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IRS Large Business and International Division Increasingly Looks to Chief Counsel's Office to Advance Initiatives

The Internal Revenue Service Large Business and International Division (LB&I) administers United States tax law for corporations, partnerships and individuals with assets greater than \$10 million. These taxpayers typically have large numbers of employees, deal with complicated tax and accounting issues, and conduct their operations globally, which further complicates regulation. LB&I, meanwhile, must accomplish its mission while contending with funding constraints, significant workforce attrition and increased demands for output and documented successes.

Accordingly, LB&I has sought to better leverage its limited resources by focusing on key initiatives. From regulations like FATCA and new focuses like its global high-wealth industry area to long-standing programs surrounding financial products, the LB&I has focused its attention and resources into those areas of greatest potential impact and existing institutional expertise.

To help execute its agenda, LB&I increasingly has relied on the expertise of the attorneys in the IRS Office of Chief Counsel. Although many of LB&I's initiatives are well-publicized, and the division has a transparent organizational structure, the role of the Office of Chief Counsel in its activities has remained, to a large extent, shrouded in mystery. Many taxpayers are not fully aware of the IRS's significant attorney resources and how embedded those attorneys have become in LB&I's operations.

Entities and individuals under the administration of the LB&I will need to better understand the LB&I's initiatives and gain insights into the role that the Chief Counsel's office plays in LB&I examinations. The primer below outlines the strategic areas in which the Chief Counsel's office provides significant support.

LB&I and Office of Chief Counsel: Structure and Relationship

LB&I. LB&I is one of four primary operating divisions in the IRS, has approximately 6,000 staff members and is organized into 12 groups:

- six domestic industries: communications, technology, and media; financial services; heavy manufacturing and transportation; natural resources and construction; retailers, food, pharmaceuticals and healthcare; and global high-wealth;
- four international industries: international business compliance, international individual compliance, international strategy and transfer pricing operations;
- a shared support group that includes the business systems planning, management and finance, and planning, analysis, inventory and research functions; and
- a profiling and technical guidance function.

Office of Chief Counsel. In addition to the four primary operating divisions, certain specialized IRS units work directly and closely with the IRS Commissioner, one of which is the Office of Chief Counsel. The Chief Counsel, the only presidentially appointed Assistant General Counsel in the Treasury Department, is the top legal adviser to the

IRS Commissioner on all matters pertaining to the interpretation, administration and enforcement of the Internal Revenue Laws (as well as all other legal matters).

The Office of Chief Counsel has an LB&I Division, which parallels the structure of IRS LB&I. It has a division headquarters, co-located with LB&I's, and five counsel areas, each with an area counsel co-located in the same city as the parallel LB&I industry director.¹

LB&I Initiatives With Designated Chief Counsel Support

Among the most important areas where the Chief Counsel's office attorneys are working with LB&I include:

FATCA

LB&I is charged with overseeing the implementation of the Foreign Account Tax Compliance Act (FATCA), which is scheduled to be implemented on July 1, 2014. FATCA, enacted as part of the Hiring Incentives to Restore Employment Act of 2010, seeks to increase transparency for the IRS with respect to U.S. persons that may be investing and earning income through non-U.S. institutions. FATCA requires U.S. persons who meet the reporting threshold for foreign financial assets to include information about certain foreign financial assets and accounts with their income tax returns. Foreign financial institutions also are required to report to the IRS financial account information for accounts held by those U.S. persons.²

In terms of implementation and organization, FATCA is the responsibility of the newly created Foreign Payments Practice Office (FPP Office), housed within the LB&I international business compliance area and headquartered in Manhattan. The FPP Office also consists of six teams of withholding international examiners located in California, Florida, Illinois, New Jersey, New York and Texas. LB&I believes that directing the day-to-day FATCA operations from field offices will enable it to be more efficient and better positioned to interact with examination teams, foreign financial institutions, U.S. withholding agents and with its legal support in the local Chief Counsel offices.

Chief Counsel Support. Traditionally, LB&I's foreign withholding program and qualified intermediary programs were based in Manhattan. Given this pre-existing strength, Manhattan-based Chief Counsel had a prominent role in working with LB&I to help develop the FATCA program, including drafting the international compliance management models, the FATCA instruction and user manuals, and the registration FAQs (including responding to inquiries). Additionally, these attorneys have worked with the IRS Office of Associate Chief Counsel, International in drafting the FATCA regulations, training the international examiners and speaking to outside stakeholders at various public venues to educate them and obtain useful feedback. Chief Counsel attorneys are expected to continue to have a robust role in helping the FPP Office administer its program in the future by addressing legal and compliance issues that may arise.

Financial Products Specialist Program

In late 2012, LB&I moved its entire Financial Products Specialist Program (FP Program) into the division's financial services industry group to increase efficiency. With approximately 150 financial products specialists geographically dispersed across the United States, the FP Program supports examination teams for all six LB&I domestic industry groups and all IRS operating divisions. FP Pro-

1 Five area counsel correspond to the six domestic industry directors: The area counsel for financial services serves as the chief legal advisor to both the financial services and the global high-wealth industry directors.

2 See "Treasury and IRS Release FATCA Regulations" (March 13, 2014), available at <http://www.skadden.com/treasury-and-irs-Release-fatca-regulations>.

gram specialists are revenue agents who possess broad expertise in tax law and who have received special training in financial instruments and terminology, financial industry practices and the taxation of financial instruments and markets. The issues they handle are among the most complex LB&I examines.

Chief Counsel Support. The Office of Chief Counsel has charged the financial services area counsel with providing strategic, logistical and legal support to the FP Program. Given the obvious nexus of financial products issues to financial services, most of the support is provided directly by financial services area attorneys in the Manhattan and Long Island offices, as they traditionally have possessed the requisite expertise. However, a nationwide cadre of attorneys in many of the Chief Counsel's LB&I field offices have been identified to provide support to the FP Program specialists for the myriad issues that develop outside New York City; an associate area counsel supervises their work. To aid the financial services area counsel in the overall oversight of the FP Program, a senior-level attorney helps monitor case assignments and issue development and spearheads any coordination with LB&I's Division headquarters and the IRS National Office. Since the move of the FP Program into LB&I's financial services industry group, LB&I attorneys have developed a closer working relationship with the financial products specialists throughout the country and aided them in identifying issues and developing its audits. Financial institutions and taxpayers with financial products issues should expect to see LB&I attorneys have a continued proactive role in LB&I's examinations.

The Global High-Wealth Industry

The LB&I global high-wealth (GHW) industry area is one of the division's newest programs. It began operations in November 2009 and was formed to take a holistic approach in examining high-wealth individuals. GHW is headed by an industry director but, unlike the other five industry directors, does not have any corresponding geographic lines of authority. Although an individual Form 1040 is at the center of each GHW audit, GHW employs an enterprise approach to its audits, bringing all the entities connected to the high-wealth individual under the microscope. The IRS has determined that the enterprise approach is necessary because examinations on a return-by-return or year-by-year basis fall short of providing a complete picture of the tax compliance of individuals and the enterprises they control. At a recent ABA Tax Section meeting, GHW was described as a "one-stop shop for taxes of all types" of high-wealth individuals.

High-wealth individuals are defined as taxpayers with assets or earnings of tens of millions of dollars. GHW receives an initial listing of the high-wealth population from LB&I's planning, analysis, inventory and research function and then uses mathematical computations to assess the level of compliance risk and determine the taxpayers' examination potential. The returns with the highest risk indicators are further evaluated for examination. GHW has more than 100 revenue agents who use the full range of LB&I specialists to help in its examinations, relying heavily on support from financial products specialists, international examiners and local Chief Counsel attorneys.

Chief Counsel Support. Given the existing strong nexus to the financial products program, management of the legal side of the program was placed with the financial services area counsel; the same senior-level counsel who assists with the FP Program also helps the financial services area counsel administer GHW-related matters. The Chief Counsel's office has committed to having its attorneys involved in the earliest stages of high-wealth individual examinations to facilitate the process and help identify and develop sustainable audit adjustments.

Former IRS Commissioner Doug Shulman initially touted GHW as a game-changing strategy in 2010, but the industry group has had a turbulent path. GHW failed to meet its early and modest objectives, but it has learned from those mistakes relating to "kitchen sink" audits using broad and

burdensome information document requests in an attempt to identify issues. More recently, GHW has taken a more sophisticated and streamlined approach, relying more on financial product specialists and attorneys for help in deploying its limited resources effectively. We expect LB&I attorneys will have an increasingly strategic role in GHW's continued evolution.

The Whistleblower Program

The IRS Whistleblower Office, established by the Tax Relief and Health Care Act of 2006 and operating under the direction of the Deputy Commissioner for Services and Enforcement, processes, manages and tracks information received from individuals who spot tax problems in their workplace, while conducting day-to-day personal business or anywhere else they may be encountered. Although the IRS has had the ability to pay discretionary whistleblower awards since 1867, the 2006 act resulted in significant changes to the program. Under new Internal Revenue Code Section 7623(b), the IRS generally is required to pay an award to a whistleblower whose information substantially contributes to the collection of tax, penalties, interest and other amounts where the amount in dispute is more than \$2 million. This mandatory award is up to 30 percent of collected proceeds, with no cap, and is administered by the Whistleblower Office, which evaluates the claims.

Although the Whistleblower Office may investigate claims, it assigns them (using the characteristics of the target taxpayer) to the appropriate IRS operating division or to IRS Criminal Investigation. If an audit or investigation is conducted based on the information contained in the claim, the Whistleblower Office will determine whether the whistleblower is eligible for an award under Section 7623(b).³

Whistleblower awards totaled approximately \$50 million in 2013, down from approximately \$125 million in 2012 due, in part, to an 8.7 percent reduction dictated by sequestration spending cuts. In 2013 the Whistleblower Office had fewer than 40 staff members to process the 4,067 Section 7623(a) and (b) submissions identifying 9,472 claims against taxpayers. LB&I handles the lion's share of whistleblower activity under Section 7623(b); approximately 60 percent of these submissions and claims were referred to the division. These claims often relate to the activities of LB&I's largest taxpayers. Within LB&I, the majority of whistleblower claims relate to financial services firms.

Chief Counsel Support. The Whistleblower Office has turned to the Office of Chief Counsel for strategic, logistical and legal support; a senior attorney serves as special counsel to the office's director. The Chief Counsel's office provides additional support for this program in a number of ways. Each of Chief Counsel operating divisions has its own pre-existing programs, structures and protocols for providing logistical and legal support to the Whistleblower Office. In Chief Counsel's LB&I Division, there is a senior-level counsel that helps oversee the program nationwide and serves as a liaison to the IRS National Office. Modeled after the original promoter program structure (addressed below), each area has a point of contact (an associate area counsel or senior attorney) and a cadre of designated lawyers to provide logistical and legal support. Chief Counsel attorneys are actively engaged and have assisted in conducting taint reviews (to screen for potentially privileged information or documents), assisted in determining whether the provided information is of value to the IRS, helped in reviewing whether the information can be traced to "collected proceeds" (the tax revenues collected), and provided advice on underlying substantive issues.

It is anticipated that LB&I will continue to use information provided by whistleblowers and that, given staffing needs, Chief Counsel attorneys will continue to play a vital role in analyzing the valuable information provided by whistleblowers. With increased publicity concerning the whistleblower program and the higher awards that are possible, it is anticipated that submissions will continue to rise.

3 The Whistleblower's Office also is responsible for processing claims under Section 7623(a), the original discretionary award program.

The Tax Shelter Promoter Program

The LB&I Office of Tax Shelter Analysis (OTSA) was created in February 2000 as part of the division's prefiling and technical guidance function. OTSA serves as a centralized collection point for all leads involving abusive tax shelters and other reportable transactions, and is charged with providing information and services to all IRS operating divisions and functions as well as other interested parties, including Treasury and Congress. The division's Tax Shelter Steering Committee provides leadership and executive oversight in implementing the tax shelter promoter program. A subcommittee, the Technical Tax Shelter Promoter Committee, is responsible for authorizing LB&I's civil investigations. The Promoter Committee is jointly led by the LB&I financial services industry director and the Office of Chief Counsel's financial services area counsel.

If information is received from any sources (including OTSA, audit teams, informants or criminal investigations) that suggests that material advisers (prior to the American Jobs Creation Act of 2004, these entities were referred to as "promoters") failed to disclose tax shelters or did not maintain investor lists, that information is presented to the Promoter Committee. If a *prima facie* case is made for a potential violation, then the Promoter Committee may authorize a promoter investigation. Without the Promoter Committee's approval, no promoter investigation may commence. Once a promoter investigation is authorized, an examination team is selected to conduct the audit. The promoter audits serve two main purposes:

- to determine whether the material adviser complied with their obligations to register (now disclose) tax shelters (now reportable transactions) and maintain investor lists, and
- to obtain information about investors in tax shelters so that the investors can be identified and audited, and if litigated, to support the litigation.

If it is determined that material advisers have not complied with the law, then penalties can be imposed to punish and deter future violations.

Chief Counsel Support. Since the inception of the promoter program, the Office of Chief Counsel has played a key and active role in supporting promoter investigations.⁴ At the inception of the program, each of the five LB&I area counsel appointed a tax shelter coordinator to help oversee the promoter audits and supervise the LB&I counsel attorneys assigned to each promoter case. Given the volume of cases, complexity of the issues and nature of the expertise required, Chief Counsel attorneys often have had a highly active role in most of the hundreds of such examinations that have occurred to date. Chief Counsel attorneys have helped draft information document requests and summonses, conducted Q&As in connection with summonses for testimony, handled correspondence with representatives, provided training to agents, provided legal advice on issues, reviewed documents for potential identification of new or emerging transactions, drafted legislative proposals, liaised with the criminal investigation division to conduct parallel civil/criminal investigations, worked with the Department of Justice and U.S. Attorney Offices in litigation and helped negotiate administrative settlements.

Although some of the high-profile press surrounding the promoter program has abided, the referrals to LB&I's promoter committee continue to roll in. The Promoter Committee and its designated attorneys are committed to preventing a new proliferation of abusive technical tax shelters by being more vigilant in monitoring material adviser disclosures.

⁴ The vast majority of LB&I's promoter audits have targeted financial services firms, law firms, accounting firms and boutique tax advisers.