BLOG

Lights, Camera, Audit: High-Income Taxpayers, Partnerships, Corporations, and Promoters Headline Recently Announced IRS Enforcement Priorities

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The Inflation Reduction Act of 2022 (IRA), passed into law on August 16, 2022, represented a shift in the world of U.S. federal tax enforcement. This shift—or as most might suggest, a reversal of course—departed from the IRS that many have come to know in recent years, maligned by funding cuts, widespread attrition, and loss of institutional knowledge needed to administer the nation's complex set of federal tax laws. Since that time, the IRS has begun the process of utilizing appropriations from the IRA and identifying and effectuating its tax enforcement strategy. Below are some recent developments highlighting the areas of expected enforcement.

IRS ANNOUNCEMENT DETAILS FOCUS ON LARGE AND COMPLEX TAXPAYERS

On September 8, 2023, the IRS announced that it will start a "sweeping, historic effort to restore fairness in tax compliance" by focusing its attention on high-income taxpayers, partnerships, large corporations, and promoters. In the Service's announcement, IRS Commissioner Daniel Werfel commented that "[t]his new compliance push makes good on the promise of the [IRA] to ensure the IRS holds our wealthiest filers accountable to pay the full amount of what they owe." Commissioner Werfel added that the agency "will increase [its] compliance efforts on those posing the greatest risk to our nation's tax system, whether it's the wealthy looking to dodge paying their fair share or promoters aggressively peddling abusive schemes." The IRS's announcement followed with another announcement on September 20, 2023, that the Service would establish a new network unit within the Large Business and International (LB&I) division to concentrate on these large and complex pass-through entities.

In its September 8 announcement, the IRS elaborated on its expansion of high-income/high-wealth and partnership compliance work, along with the designated priority areas for targeted compliance in fiscal year (FY) 2024. Some of these areas are noted below.

- **Prioritization of High-Income Cases.** Taxpayers with total positive income above US$1M that have more than $250,000 in assessed tax liability are expected to attract increased scrutiny. In its announcements, the IRS noted plans to have dozens of revenue officers focusing on high-income cases and initiating contact with approximately 1,600 taxpayers that the agency asserts collectively owe hundreds of millions of dollars in taxes.
- **Expansion of Pilot Focuses on Largest Partnerships Leveraging AI.** In 2021, the IRS launched the Large Partnership Compliance (LPC) program, with examinations focusing on large and complex partnerships returns. In its recent effort, the IRS is expected to expand the LPC program to additional partnerships, leveraging artificial

intelligence (AI) to assist in the selection of these returns. The increased funding is expected to help the IRS to improve its antiquated technology and develop AI capabilities to identify taxpayers evading their federal tax obligations and emerging trends of tax noncompliance.

The IRS expects to open examinations of 75 of the largest partnerships in the United States across a variety of industries including financial services, real estate, professional services, etc.

- **Greater Focus on Partnership Issues Through Compliance Letters.** The IRS expects to start corresponding with 500 partnerships with over US$10M in assets whose tax returns feature balance sheets with discrepancies and unsatisfactory, or no, attached statements explaining the discrepancies. The IRS may consider an audit depending on each partnership's response.
- **Expanded Work on Digital Assets.** The IRS has indicated that it will continue expanding its compliance efforts involving digital assets through the use of John Doe summonses and finalizing its proposed regulations regarding broker reporting. More digital-asset cases are expected to be developed for additional audit work in FY 2024.
- **More Scrutiny on FBAR Violations.** The IRS expects to audit the most egregious cases of Report of Foreign Bank and Financial Accounts (FBAR) nonfilers, as the agency's analysis indicates hundreds of possible FBAR nonfilers with account balances averaging over US$1.4M.

CORPORATE TAXPAYERS NOT SPARED

On October 20, 2023, the IRS issued IR-2023-194 announcing a trio of corporate tax initiatives applicable to large corporations aimed at ensuring that large corporations pay taxes owed. The announcement doubled down on previously announced initiatives focusing on high-income individuals and complex partnerships, while establishing and noting three corporate compliance initiatives and priorities. These include the:

- **Large foreign-owned corporation transfer pricing initiative.** Among the initiatives announced, the IRS announced a large foreign-owned corporations transfer pricing initiative, indicating that it would increase compliance efforts on U.S. subsidiaries distributing goods in the United States, but failing to pay tax on profits earned of U.S. activities. To accomplish its goal, the IRS intends to send compliance alerts to 150 subsidiaries of large foreign corporations with notices "reiterat[ing] their U.S. tax obligations and incentiviz[ing]." The IRS's announcement noted that certain foreign companies report losses or exceedingly low margins through the improper use of transfer pricing to avoid reporting the appropriate amount of U.S. income.
- **Expansion of the LCC Program.** LB&I expects to expand the Large Corporate Compliance Program (LCC) by commencing an additional 60 audits of the largest corporate taxpayers. The IRS notes that targets of these audits are expected to be identified using a combination of AI and subject matter expertise from key areas, such as corporate planning and transactions, cross-border taxation, etc.
- **Continued Enforcement of Repealed IRC Section 199 Deduction.** The announcement noted the IRS's campaign to address noncompliance and to review high-risk claims of the now repealed domestic production activities deduction under IRC Section 199. The announcement heralded the agency's already successful efforts, while noting that the breadth of refund claims totaled more than US$6M, with many of the claims coming from taxpayers claiming the deduction for the first time.

WHAT'S NEXT?

The IRA increased the IRS budget by roughly US$80B over 10 years, with the money broken up into the four main categories of enforcement, operations support, business systems modernization, and taxpayer services. Among its other goals, the agency says it wants to leverage data analytics and technology to audit complex tax returns. The additional funds are also expected to counteract the attrition of the large decade and permit the IRS to hire specialists needed to accomplish the Service's enforcement initiatives.

If you have any questions, please contact the authors or another member of the Winston & Strawn Tax Controversy & Criminal Tax Practice.

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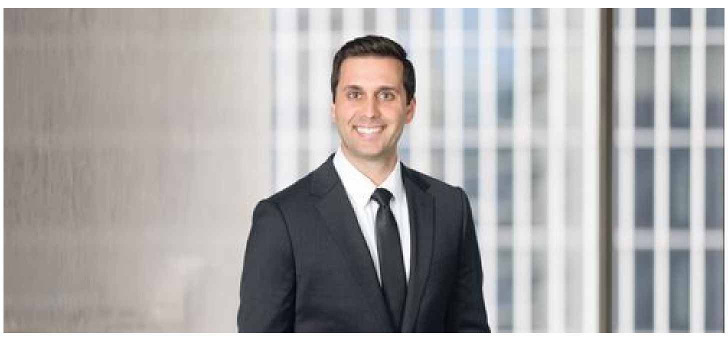

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