000).

[3] Rev. Proc. 94-69, § 1.02.

[4] *See* I.R.C. § 6662(d)(2)(B)(ii)(II); Treas. Reg. § 1.6662-3(c)(1).

[5] Rev. Proc. 94-69, § 4.03.

apply to any taxpayer that currently was in the CIC (for tax years before 2017) and in the new LCC program (for tax years after 2016).[6]

The Request for Comments states that:

> Revenue Procedure 94-69 does not apply to LCC taxpayers that were not previously CIC taxpayers, or to any CIC taxpayers that did not have an open CIC examination as of May 2019. . . . 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. Accordingly, the IRS is considering obsoleting Revenue Procedure 94-69.

The Section believes that the procedures described in Rev. Proc. 94-69 continue to fulfill a necessary role in the disclosure and examination process for LCC taxpayers that, despite the elimination of the CEP and the CIC, effectively remain under continuous or near-continuous examination. Rev. Proc. 94-69 does not create a disparity among taxpayers but rather recognizes the disparity in examination rates for large corporate taxpayers and other taxpayers. In our opinion, eliminating this disclosure mechanism would reduce overall disclosure and make the examination process less efficient.

These Comments are presented in two parts, each of which draws on Section members' experiences representing LCC taxpayers that have made disclosures pursuant to Rev. Proc. 94-69 in the past and that anticipate making disclosures in the future pursuant to Rev. Proc. 94-69 or any successor guidance. Part I discusses the reasons why LCC taxpayers use the Rev. Proc. 94-69 process and explains why the availability of this process does not provide a disincentive for LCC taxpayers to report their tax positions accurately and fully on an original return. It also discusses the importance of the penalty protection provided by Rev. Proc. 94-69, particularly in the transfer pricing area where, in the case of mistakes, the section 6662(e) penalty is largely a strict liability penalty.[7]

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[6] "Revenue Procedure 94-69 will continue to apply to any taxpayer currently in the CIC and the new LCC program. This revenue procedure is currently under review." *See* Douglas O'Donnell, *Memorandum for All Large Business and International Division Employees: Interim Guidance on Implementation of the Large Corporate Compliance (LCC) Program* (May 21, 2019).

[7] A taxpayer generally can raise a reasonable cause defense against valuation misstatement penalties attributable to a net section 482 transfer price adjustment only if certain contemporaneous documentation requirements are met at the time the original return or QAR was filed. *See* I.R.C. § 6662(e)(3)(D); Treas. Reg. § 1.6662-6(c)(6).

Part II contains two alternative recommendations which we believe would allow the Service to continue to offer procedures similar to those currently available in Rev. Proc. 94-69. The first recommendation proposes new objective criteria to re-define the population of LCC taxpayers that would be entitled to use procedures similar to those under current Rev. Proc. 94-69 or successor guidance on a going-forward basis, given the replacement of the CEP and CIC with the LCC. The second recommendation would take a different approach, allowing any LCC taxpayer to avail itself of procedures similar to those under current Rev. Proc. 94-69 or successor guidance through a combination of voluntary disclosures ultimately culminating in the filing of a QAR.

Comments

I. Background

A. Obsoleting Rev. Proc. 94-69 Would Not Improve the Accuracy of Original Returns.

We believe that obsoleting Rev. Proc. 94-69 would not improve the accuracy of original returns because the types of errors disclosed under Rev. Proc. 94-69 generally are not known (and are not discoverable) at the time the original return is filed. Four categories of frequently disclosed errors under Rev. Proc. 94-69 illustrate this point:

- *First*, many of the errors LCC taxpayers make are attributable to the reporting of complicated transactions involving multiple entities under a complex set of tax laws. Tax returns often are thousands of pages long, with each return involving myriad determinations regarding the proper treatment of tax items or categories of items. Even if a taxpayer manages to report all items correctly, each item might affect multiple limitations, credits, carrybacks, or carryforwards, all of which must be taken into account for an accurate determination of tax liability. No amount of diligence will avoid all errors.

- *Second*, reporting items arising from joint ventures commonly cause unavoidable errors. LCC taxpayers often must estimate income from partnerships due to the receipt of late Schedule K-1s, *Partner's Share of Income, Deductions, Credits, etc*. Partnerships sometimes correct Schedule K-1s after the return has been filed. These errors are inevitable due to the complexity of the tax laws and will continue to be made regardless of Rev. Proc. 94-69.

- *Third*, Rev. Proc. 94-69 often is used to disclose carryover adjustments resulting from prior-year examinations completed after a return is filed. Because the LCC taxpayer in that case was not aware of the examination adjustment when it filed its original tax return, the LCC taxpayer could not have filed its original return correctly.

- *Fourth*, errors arising from incorrectly reported book income are another source of the corrections disclosed under Rev. Proc. 94-69. To determine its book income, the typical LCC taxpayer must account for thousands of items.

Numerous employees across geographically diverse business units must apply hundreds of steps to account for book income at the parent-company level. Moreover, companies' constantly change their accounting processes because they add lines of businesses, acquire assets, and sell subsidiaries (among other activities), and they must adjust their processes accordingly. Also, software becomes obsolete and financial accounting standards change, requiring additional changes. The complexity of the process coupled with the constant changes in processes, standards, and personnel make errors inevitable despite the many non-tax incentives to report book income correctly. Because book income is the starting point for any LCC taxpayer's tax return preparation, errors in book income lead to errors in taxable income.

In our view, obsoleting Rev. Proc. 94-69 would not impact whether, after filing their returns, taxpayers discover that they made any of the errors described in the four categories described above, and instead would impact only whether they disclose those errors, because, as explained below, the alternative disclosure mechanisms are inadequate for LCC taxpayers. Therefore, obsoleting Rev. Proc. 94-69 would not achieve the Service's objective of improving compliance on the original return, and instead would result in the same amount of errors and could reduce disclosure and transparency.

B. Alternative Disclosure Mechanisms Are Inadequate.

We believe that, for LCC taxpayers facing the inevitable errors, post-filing examination adjustments, and new Service guidance and case law described above, the three alternative disclosure mechanisms referenced in the Request for Comments would be inadequate for the reasons discussed below:

- *First*, the disclosures that accompany an original return (Form 8275, Form 8275-R, and Schedule UTP) are not an option because the circumstances giving rise to the disclosure arise after the return is filed.

- *Second*, filing an amended return each time an adjustment is identified is not a practical option. Amending a return involves two key steps: (1) identifying and reporting the adjustments and (2) adjusting the tax liability (including taking into account changes in limitations, credits, carrybacks, and carryforwards). For many LCC taxpayers, especially those with international operations, step (2) is extremely complex. Reviewing those calculations is resource-intensive for both taxpayers and the Service. Under Rev. Proc. 94-69, step (2) is required to be performed only on two occasions: when the return is originally filed and when the examination is complete. If Rev. Proc. 94-69 or a similar procedure were not available, both taxpayers and the Service would be required to devote resources to step (2) multiple times. In our view, the expenditure of resources in preparing and reviewing multiple amended returns would not improve the quality of compliance and likely would be rendered superfluous at the end of an examination.

  Moreover, filing an amended return is a costly option for many LCC taxpayers because their filing triggers an obligation to file dozens of amended state tax

returns. Again, this substantial burden would accomplish little because the state amended return filing process would have to be repeated at the end of the examination.

In addition, LCC taxpayers that effectively are under continuous examination due to their risk profiles sometimes have notice of a tax return's examination before the return even is filed. For example, an Exam team nearing the completion of the 2014-2016 examination cycle might schedule the beginning of the next examination cycle (2017-2019) before the 2019 return is even filed. Thus, the filing of an amended return would provide no penalty protection to these taxpayers regardless of when it was filed.[8]

- *Third*, Publication 5125 already allows all taxpayers to submit informal claims for refund to the Exam team within 30 calendar days of the opening conference. This 30-day window currently is in place to allow all LB&I taxpayers to submit informal claims that result in refunds, without the need to file formal amended returns.[9] While we believe this 30-day window should remain in place for all LB&I taxpayers, adverse disclosures during this time period result in no penalty protection. Therefore, we believe the 30-day window would not be a viable alternative to Rev. Proc. 94-69.

We believe that, as a result, absent Rev. Proc. 94-69 (or a similar process) LCC taxpayers might reduce their disclosures significantly, resulting in less taxpayer compliance and an unnecessary drain on the Service's resources.

C. Rev. Proc. 94-69 Provides a Practical Solution for LCC Taxpayers That Are Subject to Continuous or Almost Continuous Examination.

The Request for Comments asserts that Rev. Proc. 94-69 creates a disparity because it is available only to a small group of large corporate taxpayers. While true, we believe that this statement fails to account for the practical lack of disclosure opportunities caused by the disparate examination rates of large corporate taxpayers as compared with other taxpayers.

Taxpayers that are not under continuous or frequent examination can accept the possibility—rather than the certainty—of examination. The law gives such taxpayers an incentive to file a QAR by providing penalty protection. A QAR must be filed before "[t]he date the taxpayer is first contacted by the Internal Revenue Service (IRS) concerning any examination . . . ."[10] Thus, taxpayers that might never be examined have an incentive to correct known errors.

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[8] Treas. Reg. § 1.6664-2(c)(2), (3)(i)(A).

[9] *See* I.R.M. 4.46.3.7.1.1.

[10] Treas. Reg. § 1.6664-2(c)(3)(i)(A).

By contrast, many large corporate taxpayers are almost certain to be examined. In our view, Rev. Proc. 94-69 provides a workable solution for this small group of taxpayers to make disclosures at the beginning of their examination. For taxpayers in frequent and regular contact with the Service, Rev. Proc. 94-69 eliminates potential disputes as to whether a QAR (even when feasible) is filed before the date the taxpayer is first contacted by the Service concerning an examination. As a result, Rev. Proc. 94-69 increases voluntary disclosure and voluntary compliance among large corporate taxpayers and reduces the administrative burdens on taxpayers and the Service.

D. Treasury Relied on Rev. Proc. 94-69 in Adopting Regulations Under Section 6662(e).

We believe that the U.S. Department of the Treasury ("**Treasury**") recognized the importance of the disclosure regime in Rev. Proc. 94-69 by promulgating regulations allowing it to be used to mitigate the section 6662(e) penalty, and that eliminating it would upset the balance that Treasury has created. Section 6662(e) imposes a penalty on any underpayment attributable to a substantial valuation misstatement. The results of controlled transactions reported on a return are used to determine whether there is a substantial valuation misstatement subject to a 20% penalty or a gross valuation misstatement subject to a 40% penalty.[11] The Treasury Regulations under section 6664 state that:

> The results of controlled transactions that are reported on an amended return will be used only if the amended return is filed before the Internal Revenue Service has contacted the taxpayer regarding the corresponding original return. *A written statement furnished by a taxpayer subject to the Coordinated Examination Program or a written statement furnished by the taxpayer when electing Accelerated Issue Resolution or similar procedures will be considered an amended return for purposes of this section if it satisfies either the requirements of a qualified amended return for purposes of §1.6664-2(c)(3) or such requirements as the Commissioner may prescribe by revenue procedure.*[12]

In addition, the Treasury Regulations allow the Service to prescribe by revenue procedure the manner in which qualified amended returns apply to particular classes of taxpayers,[13] which is precisely what Rev. Proc. 94-69 does.

II. Recommendations

As described in Part I, we believe that the underlying reasons why Rev. Proc. 94-69 is necessary and appropriate for a limited subset of taxpayers continue to exist.

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[11] Treas. Reg. § 1.6662-6(a)(2).

[12] *Id.* (emphasis added). Temp. Treas. Reg. § 1.6662-6T(a)(2), T.D. 8519, 59 Fed. Reg. 4,791 (Feb. 2, 1994), contained substantially identical language.

[13] Treas. Reg. § 1.6664-2(c)(4)(ii).

The Rev. Proc. 94-69 disclosure regime does not provide a disincentive for accurate reporting on the original return. Rather, it encourages disclosure in a way that benefits both the Service and LCC taxpayers and provides penalty protection for errors discovered after that original return is filed that cannot be achieved through other currently available alternatives. Therefore, our preference would be to retain Rev. Proc. 94-69 in its current form. If, however, Treasury[14] and the Service determine otherwise, we recommend that they adopt one of the alternatives described in Sections A and B below. We favor the alternative described in Section A because it would require fewer adjustments and resources from taxpayers and the Service. In either event, we recommend that Treasury and the Service apply the grandfather rule described in Section C below.

A. Develop an Objective Category of LCC Taxpayers Subject to Rev. Proc. 94-69 or Similar Procedures.

We recommend that Treasury and the Service allow LCC taxpayers that satisfy certain objective criteria to make disclosures upon the opening of a new examination cycle to avoid the applicable accuracy-related penalties under section 6662(b)(1)-(3). The Request for Comments acknowledges that a certain number of LCC taxpayers will be examined in consecutive years based on their risk profile, even though the LCC is not itself a continuous examination program. As discussed in detail in Part I, we believe the Service and tax administration generally benefit from greater voluntary compliance by allowing these large taxpayers to correct their returns and obtain penalty relief through this informal disclosure process. Taxpayers also might seek to adjust their returns for carryover items resulting from prior examinations that were completed after the return was filed. The informal disclosure process allows taxpayers to avoid the economic and efficiency costs of filing multiple formal amended returns and to defer the filing of duplicative state and other regulatory filings until the end of the Service's examination.

We recommend that Treasury and the Service apply disclosure procedures similar to Rev. Proc. 94-69 to LCC taxpayers described in one of the following three categories:

(1) Any LCC taxpayer that is notified of the opening of a new examination while currently under examination for an earlier year or within 120 days of when the examination for an earlier year ends;

(2) Any LCC taxpayer that has been under examination for three of the prior five tax years at the time it is notified of the opening of a new examination; or

(3) Any LCC taxpayer required under Treas. Reg. § 1.6038-4(a) to file Form 8975, *Country-by-Country Report*.[15]

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[14] We include Treasury in our recommendations in the event that changes to the Treasury Regulations or similar guidance are needed.

[15] This form would serve as a proxy to identify the LCC taxpayers that are effectively under continuous examination. Like the other proposals, this would provide an objective criterion of easily-identifiable eligible taxpayers.

We propose that this group of LCC taxpayers be allowed to provide disclosures in a written statement within a 15-day window (or other agreed-upon date) beginning with the Service's first written information document request and obtain the same penalty protection provided for by Rev. Proc. 94-69 for any adjustments resulting from such disclosures. This would allow LCC taxpayers that effectively are under continuous examination to avoid penalties if their position has a reasonable basis. As discussed above, the disclosure alternatives available to other taxpayers are not available to this small category of LCC taxpayers.

For example, under category (1), assume an LCC taxpayer under examination for the 2017 tax year learns in October 2020 that LB&I is opening an examination of the 2018 tax year; thus, this LCC taxpayer would be eligible to use the disclosure procedures in Rev. Proc. 94-69 at the opening of the 2018 examination. Similarly, if the 2017 examination ended in August 2020, the taxpayer would fall within the 120-day window and still qualify for the Rev. Proc. 94-69 disclosure procedures. The 120-day window is similar to the already-existing audit protection rule in Rev. Proc. 2015-13 for accounting method changes[16] and would allow flexibility for disclosures made near the end of the closing of an earlier examination without triggering a foot fault. Thus, it would protect taxpayers with carryover adjustments that are known with certainty once the examination ends with the issuance of the revenue agent's report or similar document.

Under category (2), an LCC taxpayer under examination for the 2014, 2015, and 2016 tax years would be eligible to use the disclosure procedures in Rev. Proc. 94-69 at the opening of the 2018 examination, even though it was not under examination for 2017 (because, for example, 2017 was a loss year). Categories (1) and (2) would apply regardless of whether the taxpayer received notice of the subsequent examination formally in a Service letter or informally from the LB&I Exam team.

Under category (3), an LCC taxpayer that is a U.S. multinational enterprise and required to file Form 8975, reflecting its operations around the world, would be eligible to use disclosure procedures similar to current Rev. Proc. 94-69. These taxpayers are likely to have transfer pricing issues and potentially be subject to a penalty under section 6662(e) for which a reasonable cause defense might not be available. Therefore, we recommend that they be allowed to disclose and receive penalty protection as permitted under Treas. Reg. § 1.6662-6(a)(2).

These three categories identify a subgroup of LCC taxpayers that find themselves in different circumstances from the LCC population at large. These LCC taxpayers either (1) have multiple examinations open at once, which prevents them from filing a QAR prior to "first contact" by the Service; (2) are subject to multiple examinations within a short time period (three of the prior five years); or (3) already are subject to enhanced reporting requirements. LCC taxpayers in these three categories have independent incentives to report their tax positions accurately on the original return, and expect that

[16] Rev. Proc. 2015-13, § 8.02(1)(b), 2015-5 I.R.B. 419.

most tax years will be examined, but need a way to disclose adjustments discovered after the filing of their original return that provides penalty protection.

B. Develop a Disclosure Process Open to All LCC Taxpayers.

In the alternative, we recommend that Treasury and the Service implement a new voluntary disclosure process that would allow any LCC taxpayer that chose to participate to avoid the applicable accuracy-related penalties under section 6662(b)(1)-(3).

This new disclosure process would involve two basic steps: (1) the LCC taxpayer would file one or more written disclosure notices with the Service (prior to first contact with respect to an examination for the tax year to which the disclosure notice relates or, for a taxpayer notified of the examination of a tax year before the original return was filed, prior to the examination commencing for the tax year to which the disclosure notice relates) identifying an issue and the associated amount; and (2) either the Service would open an examination and consider whether to include the disclosed items in the Revenue Agent's Report ("**RAR**"), or, if no examination was opened, the LCC taxpayer would commit to filing an amended return incorporating certain of the disclosed issues. These steps and the rationale for this proposal are explained in more detail below.

- *First*, after filing the original return for a tax year, but before first being notified of an examination for the tax year to which the disclosure notice related (or, for a taxpayer notified of the examination of a tax year before the original return was filed, prior to the examination commencing for the tax year to which the disclosure notice related), an LCC taxpayer could file with the Service a disclosure notice containing (1) a description of the issue and (2) the amount thereof, similar to the current disclosures provided under Rev. Proc. 94-69. The disclosure notice would state whether (i) the LCC taxpayer had no reasonable basis to exclude the adjustment (if an amended return were to be filed on the date of the disclosure notice), and thus agreed the adjustment would result in additional tax (*e.g.*, an error from one of the four categories discussed above), or (ii) the LCC taxpayer had a reasonable basis to exclude the adjustment (if an amended return were to be filed on the date of the disclosure notice), and thus did not agree that additional tax was due. The disclosure would be filed with the Service Center where the LCC taxpayer filed its original return for the affected tax year.[17] The Service would be able to use the information provided on these disclosures in performing its risk analysis of the LCC taxpayer's return in order to determine whether to select the return for examination.

- *Second*, if the Service opened an examination of the LCC taxpayer, the disclosed issues could be examined and potentially adjusted, just as with current Rev. Proc. 94-69 disclosures, and incorporated into the RAR. If the Service opened an examination for the year, the LCC taxpayer would not be required to file an

[17] If the taxpayer electronically filed its return, the LLC taxpayer would file the disclosure with the Service Center where it would paper-file the return.

amended return with respect to any disclosures made and would receive penalty protection for all disclosed issues. If the Service did not open an examination of the LCC taxpayer, the LCC taxpayer would commit to file an amended return for any disclosed issue for which the LCC taxpayer did not have a reasonable basis and agreed would result in additional tax due and would receive penalty protection for any disclosed issue included on an amended return.

If the LCC taxpayer realized that its disclosure notice was made in error and that no disclosure should have been made, the LCC taxpayer could file a statement explaining why the disclosure was in error and withdraw the disclosure. If a disclosure notice, an amended return filed with respect to a filed disclosure, or a disclosure withdrawal was filed when fewer than 180 days remained on the assessment statute for a tax year not examined by the Service, the LCC taxpayer would agree to extend the assessment statute to the date 180 days from the date the disclosure notice, amended return, or disclosure withdrawal was filed. This would provide the Service sufficient time for review if the Service otherwise did not examine the tax year at issue. If the LCC taxpayer failed to file an amended return with respect to a disclosed issue for which the LCC taxpayer did not have a reasonable basis and agreed would result in additional tax due, or failed to agree to extend the assessment statute if fewer than 180 days remained on the assessment statute for the tax year at issue when a disclosure notice, amended return, or disclosure withdrawal was filed, no penalty protection would apply for the disclosed issues. In addition, if the LCC taxpayer failed to amend or extend the statute of limitations, the Service could adopt procedures which would make the defaulting taxpayer ineligible to file additional disclosures pursuant to this disclosure process for some period of time.

This type of disclosure regime would allow LCC taxpayers to self-select into the process on the condition that the items disclosed ultimately would be included on an amended return, examined and included in an RAR, or withdrawn. Because only items disclosed prior to "first contact" for a tax year would qualify (or, for a taxpayer notified of the examination of a tax year before the original return was filed, prior to the examination commencing), it would ensure that, just as with current QARs, taxpayers would not be acting with the benefit of hindsight. However, it would recognize that both LCC taxpayers and the Service benefit from LCC taxpayers disclosing adjustments identified after the filing of the original return. Such disclosure provides the Service more information to consider in making its risk assessment for examination selection and makes any examination of the tax year at issue more efficient. Finally, LCC taxpayers would have an incentive to follow through with filing an amended return for errors they agreed would result in additional tax even if the Service did not open an examination, as failing to do so would preclude the LCC taxpayer from participating in the disclosure program for some period of time.

C. Apply a Grandfather Rule.

In the interim, while Treasury and the Service are determining how to proceed, we recommend that the current grandfather rule continue to apply to examinations

commenced for tax years ending before the date that Rev. Proc. 94-69 either is declared obsolete, modified, or replaced with an alternative disclosure mechanism.