



## Part 4. Examining Process

### Chapter 46. LB&I Examination Process

#### Section 4. Executing the Examination

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##### Manual Transmittal

March 09, 2016

##### Purpose

(1) This transmits revised IRM 4.46.4, *LB&I Examination Process, Executing the Examination*.

##### Scope

Not all examinations are the same in scope, size, and complexity; therefore, portions of this IRM may be more applicable to some cases than others.

##### Material Changes

- (1) Changed section title to be more descriptive of the contents.
- (2) Modified 4.46.4.1, *Overview*, to incorporate the issue-driven examination as described in Publication 5125, *LB&I Examination Process*.
- (3) Modified 4.46.4.2, *Examination Techniques Used to Gather Evidence*, to focus on examination techniques used in the execution phase.
- (4) In 4.46.4.3, *Researching Federal Tax Law*, replaced Technical Expedited Advice Memoranda with Chief Counsel Advice.
- (5) Added 4.46.4.4, *Using Technical Expert Resources*, to encourage examiners to seek technical expert assistance from Counsel and subject matter experts.
- (6) Modified 4.46.4.5, *Information Document Request Process* (previously 4.46.4.4, *Information Document Request Management Process*) to implement the LB&I Directive, LB&I-04-0214-004, *Updated Guidance for Examiners on Information Document Requests Enforcement Process*. Replaced Exhibits 4.46.4-1 and 4.46.4-2, with Exhibit 4.46.4-1, *Requirements for Issuing IDRs* and Exhibit 4.46.4-2, *IDR Enforcement Process* to support the IDR Directive.
- (7) Added 4.46.4.6, *Issue Monitoring and Development*, to describe the roles and responsibilities of an issue manager during the execution phase of an LB&I issue-driven examination.
- (8) Added 4.46.4.7, *Case Monitoring and Management*, to describe the roles and responsibilities of a case manager during the execution phase of an LB&I issue-driven examination. Modified Exhibit 4.46.4-5, *On-Site Visits and Case or Issue Reviews*, to provide examples of methods to monitor the case or issues when conducting an issue-driven examination.
- (9) Added 4.46.4.8, *Continuous Risk Analysis*, to describe the roles and responsibilities of the LB&I team members during the execution phase of an LB&I issue-driven examination.
- (10) Added 4.46.4.9, *Written Acknowledgment of the Facts*, to provide guidance on how to seek written acknowledgment of the facts from LB&I taxpayers for unagreed issues. Added Exhibit 4.46.4-3, *Pro-Forma IDR for Acknowledgment of Facts on Unagreed Issues*, to support this process.
- (11) Moved 4.46.4.10, *Penalty Consideration* (previously 4.46.4.5).
- (12) Added 4.46.4.11, *Notice of Proposed Adjustment*, to provide guidance for issue teams on issuing NOPAs to LB&I taxpayers.
- (13) Editorial changes made throughout.

##### Effect on Other Documents

This IRM incorporates LB&I Directive LB&I-04-0214-004, *Updated Guidance for Examiners on Information Document Requests Enforcement Process* which supersedes LB&I Directives LB&I-04-0613-004, *Large Business & International Directive on Information Document Requests (IDRs)* and LB&I-04-1113-009, *Large Business and International Directive on Information Document Requests Enforcement Process*. IRM 4.46.4 dated November 25, 2011 is superseded.

##### Audience

All LB&I personnel

## Effective Date

(03-09-2016)

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### 4.46.4.1 (03-09-2016)

#### Overview of the Execution Phase

1. The audit steps for each issue selected in the examination plan are implemented during the execution phase. Issue teams will develop each issue by gathering factual data through continued mutual transparency and cooperation. The depth and the scope of each issue examined is a matter of professional judgment. The documents examined and the conclusions reached should be recorded in the workpapers.
2. To assist the issue team in gathering the facts, a cooperative and transparent taxpayer will assist in the factual development of each issue as described in Publication 5125, *LB&I Examination Process*. The primary method of obtaining information is through Form 4564, *Information Document Request (IDR)*. IDRs are required to be issue-focused and discussed with the taxpayer and/or their representative to set a reasonable response date for the request.

#### Exception:

IDR(s) that are issued at the beginning of an examination that request basic books and records and general information about a taxpayer's business are not subject to this requirement.

#### Reminder:

The mandatory transfer pricing IDR response time is 30 days as codified by law.

3. Each issue team will conduct continuous, interactive discussions to ascertain whether to continue or modify examination procedures and to resolve any factual or legal differences as IDR responses are reviewed.
4. The progress of the examination should be monitored in a collaborative manner by the case manager and issue manager. Penalties should be considered concurrently with the development of the issues, and the assertion or non-assertion of any penalties should also be fully explained and documented in the workpapers. All managers on the issue team must be actively involved with the development of each penalty issue when an issue team determines penalties are warranted.
5. The issue team is expected to solicit an acknowledgment of the facts to seek the taxpayer's concurrence on the facts, resolve any factual differences, and/or document factual disputes for potentially unagreed issues. The issue team will then apply the law to the complete set of facts in a fair and impartial manner when preparing the Form 886-A, *Explanation of Items*. The issue manager should ensure that all relevant facts, including additional and/or disputed facts, are appropriately considered before issuing a Form 5701, *Notice of Proposed Adjustment (NOPA)*.
6. Before issuing a NOPA, the issue team must discuss LB&I's tax position with the taxpayer and explain the law applied in making each determination. Also, the issue team should agree to a NOPA response date, unless a standard date was established in the examination plan for all NOPAs.

### 4.46.4.2 (03-09-2016)

#### Examination Techniques Used to Gather Evidence

1. In addition to the audit steps outlined in the exam plan, the issue team(s) may also consider other examination techniques used to gather evidence:
  - A. Interviews (IRM 4.10.3.3)
  - B. Tours of business sites (IRM 4.10.3.4)
  - C. Sampling techniques (IRM 4.10.3.13)
  - D. Balance sheet analysis (IRM 4.10.3.9)
  - E. Analysis of Schedules M-1, M-2 and M-3 (IRM 4.10.3.7)
2. Refer to IRM 4.46.3.7.1.2.1, *Examples of Audit Steps*.
3. Additional balance sheet analysis information can be found in IRM 4.10.4.3.4.1, *Balance Sheet Analysis (Corporations and Other "Business" Returns)*, and IRM Exhibit 4.10.3-5, *Balance Sheet Examination Techniques*.
4. Additional information about analyzing Schedules M-1, M-2 and M-3 can be found in IRM 4.10.4.3.4.2, *Schedules M-1, M-2, and M-3 (Corporation and Other "Business" Returns)*.

### 4.46.4.2.1 (03-09-2016)

#### Interviews

1. IRC 7602 authorizes the Secretary or a delegate to examine books and records and to take testimony under oath.
2. Interviews are used to develop facts and establish evidence. The initial interview should be tailored to the taxpayer and the issues under consideration. Should the taxpayer not cooperate in an interview, cases may be developed through the testimony of witnesses. The record of interviews can take one of the following forms:
  - A. Transcript of interview
  - B. Question-and-answer statement
  - C. Affidavit
  - D. Memorandum of interview
  - E. Audio recording

### 4.46.4.2.2 (03-09-2016)

#### Tours of Business Sites

1. Treas. Reg. 301.7605-1(d)(3)(iii) states: "regardless of where an examination takes place, the Service may visit the taxpayer's place of business to establish facts that can only be established by direct visit, such as inventory or asset verification. The Service generally will visit for these purposes on a normal workday of the Service during the Service's normal tour of duty hours".
2. Tours of business sites should be conducted as needed during examinations of all business entities. Generally, the principal location and any locations acquired during the period under examination should be visited. See IRM 4.10.3.4, *Tours of Business Sites*.

#### 4.46.4.2.3 (03-09-2016)

##### Sampling Techniques

1. There are two basic types of sampling: judgment and statistical.
  - A. Judgment sampling requires examiners to use professional judgment in performing the sampling procedure and in evaluating the results of the sample.
  - B. Statistical sampling is a procedure used to choose a portion of the whole to make a statement about the entire population. Other terms applied to statistical sampling include probability sampling and random sampling. See Rev. Proc. 2011-42.
2. Computer Audit Specialist (CAS) assistance must be requested for issues involving statistical sampling whether originated by the IRS or by the taxpayer.

#### 4.46.4.3 (03-09-2016)

##### Researching Federal Tax Law

1. LB&I examiners must consider the various legal authorities and guidance available to them when developing and resolving issues. Some of these include:
  - A. Internal Revenue Code (IRC)
  - B. Committee Reports
  - C. Treasury Regulations
  - D. Revenue Rulings
  - E. Delegation Orders (DO)
  - F. Private Letter Rulings (PLR)
  - G. Technical Advice Memoranda (TAM)/Chief Counsel Advice (CCA)
  - H. Court Opinions
  - I. Tax Treaties
2. IRM 4.10 , *Examination of Returns*, provides a detailed explanation of each of these sources and the format for citing them in reports.
3. The use of IRS contracted subscription internet services is recommended to perform electronic tax research. (i.e. Westlaw, LexisNexis or Accurint). Information can be accessed to obtain references for a given topic by searching for specific key words or key word groups.

#### 4.46.4.4 (03-09-2016)

##### Using Technical Expert Resources

1. During the execution phase, examiners must develop factual issues using the appropriate examination techniques and determine the correct tax liability by researching the federal tax law and consulting with a subject matter expert (SME) , Counsel and other technical experts, when appropriate. Examiners must also correctly interpret and apply the law in light of congressional intent, in a fair and impartial manner, based on the facts and circumstances of the case.
2. The issue team is strongly encouraged to consult with a subject matter expert as technical questions arise.

#### 4.46.4.5 (03-09-2016)

##### Information Document Request Process

1. The Information Document Request (IDR) Process will be used for all LB&I examinations. The IDR Process gives the examination team a structured process to use when gathering information during an examination. The process is intended to encourage collaboration between the taxpayer and IRS personnel to agree on and provide information needed to support an examination.
2. Both general procedures and enforcement procedures are part of the IDR Process found in *Exhibit 4.46.4-1* and *Exhibit 4.46.4-2*.

#### 4.46.4.5.1 (03-09-2016)

##### General IDR Procedures

1. Form 4564, *Information Document Request* (IDR), or a computer facsimile thereof, should be used to request information from the taxpayer. Three copies of the form should be prepared and distributed as follows:
  - A. The original will be given to the taxpayer.
  - B. The second copy of the IDR will be filed in the IDR Log (if a paper log is maintained). The team coordinator is responsible for maintaining the IDR Log. Appropriate information should be listed in the log as IDRs are issued. The case manager is responsible for ensuring that the IDR Log is properly, accurately and timely completed. IMS can also be used for this purpose.
  - C. The third copy will be maintained by the issuing examiner. IMS can also be used for this purpose.
2. IDRs are an important part of the information gathering process during any examination. When issuing IDRs, LB&I examiners should follow the requirements for issuing IDRs that are found in *Exhibit 4.46.4-1*.
3. If a taxpayer indicates that any requested information will not be provided without a summons the IRS should move directly to the issuance of a summons.

#### 4.46.4.5.2 (03-09-2016)

##### IDR Enforcement Process

1. IDRs must be in compliance with *IRM 4.46.4.5.1* before the Service can issue a summons based on the IDR and later seek summons enforcement, if necessary. The process from IDR to summons issuance has three graduated steps:
  - A. a Delinquency Notice
  - B. a Pre-Summons Letter
  - C. a Summons

This process is mandatory and has no exceptions. It requires LB&I managers at all levels to be actively involved early in the process and ensures that Counsel is prepared to support IDRs through the issuance of a summons when necessary. If, during the discussion of an IDR, a taxpayer indicates that the requested information will not be provided without a summons, the IDR enforcement procedures do not apply and the IRS should move directly to the issuance of a summons.

2. The timing of the application of the enforcement process is set forth in *Exhibit 4.46.4-2*.

#### 4.46.4.6 (03-09-2016)

##### Issue Monitoring and Development

1. The issue manager is responsible for ensuring that the issue team is held accountable for the development of their respective issue(s). In addition, the issue manager must keep the case manager informed of the progress of the issue and must inform the case manager of any potential impact the issue may have on the case timeline. Any conflicts regarding the development of the issue between the issue manager and the case manager should be elevated to senior management.
2. The issue manager has overall responsibility for managing the issue as documented in IRM 4.46.1.
3. In addition to the case manager responsibilities documented in IRM 4.46.1, the case manager will support the issue manager in developing the issues.
4. Each issue will be risk assessed and evaluated as facts are developed. Information provided by taxpayers such as presentations, IDR responses or tax workpapers will be considered by the issue team for purposes of continuing, expanding, narrowing or dropping the issue.
5. The issue team will consult with SMEs and Counsel as needed.
6. Methods to monitor include:
  - Taxpayer status meetings/discussions
  - Internal team meetings/discussions
  - On-site visits and case or issue reviews (See *Exhibit 4.46.4-5*)
  - Mid-cycle risk analysis
  - Conference calls/OCS/Live Meeting
  - IBMIS reports
  - IMS Team website
7. To facilitate early issue resolution, NOPAs will be issued as soon as a tax determination is made or by the milestone date, whichever is sooner. NOPAs should not be held until the end of the examination.
8. The issue team must advise the taxpayer when a determination is made, or that no adjustment is forthcoming and the issue is closed.

#### 4.46.4.7 (03-09-2016)

##### Case Monitoring and Management

1. The progress of the examination will be monitored by the case manager and team coordinator as outlined in the examination plan. The case manager and team coordinator will monitor various aspects of the examination, and they will solicit the issue team's participation as needed. Monitoring the progress of the examination is essential as the case manager must respond to changing circumstances.
2. The case manager should collaborate with issue managers on the progress and development of the issues. When changes are made that impact the ECD, the case manager should discuss with the issue managers and the taxpayer. If extending an issue timeline requires extending the case timeline and ECD, the issue manager should explain to the case manager the reason for extending the issue timeline and should also prepare a revised issue timeline along with a written explanation. Once that issue manager and the case manager agree that an extension of the ECD is appropriate, they will follow Industry policy for requesting approval to extend the ECD and the statute if necessary.

#### 4.46.4.8 (03-09-2016)

##### Continuous Risk Analysis

1. Examiners must use their professional judgment to determine which issues will continue to be examined or modified in scope. New information discovered by LB&I during an examination may necessitate expanding or modifying the plan, including adding new issues to the exam plan.
2. New information provided by the taxpayer that could result in a refund will require a valid informal claim if there is nexus with an issue identified for examination; otherwise, a formal claim is required.
3. The exam team should collaborate with the taxpayer to appropriately modify an existing timeline or establish an issue team and timeline when adding a new issue.
4. To foster consistency and obtain additional technical expertise, Counsel and other technical experts should be consulted. This will enable the issue team to make the most effective and efficient decision for the government.
5. Materiality and compliance considerations will be evaluated when conducting the risk analysis for each issue. As soon as a determination is made, the issue team will inform the taxpayer whether an issue is being added, continued, expanded, narrowed, or dropped.
6. As new information is received, such as responses to IDRs, the issue team will risk-assess each issue on a continuous basis. The issue team will analyze the information and ascertain whether to continue or modify the examination procedures and issue timeline.
7. The issue team will keep the taxpayer informed of the status of each issue through discussions and/or scheduled meetings. These discussions should be interactive and will provide the taxpayer an opportunity to submit additional supporting documentation, clarify any facts and explain their tax position. These interactive discussions should promote an efficient tax determination.
8. At any point in this phase, all parties should work together to resolve issues at the earliest appropriate point in the examination.

#### 4.46.4.9 (03-09-2016)

##### Written Acknowledgment of the Facts (AOF)

1. LB&I requires that all information, including all relevant facts and supporting documentation, be submitted to LB&I for consideration in the development of an issue. The taxpayer has primary responsibility for ensuring the facts have been fully provided to LB&I, so that the law is applied to the full set of facts.
2. The issue team should collaborate with the taxpayer to develop all facts before issuing a NOPA. The issue team is expected to conduct on-going interactive discussions throughout the execution phase to resolve any factual disputes and discuss tax positions on issues examined.
3. Before an unagreed issue is sent to Appeals, the issue team will solicit a written acknowledgment of the facts to ensure all relevant facts, including those favorable to the taxpayer, are fully developed. This process will allow the issue team to address any additional or disputed facts identified by the taxpayer before the case is sent to Appeals.
4. The issue manager should review the taxpayer's response to the acknowledgement of facts to assess the strengths and weaknesses of each side's position and to ascertain if the issue can be resolved at the examination level.
5. The taxpayer must be reminded that the case will be returned to exam's jurisdiction for consideration or examination if new information is provided by the taxpayer after a case is closed to Appeals.

#### 4.46.4.9.1 (03-09-2016)

##### Hold Issue Discussions

1. Discussions held early and often with the taxpayer during issue development will enable the issue team to make a timely tax determination. The issue team should conduct issue discussions, share the proposed tax determination and solicit feedback on the taxpayer's position prior to issuing a final NOPA. All issue team members will discuss the tax issue in an open and transparent manner. Issue discussions provide an opportunity for the issue team to:
  - Ensure all relevant facts have been developed
  - Explain LB&I's tax determination
  - Understand the taxpayer's tax position
  - Strive to reach agreement on the issue

#### 4.46.4.9.2 (03-09-2016)

##### Prepare a Form 886-A Explanation of Items

1. If the taxpayer does not agree with LB&I's tax determination and the issue is likely to go to Appeals, the issue team will prepare and provide to the taxpayer a Form 886-A containing all facts and will solicit the taxpayer's written acknowledgment of the facts.
2. To obtain an acknowledgment of the facts, a comprehensive Facts section of the Form 886-A must document all relevant facts both in favor of the taxpayer and the government. The extent of development of the other sections of the Form 886-A may vary depending on the complexity of the tax issue. Without an understanding of LB&I's tax position and the law applied, the taxpayer may not have the context needed to ascertain whether all of the relevant facts have been identified for the tax issue. Therefore, judgment is left to the issue team to determine the extent of detail necessary in each section of the Form 886-A.

#### 4.46.4.9.3 (03-09-2016)

##### Issue the Form 886-A with a Pro-Forma IDR

1. Use a pro-forma IDR (see *Exhibit 4.46.4-3*) along with the Form 886-A to solicit a written acknowledgment of the facts (AOF). The contents of the pro-forma IDR and contents of the Form 886-A will be discussed with the taxpayer. The discussion will also establish a reasonable time for the taxpayer to respond.
2. Explain to the taxpayer that the pro-forma IDR will not be followed by a summons and that their response to the IDR does not indicate agreement to the issue or any proposed adjustments. The purpose of the pro-forma IDR is to acknowledge that all relevant facts have been identified and provides the taxpayer the opportunity to submit additional relevant facts and supporting documentation or to identify disputed facts.
3. The taxpayer should review the Form 886-A and respond to the points below in writing within an agreed upon date.
  - A. Taxpayer agrees to the facts as written.
  - B. Taxpayer provides additional relevant facts and supporting documentation.
  - C. Taxpayer identifies disputed facts and provides clarification and/or supporting documentation.
4. If the response is not received by the agreed response date, do **not** follow the IDR enforcement process. The issue manager should inquire about the reasons for the delay and determine if the taxpayer intends to respond. The taxpayer's response or lack of response to the IDR will be included in the Form 886-A when the NOPA is issued.
5. To identify this IDR as one that will not be followed by a summons, it is recommended to use the alpha indicator prefix, AOF, in IMS to identify an IDR issued for the purposes of obtaining an acknowledgement of the facts.

#### 4.46.4.9.4 (03-09-2016)

##### Incorporate the Taxpayer's Response in the Form 886-A Issued with the NOPA

1. A statement indicating the taxpayer's response to the IDR must be included in the opening of the Facts section. The issue team will determine the appropriate method to take when preparing the Form 886-A to ensure that all of the relevant facts have been incorporated and considered.
2. In addition, an explanation of whether the issue team agrees or disagrees with the additional or disputed facts provided by the taxpayer must be included. The issue team will identify the additional or disputed facts provided by the taxpayer in a sub-section of the Facts section in the Form 886-A or, if voluminous, include the taxpayer's response as an attachment to the Form 886-A. It is impossible to capture every scenario you may encounter, however, some examples are provided for options to use in documenting the response.
  - Example 1: Taxpayer Agrees with the Facts** "The taxpayer was issued IDR AOF# \_\_\_ on January 1, 20xx to acknowledge all relevant facts have been provided. The taxpayer agreed with the facts as written."
  - Example 2: Taxpayer Provided Additional Facts** "The taxpayer was issued IDR AOF# \_\_\_ on January 1, 20xx to acknowledge all relevant facts have been provided. The taxpayer provided additional facts, which LB&I has taken into consideration. The tax determination was modified to reflect the additional facts provided, however the issue remains unagreed. The additional facts provided by the taxpayer are detailed in the Facts section." OR "...are included as an attachment."
  - Example 3: Taxpayer Identifies Disputed Facts** "The taxpayer was issued the IDR AOF# \_\_\_ on January 1, 20xx to acknowledge all relevant facts have been provided. The taxpayer identified disputed facts. The disputed facts have been included in a sub-section at the end of the Facts section." OR "...have been included as an attachment to the Form 886-A."
  - Example 4: Taxpayer Did Not Respond to the Pro-Forma IDR** "The taxpayer was provided the IDR AOF# \_\_\_ on January 1, 20xx to acknowledge all relevant facts have been provided. The taxpayer did not respond to the IDR by the agreed upon response date. A follow up discussion between the taxpayer and the issue manager was held on January 15, 20XX. During the discussion the taxpayer stated that..."
3. The issue manager should ensure that all relevant facts, including additional and/or disputed facts, are appropriately considered in determining LB&I's tax position before the issue team prepares a NOPA.

#### 4.46.4.10 (03-01-2006)

##### Penalty Consideration

1. The Service maintains an ongoing effort to develop, monitor and revise programs designed to assist taxpayers in complying with legal requirements and to avoid penalties. As indicated in Policy Statement P-20-1, the Service uses penalties to encourage voluntary compliance.
2. Policy Statement P-20-1 also states that the IRS administers a penalty policy that is designed to:
  - A. Ensure consistency
  - B. Ensure accuracy of results in light of the facts and the law
  - C. Provide methods for taxpayers to have their interests heard and considered
  - D. Require impartiality and commitment to achieve the correct decisions

E. Allow for prompt reversal of initial determinations when sufficient information has been presented to indicate that the penalty is not appropriate

F. Ensure that penalties are used for their proper purpose and not as bargaining points in the development or processing of cases

#### **4.46.4.10.1 (03-09-2016) Examiner Responsibility**

1. The examiner is responsible for identifying the appropriate penalties, determining whether to assert penalties, and accurately calculating the penalty amount.
2. The examiner will inform the taxpayer as early as possible when and why penalties are being considered. The examiner will provide the taxpayer an opportunity to respond to and/or refute the assertion based on facts and legal application.
3. Examiners must document the manager's involvement on Form 9984, *Examining Officer's Activity Record* and in the workpapers related to the penalty under consideration.
4. Consult with Counsel and with the subject matter experts in the Penalties practice area if needed.

#### **4.46.4.10.2 (03-09-2016) Managerial Involvement**

1. The case manager and issue manager must be actively involved with the development of all penalty issues. Coordination with Criminal Investigation and specialists may be required.
2. The case manager and the issue manager must approve:
  - Any penalty asserted
  - Any case where there is a substantial understatement of tax and no penalty proposed
3. For more information, see IRM 20.1.5.1.6.

#### **4.46.4.10.3 (03-09-2016) Common Penalties**

1. See IRM 20.1, *Penalty Handbook*, for a list of common civil tax penalties. This list includes the applicable IRC section, penalty amount and description, penalty reference numbers, detailed explanation and computation methods. These penalties include the following:
  - A. Failure to pay estimated income tax
  - B. Failure to file
  - C. Failure to pay (on returns secured by LB&I)
  - D. Fraud
  - E. Frivolous returns
  - F. Accuracy-related penalties on underpayment, including negligence or disregard of rules or regulations, substantial understatement of income tax, substantial or gross valuation misstatements
  - G. Accuracy-related penalties on understatements with respect to a reportable transaction
  - H. Failure to include reportable transaction information with a return
  - I. Erroneous claim for refund or credit

#### **4.46.4.10.4 (03-09-2016) Penalties Relating to International Issues**

1. There are very specific penalties relating to international issues. The identification of the appropriate penalties relating to international issues is covered in IRM 20.1.9, *International Penalties*.

#### **4.46.4.10.5 (12-29-2009) Fraud**

1. A civil fraud penalty case may be developed based on the facts and circumstances of a civil examination or may occur at the completion of a criminal prosecution case. In either situation, the examiner and team manager must contact their local Fraud Technical Advisor when fraud is suspected. The examiner and Fraud Technical Advisor will jointly prepare Form 11661, *Fraud Development Recommendation – Examination*.
2. Assertion of a civil penalty is a shared responsibility of the examiner, team manager and Fraud Technical Advisor. Civil fraud determinations no longer require a referral or concurrence by Criminal Investigation. All procedures outlined in IRM 25.1.6 relative to civil fraud cases must be followed.
3. If during the fraud development process, firm indications of fraud exist and criminal criteria is met, a referral via Form 2797, *Referral Report of Potential Criminal Fraud*, must be prepared and submitted via the Fraud Technical Advisor to Criminal Investigation.
4. Specific guidance on all aspects of both criminal and civil fraud may be found in IRM 25.1, *Fraud Handbook*. IRM 25.1.10 specifically addresses additional procedures required for LB&I cases. Additional information is available on the LB&I Fraud web site [http://lmsb.irs.gov/hq/pqa/Post-filing/fraud\\_LMSB\\_home.asp](http://lmsb.irs.gov/hq/pqa/Post-filing/fraud_LMSB_home.asp).

#### **4.46.4.10.6 (03-01-2006) Workpaper Documentation on Penalties**

1. The case file should fully document the consideration, assertion or non-assertion, and computation of all applicable penalties. An applicable penalty is defined to be one which the legal premise for application is present in the case. The decision to assert penalties must have a legal basis in the Internal Revenue Code or other authority.
2. Penalties should not be asserted without an explanation. The extent of the explanation will depend on the nature of the adjustments and the amounts involved. However, canned statements, such as "negligence penalty applicable" or "negligence penalty deemed to be not applicable", are not sufficient.
3. Alternative penalty positions should be documented in the workpapers when applicable (e.g., fraud versus negligence penalties and various components of the accuracy-related penalty).

#### **4.46.4.10.7 (03-01-2006) Burden of Proof Regarding Assessment of Penalties**

1. IRC 7491(c), which applies only to individuals, states that the IRS has the burden of production in a court proceeding when the issue is a penalty, an addition to tax, or an additional amount imposed by the Internal Revenue Code. The IRS must first present evidence that imposition of the amount is appropriate. Only then must the taxpayer assume the ultimate burden of persuasion to raise appropriate defenses, such as reasonable cause, to the imposition of the penalty.

#### 4.46.4.10.8 (03-01-2006)

##### Definitions

1. The following definitions are related to the burden of proof requirements for assessment of penalties:
  - A. "Penalties" include all penalties assessed under Title 26 and/or 31. An example is IRC 6662 that imposes the accuracy-related penalty on underpayments.
  - B. "Addition to Tax" is any amount computed by reference to the amount of tax. An example is the addition to tax imposed by IRC 6654 for failure by an individual to pay estimated income tax.
  - C. "Additional Amount" refers to an amount that can be assessed by the IRS that is not an addition to tax or penalty. An example is the amount imposed under IRC 6673 for the sanctions and costs awarded by a court when a taxpayer's position is frivolous. Additional amounts under IRC 7491(c) do not include excise taxes imposed by Chapters 42 and 43 of the Internal Revenue Code or interest under IRC 6601.

#### 4.46.4.10.9 (11-25-2011)

##### Economic Substance Doctrine

1. On March 30, 2010, the Health Care and Education Reconciliation Act was enacted. This law amended the Internal Revenue Code to codify the Economic Substance Doctrine under IRC 7701(o). It also amended penalty provisions under IRC 6662, IRC 6662A, IRC 6664 and IRC 6676.
2. IRC 6662 was amended to add a new penalty to be applied to any underpayment attributable to transactions lacking economic substance. The new penalty under IRC 6662(b)(6) applies a 20 percent penalty on noneconomic substance transactions. IRC 6662(i) increases the penalty to 40 percent if the relevant facts affecting the tax treatment are not disclosed. The penalty is applicable for transactions entered into after March 30, 2010.
3. Any proposal to impose an IRC 6662(b)(6) penalty at the examination level must be reviewed and approved by the appropriate Director of Field Operations (DFO) before the penalty is proposed in order to ensure consistent administration of the accuracy-related penalty.
4. The LB&I Commissioner has issued guidance which instructs examiners and their managers on how to determine when it is appropriate to seek the approval of the DFO in order to raise the economic substance doctrine. The examiner is required to develop and analyze a series of inquiries outlined in four steps before obtaining DFO approval when it is determined that the economic substance doctrine is applicable. The four steps are:
  - A. **Step one - DOCTRINE LIKELY NOT APPROPRIATE:** The examiners must evaluate a number of factors that tend to show that application of the economic substance doctrine to a transaction is likely not appropriate. If the examiner continues to believe that the doctrine applies, go to step two.
  - B. **Step two - DOCTRINE MAY BE APPROPRIATE:** Requires the examiner to evaluate further whether additional circumstances in the case are those that tend to show that application of the doctrine is appropriate.
  - C. **Step three - DEVELOPMENT OF CASE FOR APPROVAL:** If the examiner continues to believe the application of the doctrine is warranted after conducting steps 1 and 2, a series of seven inquiries must be made before seeking approval to apply the doctrine.
  - D. **Step four - DFO APPROVAL:** If the examiner and his or her manager and territory manager determine that the application of the doctrine is merited, guidance is provided on how to request DFO approval.

*Exhibit 4.46.4-4* contains the full guidelines set forth for each step.

5. In addition, the penalties provided in IRC 6662(b)(6) and (i) and IRC 6676 are limited to the application of the economic substance doctrine and may not be imposed due to the application of any other "similar rule of law" or judicial doctrine (e.g., step transaction doctrine, substance over form or sham transaction).

#### 4.46.4.11 (03-09-2016)

##### Notice of Proposed Adjustment (NOPA)

1. For LB&I cases, all adjustments are proposed and incorporated in writing on Form 5701, *Notice of Proposed Adjustment*, and Form 886-A, *Explanation of Items*. Form 5701 provides a summary of the proposed adjustment. Form 886-A provides a detailed explanation of the adjustment.
2. When issuing a NOPA to propose an adjustment, the tax determination made is based on the facts developed during the examination. NOPAs will be issued as soon as a tax determination has been made but no later than the milestone date set in the issue timeline.
3. For those issues that are known to be agreed through discussions with the taxpayer, it is still important to develop an effective Form 886-A to provide an understanding of the audit trail. An effective Form 886-A will also assist future audits to understand what was examined and the law applied to reach the conclusions. See IRM 4.46.6.11, *Explanation of Items, Form 886-A*.
4. The issue manager should review Form 886-A and Form 5701 for accuracy and completeness before signing the Form 5701. Based on LB&I guidance, the issue manager should secure appropriate senior management approvals.
5. For issues that are unagreed the issue team must solicit an acknowledgment of the facts (see *IRM 4.46.4.9*) before issuing a NOPA. The issue manager should review the Form 886-A to ensure that the taxpayer's additional and/or disputed facts were included and were appropriately considered. The issue manager should also assess the strengths and weaknesses of each side's position and ascertain if the issue can be resolved at the examination level.

#### 4.46.4.11.1 (03-09-2016)

##### NOPA Response Date

1. During the planning phase, the issue team will have reached an agreement regarding response dates relating to the issuance of and response to each NOPA. Refer to Opening Conference Agenda, IRM Exhibit 4.46.3-3.
2. To facilitate early issue resolution, the NOPA should be presented to the taxpayer as soon as the issue team reaches a tax determination, instead of at the end of the examination.
3. Before issuing a NOPA, the issue team must discuss and should agree to a reasonable date for response, unless a standard response date for all NOPAs was established at the opening conference.
4. If the taxpayer does not agree to a proposed response date, the date will be set by the issue manager.

#### 4.46.4.11.2 (03-09-2016)

##### Issue the NOPA

1. The issue manager has the responsibility to review each NOPA for accuracy, organization and completeness, and approve by signing the Form 5701 before issuing the NOPA to the taxpayer. NOPAs meeting certain dollar thresholds or on specific issues may require senior manager approval depending on the policies in place.
2. The issue team must discuss all issues with the taxpayer prior to issuing a NOPA. Items to be discussed before issuing the NOPA are:

A. The government's tax position and an explanation of the law applied in making each determination

B. A NOPA response date

3. In addition, for unagreed issues:

A. Fast Track settlement must be considered, if appropriate. Other issue resolution tools should be considered, as warranted.

B. Remind the taxpayer that if a case is closed to Appeals and new information is provided by the taxpayer, the case will be returned to exam's jurisdiction for consideration. If the taxpayer raises a new theory or alternate legal analysis, the case will remain in Appeals' jurisdiction, but the exam team will be given the opportunity to respond in writing to the new argument. See IRM 8.7.11.5.3.

C. Issue team should remind taxpayers to provide a legal position by the NOPA response date.

#### **4.46.4.11.3 (03-09-2016)**

#### **Taxpayer's Written Response to Unagreed Issues**

1. The taxpayer will be requested to provide a written response indicating their legal position to the NOPA within an agreed upon date. The taxpayer's response will allow the issue team to more quickly determine the appropriate resolution tool such as Fast Track or Early Referral to Appeals. The sooner each issue is resolved, the sooner resources of both the taxpayer and LB&I can be applied elsewhere.

2. If the response is not received by the agreed response date, the issue manager should inquire about the reasons for the delay and if the taxpayer intends to respond.

#### **Exhibit 4.46.4-1**

#### **Requirements for Issuing IDRs**

IDRs are an important part of the information gathering process during any examination. When issuing IDRs, LB&I examiners and specialists should follow the requirements listed below:

A. Discuss the issue related to the IDR with the taxpayer.

B. Discuss how the information requested is related to the issue under consideration and why it is necessary.

C. After this consultation with the taxpayer, determine what information will ultimately be requested in the IDR.

D. Ensure the IDR clearly states the issue that is being considered and that the IDR only requests information relevant to the stated issue. An IDR issued at the beginning of an examination that requests basic books and records and general information about a taxpayer's business is not subject to this requirement. Once this initial IDR has been issued, subsequent IDRs must state an issue to be in compliance with this requirement

E. Only one issue should be addressed on each IDR.

F. Utilize numbers or letters on the IDR for clarity.

G. Ensure that the IDR is written using clear and concise language.

H. Ensure that the IDR is customized to the taxpayer or industry.

I. Provide a draft of the IDR and discuss its contents with the taxpayer. Generally this process should be completed in 10 business days.

J. After this discussion is complete, determine with the taxpayer a reasonable timeframe for a response to the IDR.

K. If agreement on a response date cannot be reached, the examiner or specialist will set a reasonable response date for the IDR.

L. When determining the response date, ensure that the examiner or specialist commits to a date by which the IDR response will be reviewed and a response provided to the taxpayer on whether the information received satisfies the IDR. Note this date on the IDR.

#### **Exhibit 4.46.4-2**

#### **IDR Enforcement Process**

IDRs that are issued in compliance with the requirements of Exhibit 4.46.4-1 are subject to the enforcement process set forth in this Exhibit 4.46.4-2.

The process has three graduated steps:

A. a Delinquency Notice

B. a Pre-Summons Letter

C. a Summons

This process is mandatory and has no exceptions. The timing of the application of the enforcement process is set forth below in a separate section.

#### **Extension Authority**

Before the Enforcement Process is triggered, an examiner or specialist has the authority to grant a taxpayer an extension of up to 15 business days before the Enforcement Process begins. An examiner or specialist may grant one extension with respect to the same IDR. This extension may be granted in the following two situations:

A. **Taxpayer Fails to Respond.** If a taxpayer fails to provide any response by the IDR due date, the examiner or specialist should, within 5 business days after the IDR due date, discuss with the taxpayer the cause of the failure to respond and determine if an extension is warranted. If the examiner or specialist determines that the taxpayer's explanation warrants it, the examiner or specialist may grant the taxpayer an extension of up to 15 business days from the date the extension determination is made and communicated to the taxpayer.

B. **Taxpayer Provides Incomplete Response** If a response is received but the examiner or specialist determines that it is not complete, the examiner or specialist should discuss with the taxpayer the reasons why the response is not complete and determine within 5 business days whether an extension is warranted. If the examiner or specialist determines that the taxpayer's explanation warrants it, the examiner or specialist may grant the taxpayer an extension of up to 15 business days from the time the extension determination is made and communicated to the taxpayers.

#### **Timing of Application of IDR Enforcement Process**

The timing of the application of the IDR Enforcement Process is set forth below.

#### **No Response Received by Due Date**

A. If no response is received by the IDR due date and no extension is granted, the IDR enforcement process begins on the date the extension determination is communicated to the taxpayer.

B. If an extension is granted and no response is received by the extended due date, the IDR enforcement process begins as of the extended due date.



## Response Received by Due Date

If a response is received by the due date, the IRS must determine whether the response is complete. This determination should be made on or before the date the examiner or specialist stated in the IDR.

- A. **If the IDR is considered complete upon review**, the examiner or specialist must notify the taxpayer that the IDR is complete and closed.
- B. If the IDR response is not complete, the timing of the enforcement process is as follows:
  - A. **If the IDR response is not complete and no extension is granted**, the IDR enforcement process begins on the date the extension determination is communicated to the taxpayer.
  - B. **If the IDR response is not complete and an extension is granted:**
    - A. If no additional information is received at the end of the extension period (may be up to 15 business days), the IDR enforcement process begins as of the extended due date.
    - B. If additional information is received at the end of the extension period, this information must be reviewed for completeness. This review should be completed as soon as practical but in most cases not more than 15 business days from receipt of the response. If the IDR response is determined to be incomplete, the IDR enforcement process begins on the date the examiner or specialist notifies the taxpayer that the response remains incomplete. If the IDR is complete, the examiner or specialist should notify the taxpayer and close the IDR.

## Delinquency Notice (Letter 5077)

Once the IDR Enforcement Process applies based on the timing described in section titled "Timing of Application of IDR Enforcement Process" , the examiner or specialist along with their manager must complete the first phase of the enforcement process, the Delinquency Notice, by following the procedures described below:

- A. Discuss the Delinquency Notice with the taxpayer. During this discussion, ensure that the taxpayer understands the next steps in the enforcement process if the information requested in the IDR is not provided by the response date established in the Delinquency Notice.
- B. Issue the Delinquency Notice signed by the Team Manager to the taxpayer within 10 days of the application of the Enforcement Process.
- C. The Delinquency Notice should include a response date that is generally no more than 10 business days from the date of the Delinquency Notice. A Territory Manager must approve any date beyond 10 business days.
- D. Provide a copy of the Delinquency Notice and the IDR to your assigned Counsel.

## Pre-Summons Letter (Letter 5078)

If a taxpayer does not provide a complete response to an IDR by the Delinquency Notice response date, the examiner or specialist must complete the next phase of the enforcement process, the Pre-Summons Letter, by following the procedures described below:

- A. Discuss the lack of a complete response to the Delinquency Notice with the Team Manager, Specialist Manager, the respective Territory Managers and Counsel and prepare the Pre-Summons Letter.
- B. The appropriate Territory Manager must discuss the Pre-Summons Letter with the taxpayer. During this discussion, ensure that the taxpayer understands the next steps in the enforcement process if the information requested in the IDR is not provided by the response date established in the Pre-Summons Letter.
- C. Issue a Pre-Summons Letter signed by the appropriate Territory Manager. This must be done as quickly as possible but generally no later than 10 business days after the due date of the Delinquency Notice. Address this letter to the taxpayer management official that is at a level equivalent to the LB&I Territory Manager. This should be a level of management above the taxpayer management official that received the Delinquency Notice.
- D. Include a response date in the Pre-Summons Letter that is generally 10 business days from date of Pre-Summons letter.
- E. A Director of Field Operations (DFO) must approve any date beyond the 10 business days response period.
- F. Discuss the Pre-Summons Letter with Counsel.
- G. DFO(s) must be made aware of the Pre-Summons Letter prior to issuance.

## Summons

If a taxpayer does not provide a complete response to an IDR by the Pre-Summons Letter response date, the examiner or specialist must complete the next phase of the enforcement process, the summons, by following the procedures described below:

- A. Discuss the lack of response to the Pre-Summons Letter with the Team Manager, Specialist Manager, the respective Territory Managers and DFOs, and Counsel and prepare the summons
- B. Coordinate the issuance of the summons with assigned Counsel
- C. Summons procedures can be found in IRM 25.5

## Exhibit 4.46.4-3

### Pro-Forma IDR for Acknowledgment of Facts on Unagreed Issues

This image is too large to be displayed in the current screen. [Please click the link to view the image.](#)

## Exhibit 4.46.4-4

### Guidance for Examiners and Managers on the Codified Economic Substance Doctrine and Related Penalties

Section 1409(a) of the Health Care and Education Reconciliation Act of 2010 (the "2010 Act" ) codified a conjunctive economic substance test in new IRC 7701(o). The new statute defines the economic substance doctrine as the common law doctrine under which certain tax benefits are not allowable if the transaction does not have economic substance or lacks a business purpose and states that "[t]he determination of whether the economic substance doctrine is relevant to a transaction shall be made in the same manner as if [the legislation] had never been enacted."

The statute further states that jn the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if—

- A. the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and
- B. the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction."

As a result, enactment of IRC 7701(o) resolved the longstanding conflict among various circuit courts of appeal regarding how the doctrine should be applied by codifying a two-part conjunctive test.

In addition, the 2010 Act added section IRC 6662(b)(6), which imposes a strict liability penalty of 20 percent (40 percent for undisclosed transactions) of any underpayment attributable to the disallowance of claimed tax benefits by reason of the application of the economic substance doctrine or failing to meet the requirements of any similar rule of law. Amendments to section 6664 make clear that the "reasonable cause" exception is not applicable to this penalty, and a corresponding amendment to section 6676 provides that a strict liability penalty also applies to refund claims, although in that case the penalty is limited to 20 percent.

IRC 7701(o) and the related strict liability accuracy-related penalty apply to transactions entered into after March 30, 2010, which was the date of enactment of the 2010 Act.

## **PURPOSE OF GUIDANCE**

The purpose of this guidance is to instruct examiners and their managers how to determine when it is appropriate to seek the approval of the DFO in order to raise the economic substance doctrine. Once an examiner determines that raising the doctrine may be appropriate, this directive sets forth a series of inquiries the examiner must develop and analyze in order to seek approval for the ultimate application of the doctrine in the examination.

In addition, the penalties provided in sections 6662(b)(6) and (i) and 6676 are limited to the application of the economic substance doctrine and may not be imposed due to the application of any other "similar rule of law" or judicial doctrine (e.g., step transaction doctrine, substance over form or sham transaction).

This guidance has four steps. First, an examiner should evaluate whether the circumstances in the case are those under which application of the economic substance doctrine to a transaction is likely not appropriate. Second, an examiner should evaluate whether the circumstances in the case are those under which application of the doctrine to the transaction may be appropriate. Third, if an examiner determines that the application of the doctrine may be appropriate, the guidance provides a series of inquiries an examiner must make before seeking approval to apply the doctrine. Fourth, if an examiner and his or her manager and territory manager determine that application of the economic substance doctrine is merited, guidance is provided on how to request DFO approval.

Generally, in applying this guidance, when a transaction involves a series of interconnected steps with a common objective, the term "transaction" refers to all of the steps taken together. However, in certain circumstances, it may be appropriate to apply this guidance separately to one or more steps that are included within a series of arguably interconnected steps. This may be appropriate in situations where an integrated transaction includes one or more tax-motivated steps that bear only a minor or incidental relationship to a single common business or financial transaction. If an examiner wants to apply this guidance separately to one or more steps with a common objective, the examiner is required to seek guidance from their manager and consult with their local counsel before doing so.

An examiner should notify a taxpayer that the examiner is considering whether to apply the economic substance doctrine to a particular transaction as soon as possible, but not later than when the examiner begins the analysis in the steps described below.

### **STEP 1: DOCTRINE LIKELY NOT APPROPRIATE**

The following facts and circumstances tend to show that application of the economic substance doctrine to a transaction is likely not appropriate. If some of the factors described in this guidance apply to the transaction and an examiner continues to believe that the application of the doctrine is appropriate, the examiner should continue to analyze the transaction using the guidance set forth in Steps 2-4.

- Transaction is not promoted/developed/administered by tax department or outside advisors
- Transaction is not highly structured
- Transaction contains no unnecessary steps
- Transaction that generates targeted tax incentives is, in form and substance, consistent with Congressional intent in providing the incentives
- Transaction is at arm's length with unrelated third parties
- Transaction creates a meaningful economic change on a present value basis (pre-tax)
- Taxpayer's potential for gain or loss is not artificially limited
- Transaction does not accelerate a loss or duplicate a deduction
- Transaction does not generate a deduction that is not matched by an equivalent economic loss or expense (including artificial creation or increase in basis of an asset)
- Taxpayer does not hold offsetting positions that largely reduce or eliminate the economic risk of the transaction
- Transaction does not involve a tax-indifferent counterparty that recognizes substantial income
- Transaction does not result in the separation of income recognition from a related deduction either between different taxpayers or between the same taxpayer in different tax years
- Transaction has credible business purpose apart from federal tax benefits
- Transaction has meaningful potential for profit apart from tax benefits
- Transaction has significant risk of loss
- Tax benefit is not artificially generated by the transaction
- Transaction is not pre-packaged
- Transaction is not outside the taxpayer's ordinary business operations

In addition, it is likely not appropriate to raise the economic substance doctrine if the transaction being considered is related to the following circumstances:

- The choice between capitalizing a business enterprise with debt or equity
- A U.S. person's choice between utilizing a foreign corporation or a domestic corporation to make a foreign investment
- The choice to enter into a transaction or series of transactions that constitute a corporate organization or reorganization under subchapter C
- The choice to utilize a related-party entity in a transaction, provided that the arm's length standard of section 482 and other applicable concepts are satisfied

### **STEP 2: DOCTRINE MAY BE APPROPRIATE**

The following facts and circumstances tend to show that application of the economic substance doctrine may be appropriate:

- Transaction is promoted/developed/administered by tax department or outside advisors
- Transaction is highly structured
- Transaction includes unnecessary steps
- Transaction is not at arm's length with unrelated third parties
- Transaction creates no meaningful economic change on a present value basis (pre-tax)

- Taxpayer's potential for gain or loss is artificially limited
- Transaction accelerates a loss or duplicates a deduction
- Transaction generates a deduction that is not matched by an equivalent economic loss or expense (including artificial creation or increase in basis of an asset)
- Taxpayer holds offsetting positions that largely reduce or eliminate the economic risk of the transaction
- Transaction involves a tax-indifferent counterparty that recognizes substantial income
- Transaction results in separation of income recognition from a related deduction either between different taxpayers or between the same taxpayer in different tax years
- Transaction has no credible business purpose apart from federal tax benefits
- Transaction has no meaningful potential for profit apart from tax benefits
- Transaction has no significant risk of loss
- Tax benefit is artificially generated by the transaction
- Transaction is pre-packaged
- Transaction is outside the taxpayer's ordinary business operations

### STEP 3: DEVELOPMENT OF CASE FOR APPROVAL

If after applying the guidance set forth above an examiner believes that the application of the economic substance doctrine may be appropriate, the examiner must answer the following series of inquiries before seeking the approval of his or her appropriate DFO to apply the doctrine.

- Is the transaction a statutory or regulatory election? If so, then the application of the doctrine should not be pursued without specific approval of the examiner's manager in consultation with local counsel.
- Is the transaction subject to a detailed statutory or regulatory scheme? If so, and the transaction complies with this scheme, then the application of the doctrine should not be pursued without specific approval of the examiner's manager in consultation with local counsel.
- Does precedent exist (judicial or administrative) that either rejects the application of the economic substance doctrine to the type of transaction or a substantially similar transaction or upholds the transaction and makes no reference to the doctrine when considering the transaction? If so, then the application of the doctrine should not be pursued without specific approval of the examiner's manager in consultation with local counsel.
- Does the transaction involve tax credits (e.g., low income housing credit, alternative energy credits) that are designed by Congress to encourage certain transactions that would not be undertaken but for the credits? If so, then the application of the doctrine should not be pursued without specific approval of the examiner's manager in consultation with local counsel.
- Does another judicial doctrine (e.g., substance over form or step transaction) more appropriately address the noncompliance that is being examined? If so, those doctrines should be applied and not the economic substance doctrine. To determine whether another judicial doctrine is more appropriate to challenge a transaction, an examiner should seek the advice of the examiner's manager in consultation with local counsel.
- Does recharacterizing a transaction (e.g., recharacterizing debt as equity, recharacterizing someone as an agent of another, recharacterizing a partnership interest as another kind of interest, or recharacterizing a collection of financial products as another kind of interest) more appropriately address the noncompliance that is being examined? If so, recharacterization should be applied and not the economic substance doctrine. To determine whether recharacterization is more appropriate to challenge a transaction, an examiner should seek the advice of the examiner's manager in consultation with local counsel.
- In considering all the arguments available to challenge a claimed tax result, is the application of the doctrine among the strongest arguments available? If not, then the application of the doctrine should not be pursued without specific approval of the examiner's manager in consultation with local counsel.

### STEP 4: DFO APPROVAL

If an examiner completes the inquiries described above and as a result concludes that it is appropriate to seek approval for the application of the economic substance doctrine, the examiner, in consultation with his or her manager and territory manager, should describe for the appropriate DFO in writing how the analysis described in the guidance above was completed. The DFO in considering an examiner's request for approval should review the written material provided and consult with Counsel before a decision is made. If the DFO believes it is appropriate to approve the request, the DFO should provide the taxpayer an opportunity to explain their position, either in writing or in person (at the DFO's discretion), addressing whether the doctrine should be applied to a particular transaction. Once the DFO has made a final decision, that decision should be conveyed to the examiner in writing.

This guidance is not an official pronouncement of law, and cannot be used, cited, or relied upon as such.

#### Exhibit 4.46.4-5

#### On-Site Visits and Case or Issue Reviews

On-site visits and case or issue reviews by the case and/or issue manager can be an effective method to monitor the progress of the case and/or development of tax issues. Before a review is conducted, the manager should prepare an agenda to ensure the time spent is focused and productive. When the on-site visit includes a meeting with the taxpayer, the agenda should be shared with the exam team and provided to the taxpayer in advance to allow sufficient time for the taxpayer to add items to the agenda, and conduct any research, inquiry, or development of background material necessary for meaningful discussions.

#### On-Site Activities and Case or Issue Reviews

In addition to the aspects or items mentioned in *IRM 4.46.4.6* and *IRM 4.46.4.7*, the case or issue manager during on-site visits should ensure that:

- Issue discussions are being conducted in a transparent and cooperative manner during the development of each issue.
- The IDR management and enforcement process are being followed.
- Continuous risk analysis is being conducted for each issue.
- Issue teams have the appropriate resources needed to develop an issue.
- The claims process is being followed.
- Issue teams are conducting interactive discussions to resolve any factual or legal differences.
- The law is being applied to the facts with an unbiased view.
- LB&I issue team members take a unified approach on a tax position when discussing with the taxpayer.
- LB&I and the taxpayer understand each side's tax positions.

- The acknowledgment of the facts for unagreed issues has been issued and discussed with the taxpayer.
- Forms 4764-B and related workpapers are being completed contemporaneously and reviewed.
- Action items from previous on-site visits or reviews have been addressed.

The case manager and issue manager should keep each other informed of the outcome of these visits or reviews.

#### **Documenting On-Site Visits and Case or Issue Reviews**

Managers should document the minutes to the review in writing to memorialize any understandings or agreements reached, decisions made, and outstanding items for each agenda item covered. The minutes may be used as a starting point for the next review and may be shared as appropriate with the case or issue manager, exam team, and taxpayer.

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