WINSTON & STRAWN LLP

BLOG

Winston & Strawn Monthly Tax Controversy Update – *October 2023*

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Month of October Brings Its Share of Tricks and Treats

Welcome to the October 2023 edition of the Winston & Strawn *Monthly Tax Controversy* newsletter. In this installment, we highlight both *tricks* and *treats* from the spooky month of October concerning recent developments in the IRS's priorities related to increased tax enforcement of corporations and the announcement of a withdrawal process for employee retention tax credit (ERC) claims. We additionally highlight a recent Tax Court case implicating a hotel's customer rewards programs and note some taxpayer-friendly guidance on the acceptability of digital signatures on certain forms.

TRICK

CORPORATE TAXPAYERS IN ON THE MIX

The IRS extended its articulation of its enforcement priorities to corporations, issuing IR-2023-194 on October 20, 2023, announcing a trio of corporate tax initiatives applicable to large corporations aimed at ensuring such corporations pay taxes owed. The announcement established and noted three corporate compliance initiatives and priorities, including:

- **Large foreign-owned corporation transfer pricing initiative**. Among the initiatives announced was a large foreign-owned corporations transfer pricing initiative, indicating that the IRS would increase compliance efforts on U.S. subsidiaries distributing goods in the United States but failing to pay tax on profits earned from U.S. activities. To accomplish its goal, the IRS intends to send compliance alerts to 150 subsidiaries of large foreign-owned corporations with notices "reiterat[ing] their U.S. tax obligations and incentiviz[ing] compliance." 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**. The IRS's Large Business and International (LB&I) Divisions 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- **Continued Enforcement of Repealed IRC Section 199 Deduction**.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.

TAX COURT HOLDS HOTEL REWARDS PROGRAM FUND INCLUDIBLE INTO INCOME

The Tax Court held that contributions collected for a fund to redeem reward points by a hotel chain as part of its rewards program should be included in income in the case of *Hyatt Hotels Corporation & Subsidiaries v. Commissioner* (T.C. Memo. 2023-122).

The case pertained to the customer rewards program operated by Hyatt which required individual hotel owners to make payments into a rewards program fund. The fund, in turn, would be used to compensate hotel property owners when customers redeem rewards points for a stay at a hotel. Notably, Hyatt would use funds to pay administrative and advertising expenses and additionally invest some of the remaining funds into marketable securities.

The Tax Court ruled that the taxpayer's approach did not involve a method of accounting with revenue that would be subject to a Section 481(a) adjustment. Nevertheless, the court held that the contributions collected for the fund should be included in income as a result of the taxpayer's direct beneficial interest in the funds and stressed the inapplicability of the trust fund doctrine, which the taxpayer had asserted in its arguments to exclude the amounts from gross income.

TREAT

EMPLOYEE RETENTION CREDIT (ERC) WITHDRAWAL PROCESS ANNOUNCED

The IRS released IR-2023-193 on October 19, 2023, announcing the availability of a withdrawal process for taxpayers seeking to withdraw their previously filed ERC claims. Under the withdrawal process, taxpayers who have submitted claims are permitted to withdraw their claims without incurring penalties and interest, which are normally associated with disallowed claims. The Service noted in its announcement that the withdrawal option was created to help small business owners who were pressured or misled by ERC marketers or promoters into filing claims not meeting the requirements. The announced withdrawal procedure also follows an earlier IRS announcement (IRS 2023-169) placing an immediate moratorium on processing new ERC claims and providing notice of increased scrutiny of pending ERC claims, effective as of September 14, 2023. Methods pursuant to which taxpayers should request an ERC claim withdrawal vary depending on whether the taxpayer (i) has not received a refund and has not been notified that their claim is under audit, (ii) has not received a refund but has been notified that their claim is under audit, or (iii) has received a refund check but has not cashed or deposited the check.

ELECTRONIC SIGNATURES HERE TO STAY

The IRS announced on October 17, 2023 that taxpayers and their representatives may continue to use digital signatures or (alternatively) an image of the signatures to sign certain forms and documents. The newly updated Internal Revenue Manual (IRM) 10.10.1 enumerates the forms and documents permitted to be signed digitally, specifying that the updated policy should not be applied to any forms or documents not specifically provided within the updated guidance.

Notably, the IRS has historically required wet signatures for most of its submitted tax documents, but those requirements changed in the months following the beginning of the COVID-19 pandemic. Initially, the IRS issued guidance on March 27, 2020 allowing for the acceptance of digital signatures and permitting the use of electronic or digital signatures on certain paper forms that required a handwritten signature. These digital flexibilities were subsequently extended to October 31, 2023.

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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Authors

James N. Mastracchio

Susan Elizabeth Seabrook

Karl Kurzatkowski

Zachary C. Weit

Nicholas Netland

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Related Professionals

James N. Mastracchio

Susan Elizabeth Seabrook

Karl Kurzatkowski

Zachary C. Weit

Nicholas Netland

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