

The Issue Focus Approach After One Year: Can LMSB Steer Clear of the Shelter Paradigm?

By David B. Blair and George A. Hani

Introduction

In the spring of 2007, the IRS's Large and Mid-Sized Business Division (LMSB) announced its "Industry Issue Focus" approach to the selection of issues for examinations.¹ Now that LMSB and taxpayers have had the benefit of a full year of experience with the new approach, it is appropriate to evaluate the approach, which has become the cornerstone of the LMSB enforcement strategy. LMSB has modified the program slightly and has sought to modify the messaging about what the program means. This article discusses the changes to the IIF program, reviews comments and criticisms of the approach, and presents LMSB management's response to those comments. It then discusses options and strategies for resolving controversies involving these issues.

To start, LMSB has changed the name of the program. Rather than Industry Issue Focus, LMSB now refers to the program as just "Issue Focus." This change was made in part to avoid confusion with LMSB's Industry Issue Resolution (IIR) program, but also reflects the reality that some of the issues covered in the program cross industry groups.

Discussion

A. Overview of the Issue Focus Approach

Under the Issue Focus approach, LMSB identifies key compliance issues and clusters those issues into three tiers with varying degrees of coordination from tier to tier. For each issue, LMSB forms an Issue Management Team (IMT) which is led by an Issue Owner Executive (IOE) to coordinate the development and resolution of the tiered issue. Tier I and Tier II issues require oversight and control of the taxpayer's issue by the IOE, who is responsible for ensuring that the issue is identified, developed and resolved in a consistent manner across all LMSB cases involving similarly situated taxpayers. The disposition of any Tier I or Tier II issue must be in accordance with the guidance from the IOE and his or her IMT. Tier III issues do not require oversight and control by the IOE.

The principal purpose of the Issue Focus approach is to set priorities in respect of LMSB's limited audit resources. The Pre-Filing and Technical Guidance (PFTG) office, which is responsible for the coordination under the Issue Focus approach, has more than 100 Technical Advisers (TAs), each with his or her own list of issues that the TA considers worthy of audit attention. PFTG recognizes that LMSB cannot audit all these issues with the same level of intensity. Accordingly, a Compliance Strategy Council designates certain issues as Tier I or Tier II. Currently, there is no opportunity for direct taxpayer input into the designation of an issue as a Tier I or Tier II issue. By designating an issue, LMSB sends a signal to its audit teams as well as to taxpayers that the issue is a priority for the

IRS. Even after the selection of an issue has become public, there is still no formal mechanism for taxpayer input, although the IOE is also publicly identified and taxpayers can contact that person or file submissions.

PFTG also hopes to use the Issue Focus approach to preserve resources by staying ahead of the curve. Through programs like Compliance Assurance Process (CAP) and Pre-Filing Agreement (PFA) programs, LMSB hopes to identify emerging issues earlier in the audit cycle. The clearest examples of this approach are that the designation of both the domestic production deduction under section 199 and foreign earnings repatriation under section 965 as Tier I issues even though taxpayers have only recently filed returns affected by these relatively new code provisions.² Thus, LMSB recognized that the coupling of potentially large dollars at issue with relatively new code provisions would require significant resources. Identifying each as a Tier I issue signaled to taxpayers that LMSB will look closely at these issues. In the long-run, the IRS believes that devoting the resources at the front-end will save resources compared with the normal audit timeline.

When the tiering approach was first announced, there were 15 Tier I issues (counting all listed transactions as one Tiered Issue). No new issue has been designated as a Tier I issue, but Nonqualified Deferred Executive Compensation (section 409A) was removed from the Tier I list in the summer of 2007 and backdated stock options dropped from the list in April 2008. There were initially 12 issues identified as Tier II issues. Since then, no new issue has been designated as a Tier II issue and one issue (Deferred Home Construction Costs) is no longer considered a Tier II issue. As of June 1, 2008, no issues had been formally designated as Tier III issues. PFTG management has indicated that each Industry Director within LMSB has been asked to identify two Tier III issues. PFTG hopes to make those designations public shortly.

What causes an issue to be a Tier I issue versus a Tier II issue is somewhat mysterious. Tier I issues are those that the IRS concludes have high strategic importance. They tend to be more established issues in the sense that they have a longer history of development with taxpayers and the IRS.³ Tier I issues often build on a technical advice memorandum (TAM) or generic legal advice memorandum (GLAM) that provides technical backup to the IRS position. For these tiered issues, the IOE has jurisdiction over all settlements, and any settlement with LMSB must follow the IOE's guidance.

Tier II includes emerging issues where the IRS believes that there is a need for further development in the law or guidance. Among the IRS's objectives with Tier II issues is to identify good candidates for litigation or the issuance of guidance. The examination function must coordinate with the IOE, so that the disposition of a Tier

II case does not undermine LMSB's overall strategy for developing the law in the area. The IOE, however, does not have exclusive jurisdiction over the settlement terms. In our experience, there appears to be more flexibility to negotiate a settlement of a Tier II issue, which may reflect the distinct characteristics of this portion of the Issue Focus approach.

An interesting example of a Tier II issue is the Gift Card issue. In the directive, the Technical Advisers identified three issues involving the recognition of income from gift cards that "must be raised" by examining agents.⁴ The directive also contains a detailed elaboration of the IRS position on these three issues. In addition, the directive identifies 14 other issues that the Technical Advisers are "aware of," but does not provide any description of the issues or the IRS's proposed position. Presumably, the IRS position on these related issues remains in the development stage. This type of early warning provides taxpayers an opportunity for substantive input as the IMT is still developing its strategy on the issue.

Review of the issues reveals that both Tier I and Tier II contain a wide variety of issues in terms of substantive areas (with a heavy dose of international), industry scope, history, and level of development of the IRS position. As a practical matter Tier I issues generally involve more tax dollars than Tier II issues. Tier I issues affect more industries or taxpayers, and therefore are assigned a higher priority by LMSB. Tier II issues appear more likely to be contained within one industry or affect a more limited number of taxpayers. Thus, although an enhanced enforcement priority, Tier II issues are a step behind the Tier I issues.

Each IMT, under the direction of the IOE, is responsible for developing the strategy for the IRS approach to the tiered issue. IMTs include personnel from multiple IRS functions, including Technical Advisers, Appeals, LMSB Counsel, and National Office Counsel.⁵ They publish directives outlining the designated IRS approach to the issue. All Tier I issues have at least one published directive, and some Tier I issues have had multiple published directives and may have other backup materials, such as a coordinated issue paper (CIP).⁶

B. Effect of Coordination

The coordination that is the hallmark of the Issue Focus approach is not new to IRS enforcement efforts. The Issue Focus approach, with the IMT and IOE, resembles the approach that the IRS took in the tax shelter wars over the past decade.⁷ The IMTs evolved from the cross-functional teams that the IRS established to identify corporate tax shelters, develop uniform IRS positions on those transactions, and coordinate with field examiners to ensure consistent treatment among taxpayers.

The high-degree of coordination has created some challenges for the administration of taxpayer audits. The mere presence of a Tier I or Tier II issue can cause the examination team to react as it would to the presence of an abusive tax shelter. This means that the examination team may approach the taxpayer more skeptically, with the approach extending to other, non-tiered issues. These audits can quickly become contentious, including threats of the use of a summons. Some observers have commented that penalties are being asserted more frequently, especially with respect to tiered is-

issues, and predicted that the use of penalties in these types of cases will increase. PFTG management has indicated that LMSB does not wish to create the same patina for the audit of a tiered issue as there was in audits of listed transactions, even though listed transactions are included as one of the Tier I issues. Indeed, LMSB takes great pains to not call the publication of the tiered issues a "list" precisely to avoid having the tiered issues cast in the same light as a listed transaction.

The extensive control of tiered issues also presents questions regarding case authority. In some cases, once a Tier I or Tier II issue has been identified, the regular audit team defers entirely to the IMT and declines to take ownership of the issue. In these cases, the regular examination team will ask the questions that the directive instructs it to ask and will gather the information the directive instructs it to gather, but will relinquish control of the issue to the IMT. The regular examination team evinces no interest in exercising any judgment with respect to information being gathered or the ultimate resolution of the issue. Even where the presence of a Tier I or Tier II issue does not evoke such a deferential reaction from the regular examination team, there has been some aspect of a "my hands are tied" reaction.

PFTG management has indicated that the Issue Focus approach is not intended to eliminate discretion by the regular examination teams. Rather, the program strives for the IMT to "control the strategy" while the examination team "controls the case." Many tiered issues are mandatory examination items regardless of any materiality thresholds established for the audits. Other tiered issues, however, do not require an examination if the particular taxpayer's issue would fall below materiality thresholds established for the audit. Furthermore, some tiered issues are fact-intensive inquiries and a particular taxpayer's situation may not fit within the paradigm envisioned by the IMT. In these cases, if taxpayers can show their regular examination team why their case is different, they may be able to resolve their cases on more favorable terms. The Issue Focus program seeks to achieve equal treatment of similarly situated taxpayers. The burden is upon the taxpayer to show why it is not similarly situated.

The distinction between controlling the case and controlling the strategy is a nuanced distinction that may be lost on some examination teams. In a situation in which a taxpayer seeks to show why it is different (and deserving of a favorable resolution), the examination team may still be unwilling to recognize those distinctions as meaningful. Some examination teams may defer completely to the IMT, believing that decisions to allow more favorable treatment are "above my pay grade" and thus that the path of least resistance is to fit your case into the mold envisioned by the IMT. The examination team may fear that they will set a precedent even though individual audit resolutions are not supposed to have such effect. Although PFTG disclaims any desire to create "cookie-cutter" resolutions or "one-size-fits-all" packages, it places great importance upon consistency for similarly situated taxpayers. These concepts can sometimes collide when examination teams are not strong enough to distinguish particular cases. The easy road is to lump affected taxpayers together so that no one needs to answer why a particular taxpayer received different treatment.

The standardized nature of the Issue Focus coordination sets a tone for the audit, whether intentional or not. The directives and the standardized IDRs are drafted to be as widely applicable as possible. These documents naturally are not tailored to the particular circumstances of the taxpayer under audit. Responding to the standardized IDRs may be difficult. Even experienced examiners have issued standardized IDRs and been unwilling to tailor the IDRs to the particular situation. PFTG has indicated that the standardized IDRs should not be viewed as set in stone, but rather (like the situation with all other IDRs) the examiners should be willing to discuss reasonable changes that make sense under the particular circumstances. If the audit team is unwilling to entertain these types of discussions, it would be appropriate under the rules of engagement for the taxpayer to escalate the issue to the IMT to discuss reasonable accommodations.⁸

Some of the standardized IDRs appear to be drawn from the most contentious audit experiences. If the tone of these IDRs sets the tone for the entire audit, the audit will be more contentious than it might otherwise have been. For example, in the most recent directive on the section 118 issue, question 10 in the standardized IDR appears to be gearing up for a privilege dispute regarding opinions and advice,⁹ even though the taxpayer may not have claimed reliance on any opinions in taking the original position (or for penalty protection). Indeed, the IDR covers advice received even if the taxpayer rejected that advice and did not rely upon it for purposes of its return position. Starting the examination of an issue with an IDR that includes these types of questions sets the stage for a contentious examination.

The benefit for taxpayers is that PFTG has identified these issues as their priority. The IRS has devoted a section of its website to the tiered issues, including links to all the directives and standardized IDRs.¹⁰ Taxpayers can (and should) use these materials to prepare for the audit. These directives are essentially the “playbook,” setting forth the IRS’s litigating position with citations the IRS expects to support its position. Taxpayers also must make these issues a priority. The directives give the taxpayer advanced warning of what the IRS will ask and may also identify the areas for which the examination team has some discretion. The directives can be used as a guide to see where the IRS draws the line, and therefore aid in an important tactical decision for a taxpayer — whether it wants to be viewed as like other taxpayers or to distinguish itself from the herd.

The Issue Focus approach is characterized by significant transparency to the taxpayer community. Thus, LMSB maintains a list of the tiered issues on its website and publishes directives for each tiered issue.¹¹ These materials provide insight into LMSB’s view of the issue, the authorities on which it relies, and its strategy for the issue. The directives are helpful in defining the scope of the issue, which can be helpful in determining whether a taxpayer’s case falls outside the tiered issue’s scope. Directives provide an overview of the legal issues and often cross-reference relevant authorities and other published guidance. They also may describe different factual scenarios and call for different treatment depending on these differences in the facts. All this information is helpful in preparing the taxpayer’s presentation of the tiered issue to LMSB and Appeals.

For example, if the directive prescribes a firm IRS position in one set of circumstances but allows the field examiners more discretion in others, it is critical to determine which set of circumstances describes the taxpayer’s case.

A critical review of the directive may reveal built-in bias in favor of adopting a taxpayer-adverse position even in the presence of taxpayer-favorable facts. For example, Directive #2 on Cost Sharing Arrangements with Buy-In Payments states that the “best method rule” of the transfer pricing regulations will generally require the adoption of certain “unspecified” transfer pricing methods proposed in the coordinated issue paper on the subject. Directive #2 acknowledges that factual distinctions could justify using transfer pricing methods other than those described in the CIP. Nevertheless, it discourages deviating from the methods in the CIP by requiring field examiners to submit a special memorandum to the IOE justifying a decision not to apply the methods in the CIP.¹²

C. Resolving Tiered Issues

1. Historical Detour: IRS Blanket Settlement Offers for Shelters

The Issue Focus approach borrows from the tactics the IRS employed in the tax shelter wars of the late 1990s and early 2000s. A critical element of the IRS’s fight against tax shelters was its success in getting large numbers of taxpayers to come forward and disclose their listed and other reportable transactions. Success on the disclosure front, however, left the agency with a large backlog of controversies, and it had to devise a method of resolving these controversies short of taking each one to court. The IRS came out with a number of settlement initiatives that offered pattern settlements to taxpayers with certain categories of shelters.¹³ The settlement initiatives reflected the IRS’s conclusion that there was little substantive difference among the transactions within a certain category.¹⁴ They were limited-time offers, and the IRS made a point of stating that taxpayers should not expect to get as good a deal in Appeals.¹⁵ The settlement initiatives also raised the issue of penalties, with later initiatives typically requiring the taxpayer to accept some penalty for undisclosed shelter transactions.¹⁶

The Issue Focus approach has the potential to create another backlog of cases for the IRS. The program directs examining agents to identify and audit specific categories of issues, to make adjustments based on prescribed technical positions, and, in some cases, to consider imposing penalties. This may result in a significant number of controversies involving tiered issues that will need to be resolved. Although the IRS may choose to take some of the cases to court, it will seek to settle many others. The one-size-fits-all approach of the tax shelter settlement initiatives, however, is ill-suited for some tiered issues. Tiered issues may arise in various factual scenarios, and these factual differences can have a material effect on the merits of the taxpayer’s case. It will be important, therefore, for the IRS to establish settlement procedures under the Issue Focus approach that are more flexible than the settlement initiatives of the tax shelter wars.

The IRS is quick to point out that the Issue Focus approach is not the same as the listed transaction program in the tax shelter wars. PFTG management emphasizes that LMSB uses IMTs to

control development of the strategy for the tiered issue, but that the field examiners retain control over their cases. In some instances, this would appear to be a distinction without a difference, because the IMT's directive both designates an issue a mandatory examination item and mandates that Exam adopt a particular substantive position. In other instances, however, the directives allow Exam to exercise independent judgment over whether to propose an adjustment.¹⁷ Because some tiered issues are fairly broad in scope, the IMT's strategy may allow for flexibility in resolving cases that present a low compliance risk.

Another distinction from the listed transaction program is that LMSB has not announced settlement initiatives under the Issue Focus approach. Rather than publicly announcing "take-it-or-leave-it" settlement offers that apply similar terms to all taxpayers with a specified listed transaction, LMSB has directed the IMTs to develop settlement strategies for tiered issues. In developing these settlement strategies, the IMTs may choose from among available settlement tools and litigation options.¹⁸ Moreover, an IMT's strategy for resolving a tiered issue may incorporate flexibility to take into account factual differences among taxpayers with the tiered issue.

In the long run, Appeals is to develop Appeals Settlement Guidelines for the tiered issues.¹⁹ This process can take time, and Appeals has not yet developed settlement guidelines for many of the issues. Thus, taxpayers will have to work with their Appeals team to reach a tentative settlement, which will then go to the Appeals coordinator on the tiered issue for review. In other cases, the Appeals coordinator for the issue will serve as the Appeals officer, reducing the number of steps and limiting the potential for Appeals to "re-trade" the taxpayer through a multi-level negotiation.²⁰

LMSB has identified certain issues as requiring further development in the applicable law or guidance. For example, the original announcement of the program stated that Tier II issues include areas where LMSB would seek to develop the existing authorities and guidance to support their position. In these instances, the IMT's strategy likely will include selecting cases as candidates for a National Office guidance or litigation vehicles. The IMTs may even designate selected cases for litigation, which precludes settlement without a full taxpayer concession.²¹ Taxpayers should investigate whether the IMT's strategy includes selecting cases for National Office guidance or litigation because it can influence the taxpayer's strategy in presenting the case. Industry associations and taxpayer forums such as meetings of Tax Executives Institute meetings can be a useful resource for learning from other companies about the IRS's activities with respect to a tiered issue.

2. Push to the Front of Queue or Hang Back?

In formulating a strategy for resolution of tiered issue, taxpayers should consider whether it is best to push to the front of the line or temporize until a number of cases have settled and a pattern emerges. Pushing to the lead can give the taxpayer more influence over the terms of its settlement. The IMT is responsible to formulate a strategy for developing and resolving cases involving its tiered issue, and the early cases are likely to have a disproportionate effect on how the IMT views the strengths and weaknesses of the IRS's position. A well-developed case can show the IMT that there are

material factual differences between, on the one hand, the generic paradigms that are often used to summarize a "problem" transaction or arrangement and, on the other hand, cases that arise in the real world. Not only might this persuade the IRS to settle the specific case, it also can influence the IMT to acknowledge the potential for various scenarios in its industry directives on the issue. In contrast, once the IMT settles a number of cases based on facts that are close to its paradigm, it may be more difficult to convince them that later cases deserve a different deal. If the IRS settles into a pattern in how it approaches an issue, a "hang back" strategy may be advantageous for taxpayers with weaker facts and those who are willing to accept a settlement similar to that offered other taxpayers.

3. Fast Track Settlement for Tiered Issues

Fast Track is available to resolve tiered issues, if the taxpayer, examination team, IMT coordinator, and Fast Track coordinator all agree. Some taxpayers have been successful in getting some tiered issues into Fast Track, but others have not because not all IRS constituencies agreed. In appropriate circumstances, there can be substantial benefits to using the Fast Track program to resolve an Issue Focus case. Fast Track occurs before issuance of the 30-day letter, which means that "hot interest" will not apply to any deficiency that comes out of the Fast Track settlement.²² The parties agree to seek a resolution within 120 days, and this compressed time frame conserves resources relative to more open-ended processes. It also allows the taxpayer to achieve certainty earlier than traditional Appeals or litigation. In addition, the Fast Track process brings the decision-makers for the IRS and the taxpayer to the negotiating table. Hence, the IMT decision-makers and Appeals coordinators are active participants in the Fast Track session. Because the various IRS constituencies must appoint a decision-maker for the session (and because they are all in attendance), the taxpayer can reach an agreement with a higher level of confidence that the deal will actually get done on the basis discussed during the Fast Track session.²³

On a more substantive level, the willingness of both sides to enter into the Fast Track process is a positive sign on the prospects of settlement. This aspect of the process cuts both ways; both the IRS and the taxpayer should be prepared to compromise. The mediation techniques employed in the Fast Track work best where there is room for compromise on both sides. The Fast Track process is not as well suited to a winner-take-all negotiation strategy.

As noted above, in our experience LMSB has been open to using Fast Track to resolve some tiered issues. It is critical to have the support of the Exam team, so we typically start there. Exam can contact the coordinator for the IMT's input. Even with these constituencies on board, it is helpful to approach the Fast Track coordinator for her or his view on how the case can best be positioned for acceptance into the Fast Track program.

The taxpayer should have a strategy for addressing the various IRS constituencies attending a Fast Track session on an Issue Focus case. From a logistical point of view, a Fast Track session on an Issue Focus case can be unwieldy because of the number of participants on the IRS side. Typically, the Appeals Officer responsible for running the Fast Track Session will conduct a preliminary call to introduce the program and the mediation team, which provides

an opportunity to address logistical issues. For example, a critical point is to obtain a designation of the IRS decision-maker.

From a substantive point of view, the taxpayer should address the views of the examination team, the IMT, the Appeals coordinator for the issue, and the mediator. Keep in mind that these constituencies can have different perspectives on the issue. For example, the IMT coordinator may have had significant involvement in drafting the industry directive on the tiered issue and could be heavily committed to the positions taken therein. The examination team may be inclined to view the issue in the broader context of the overall audit and the effect of the issue on its relationship with the taxpayer. The Appeals coordinator may be looking for settlement mechanisms for that can be used in later cases. The challenge for the taxpayer and the mediator is to point out facts and arguments that help these constituencies to coalesce around a position that the taxpayer can accept.

4. Appeals

Traditional Appeals remains an option for taxpayers with tiered issues.²⁴ The IMTs include Appeals representatives (Appeals technical guidance coordinators), who are responsible for coordinating the issue within Appeals.²⁵ The Appeals technical guidance coordinator may be assigned to work the tiered issue. At a minimum, they will have to review the proposed settlement and indicate concurrence or disagreement.²⁶ Accordingly, the taxpayer cannot expect to start with a clean slate at Appeals. Nevertheless, Appeals may be an attractive option because it offers the opportunity to obtain a settlement based on hazards of litigation. Tiered issues may arise in a wide variety of factual scenarios. Moreover, the IMT, including the Appeals technical guidance coordinator, are responsible for selecting appropriate cases for litigation or guidance on the tiered issue. From the IRS's perspective, therefore, there may be benefits to settling a case that presents distinctive facts and significantly higher litigation hazards to the IRS.

5. How Will The Issue Focus Approach Affect Litigation?

Notwithstanding the various settlement options, tiered issues have a higher probability of ending up in court than other types of cases. First, tiered issues sweep in cases that have more factual variation than the sets of listed transactions in the tax shelter wars. These factual variations will make some cases stronger than others. If Exam and Appeals are not responsive to these differences in settling cases, and instead view tiered issue cases generically, some taxpayers will choose to litigate. Second, tiered issues often involve large amounts of tax, which will make it harder to walk away if the taxpayer fundamentally disagrees with the IRS's assessment of the litigation hazards. Third, the IRS's use of penalties could make the litigation decision much easier. For example, in one cost sharing buy-in case LMSB proposed more than \$300 million of penalties over two years. Not surprisingly, the taxpayer decided to pursue litigation.²⁷


If the law is uncertain and litigation is on the horizon, the IRS and Chief Counsel have a strong interest in selecting the best candidates for litigation. As a result, those taxpayers with the strongest cases can benefit from thorough preparation and aggressively

pushing toward the front of the queue. Not only will this provide an advantage in the event of a trial, but it also will motivate the IRS to take a hard look at the specific case and decide whether proceeding to trial serves its strategic objectives for the tiered issue.

The Issue Focus approach could be good news for taxpayers with non-tiered issues. As in the shelter wars, LMSB's focus on tiered issues will tend to divert resources from taxpayer-specific issues, which by their very nature require more effort at the local level. Resource-intensive local efforts are difficult to execute and support in the age of limited IRS resources and the drive for currency.²⁸ Indeed, the Issue Focus approach is based on the premise that the IRS has limited enforcement resources and must therefore focus those resources on selected issues with the highest potential return and compliance effect.²⁹ What is unstated, however, is how the IRS intends to maintain a viable presence on local issues that fall outside the Issue Focus, tax shelter, and similar high-profile programs. Over time, LMSB's centralization of issue selection, development, and coordination could create a less autonomous culture, and less initiative, at the exam team level.

Conclusions

One year into the Issue Focus program, there are positive signs and some warning bells for taxpayers. On the positive side, LMSB management has emphasized that the Issue Focus approach is not a reincarnation of the listed transaction program of the tax shelter wars. In addition, the program has been more transparent than similar programs in the past. Finally, there appear to be viable alternatives for resolving at least some tiered issue cases based on the taxpayer's individual facts and without the necessity of litigation.

That said, in many cases the Issue Focus approach severely restricts the discretion of the local examiners and Appeals by mandating that they take prescribed positions on many of the tiered issues. Moreover, in some instances the IMT directives include penalties. This aspect of the program is likely to force at least some tiered issues to court, which is an explicit goal of the IRS for some issues. Optimally, LMSB management will get the word out that not all cases involving tiered issues are litigation vehicles, and that most can be resolved on the basis of the taxpayer's particular facts. 

David B. Blair is a member of Miller & Chevalier Chartered in Washington, D.C., where he focuses on tax controversies and litigation. He has served as chair of the Tax Section of the Federal Bar Association and an adjunct professor for the LL.M. program at the Georgetown University Law Center. He received his undergraduate degree from Georgetown University and his law degree from Cornell University. Before joining Miller & Chevalier, Mr. Blair was a trial attorney with the Tax Division of the U.S. Department of Justice and clerked for the Hon. Frank M. Johnson, Jr. of the United States Court of Appeals for the Eleventh Circuit. He may be reached at dblair@milchev.com.

George A. Hani is a member of Miller & Chevalier Chartered in Washington, D.C., where his practices focuses on tax planning and consulting as well as audit, appeals, and docketed cases. He has worked on the staff Office of International Tax Counsel at the U.S. Treasury Department's Office of Tax Policy and as an attorney in the IRS Office of Associate Chief Counsel (International). He received his under-

graduate degree from Duke University, Masters of Education degree from Harvard University, and his J.D. degree from the Columbus School of Law at Catholic University of America. He may be reached at ghani@milchev.com.

1. See David B. Blair & George A. Hani, *LMSB's Industry Issue Focus Approach: Applying Lessons Learned from Battling Tax Shelters to Mainstream Tax Issues*, THE TAX EXECUTIVE (May-June 2007).
2. See Directive #1 (12-06-2006) and Directive #2 (08-24-2007) for the Domestic Production Deduction IRC § 199 and Directive #1 (with IDR questions) (10-02-2007) and Directive #2 (04-21-2008) for the Foreign Earning Repatriation.
3. See Internal Revenue Manual § 4.51.5.1
4. See Directive #1 for Gift Cards: Deferral of Income (May 23, 2007).
5. See Internal Revenue Manual § 4.51.6.6.1.
6. The IRS posts a list of issues and links to the directives and CIPs on its website at the following address: <http://www.irs.gov/businesses/article/0,,id=167377,00.html>.
7. See David B. Blair & George A. Hani, *supra* note 1.
8. The rules of engagement are discussed in the Internal Revenue Manual at §§ 4.51.1 and 4.51.5.
9. See Industry Directive #3 on Section 118 Abuse at Attachment Question 10 (October 5, 2007).
10. See <http://www.irs.gov/businesses/article/0,,id=167377,00.html>.
11. In addition, LMSB has released a set of "tri-fold" quick reference guides for field examiners on each Tier I issue. These tri-folds are posted on the IRS website.
12. See Transfers of Intangibles Offshore/Section 482 Cost Sharing Buy-In Payment, Issue Directive #2 (March 21, 2008).
13. These settlement initiatives began with offers to settle certain categories of transactions (e.g., COLI, basis-shifting, and contingent liability) on specific terms. See Ann. 2002-96, 2002-2 C.B. 756; Ann. 2002-97, 2002-2 CB 757; Rev. Proc. 2002-67, 2002-2 C.B. 873.
14. The settlement initiative for contingent liability company transactions included procedures to take into account some variation in the merits of a taxpayer's particular transaction. See Rev. Proc. 2002-67, §§ 6-7, 2002-2 C.B. 763.
15. See, e.g., Ann. 2002-97, 2002-2 C.B. 757 (announcing that Appeals settlement guidelines on the basis transaction would be at least as harsh as the settlement initiative).
16. Compare Ann. 2002-96, 2002-2 C.B. 756 (COLI taxpayers not required to agree to penalty) with Ann. 2004-46, 2004-1 C.B. 964 (taxpayers with undisclosed Son of Boss transactions must pay penalties).
17. See, e.g., Industry Directive #1 on Enhanced Oil Recovery Credit (May 2, 2007) (discussing factual differences that affect the availability of the credit). In some instances, the examination team might decide not to pursue an otherwise mandatory Issue Focus issue because the issue does not meet the materiality threshold that was agreed to with the taxpayer.
18. These tools include Fast Track, traditional Appeals, Delegation Order 4-25 (settlement at the examination level under Appeals Settlement Guidelines), and litigation.
19. Moreover, the settlement guidelines are not made public or are published only in redacted form. See <http://www.irs.gov/individuals/article/0,,id=108652,00.html> (posting some Appeals settlement guidelines).
20. See Internal Revenue Manual § 8.7.3.3 (role of Appeals technical guidance coordinator).
21. See Internal Revenue Manual § 4.51.6.8.2.4.
22. See I.R.C. § 6621(c).
23. Of course, the settlement is not final until the IRS executes the closing agreement, which occurs after the Fast Track session. See Internal Revenue Manual §§ 4.51.4.5.3.9, 4.51.4.5.4.1. A Fast Track session report, which both decision-makers sign before leaving the Fast Track session, is a useful tool for enhancing certainty coming out of the session. There are reports, however, of instances where the IRS backed away from the agreement reached in a Fast Track session.
24. The exception is where the case has been designated for litigation. Cases designated for litigation cannot be settled absent a full concession by the taxpayer. See Internal Revenue Manual § 4.51.6.8.2.4.
25. See Internal Revenue Manual §§ 4.61.6.6, 4.51.6.6.1.
26. See Internal Revenue Manual § 8.7.3.3.
27. Ironically, after the taxpayer filed a petition with the Tax Court, the IRS agreed to drop the penalties. See *Veritas Software Corp. v. Commissioner*, Tax Court No. 012075, Stipulation of Settled Issues (April 10, 2007).
28. The IRS is facing a crisis in retaining experienced personnel and new hires, which can only exacerbate this issue. See "Annual Report of the IRS Oversight Board," reprinted at 2008 TNT 73-43 at 19 (April 2008).
29. See Industry issue Focus (IIF) Fact Sheet (March 2007), available at <http://www.irs.gov/businesses/article/0,,id=168490,00.html>.