IRS Insights | A closer look

In this edition

IRS proposes regulations regarding taxpayer access to Appeals

IRS replaces penalty protection previously offered by Rev. Proc. 94-69

Challenge to transition tax regulation precludes proration under Section 965(h)

Chief Counsel analyzes adequate disclosure in context of noneconomic substance transactions

IRS proposes regulations identifying syndicated conservation easements as listed transactions following Tax Court ruling invalidating Notice 2017-10

IRS announces new CAP phase: Bridge Plus

IRS proposes regulations regarding taxpayer access to Appeals

In 2019, the Taxpayer First Act established the IRS Independent Office of Appeals and added Section 7803(e) to the Internal Revenue Code. Recently, the IRS proposed regulations under the new Section 7803(e).

Taxpayer First Act and Appeals

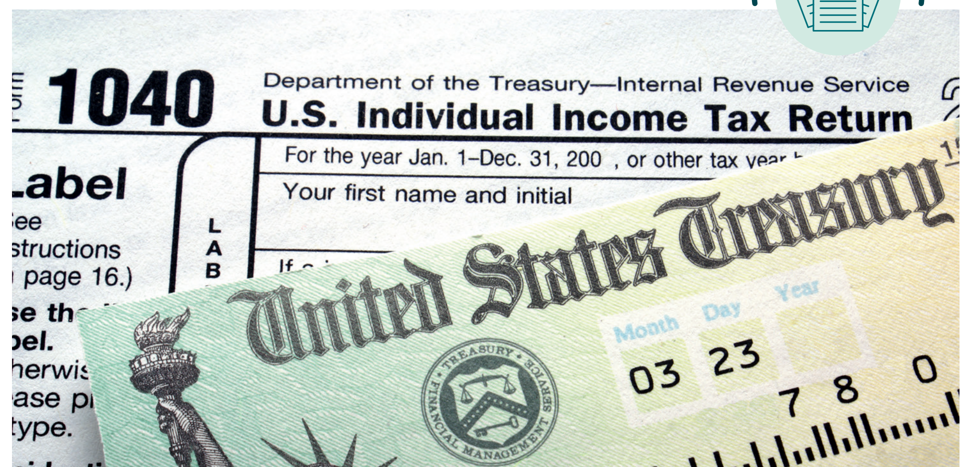
Congress created the Independent Office of Appeals "to codify the role of the independent administrative appeals function within the IRS."[1] The Taxpayer First Act states that the purpose of Appeals is to resolve federal tax controversies without litigation on a basis that is (1) fair and impartial, (2) "promotes a consistent application and interpretation of, and voluntary compliance with, the federal tax laws," and (3) enhances public confidence in the IRS.[2]

The Taxpayer First Act states that the right to go to Appeals "shall be generally available to all taxpayers," but it does allow the IRS to deny a taxpayer the right to go to Appeals.[3] However, if the IRS denies the taxpayer access to Appeals, the IRS must now issue a written notice to the taxpayer explaining the basis for the denial.[4] Congress also required that the IRS establish procedures by which taxpayers can protest the denial of the request to go to Appeals.[5]

Proposed regulations

The IRS recently issued proposed regulations under Section 7803(e). The proposed regulations focus on when the IRS can deny a taxpayer's right to Appeals. The IRS identified 24 categories where it can deny the right, including frivolous positions, challenges to Treasury regulation, challenges to Notice or Revenue Procedure, cases designated for litigation, and challenges that statute is unconstitutional.[6] Additionally, the IRS has requested comments on whether the IRS should be able to deny a taxpayer's right to go to Appeals regarding 9100 relief and requests for changes in accounting method.[7]

The regulations are not in effect yet—the IRS has proposed the regulations go into effect 30 days after the final regulations are published.



IRS replaces penalty protection previously offered by Rev. Proc. 94-69

For almost 30 years, large corporate taxpayers relied on Rev. Proc. 94-69 to allow them penalties protection by reporting additional tax and making adequate disclosures after an examination started. On November 16, 2022, the IRS obsoleted Rev. Proc. 94-69 and replaced it with Rev. Proc. 2022-39. The new revenue procedure still offers some penalty protection to certain large taxpayers but with new eligibility rules.

Background

To avoid accuracy-related penalties for underreporting of tax, taxpayers generally must either file qualified amended returns before the IRS begins an examination or adequately disclose any position that has only a reasonable basis on their returns. Historically, large corporate taxpayers who were under continuous audit did not have the ability to file qualified amended returns disclosing additional tax positions before the IRS began an examination.

To accommodate these taxpayers, the IRS issued Rev. Proc. 94-69, which allowed large corporate taxpayers to report additional tax due or make adequate disclosures *after* an audit began and still receive penalty protection.

In August 2020, the IRS announced that it was considering obsoleting Rev. Proc. 94-69. Many taxpayers and practitioners expressed concerns about the obsoletion of penalty protection for large corporate taxpayers. In September 2021, the IRS announced it would retain some of the protections of Rev. Proc. 94-69, but that it was still finalizing the replacement. On November 16, 2022, the IRS issued Rev. Proc. 2022-39, which obsoletes and replaces Rev. Proc. 94-69.

New procedures in Rev. Proc. 2022-39

Under the new revenue procedure, "eligible taxpayers" can show additional tax due or make adequate disclosure with respect to an item or a position on a previously filed return to avoid imposition of the accuracy-related penalties in Sections 6662(b)(1) and 6662(b)(2). In a change from prior guidance, the IRS says the new procedures also apply to large partnerships.

Generally, taxpayers are "eligible taxpayers" if the IRS has selected for audit four of the five tax returns preceding the year at issue. Specifically, corporations are "eligible taxpayers" if they are (1) selected for examination under Large Corporate Compliance (LCC) or a successor program and (2) on the date on which the IRS first contacts the taxpayer concerning an examination of an income tax return, at least four of the taxpayer's income tax returns for the five taxable years preceding the taxable year at issue are (or were) under examination under the LCC, the Coordinated Industry Case, or a successor program. Likewise, partnerships are "eligible taxpayers" if they are (1) selected for examination under Large Partnership Compliance (LPC) or a successor program and (2) on the date on which the IRS first contacts the partnership concerning an examination of a return of partnership income, at least four of the partnership's returns for the five taxable years preceding the taxable year at issue are (or were) under examination under the LPC or a successor program.

The revenue procedure states that the IRS will inform taxpayers selected for examination under the LCC or the LPC that they are eligible taxpayers under Rev. Proc. 2022-39.

To receive the penalty protection afforded in Rev. Proc. 2022-39, eligible taxpayers must file Form 15307, *Post-Filing Disclosure for Specified Large Business.* If an eligible taxpayer properly completes Form 15307, it is treated as a qualified amended return with respect to a particular taxable year of an eligible taxpayer. The Form 15307 is due within 30 days of the IRS's request for the form (or within a time period agreed to by the taxpayer and IRS personnel).

The new procedures apply to any examinations that began after November 16, 2022 (the date the revenue procedure was released). As a transition rule, Rev. Proc. 94-69 continues to apply to the taxpayers eligible for such relief with respect to examinations of taxable year 2020 and earlier years.

Challenge to transition tax regulation precludes proration under Section 965(h)

The IRS recently released a Chief Counsel Advice Memorandum (the "Memorandum")[8] that addressed the application of Section 965(h)(4) on an unreported tax liability stemming from a regulation challenge. The Memorandum concluded that the portion of the tax liability not reported was a deficiency due to negligence or intentional disregard of Reg. §1.78-1, and, because of this, the view of IRS Counsel is that the taxpayer was not entitled to prorate the deficiency under Section 965(h)(4). As such, the deficiency was due on notice and demand.

Taxpayers can elect to pay their Section 965(h) liability in eight installments.[9] When a Section 965(h)(1) election is made and a deficiency is assessed with respect to the net tax liability, the deficiency is also prorated to the installments.[10] However, the election to pay in installments does not apply to deficiencies resulting from negligence, intentional disregard of rules and regulations, or fraud with intent to evade tax.[11]

The Memorandum indicated that Reg. §1.78-1 was applicable to the taxpayer's 2018 tax year as it was first published on December 7, 2018, and finalized (without changes) on June 21, 2019. However, the taxpayer's return did not reflect the application of this regulation. Therefore, any deficiency determined by the IRS (if assessed) would be a deficiency due to intentional disregard of Reg. §1.78-1, and proration of the deficiency was precluded by Section 954(h)(4).

The Memorandum also stated that its conclusion would stand regardless of whether Form 8275-R, *Regulation Disclosure Statement*, or any other disclosure of the position was filed because Section 965(h)(4) and Reg. §1.965-7(b)(1)(ii)(C) do not provide an exception for disclosure of a disregarded rule. The same conclusion would also apply if the deficiency was determined to be due to negligence or intentional disregard of any other rule or regulation that would ultimately increase the Section 965(h) net tax liability.

Chief Counsel analyzes adequate disclosure in context of noneconomic substance transactions

On November 4, 2022, the IRS released a Chief Counsel Advice Memorandum[12] addressing adequate disclosure for the purposes of avoiding a higher percentage accuracy-related penalty under Section 6662(i).

Background

In this case, there was a taxpayer who disclosed micro-captive insurance transactions on a Form 8886, *Reportable Transaction Disclosure Statement*, but the taxpayer did not also disclose the transaction on Form 8275, *Disclosure Statement*, as purportedly required by IRS Notice 2010-62. The IRS Office of Chief Counsel ("Chief Counsel") considered whether a taxpayer has adequately disclosed noneconomic substance transactions, for the purposes of Section 6662(i)(2), where the material facts of the transactions are disclosed as reportable transactions on Form 8886 but are not separately disclosed on Form 8275.

Chief Counsel's analysis

Section 6662(i) provides for an increase in the amount of the accuracy-related penalty from 20% to 40% where an underpayment is attributable to a nondisclosed noneconomic substance transaction. In Section 6662(i)(2), "nondisclosed noneconomic substance transaction" is defined as a transaction lacking economic substance with respect to which the relevant facts affecting the tax treatment are not adequately disclosed in the return or in a statement attached to the return. Significantly, no Treasury Regulations were promulgated to require the filing of Form 8275 to disclose a noneconomic substance transaction to avoid the imposition of the 40% accuracy-related penalty under Section 6662(i). In 2010, the IRS issued Notice 2010-62, ostensibly requiring noneconomic substance transactions under Section 6662(b) that are also reportable transactions under Section 6011 to be disclosed both on Form 8886 and on Form 8275. In March 2019, Treasury and the IRS released a *Policy Statement on the Tax Regulatory Process*, stating that subregulatory guidance is not intended to affect taxpayer rights or obligations independent from underlying statutes or regulations. The 2019 policy statement further asserted that the IRS will not argue that subregulatory guidance has the force and effect of law.

In light of this background and the absence of Treasury Regulations requiring a taxpayer to disclose a noneconomic substance transaction on Form 8275, Chief Counsel determined that the IRS should rely on the language in Section 6662(i)(2) and relevant case law to evaluate the adequacy of a disclosure. Acknowledging that courts have not specifically analyzed what constitutes

adequate disclosure under Section 6662(i)(2), Chief Counsel reviewed cases in which the Tax Court had interpreted similar disclosure requirements and found that, from the Tax Court's perspective, the critical inquiry is whether the taxpayer adequately disclosed sufficient relevant data concerning the treatment of the item to alert the IRS to potential controversy (citing *Elliott v. Commissioner*, T.C. Memo. 1997-294).

Conclusion

Ultimately, in CCA 202244010, Chief Counsel concluded that, because Notice 2010-62 does not have the full force and effect of law, a Form 8886 timely filed with a return or a qualified amended return that completely describes the material facts of a noneconomic substance transaction likely meets the disclosure requirements under Section 6662(i). However, if a Form 8886 is deficient in some way or omits material facts of the noneconomic substance transaction, then it might not meet the disclosure requirements under Section 6662(i).

IRS proposes regulations identifying syndicated conservation easements as listed transactions following Tax Court ruling invalidating Notice 2017-10

On December 8, 2022, the IRS issued a notice of proposed rulemaking (the "Proposed Regulations") identifying syndicated conservation easement ("SCE") transactions as "listed transactions" requiring disclosure to the IRS.[13] The Proposed Regulations follow recent court decisions holding that the IRS lacks authority to identify listed transactions through IRS Notices.[14] Specially, with respect to SCE transactions, the Tax Court held that Notice 2017-10 was subject to the notice-and-comment rulemaking requirement of the Administrative Practice Act ("APA").

Notice 2017-10

In 2017, the IRS published Notice 2017-10 identifying all SCE transactions and substantially similar transactions as "listed" transactions and subjecting them to the regulations issued under the "reportable transaction" disclosure regime of Section 6011. Taxpayers participating in reportable transactions are required to disclose their participation to the IRS.[15] Additionally, material advisers are required to disclose these transactions to the IRS and must also maintain a list of taxpayers to whom they provided advice regarding these transactions.[16] Following the publication of Notice 2017-10, failure to disclose SCE transactions could result in the assessment of penalties against taxpayers and material advisers.

Tax Court decision in *Green Valley*

In the *Green Valley* case, a 15-2 majority held that the IRS was required (and failed) to follow the APA notice-and-comment procedures when it issued Notice 2017-10.

Green Valley Investors, LLC and three other partnerships participated in SCE transactions in tax years ending prior to the issuance of Notice 2017-10. The partnership returns claim the charitable contribution deductions were audited by the IRS, and the IRS determined that the partners were not entitled to the charitable deductions because the partnerships (1) failed to meet the requirements under Section 170, and (2) could not substantiate the value of the donated easements. The IRS asserted accuracy-related penalties under Section 6662. The partnerships petitioned the Tax Court for review, and the IRS subsequently asserted reportable transaction penalties under Section 6662A in its answers. The parties filed cross motions for partial summary judgment with regard to the Section 6662A penalties. Among other arguments, the partnerships argued that Notice 2017-10 was invalid under the APA.

Relying on the Sixth Circuit's reasoning in *Mann Construction*, the Tax Court held that Notice 2017-10 was a legislative rule—subject to the APA's notice-and-comment procedures—because it "impose[d] new rights or duties and change[d] the legal status of regulated parties."[17] The Tax Court also rejected the IRS's argument that it was exempted by Congress from following the APA procedures when identifying listed transactions because it established a separate procedure under which Notice 2017-10 was issued. However, the Tax Court held that without an express indication of congressional intent the IRS could not stray from the notice-and-comment requirements of the APA.[18]

The proposed regulations

While the IRS disagrees with the Tax Court's ruling in *Green Valley* and filed a motion for reconsideration, it now seeks "to eliminate any confusion regarding the need to report [SCE] transactions and to ensure that these [court] decisions do not disrupt the IRS's ongoing efforts to combat abusive tax shelters"[19] by issuing the Proposed Regulations.

In accordance with the notice-and-comment procedures of the APA, the comment period for the Proposed Regulations was open through February 6, 2023, and a public hearing was held on March 1, 2023. When final, the Proposed Regulations will apply to *all* open tax years, including tax years that ended before the Proposed Regulations were finalized.[20] The retroactive application of the regulations may itself pose another challenge for the IRS as the Tax Court declined to decide whether the relevant penalties could be applied to tax years that were open at the time Notice 2017-10 was issued in the *Green Valley* case.[21]

IRS announces new CAP phase: Bridge Plus

On February 13, 2023, the IRS announced in IR-2023-25 changes to the Bridge phase of the CAP program by adding a new pilot phase. The new pilot phase, Bridge Plus, will be offered only to CAP participants that were in the Bridge phase for 2022 and have been recommended to participate in the Bridge phase again in 2023.

Background

The Compliance Assurance Process ("CAP") program began in 2005. The objective of the program is to reduce taxpayer burden and uncertainty while assuring the IRS of the accuracy of tax returns before filing, thereby reducing or eliminating the need for post-filing examinations. If a taxpayer is accepted into the program, IRS examiners and the taxpayer work together to identify and resolve issues as they arise during the tax year before the filing of the tax return. If successful, the IRS will issue a "Full Acceptance" letter, which constitutes written confirmation that the IRS will accept the return as filed.

In 2019, the IRS created the "Bridge phase" for CAP. During the Bridge phase, the taxpayer remains in CAP but the IRS will not accept any disclosures, conduct any reviews, or provide any assurances. Taxpayers do not receive a Full Acceptance letter, but the IRS indicated it would subsequently examine a Bridge phase year only in certain circumstances (e.g., evidence of fraud, new material, material change). Taxpayers eligible for the bridge phase are generally taxpayers that have been in the CAP for several years and have few, if any, material issues. Taxpayers can only be in the Bridge phase for two consecutive years at a time.

Bridge Plus phase

Many CAP taxpayers criticized the Bridge phase because it deprived them of an important aspect of the CAP (i.e., the review by the IRS and the potential for a Full Acceptance letter, which provides the taxpayer some certainty). In response to this feedback, the IRS has developed a new pilot phase called Bridge Plus. In Bridge Plus, taxpayers can receive a Full Acceptance letter.

To be eligible for Bridge Plus, taxpayers must provide book-to-tax reconciliations, credit utilization, and other supporting documentation shortly after their audited financial statement is finalized. Once received, an IRS team will risk-assess the documents to determine if the taxpayer is suitable for the Bridge Plus phase.

Taxpayers accepted into the Bridge Plus phase will be required to submit a draft return 30 days before filing. The IRS team will review the draft return for consistency with the taxpayer's prior submission. If the draft return is consistent with the prior submission, the taxpayer will be instructed to file a return, and the taxpayer will be issued a Full Acceptance letter.

The new Bridge Plus pilot phase will be offered only to CAP participants that were in the Bridge phase for 2022 and have been recommended to participate in the Bridge phase again in 2023. Acceptance into the program will be based on input from multiple IRS LB&I practice areas as well as the outcome of the risk assessment performed after the filing of the taxpayer's audited financial statements and requested information.

Endnotes

1. *See* House TFA Report, at 29.

2. Section 7803(e)(3)(B).

3. Section 7803(e)(4).

4. Section 7803(e)(5)(A).

5. Section 7803(e)(5)(C).

6. Prop. Treas. Reg. § 301.7803-2(c).

7. 87 Fed. Reg. 55934, 55945 (Sept. 13, 2022).

8. CCA 202235009 (dated Aug. 9, 2022, and released on Sept. 2, 2022).

9. *See* Section 965(h)(1).

10. *See* Section 965(h)(4) and Reg. §1.965-7(b)(1)(ii)(A)(1).

11. *See* Section 965(h)(4).

12. CCA 202244010 (dated Oct. 3, 2022).

13. 87 Fed. Reg. 75185 (Dec. 8, 2022).

14. *See Mann Construction, Inc. v. United States*, No. 21-1500 (6th Cir. March 3, 2022); *see also Green Valley Investors, LLC v. Commissioner*, 159 T.C. No. 5 (Nov. 9, 2022).

15. Treas. Reg. § 1.6011-4.

16 Sections 6111 and 6112.

17. *Green Valley*, 159 T.C. No. 5, at 8.

18. *Id.* at 19.

19. IRS News Release, IR-2022-214, Dec. 6, 2022.

20. 87 Fed. Reg. 75185, 75193-94 (Dec. 8, 2022).

21. *Green Valley*, 159 T.C. No. 5, at 7.

Contact us

Matt Cooper
Tax Managing Director| Tax WNT
Deloitte Tax LLP
mattcooper@deloitte.com

Howard Berman
Tax Managing Director| Tax WNT
Deloitte Tax LLP
hberman@deloitte.com

Colleen Harkins
Tax Senior Manager | Tax WNT
Deloitte Tax LLP
charkins@deloitte.com

Teresa Abney
Tax Senior Manager | Tax WNT
Deloitte Tax LLP
tabney@deloitte.com

Jennifer O'Brien
Tax Senior Manager | Tax WNT
Deloitte Tax LLP
jenobrien@deloitte.com

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