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US Treasury's 2024 proposals reveal IRS enforcement focus

Mark Martin and Thomas Bettge of KPMG in the US discuss enforcement-related proposals in US Treasury's latest Green Book, and how they would change the tax compliance and enforcement landscape for large businesses.

On March 9, US Treasury released a report entitled "General Explanations of the Administration's Fiscal Year 2024 Revenue Proposals". This is more commonly referred to as the Green Book. It provides detail on the tax legislation proposals in the Biden administration's Fiscal Year 2024 budget. With a divided Congress, it is far from certain that these proposals will become law, but they are important for two reasons. For one thing, tax proposals that go unadopted in one year tend to attain a certain afterlife in later years' proposals. Indeed, many of the substantive proposals in the Green Book hearken back to prior budgets and to the never-enacted Build Back Better Act.

More immediately, the proposals send a clear message regarding Treasury's thinking on enforcement and compliance for large taxpayers. Of the many proposals contained in the Green Book, three have particular relevance in this area. First, there is a funding proposal. The Inflation Reduction Act of 2022 provided an additional $80 billion of funding for the IRS over and beyond its annual budget through the government's fiscal year ending September 30 2031, but the Biden administration is already looking beyond that horizon. The Green Book includes a new proposal for additional IRS funds of $14.3 billion and $14.8 billion for fiscal years 2032 and 2033 respectively, and it makes clear the aim of those funds: tax enforcement for large businesses. As per the Green Book: "Long-term funding is essential for planning, especially to hire and train top talent to take on the most complex tax administration tasks, such as audits of complex partnerships and large corporations."

Second, Treasury proposes to mandate disclosure of positions contrary to regulations. Currently, such disclosures are not required, but they are strongly incentivised by accuracy-related penalties under section 6662(b)(1) of the Internal Revenue Code, which can be avoided by disclosing the contrary position on a Form 8275-R (or Schedule UTP, if applicable). The Green Book points to the increasing incidence of regulatory challenges in recent years, and the fact that some taxpayers have opted to forego penalty protection via disclosure because, in Treasury's view, they prefer to avoid scrutiny.

Treasury's Green Book proposal would apply an assessable penalty of 75% of the decrease in tax shown on the return as a result of the undisclosed position. But it would limit the new penalty to a minimum of $10,000 and a maximum of $200,000, subject to a reasonable cause and good faith exception. The contemplated penalty would apply even if the taxpayer ultimately prevailed in its contention that the regulation is invalid. Because of the $10,000 minimum, there would apparently be a penalty even if a court determined there was no underpayment of tax. If enacted, the penalty would pose a significant trap for the unwary, and it is difficult to see how it can be justified in cases where the taxpayer prevails on the merits.

Third, Treasury proposes an extension of the general three-year statute of limitations that, as described in the Green Book, is expressly targeted at complex transfer pricing and cross-border transaction cases. If more than $100 million has been omitted from gross income, a six-year statute would apply. This proposal resembles current section 6501(e)(1)(A), which extends the statute to six years in the event of a substantial omission from gross income (i.e., more than 25% of the gross income shown on the return, or certain omissions connected with foreign financial assets). For large taxpayers, the proposed $100 million threshold would be substantially less than 25% of gross income, meaning that the new proposed statute extension would apply more frequently.

Such a statute extension is both unnecessary and unhelpful. Under current law, taxpayers facing complex audits can – and as the Green Book acknowledges, typically do – extend the statute of limitations to allow IRS exam teams additional time to complete their examination. By doing so, the taxpayer both avoids the rushed issuance of a notice of deficiency that it would have to litigate, and gains a measure of control over the examination timeline. While the Green Book expresses concern that such extensions may be for a limited time, a taxpayer's ability to negotiate limited extensions is a key audit management tool that can ensure that the exam team meets appropriate milestones.

Then, too, requiring a $100 million adjustment to keep the statute open under the proposed rule would very likely limit the IRS's willingness to agree to principled settlements. The fundamental purpose of an IRS audit is to determine by how much, if at all, the taxpayer's reported income diverges from the income that should have been reported. If the continuation of that inquiry beyond a certain point is predicated on the IRS ultimately determining a divergence of over $100 million, the audit becomes – in the absence of an agreed statute extension – an all-or-nothing issue for the IRS once the normal three-year statute expires. Either the IRS prevails on an adjustment of more than $100 million, or it can prevail on nothing because a lesser adjustment would be statute-barred.

There are clear flaws with these proposals, and taxpayers may take comfort that divisions in the legislature render their prospects for enactment dubious. Nonetheless, large taxpayers would do well to heed the message behind the proposals: Treasury and IRS are looking to boost their enforcement efforts in large, complex cases.

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