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Private wealth tax controversies

Deep experience navigating
interactions with taxing authorities









“IRS interactions can be very challenging, but the Deloitte Tax controversy team guided us through the process and helped us to reach a better outcome than we thought possible.”



Content

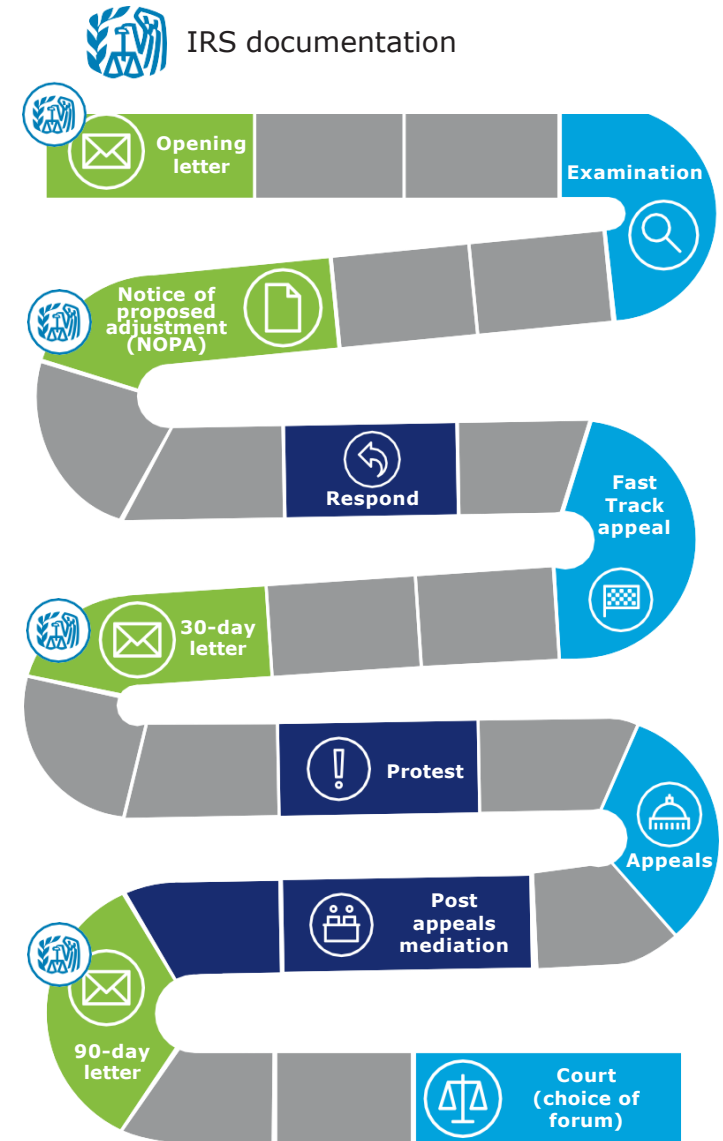
The Internal Revenue Service and state taxing authorities continue to focus on taxpayers with sophisticated personal and business situations.

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

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The tax controversy process



Overview



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

The IRS's special division dedicated to private wealth taxpayers—the Global High Wealth (“GHW”) industry group—has been at the forefront of examining high wealth taxpayers and their related entities for almost a decade. The division's purpose is to undertake a holistic examination to understand the complete financial picture of private wealth individuals and the enterprises they control, using tools normally reserved for large, corporate examinations. GHW Enterprise sits within the Large Business & International IRS division. In addition, high 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.

Due to budget limitations, the IRS has generally been forced to cut back on examinations. However, it has retained a focus and energy on high wealth taxpayers. These examinations can be rigorous. Private wealth taxpayers may benefit by taking steps today to embed best practices in the tax planning and compliance processes so that appropriate documentation is ready 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?

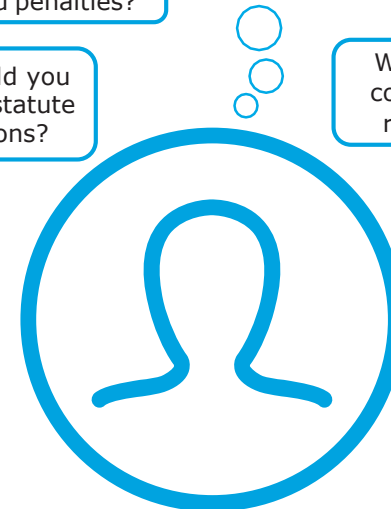
How will you obtain the necessary information and how quickly?

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

over 25 percent for those with AGI exceeding \$1 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 2016 (percent of total)	Examination coverage in Fiscal Year 2017 (percent)
No adjusted gross income	1.69	3.55
\$1 – \$25,000	36.47	0.71
\$25,000 – \$50,000	23.33	0.49
\$50,000 – \$75,000	13.26	0.48
\$75,000 – \$100,000	8.59	0.45
\$100,000 – \$200,000	12.19	0.47
\$200,000 – \$500,000	3.6	0.7
\$500,000 – \$1,000,000	0.58	1.56
\$1,000,000 – \$5,000,000	0.26	3.52
\$5,000,000 – \$10,000,000	0.02	7.95
\$10,000,000 or more	<u>0.01</u>	<u>14.52</u>

Source: IRS Data Book for 2017

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.



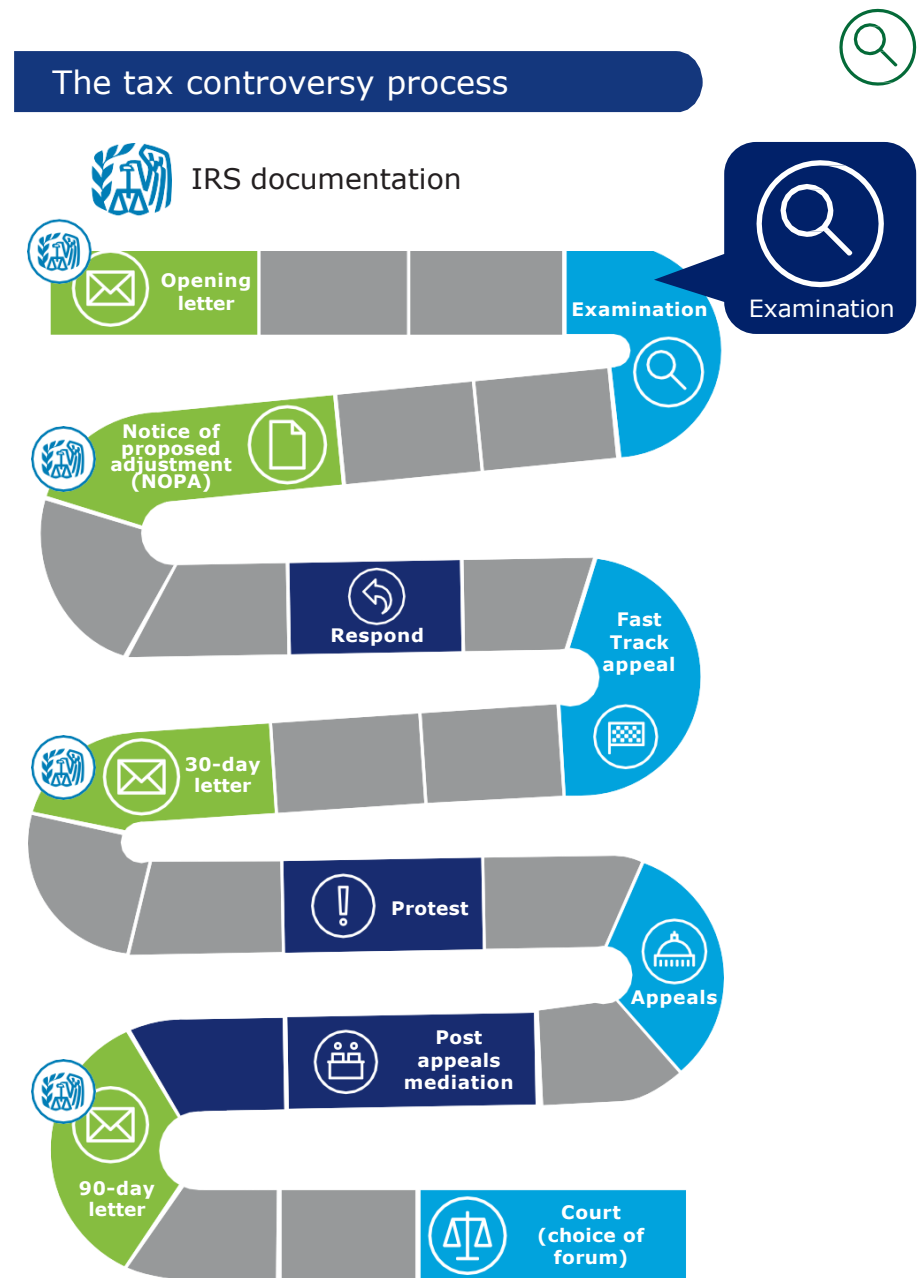
Examinations

Private wealth examinations can be stressful. 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 may define 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 response times.

Navigating a tax controversy can involve much more than just responding to IDRs and following up on the status of the examination.

Historically, the average time to complete a traditional individual examination has been about 12 to 18 months, although this timeframe could vary significantly. For example, if an examiner finds technical issues requiring referral to an appraiser or international, financial products, or other specialist, the examination will likely 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 available to taxpayers under exam by the IRS's Large Business & International, Small Business and Self Employed, and Tax-Exempt and Government Entities divisions. Each division has its own eligibility requirements for Fast Track and types of cases that it will not consider.

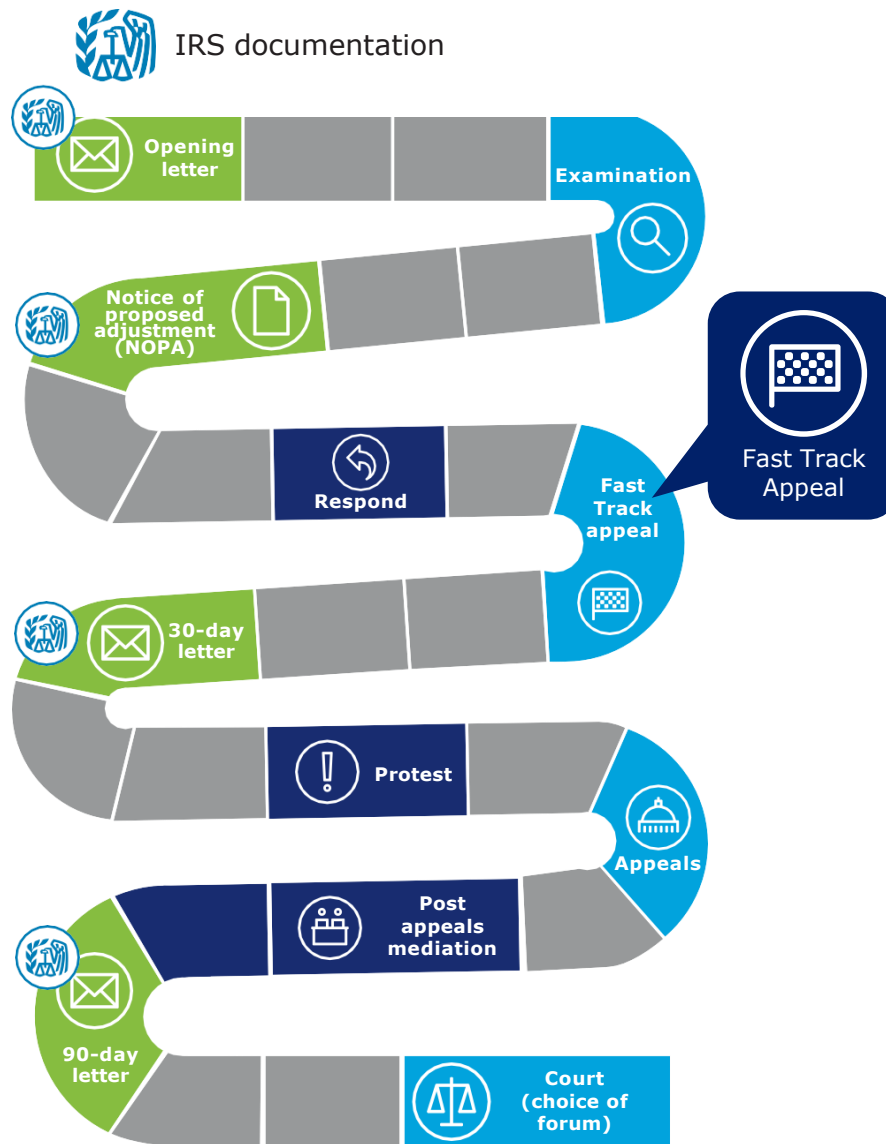
Fast Track is a voluntary, non-binding process and can be initiated either by the taxpayer or the IRS examination team. Fast Track does not eliminate the ability to use the normal appeals resolution option, if Fast Track is unsuccessful. Typically, Fast Track is completed within 60–120 days of the IRS accepting the case into the 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 mediator. The Fast Track appeals officer 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

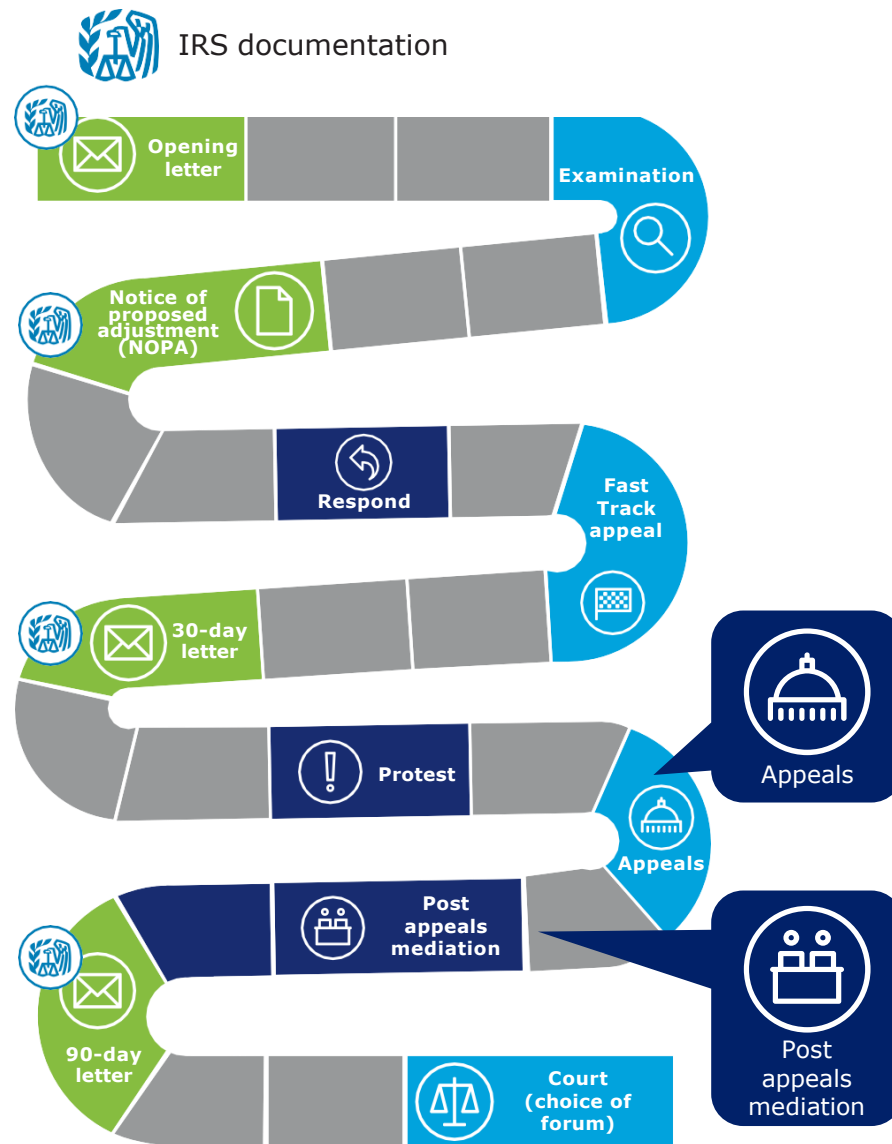
IRS appeals is a fresh look at a taxpayer's IRS dispute in which the examination team has limited or no involvement. Appeals differs from the examination function in many ways, but one of the more important differences is appeals' settlement authority. While examination must resolve issues purely based on its determination of the facts and law, as interpreted by the Commissioner, appeals can settle issues 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 litigation where the normal appeal has been 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, or both—to help reach settlement.

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

- Analysis of IRS 30-day letter
- Preparation/analysis of protest
- Representation at appeals conferences
- 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 satisfactory outcome, taxpayers have three alternative judicial forums for litigating their federal tax controversies. Each judicial forum has separate advantages and disadvantages that a taxpayer and his/her legal counsel should consider. If the taxpayer or IRS disagrees with the trial outcome, 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.

Factors to consider	
United States Tax Court	<ul style="list-style-type: none">• Do not have to pay tax to litigate• Judges are tax law specialists• Based in Washington, D.C., but judges travel the country to hear cases• No jury available• Generally court does not hear refund claims
United States Federal District Court	<ul style="list-style-type: none">• Generally court hears only refund claims• Must pay tax first to sue for a refund• Courts located throughout the country• Can request jury trial• Varying judicial precedence
United States Court of Federal Claims	<ul style="list-style-type: none">• Like federal district court, generally you must pay tax first to sue for a refund• No jury trial• Only based in Washington, D.C.• Court has its own unique judicial precedence









How Deloitte can help



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

Deloitte not only assists clients in confronting the examinations and appeals process, 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 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




In addition, Deloitte can undertake a Private Wealth Strategic Tax Review, a bespoke service designed to take a broad-based look at the entire family enterprise through a tax and wealth-planning lens and provide specific recommendations in a variety of areas, including risk management and audit readiness.



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 Private 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](#)



-  [@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 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.](#)

Contact us



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Do you have a specific issue or area of interest? Please contact us at PrivateWealth@deloitte.com to find a member of the Private Wealth group who specializes in that topic.



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Deloitte Private Wealth

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