

**Deloitte.**



**Private wealth tax controversies**

Deep experience navigating  
interactions with taxing authorities



# Content

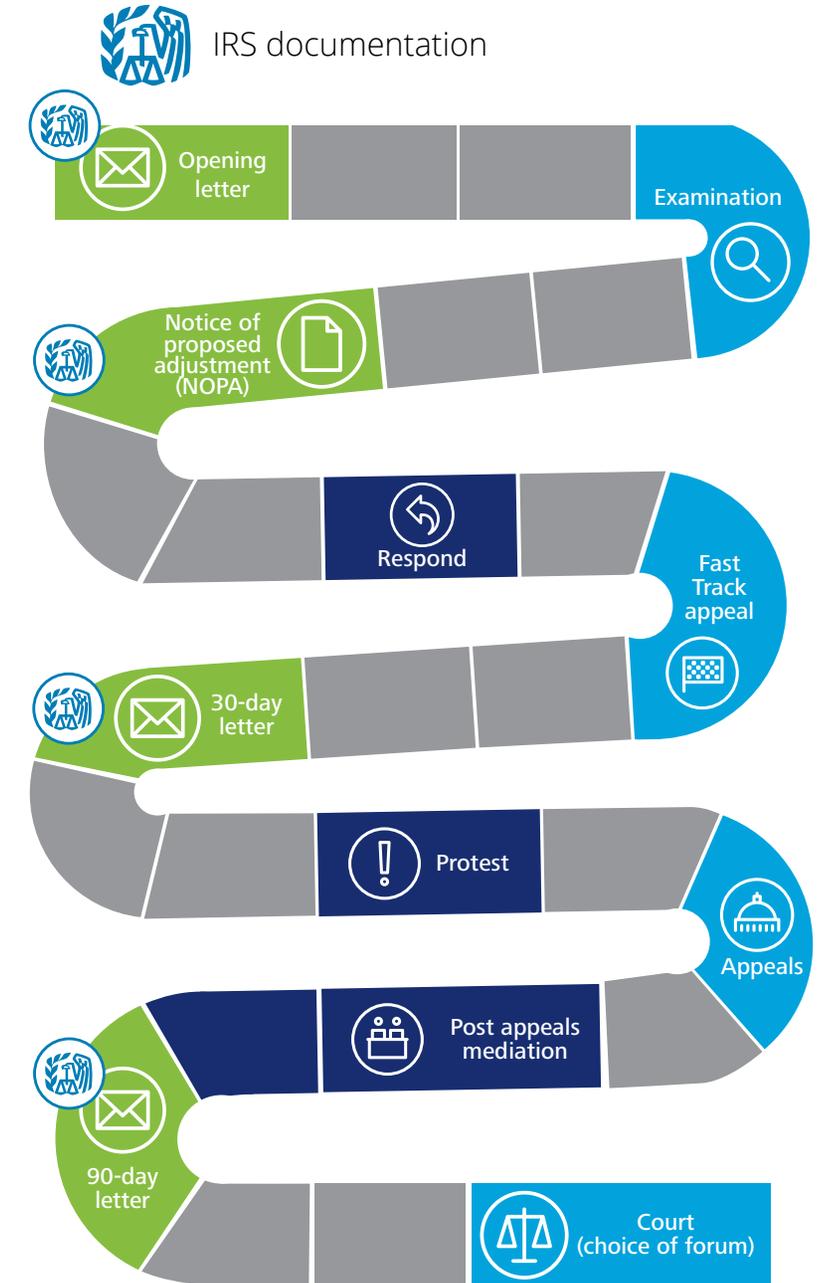
The Internal Revenue Service and state taxing authorities continue to focus on taxpayers with sophisticated personal and business situations.

This report provides guidance and information to help private wealth taxpayers understand and be prepared for these examinations and ensuing tax controversies.

	Overview	4
	The likelihood of IRS examination	5
	Examinations	6
	IRS Fast Track appeal	7
	IRS appeals and post-appeals mediation	8
	Litigation	9
	How Deloitte can help	10



## The tax controversy process



# Overview



In today's tax controversy climate, it is more important than ever to understand the important steps of the tax controversy process. Regardless of where an examination starts, the tax controversy process requires careful planning from onset to resolution.

In 2009, the IRS formed a special division called the Global High Wealth ("GHW") industry group. Its stated purpose is to increase focus on high-income taxpayers, together with their related entities.

In addition, private wealth taxpayers continue to be examined, often very thoroughly, by the Small Business and Self-Employed IRS division. This division conducts all estate and gift examinations and many employment tax examinations, regardless of size. Finally, there are the normal correspondence examinations, most of which are generated by the IRS Service Centers. As a result, high-income taxpayers are much more likely to be examined than lower-income taxpayers.

Private wealth taxpayers benefit by taking steps today to embed best practices in the tax planning and compliance processes to address the needs for necessary documentation if an examination were to occur by a taxing authority.

## Some common questions that private wealth taxpayers face are:

Which documents must be provided to respond to an agent's request, and what are the implications to other parties if those documents are provided to the IRS?

Who is best suited to present your arguments on technical issues when the law is not agreed upon?

How will you obtain the necessary information and how quickly?

How will you communicate with others—within a family office, with advisors, and with related individuals and entities?

How can you limit interest and penalties?

When should you extend the statute of limitations?

When is it beneficial to consider an alternative resolution approach?



# The likelihood of IRS examination



As adjusted gross income (“AGI”) rises, so does the likelihood of examination. Individuals with adjusted gross income of over \$1 million are more likely to be subject to examination, **with coverage rates approaching 25-percent for those with AGI over \$10 million**. Current IRS initiatives, including GHW examinations, foreign income reporting, transfer pricing, employment tax and other focus areas, suggest that private wealth taxpayers and family offices should be prepared for the possibility of an examination.

Size of adjusted gross income on return	Returns filed in Calendar Year 2014 (percent of total)	Examination coverage in Fiscal Year 2015 (percent)
No adjusted gross income	1.76	3.78
\$1 – \$25,000	38.51	1.01
\$25,000 – \$50,000	23.23	.50
\$50,000 – \$75,000	13.13	0.47
\$75,000 – \$100,000	8.42	0.49
\$100,000 – \$200,000	11.15	.064
\$200,000 – \$500,000	3.08	1.54
\$500,000 – \$1,000,000	0.48	3.81
\$1,000,000 – \$5,000,000	0.21	8.42
\$5,000,000 – \$10,000,000	0.01	19.44
\$10,000,000 or more	0.01	34.69

Source: IRS Data Book for 2015

## Tip:

It is helpful for taxpayers to do periodic risk assessments before an examination begins. These risk assessments can range from a simple discussion with internal advisors to a detailed examination readiness assessment that includes document reviews and interviews. The goal is to identify material issues that could become a focus on examination, prepare for examination of these items, and confirm that there is a system in place for addressing potential government information requests.



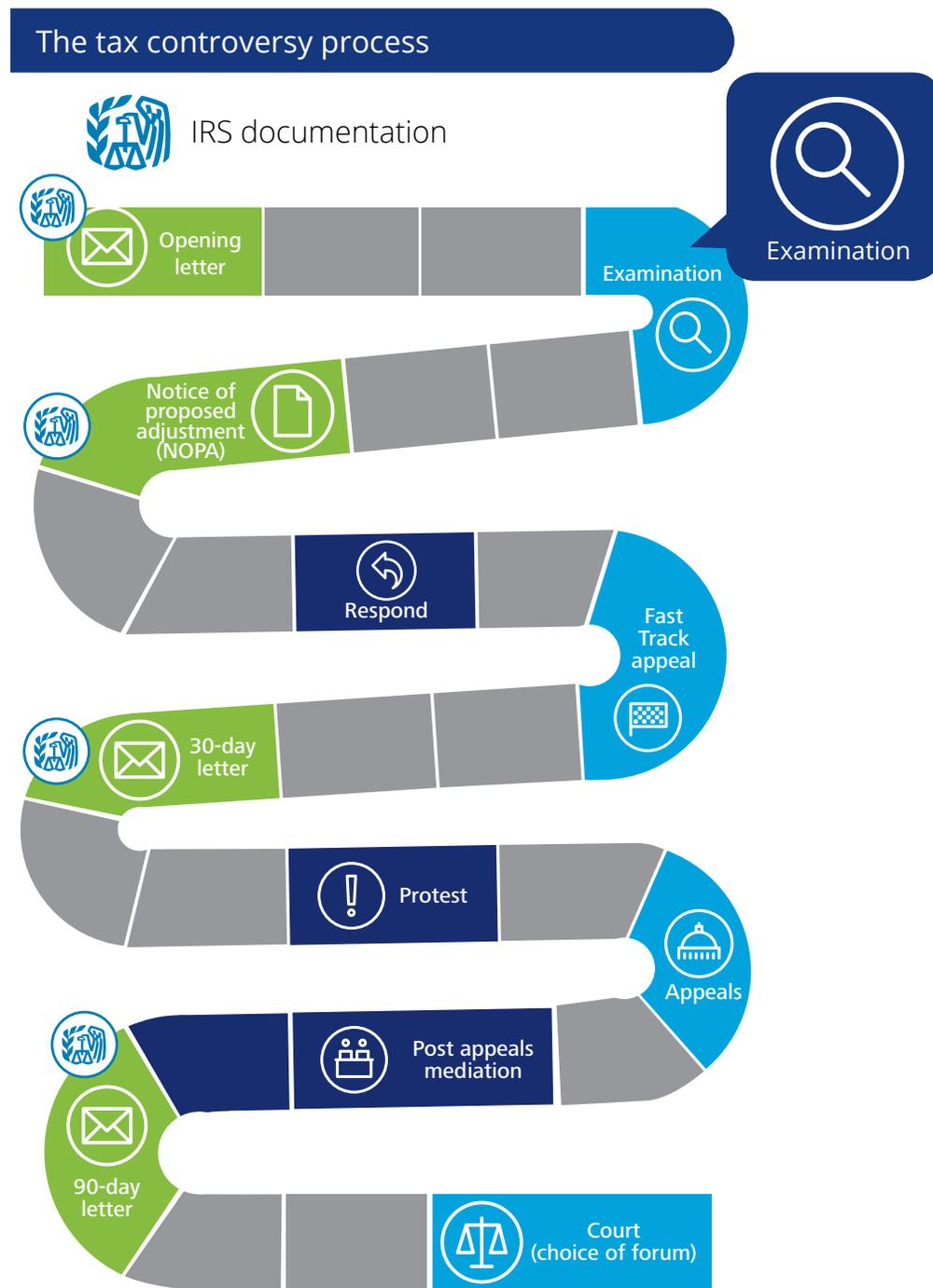
# Examinations

Private wealth examinations are often a stressful time for the taxpayer. Most examinations begin with a letter to schedule an initial appointment. Often, the examinations are scheduled promptly and the examiners may want to meet at a location relevant to the taxpayer. They also may want to conduct a tour of the business premises, if one exists.

Following the initial meeting, the examiner will likely define proposed material examination issues and begin to issue information document requests (“IDRs”). Under the GHW group’s approach, it would not be unusual to receive IDRs from more than one examiner. Examiners are often under pressure to complete examinations in a timely manner, so be prepared for expedited turnaround time requests.

In our experience, managing a tax controversy situation is as much an art as it is a science. In fact, it can involve much more than just responding to IDRs and following up to determine the status of the examination. Taxpayers may need to make critical decisions that could have a significant bearing on the outcome—most of which may well be new areas for them or their family office.

Historically, the average time to complete a traditional individual examination has been about 12 to 18 months, although the timeframe could depend on the complexity of the issues involved. If an examiner finds technical issues requiring referral to an appraiser or international, financial products, or other specialist, the examination may continue for a longer period of time.



# IRS Fast Track appeal

Fast Track is an IRS expedited dispute resolution program that takes place during the examination phase. The goal of Fast Track is to resolve issues earlier in the process and more quickly than traditional approaches. Fast Track occurs after one or more issues have been defined in a notice of proposed adjustment, but before the formal closure of the examination.

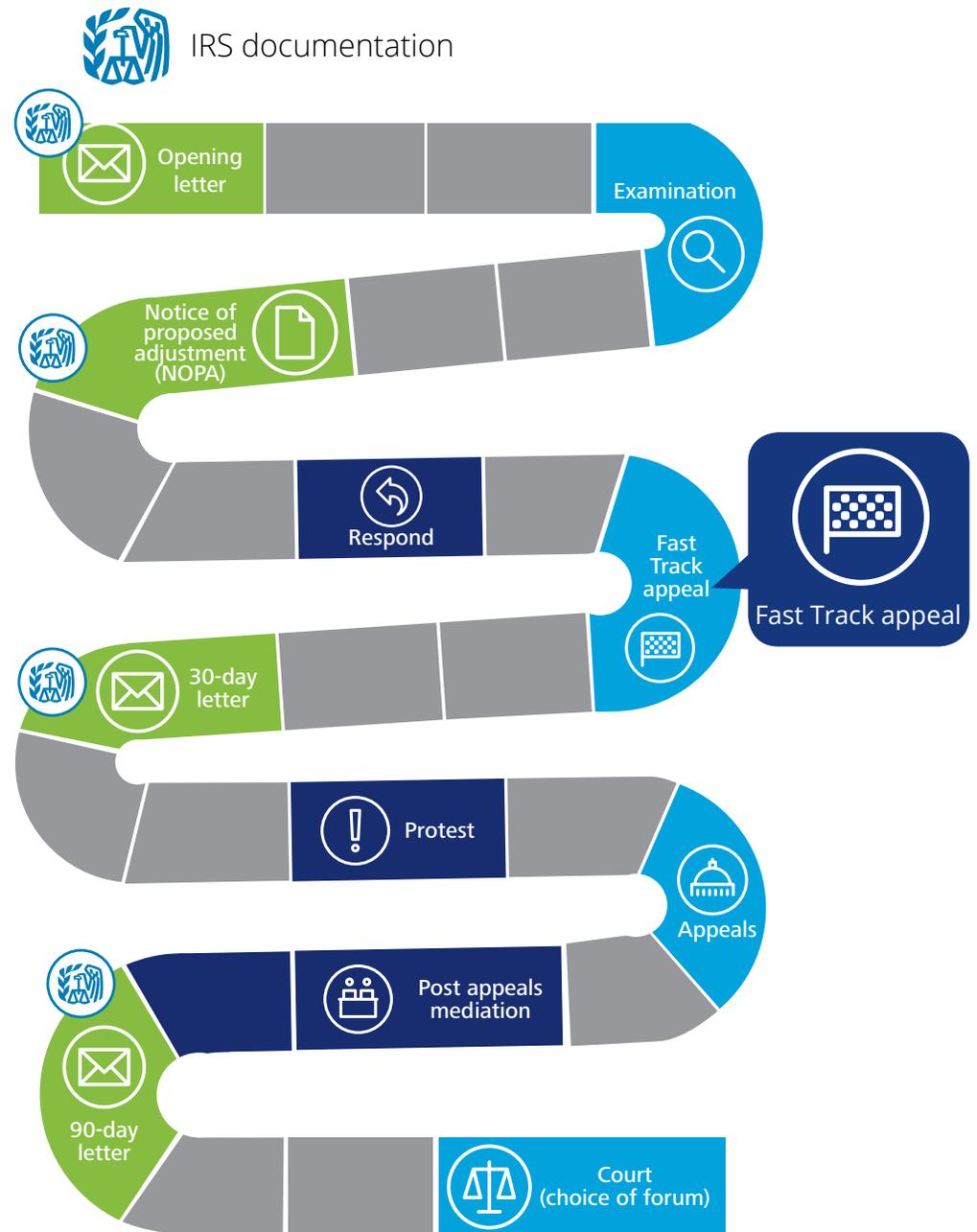
Fast Track is a voluntary, non-binding process and can be initiated either by the taxpayer or the IRS examination team. Fast Track does not reduce or eliminate the ability to use the normal appeals resolution option, if Fast Track is unsuccessful. Typically, Fast Track is completed within 120 days of the IRS accepting the case into the Fast Track program.

During the Fast Track proceedings, the IRS examination team and the taxpayer will engage in negotiations with an IRS appeals officer acting as a neutral third party. The Fast Track appeals officer will not act in a traditional appeals role, but will use dispute resolution techniques to facilitate settlement between examination and the taxpayer.

## Tip:

Fast Track can be a valuable tool, but it may not be as effective where there is an acrimonious relationship with the examination team. In that case, it may be better to go straight to IRS appeals.

## The tax controversy process



# IRS appeals and post-appeals mediation

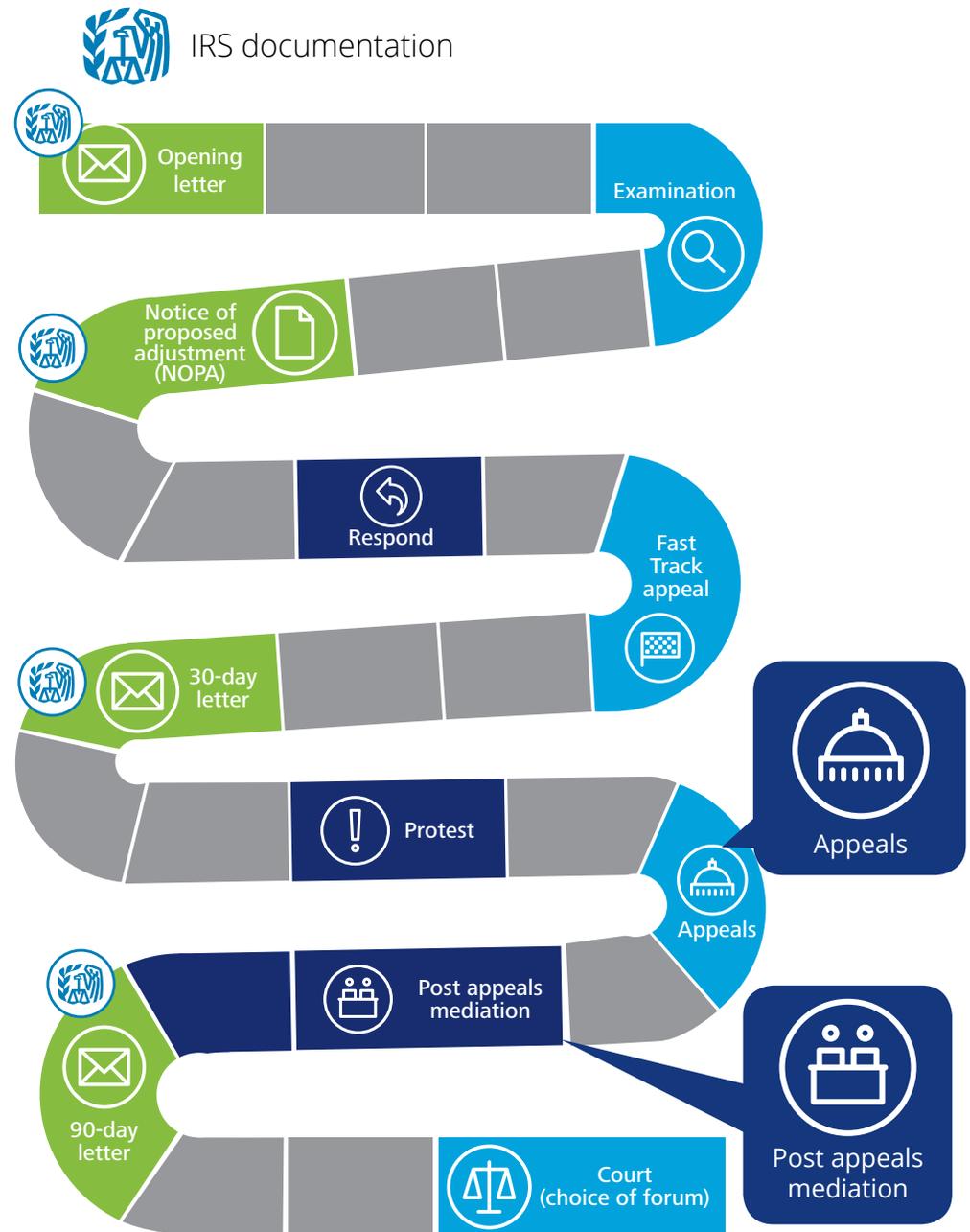
IRS appeals is a fresh look at a taxpayer's IRS dispute in which the examination team has limited or no involvement. Appeals differs from the examination function in many ways, but one of the more important differences is appeals' settlement authority. While examination must resolve issues purely based on its determination of the facts and law, as interpreted by the Commissioner, appeals can settle an issue taking into consideration the hazards of litigation. In other words, appeals officers can factor in the strengths and weaknesses of an issue, as if it were to go to court, partially compromising if appropriate.

Mediation is an extension of the appeals process and is meant to facilitate compromise and avoid the necessity of litigation where the normal appeal is unsuccessful. Post-appeals mediation is a non-binding process that uses the services of a mediator, either a different, specially-trained IRS appeals officer, or an outside mediator, to help reach settlement. The mediator will act as a facilitator, assisting in defining the issues and promoting settlement between appeals and the taxpayer.

Deloitte Tax LLP can assist taxpayers through the appeals process, which may include:

- Analysis of 30-day letter
- Preparation/analysis of protest
- Representation at appeals conference
- Representation at post-appeals mediation
- Negotiation of settlement
- Estimated computations of tax, penalties, and interest

## The tax controversy process



# Litigation

If all other dispute resolution options do not produce a successful outcome, then taxpayers have three alternative judicial forums for litigating their federal tax controversies. Each judicial forum has separate considerations that must be taken into account by a taxpayer and his/her legal counsel. If the taxpayer or IRS disagrees with the trial outcome, then judicial appeals are available from all three forums.

## Tip:

Generally, trial proceedings in all three forums are open to the public. The media can access most court filings and trial records, and these can become public news items.



	Pro	Con
United States Tax Court	<ul style="list-style-type: none"> <li>• Highly specialized judges</li> <li>• Do not have to pay tax to litigate</li> <li>• Based in Washington, D.C., but judges travel the country to hear cases</li> </ul>	<ul style="list-style-type: none"> <li>• No jury available</li> <li>• Only for proposed assessments of tax, not denials of refunds</li> </ul>
United States Federal District Court	<ul style="list-style-type: none"> <li>• Courts located throughout the country</li> <li>• Can request jury trial</li> <li>• Different judicial precedence for certain issues</li> </ul>	<ul style="list-style-type: none"> <li>• Must pay tax first in order to sue for a refund</li> </ul>
United States Court of Federal Claims	<ul style="list-style-type: none"> <li>• Different history of judicial precedence (as compared to Tax Court and District Court) to follow in applying the tax law</li> </ul>	<ul style="list-style-type: none"> <li>• Must pay tax first in order to sue for a refund</li> <li>• No jury trial</li> <li>• Only based in Washington, D.C.</li> </ul>



# How Deloitte can help



There is tremendous benefit in understanding the tax controversy process and being fully prepared for potential IRS and state examinations of tax returns, particularly for private wealth taxpayers who may be more likely to be examined.

Not only does Deloitte assist clients in examinations and appeals, but we also help clients with examination readiness assessments. Those assessments can cover a wide variety of potential issues.

For example, in an examination readiness assessment, we can:

-  Inspect all publicly available information, including website, social media communications, and pamphlet materials
-  Interview key personnel regarding operations, policies and procedures
-  Analyze transactions and documents in areas taxing authorities are likely to examine
-  Analyze adequacy of records via interviews and testing procedures
-  Analyze charitable contribution and tax-exempt entity issues
-  Provide an assessment of overall compliance, as well as recommendations for client on a go-forward basis

**Tax Controversy Manager** — In addition, Deloitte has created a web-based technology solution to help clients manage the data flow of examinations. Deloitte's Tax Controversy Manager enables users to manage the data flow prior to and during tax controversies, as well as to track and retain the various sources and types of information needed to prepare for tax controversies. It facilitates *real time knowledge sharing* within and across jurisdictions, *timely access* to information critical to negotiating tax controversies, and *visible metrics* to measure effectiveness of examination management.

To find a member of the Private Wealth group who specializes in your area of interest, please contact us at [PrivateWealth@deloitte.com](mailto:PrivateWealth@deloitte.com).

## Additional tax and wealth planning resources:

-  **Private Wealth** — Materials focused on tax and wealth planning issues for individuals, trusts, family offices, and related entities.
-  **Deloitte Growth Enterprise Services** — Cross-functional resources specific to privately held and mid-market companies.
-  **tax@hand** — Knowledge when you need it. Instantly link to the latest insights from Deloitte Tax on your iPhone, iPad, or Android device.



-  **@DeloitteTax** — Sharing news and insights to keep you in front of tax developments. Follow us on Twitter today.
-  **Tax News & Views** — Published by the Deloitte Tax LLP Tax Policy Services group in Washington, D.C., this newsletter provides a compact, reader-friendly perspective on the latest corporate tax developments coming out of Congress, the Internal Revenue Service (IRS), the Department of the Treasury, and the federal courts.
-  **Private Companies Dbriefs webcast series** — Webcasts focused on topics of interest to privately held and mid-market companies and their owners.





#### **Deloitte Private Wealth**

Deloitte's committed team builds client service relationships that span decades and generations by providing innovative solutions to address our clients' ever-evolving needs and circumstances. We are highly valued as trusted private wealth advisers with deep knowledge, broad experience, and a large domestic and global network of professionals to leverage as our clients' goals change.

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